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 GEORGE A. CALLAS AND MINDY HERZFELD AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT**

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## INTEREST OF THE *AMICI CURIAE*[1]

**George A. Callas** is a federal tax policy expert who was intimately involved in the development, design, and drafting of Section 965, the tax law at issue in this case. He has spent most of his career developing and advocating for Republican tax legislative priorities. Mr. Callas worked directly on the Tax Cuts and Jobs Act of 2017 (TCJA), Pub. L. 115-97, 131 Stat. 2054.

Mr. Callas served as congressional Republican staff for nearly 15 years. From April 2009 until the end of 2015, he served as senior tax staff on the House Committee on Ways and Means under three different Republican chairmen. During his time working for Chairman David L. Camp (R-MI), he managed Chairman Camp's comprehensive tax reform agenda, including leading the staff team responsible for drafting both Chairman Camp's 2011 discussion draft on international tax reform and his Tax Reform Act of 2014. Both proposals included earlier versions of Section 965. Mr. Callas then served as Senior Tax Counsel for then-Speaker of the U.S. House of Representatives, the Honorable Paul D. Ryan of Wisconsin. He left Congress in 2018.

Having spent all his professional career involved in Republican tax and budget policy, Mr. Callas believes in strong constitutional limits on the power of the federal government to interfere in the lives and livelihoods of Americans. Mr. Callas believes a wealth

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[1] Pursuant to Supreme Court Rule 37.6, *amici curiae* state that no counsel for any party authored this brief in whole or in part. No entity or person, aside from *amici curiae* or their counsel, made any monetary contribution used to fund the preparation or submission of this brief.

tax, such as the type proposed by Senators Elizabeth Warren and Bernie Sanders during the 2020 primaries, is likely unconstitutional as a direct tax that is neither on income (whether realized or unrealized) nor apportioned among the states. Consistent with its text, however, Mr. Callas believes that Section 965 taxes realized net income of a foreign corporation controlled by U.S. shareholders, and therefore is compliant with the Sixteenth Amendment and not analogous to a wealth tax.

**Mindy Herzfeld** is a professor of tax practice at University of Florida Levin College of Law, where since 2017 she has taught classes in international tax and tax policy. She is also of counsel at Potomac Law Group and a contributing editor at Tax Notes International, a position she has held since 2014. She has written extensively about the 2017 tax reform, the imperatives for the law change, and its consequences. Ms. Herzfeld has also written extensively on global tax developments, including at the Organization for Economic Co-operation and Development. Ms. Herzfeld is the author of the popular guide International Taxation in a Nutshell (13th ed. 2023), a widely used introduction to the subject matter for students and new practitioners in the field. She is also the author of Structuring Cross-Border Transactions: US Tax Considerations (2022). Her work is regularly cited by members of Congress, in Congressional reports, and by foreign governments. She consults with government officials both in the United States and overseas on tax reform, and recently testified before the House Ways and Means Committee at a hearing entitled "Biden's Global Tax Surrender Harms American Workers and Our Economy" (July 19, 2023). Prior to

her academic career, Ms. Herzfeld practiced international tax at law firms in New York and in Washington D.C., where she specialized in advising on international mergers and acquisitions.

Mr. Callas and Ms. Herzfeld respectfully submit this brief to explain why Petitioners and some amici curiae have fundamentally misapprehended the text, purpose, and practical effect of Section 965. Based on their demonstrated expertise in this area of law, including Mr. Callas' involvement in the drafting of Section 965 and Ms. Herzfeld's related scholarship, they are able to offer the Court a unique perspective on how Section 965 works to assist the Court in the resolution of this case.

## INTRODUCTION AND SUMMARY OF ARGUMENT

The plain language of Section 965 provides for a tax on certain "deferred foreign income." I.R.C. § 965(a); *see id.* § 951(a)(1)(A). As the courts below recognized and Respondent has explained, such a tax is permitted by the text of the Sixteenth Amendment and this Court's related precedents. But even if the text of Section 965 were ambiguous, the history, structure, and practical operation of the law—including Subpart F of the Internal Revenue Code, which contains Section 965—confirm that Section 965 does not impose a new tax on property. Rather, it curtails a deferral benefit that Congress previously afforded to certain foreign income.

In 2017, Congress chose to limit this deferral as part of a transition to a more globally competitive international tax regime. To reduce the burden of in-

cluding previously deferred income, Congress provided for a partial exemption. The new limit on the deferral benefit is part of a package of reforms that "included tax benefits for shareholders of CFCs." Pet. App. 7. Without the new limit on the deferral benefit, "any earnings and profits undistributed upon the effective date of the TCJA would escape the imposition of U.S. taxation" altogether. Pet. App. 32.

As that history and context make clear, Section 965's curtailment of a previously conferred benefit does not create a new tax on property. The Moores' tax bill does not reflect appreciation or depreciation in the value of an asset, such as shares. Rather, Section 965 taxes realized income earned by a controlled foreign corporation. Congress has always been able to do this—and it has exercised such authority in a variety of ways. That longstanding historical practice warrants careful consideration. As former Speaker Paul Ryan has warned, if this Court were to accept Petitioners' theory, many other provisions of the tax code could be unconstitutional.

Amicus George Callas was involved firsthand as Congress worked to resolve the issues with Subpart F and find a way forward that would help American companies compete on the international stage. The TCJA is intended to do just that. As decades of history demonstrate, the prior system harmed the U.S. economy by "incentivizing U.S. taxpayers to offshore earnings and profits through the use of foreign subsidiaries." Pet. App. 32. The TCJA allowed U.S. companies to repatriate profits from foreign operations tax-free, while partially exempting any income that had been deferred since 1986.

There is no wealth tax here. The TCJA does not represent a wholly new tax, as Petitioners and some amici claim, just the curtailment of a discretionary benefit. In light of statutory text, context, and history, the court of appeals correctly concluded that Section 965 is an income tax under the Sixteenth Amendment and thus "consistent with the Apportionment Clause." Pet. App. 13. More difficult questions not presented by this case should be left for another day.

## ARGUMENT

### I. THE STATUTORY TEXT IS CLEAR AND COMPLIES WITH THE SIXTEENTH AMENDMENT.

The plain language of Section 965 provides for a tax on previously "deferred foreign income." I.R.C. § 965(a)(1)-(2). It therefore passes muster under the text of the Sixteenth Amendment and this Court's many decades of related jurisprudence.

The Sixteenth Amendment provides that "Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. Const. Amend. XVI. As that text makes clear, the purpose of the Sixteenth Amendment "was to relieve all income taxes when imposed from" the apportionment requirement of Article I, Section 9, Clause 4 of the Constitution. *Brushaber* v. *Union Pac. R.R. Co.*, 240 U.S. 1, 18 (1916).

This Court has consistently interpreted the phrase "gross income" under the Internal Revenue Code to "sweep[] broadly," and "Congress intended"

the Internal Revenue Code's definition of "gross income" to reach "the full measure of [Congress's] taxing power" under the Constitution. *United States* v. *Burke*, 504 U.S. 229, 233 (1992) (quotation marks omitted). The definition of gross income "extends broadly to all economic gains not otherwise exempted." *Comm'r* v. *Banks*, 543 U.S. 426, 433 (2005).

Section 965, and its curtailment of Congress's previously conferred deferral benefit for foreign income, is a tax on income—by its own terms and under the definition of income enunciated by this Court over a period of decades. *See* Pet. App. 6-7, 12-16. The tax applies to U.S. taxpayers owning 10 percent or more of a controlled foreign corporation (CFC), and it taxes "accumulated post-1986 deferred foreign income." I.R.C. § 965(a)(1)-(2). Section 965(a) requires these taxpayers to pay taxes on their pro rata share of the CFC's post-1986 deferred income. *Id.*

Thus, amici believe that the text of Section 965(a) is clear and does not violate the Constitution. In the event there could be any ambiguity, the history, context, and practical operation of Section 965(a) confirm that it is a permissible tax on "income[], from whatever source derived," U.S. Const. Amend. XVI, not a new tax on property.

## II. BEFORE 2018, THE UNITED STATES INTERNATIONAL TAX SYSTEM WAS A HYBRID OF TWO ALTERNATIVE SYSTEMS.

When it comes to taxing income earned overseas, the United States—before the TCJA—had for years relied on a hybrid system that handicapped U.S. multinational corporations while incentivizing them to keep their earnings and profits overseas.

The United States generally taxes U.S. taxpayers on their worldwide income. Pet. App. 6. This approach is known as a worldwide tax system, flowing from the general rule that the federal income tax applies to "all income from whatever source derived." I.R.C. § 61(a). Worldwide income includes foreign-source income: Under both the United States Constitution and general tax jurisdictional principles, if a U.S. taxpayer earned foreign income directly, whether through a foreign branch or as a partner in a foreign partnership, the U.S. taxpayer could be taxed immediately on its share of the foreign income, whether or not it was distributed to the U.S. taxpayer. *Cook* v. *Tait*, 265 U.S. 47, 55 & n.2 (1924); *see also Eder* v. *Comm'r*, 138 F.2d 27, 28 (2d Cir. 1943).

A worldwide tax system contrasts with a territorial tax system, which only imposes income tax on income earned within a country's borders. *See* Republican Policy Committee, Territorial vs. Worldwide Taxation (Sept. 19, 2012), https://www.rpc.senate.gov/policy-papers/territorial-vs-worldwide-taxation; *see also* Jane Gravelle, *Reform of U.S. Int'l Taxation: Alternatives*, Cong. Res. Serv. at 2 (Aug. 1, 2017), https://crsreports.congress.gov/product/pdf/RL/RL34115 (CRS Report). Because a purely territorial system would make it difficult for tax authorities to address tax avoidance and evasion, countries with territorial tax systems generally tax some foreign-source income under rules meant to deter abuse. CRS Report at 2.

Between 1913, when Congress enacted the federal income tax, and 2018, after Congress enacted the TCJA, Congress conferred a tax benefit known as "deferral" on U.S. taxpayers who earn certain types of for-

eign income through a foreign corporation. *See generally* Office of Tax Policy, Dep't of Treasury, *The Deferral of Income Earned Through U.S. Controlled Foreign Corporations*, at 1-3, 10-13 (Dec. 2000), https://home.treasury.gov/system/files/131/Report-SubpartF-2000.pdf (Treasury Report). Thanks to the deferral benefit, taxpayers could generally defer paying tax on their foreign income until the foreign corporation "repatriated" it, such as through a dividend, or until the taxpayer sold its shares and received a capital gain. *Id.* at ix. At times during its history, the deferral benefit was seen as helping to facilitate U.S. investment overseas and assist U.S. multinational corporations with competing on the global stage, *id.* at 19-20, but taken to the extreme it allowed shareholders to avoid taxation entirely if they never repatriated their foreign income. Robert H. Dilworth, *Tax Reform: International Tax Issues and Some Proposals*, 35 Int'l Tax J. 5, 39-44 (Jan.-Feb. 2009).

The deferral benefit essentially created a self-help territorial tax system, but only for foreign earnings kept offshore. Thus, between 1913 and 2018, because of the deferral benefit, the United States applied a hybrid system—a territorial tax system for foreign earnings as long as those earnings were never repatriated, and a worldwide system for foreign earnings brought back to the United States. Joint Committee on Taxation, *Background and Selected Issues Related to the U.S. International Tax System and Systems That Exempt Foreign Business Income*, at 2 (May 20, 2011), https://www.jct.gov/getattachment/d079505b-0355-44e1-9732-45e7eeb54aaa/x-33-11-3793.pdf.

The hybrid model managed to generate the worst side-effects of both systems. On the one hand, it raised

relatively little tax revenue because U.S. multinational corporations could easily shift profits offshore and avoid paying tax if they never repatriated those profits. On the other hand, the hybrid model made U.S. multinational corporations less competitive compared to foreign multinational corporations because it discouraged them from deploying earnings in the United States, even when the United States would have been the most efficient location to invest capital. This second consequence is known as the "lockout effect," John R. Graham, Michelle Hanlon, & Terry Shevlin, *Barriers To Mobility: The Lockout Effect of U.S. Taxation of Worldwide Corporate Profits*, 63 Nat'l Tax J. 1111, 1111 (Dec. 2010), and it inspired many of the legislative efforts that followed later and are described below. Joint Committee on Taxation, *Present Law and Background Related to Proposals to Reform the Taxation of Income of Multinational Enterprises*, at 34 (July 21, 2014), https://www.jct.gov/CMSPages/GetFile.aspx?guid=e2127c48-4a90-4151-aeb4-930f3f167a90.[2]

## III. BEGINNING IN 1937, CONGRESS STARTED NARROWING THE DEFERRAL BENEFIT.

The history of Section 965 is bound up with the inefficiencies caused by the hybrid system. Policymakers have long been aware of the issues, but exactly how Congress has dealt with those issues has changed over the decades.

In 1937, Congress created the foreign personal holding company regime, the precursor to I.R.C. § 951

[2] The Internal Revenue Code, combined with financial accounting rules, exacerbated the lockout effect. *See* Dilworth, *supra*, at 36.

*et seq.* (Subpart F), the subpart of the Internal Revenue Code that contains Section 965. Revenue Act of 1937, Pub. L. No. 75-377, § 201, 50 Stat. 818-22. Congress was concerned that individuals could shift passive investments outside of the U.S. tax net by making investments through foreign corporations in tax havens. Hearings Before the Joint Committee on Tax Evasion and Avoidance, 75th Cong. 1-3 (June 17, 1937). The 1937 rules provided that certain income earned by a foreign corporation that was owned more than 50 percent by five or fewer U.S. individuals was subject to taxation, so long as the majority of the corporation's income came from passive sources (*i.e.*, dividends, interest, royalties, annuities, certain rents, and gains from stocks and securities). Revenue Act of 1937, § 201; Treasury Report at 7. Under the 1937 rules, only that passive income became taxable as a deemed dividend to the shareholder at the shareholder's income tax rate. Revenue Act of 1937, § 201; Treasury Report at 7.

After World War II, U.S. companies and U.S. multinational corporations started expanding their business activities into Europe and other markets, increasing profits through active income. Treasury Report at 8. The House Ways and Means Committee recognized that encouraging foreign investment benefited U.S. economic growth and promoted global stability and U.S. foreign policy objectives. Mindy Herzfeld, *How to Think About How the US Congress Thinks About International Tax Reform*, 5 British Tax Rev. 504, 510-11 (2022). Starting in the 1950s, however, Congress became more concerned about corporate taxpayers' use of low-taxed holding companies to escape residual U.S. tax until the income was repatriated. Treasury Report at 10.

Congress's concerns about tax avoidance led to the enactment of Subpart F in 1962. *Id.* at 9-11. In 1961, President Kennedy proposed a complete repeal of the deferral benefit on the grounds that U.S. investors and businesses were exploiting it to shift profits offshore and engage in tax avoidance. *Id.*; Hearings on the President's 1961 Tax Recommendations Before House Committee on Ways and Means, Doc. No. 140, 87th Cong. 8-10 (Apr. 20, 1961). Congress was not willing to go that far. H.R. Rep. No. 87-1447, at 57-58 (Mar. 16, 1962); Treasury Report at 10. Instead, Congress decided to deny the deferral benefit to certain categories of foreign income considered passive or highly mobile, *e.g.*, intellectual property, certain related party sales transactions, and certain related party services transactions. Pub. L. No. 87-834, § 12, 76 Stat. 1006-31 (1962); *see* I.R.C. § 954. In effect, the new law circumscribed the previously-conferred deferral benefit.

The decision to scale back President Kennedy's proposal to end deferral completely was based on policy. While Petitioners argue that Congress's decision not to apply Subpart F to all foreign income "reflects the lack of any factual basis to regard ordinary, nonmovable corporate earnings as shareholder income" (Pet. Br. 46), Congress cited economic policy, not constitutional, concerns:

> [T]he location of investments in these countries is an important factor in stimulating American exports to the same areas. Moreover, it appeared that to impose the U.S. tax currently on the U.S. shareholders of American-owned businesses operating abroad would place such firms

> at a disadvantage with other firms located in the same areas not subject to U.S. tax.

H.R. Rep. No. 87-1447, at 57-58.

Income inclusion under Subpart F was also limited to certain large U.S. shareholders in CFCs. Congress defined "control" for the purpose of CFCs as ownership of more than 50 percent of the vote or value of the foreign corporation by U.S. shareholders, each of whom owns at least 10 percent. I.R.C. §§ 951(b), 957(a), 958. The idea was to reach those shareholders who owned a sufficiently large interest to exert influence over the corporation's decision to distribute earnings.[3] The *de minimis* rule "prevent[ed] the attribution of the undistributed income back to the shareholders where their interest is small and their influence on the corporation's policy is presumably negligible." H.R. Rep. No. 87-1447, at 463.

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[3] The term "control" has a defined meaning under the Internal Revenue Code. I.R.C. § 957(a). Although Petitioners claim they lacked control over the CFC, by law they are part of the control group (particularly since Mr. Moore sat on the Board of Directors of KisanKraft). Andrew Velarde, *Moore Had Been Director of Company in Transition Tax Case*, TaxNotes (Sept. 19, 2023), https://www.taxnotes.com/tax-notes-today-federal/accumulated-earnings/moore-had-been-director-company-transition-tax-case/2023/09/19/7hch9. *See* Pet. App. 14 ("Minority owners like the Moores . . . [are] treated as individuals who have some ability to control distribution."). Such attribution of income is common in the Internal Revenue Code and reflects a permissible congressional policy judgment as to whether a particular class of taxpayers exercises a sufficient degree of control over a foreign corporation's undistributed earnings. *See* Pet. App. 14 (citing *Dougherty* v. *Comm'r*, 60 T.C. 917, 928 (1973)).

Contrary to Petitioners' suggestion that Subpart F targets only "certain narrow categories of income" (Pet. Br. 45), Subpart F accounts for a significant amount of tax revenue. In fact, the Tax Foundation estimates that repeal of Subpart F would cost almost $78 billion in federal revenue over the next decade.[4] But even that amount masks a much larger deterrent effect. Investors and businesses go to great lengths to avoid having Subpart F income inclusions, such as by using hybrid arrangements and structuring ownership of foreign enterprises to avoid CFC classification. Internal Revenue Service Notice 98-11, 1998-1 CB 433; *see also, e.g.*, *Garlock Inc.* v. *Comm'r*, 489 F.2d 197, 201-02 (2d Cir. 1973).

The compromise represented by Subpart F has undergone various changes since 1962.[5] The 2004 amendments are particularly notable and demonstrate why the passage of the TCJA was paramount. In 2004, Congress enacted an elective repatriation provision. American Jobs Creation Act of 2004, Pub. L. 108-357, § 422, 118 Stat. 1514. Because the deferral benefit allowed taxpayers not to pay the residual U.S. corporate income tax unless and until funds were repatriated, and because of financial accounting rules that allowed taxpayers to report income and not the

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[4] How the *Moore* Supreme Court Case Could Reshape Taxation of Unrealized Income, Tax Foundation (Aug. 30, 2023), https://taxfoundation.org/research/all/federal/moore-v-united-states-tax-unrealized-income/.

[5] Congress modified Subpart F to either expand or narrow the amount of income subject to deferral many times. For a concise discussion of the history of subpart F, including the key statutory changes and policies addressed in such changes, see Treasury Report at 1-11.

residual U.S. tax upon repatriation, U.S. multinationals had strong incentives to keep earnings out of the United States. In the American Jobs Creation Act of 2004, Congress permitted a one-time low-tax holiday—5.25 percent, effected through an 85 percent deduction, as opposed to the corporate income tax rate of 35 percent; in addition, companies could choose from which entities they wanted to repatriate the income. *Id.*[6]

The 2004 tax holiday created a new problem, one that continued until the passage of the TCJA—it fostered the expectation that Congress would grant future tax holidays. As a result, multinationals shifted more income and profits offshore.[7] Meanwhile, the world had changed; recognition grew that Subpart F and the worldwide tax system in general were inadequate to address globalization, digitalization, and tax competition. *See supra* Part II. By 2017, the hybrid system resulted in approximately $3 trillion of CFC earnings being locked out of the United States because of the penalties of repatriating those earnings. Mindy Herzfeld, *Designing International Tax Reform:*

[6] For example, when a company repatriated funds from Germany, which has a high tax rate, there was unlikely to be a residual U.S. tax in any event; but if a company repatriated from the Cayman Islands, which has no corporate income tax, the 5.25 percent rate would have been an extremely attractive holiday.

[7] For a discussion regarding the impact of the 2004 holiday and the buildup of foreign earnings after the holiday, see Majority Staff Report, Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, Repatriating Offshore Funds: Tax Windfall for Select Multinationals, at 39-41 (Dec. 14, 2011), http://www.gpo.gov/fdsys/pkg/CPRT-112SPRT70710/pdf/CPRT-112SPRT70710.pdf.

*Lessons From TCJA*, 28 Int'l Tax & Pub. Fin. 1163, 1171 (2021).

## IV. THE TCJA REFLECTED SIX YEARS OF CONGRESSIONAL DELIBERATION AND PUBLIC COMMENT.

The first public release of the basic architecture of the TCJA's international tax reforms occurred in October 2011. A modified version appeared in 2014. The final version was enacted into law in December 2017 as subtitle D of Title I of the TCJA, after many congressional hearings. Thus, the opportunity for public comment on the new structure of Section 965 ran for over six years before enactment—and the drafters received voluminous comments. *See infra* Part IV.B-C. From the start, the drafters believed that amending Section 965 was integral to ending the lockout effect while protecting the tax base from erosion to tax havens. During all six years of discussion, no serious argument was offered by the many business groups, investors, and policy makers who were advocating for international tax reform that the current wording of Section 965 violated the U.S. Constitution.

### A. 2011 DISCUSSION DRAFT.

The first version of current Section 965 originated in an October 26, 2011, international tax reform discussion draft proposed by then-Chairman of the House Committee on Ways and Means, Representative Dave Camp (R-MI). Ways & Means Discussion Draft Explores International Corporate Taxation, TaxNotes (Oct. 26, 2011), https://www.taxnotes.com/tax-notes-today-federal/individual-income-taxation/ways-and-means-discussion-draft-explores-international-corporate-taxation/2011/10/27/w2n2 ("2011

Discussion Draft"). By 2011, United States had become an outlier among developed countries for its world-wide tax system with deferral; the United Kingdom and Japan were the last holdouts in adopting a territorial system, which they both did in 2009. PricewaterhouseCoopers LLP, *Evolution of Territorial Tax Systems in the OECD*, at 5-6 (Apr. 2, 2013), https://www.techceocouncil.org/clientuploads/reports/Report%20on%20Territorial%20Tax%20Systems_20130402b.pdf. Chairman Camp sought to relieve the lockout effect and lessen U.S. multinational corporations' competitive disadvantage. Camp Announces Plan for Tax Cuts, Territorial Tax System, TaxNotes (Oct. 26, 2011), https://www.taxnotes.com/tax-notes-today-federal/legislative-tax-issues/camp-announces-plan-tax-cuts-territorial-tax-system/2011/10/27/w19g?highlight=camp%202011%20reform ("Ways and Means Press Release").

The 2011 Discussion Draft would have given U.S. multinational corporations that owned 10 percent or more of a CFC a new 95 percent deduction for dividends repatriated from the CFC. 2011 Discussion Draft, § 301(a). In effect, it taxed only 5 percent of such dividends. Such a deduction is called a dividends received deduction, or DRD. Chairman Camp intended this dividend exemption, a kind of modified territorial system, to make it easier for U.S. multinational corporations to compete overseas against foreign companies while being able to repatriate the resulting future profits at a minimal tax cost. *See* Ways and Means Press Release.

If Chairman Camp had applied such a reduction to both pre- and post-effective date profits held offshore without any other transition provision, it would have provided a windfall to the pre-effective date profits. That is because at the time those profits were earned, corporations had expected to pay U.S. tax on them when they were eventually repatriated. On the other hand, if the draft included a transition rule that only post-enactment foreign earnings could enjoy the 95 percent deduction while still requiring pre-enactment accumulated foreign earnings to be subject to taxation only when the earnings were brought back to the United States, the draft would have indefinitely perpetuated the same lockout effect it was trying to eliminate. It would also have created an administrative burden for taxpayers, who would have had to track two pools of foreign income—one subject to the deferral benefit and one subject to the new exemption system.

Congress decided that the simplest and most equitable solution was to erase pre-enactment deferred foreign income off of taxpayers' books but without the windfall. The 2011 Discussion Draft thus taxed deferred foreign income once, with an 85 percent exemption, while allowing for it to be repatriated in the future virtually tax-free. Christopher H. Hanna, Moore*, the Sixteenth Amendment, and the Underpinnings of the TCJA's Deemed Repatriation Provision*, SMU Law Rev. Forum (forthcoming), at 21-22, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4582774.

The 2011 Discussion Draft incorporated this idea and operated with respect to deferred foreign income as follows: First, U.S. multinational corporations would be required to include deferred foreign income

as Subpart F income, meaning it would be subject to immediate U.S. income taxation. 2011 Discussion Draft § 303(a). Second, U.S. multinational corporations would receive an 85 percent deduction for that deferred foreign income, resulting in an effective tax rate of 5.25 percent (based on the corporate tax rate of 35 percent).[8] *Id.* Third, U.S. multinational corporations could claim a pro-rated foreign tax credit to reduce the effective tax rate even further. *Id.* Fourth, under the 2011 Discussion Draft, taxpayers could then repatriate this income at minimal additional cost (1.25 percent effective tax rate).[9] *Id.* § 301. The last point was critical to ensuring that taxpayers could repatriate pre-enactment deferred foreign income and post-enactment foreign income (which benefited from the DRD, discussed earlier) on equal 95 percent tax-free terms.

### B. TAX REFORM ACT OF 2014.

The 2011 Discussion Draft went through more than two years of stakeholder feedback.[10] In 2014,

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[8] Note that the term "tax rate" is a term of convenience—these numbers are not actual rates, but rather the result of a legal mechanism that involved a deduction equal to a percentage of the amount of income included under Section 965. The result of the deduction was to exempt a portion of the includible income and thereby reduce the overall tax rate.

[9] The 2011 draft would also have allowed taxpayers to elect to pay the tax over an eight-year period. 2011 Discussion Draft § 303(a).

[10] Public comment was extensive. *See, e.g.*, WIN America Statement on Chairman Camp's Tax Proposal, TaxNotes (Oct. 26, 2011), https://www.taxnotes.com/tax-notes-today-federal/corporate-taxation/win-america-praises-camp-repatriation-tax-proposal/2011/10/27/w2dv?highlight=camp%202011%20reform; National Retail Federation Welcomes Camp Proposal

Chairman Camp introduced the Tax Reform Act of 2014, a comprehensive tax reform bill that included a modified version of the 2011 Discussion Draft. H.R. 1, 113th Cong. (2d Sess. 2014).

One major modification was the bifurcation of the deduction provided for the Section 965 inclusion into two. The bill provided for a higher percentage deduction of 90 percent (*i.e.*, a lower effective rate of 3.5 percent) for deferred foreign income invested in illiquid foreign assets, such as depreciable property, given that taxpayers might lack the liquidity to pay the tax. H.R. 1, 113th Cong., § 4003. The bill included a lower percentage deduction of 75 percent (*i.e.*, a higher effective rate of 8.75 percent) for deferred foreign income invested in liquid assets, such as cash and certain securities. *Id.* Together, these two deductions replaced the 85 percent deduction for deferred foreign income from the 2011 Discussion Draft. Again, the tax applied to deferred foreign *income*—not property. The tax did not apply to a foreign corporation that had significant assets but lacked earnings and profits. The purpose of enumerating the categories of assets in a taxpayer's aggregate foreign cash position was to determine how the taxpayer was deploying such income

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on Corporate Tax Reform, TaxNotes (Oct. 26, 2011), https://www.taxnotes.com/tax-notes-today-federal/corporate-taxation/national-retail-federation-praises-camp-corporate-tax-reform-proposal/2011/10/27/w207?highlight=camp%202011%20reform; Business Roundtable Praises Corporate Tax Reform Proposal from Ways & Means Chairman, TaxNotes (Oct. 26, 2011), https://www.taxnotes.com/tax-notes-today-federal/corporate-taxation/business-roundtable-says-camp-tax-proposal-would-benefit-companies-workers/2011/10/27/w1x9?highlight=camp%202011%20reform.

in order to alleviate the burden of the income tax through deductions of two different sizes.

The Tax Reform Act of 2014 made two other changes to the 2011 Discussion Draft. It limited historical earnings for Section 965 purposes to post-1986 foreign earnings. *Id.* This change stemmed from taxpayer feedback. After Congress enacted major changes to the foreign tax credit rules in 1986, the quality of record-keeping improved. One hearing witness explained that "[s]ince the Tax Reform Act of 1986, U.S. multinationals have had to keep records of cumulative earnings and profits for most, if not all, CFCs for foreign tax credit calculation purposes. For prior earnings (likely to be relatively small in amount), record keeping can be a real issue." Statement of Paul W. Oosterhuis Before the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means (Nov. 17, 2011), https://www.taxnotes.com/research/federal/other-documents/testimony-other-than-irs-and-treasury/skadden-partner-says-camp-territorial-plan-a-good-start-on/vzvq.

The other change in the Tax Reform Act of 2014 was to allow individuals (such as Petitioners) to defer indefinitely the tax liability calculated under Section 965. The bill added a new subsection (i) that allowed individuals who owned CFC shares indirectly through an S corporation to defer the tax until an enumerated triggering event occurred. H.R. 1, 113th Cong., § 4003. As long as those individuals did not convert their ownership into a C corporation (which would have been eligible for the DRD), taxpayers such as the Petitioners could simply create a wholly-owned S corporation

to hold the shares and avoid paying tax under Section 965 indefinitely. *Id.*

One year after Chairman Camp introduced the Tax Reform Act of 2014, Congress considered and rejected another repatriation holiday. Invest In Transportation Act, S. 981, 114th Cong. § 2 (2015). A Joint Committee on Taxation revenue estimate submitted to the Ways and Means Committee found that a repatriation holiday would cost the federal government almost $118 billion in lost revenue between 2015 and 2025. Statement of Thomas A. Barthold Before the Select Revenue Measures Subcommittee of the House Committee on Ways and Means on the Repatriation of Foreign Earnings as a Funding Mechanism for a Multi-Year Highway Bill (June 24, 2015), https://www.jct.gov/CMSPages/GetFile.aspx?guid=5ae7b971-1d7d-47f1-ba11-a6ebeeb338a6. A holiday was not, Congress decided, what was needed.

### C. SECTION 965, AS ENACTED IN THE TAX CUTS AND JOBS ACT.

Congress finally enacted a comprehensive reform in 2017. The TCJA's version of Section 965 is substantially similar to the version from the Tax Reform Act of 2014. Like the models on which it is based, Section 965, as enacted by the TCJA, does not create a new and distinct tax. Rather, it curtails the deferral benefit by including certain previously deferred foreign income in a taxpayer's taxable income. That is, it treats an amount of earnings and profits as Subpart F income, subjecting it to income tax immediately, rather than allowing it to continue to be deferred until later. It works as follows:

First, Section 965(a) and (d)(2) cause a shareholder's pro rata amount of post-1986 deferred foreign income to be included as Subpart F income and thus taxed in the current year.[11] Without any other rules in place, Subpart F would tax this income at the shareholder's full statutory tax rate. Second, Section 965(b) allows taxpayers who own shares in both profitable and unprofitable foreign corporations to net the losses (known as "E&P deficits") against the profits, to ensure that the tax base reflects net income rather than gross income. Third, Section 965(c) provides, as a matter of legislative grace, relief from full taxation in the form of a deduction equal to a percentage of the income inclusion. In recognition that some foreign corporations reinvested income in illiquid assets, leading to less liquidity with which to pay the tax, Section 965(c) also provides (as an additional benefit) a higher percentage deduction for the portion of income that has been reinvested in illiquid assets. Finally, Section 965(i) allows individuals to defer payment of the tax indefinitely if they own the shares through an S corporation, while Section 965(h) provides an election to pay the tax over an eight-year period.[12]

In structuring the TCJA this way, Congress adopted the reasoning of both the 2011 Discussion Draft and the Tax Reform Act of 2014. Congress made

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[11] Section 965(a) contains two different potential dates by which income is measured, November 2, 2017 (the day the bill text was released), and December 31, 2017, to address concerns that some taxpayers would shift their companies' earnings as soon as the bill was released.

[12] Petitioners chose not to avoid tax liability altogether by deferring payment through creation of an S corporation, nor to lessen the burden by paying over the eight-year payment period. I.R.C. §§ 965(i), (h)(1); *see* Pet. Br. 12.

certain tweaks: notably, the TCJA includes a 100 percent DRD, rather than a 95 percent DRD, to allow profits from foreign operations to return tax-free. But generally speaking, the idea is the same one on which Congress had deliberated for six years. Former Speaker of the House Paul Ryan (R-WI) stated recently: "As a person who drafted [the TCJA], the goal was to finance a conversion from one system to another, and it wasn't to . . . justify [a] wealth tax. . . . We probably tested this idea for a good six years before we put it into law. . . ." Paul Ryan, Remarks at the Hamilton Project at Brookings Institution, Taking On Tax: The Past, Present, and Future (Sept. 27, 2023), https://www.hamiltonproject.org/wp-content/uploads/2023/09/20230927_TakingOnTax_Transcript.pdf. The law includes as taxable income 10 percent U.S. shareholders' pro rata share of post-1986 deferred foreign income of specified foreign corporations. To provide relief from full taxation, it provides a larger deduction, and thus lower effective tax rate, for deferred foreign income reinvested in illiquid assets, and a smaller deduction for deferred foreign income held in liquid assets, as requested by the business community. Letter from Chamber of Commerce to Sen. Orrin G. Hatch (July 11, 2017), https://www.uschamber.com/taxes/https-www-uschamber-com-letter-comment-letter-tax-reform-chairman-hatch. The statute is crafted to measure net income accurately and allows losses to be deducted. And it allows individual shareholders to defer indefinitely Section 965 liability if they own the shares through an S corporation.

In short, rather than creating a new tax with "its own unique rate structure based on the status of the

property being taxed" (Pet. Br. 46), Section 965 curtailed a benefit by including, as taxable Subpart F income, earnings that had previously been deferred—while providing relief from that curtailment through deductions. The new law was widely praised by the business community. *See, e.g.*, U.S. Chamber of Commerce, U.S. Chamber Celebrates Historic Tax Reform and Says Farewell to the Old Tax Code (Apr. 17, 2018), https://www.uschamber.com/taxes/us-chamber-celebrates-historic-tax-reform-and-says-farewell-the-old-tax-code; U.S. Chamber of Commerce, U.S. Chamber's Donohue: These Are 'Bold Reforms for Lasting American Growth (Dec. 20, 2017), https://www.uschamber.com/taxes/us-chamber-s-donohue-these-are-bold-reforms-lasting-american-growth.

## V. SECTION 965 IS A TAX ON INCOME, NOT PROPERTY.

Allowing for the taxation of income that had not previously been taxed, thanks to a deferral benefit conferred by Congress, does not magically transform an income tax into a tax on property. Nor does allowing a deduction from income based on how that income is spent on business property convert an income tax into a tax on property. Neither of these developments, individually or in combination, create a tax on property.

Section 965 taxes all income at a taxpayer's full rate, but for the deductions: one deduction for all deferred foreign income, and a larger deduction for income reinvested in illiquid assets. If a deduction based on how income is invested could convert an income tax into a tax on property, then much of the tax code would be unconstitutional. Former Speaker Paul

Ryan, who had previously served as Chairman of the Ways and Means Committee in 2015, estimated that as much as a third of the tax code could be unconstitutional if Petitioners prevail.[13]

For example, if deductions based on how income is spent are unconstitutional, depreciation deductions would likely fall too. The TCJA allowed a deduction of 80 percent of the cost of qualifying depreciable property placed into service in 2023. To obtain this so-called "bonus depreciation," expenditures must be for property used in a trade or business with a recovery period of 20 years or less, or a type of specified property (such as computer software or water utility property). I.R.C. § 168(k). The bonus depreciation reduces the effective tax rate on income used to purchase qualifying assets by 80 percent, for example from 21 percent to 4.2 percent for corporations. *Id.* Assets purchased by a business that do not meet the definition of qualifying property generally obtain less generous tax treatment, and thus have a higher effective tax rate for income deployed to purchase such assets. Income invested in securities, for example, receives no deduction at all.

During the six years that the policy ideas behind the TCJA were being debated, no stakeholder raised any serious constitutional issues. Instead, the deliberations looked at how "the current tax system put[]

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[13] Paul Ryan, Remarks at the Hamilton Project at Brookings Institution, *supra* ("[A] lot of the tax code would be unconstitutional if [the challenge] prevailed. . . . I think it's a misguided challenge . . . . I'm not for a wealth tax, but I think if you use this as the argument to spike a wealth tax, you're going to basically get rid of, I don't know, a third of the tax code.").

American workers and companies at a severe disadvantage to foreign workers and companies" in part because of the lockout effect. Report of the Committee on Ways and Means on H.R. 1, at 370 (Nov. 13, 2017), https://www.congress.gov/115/crpt/hrpt409/CRPT-115hrpt409.pdf.[14] Contrary to Petitioners' claim that Congress enacted Section 965 "without so much as a legislative finding justifying that change" (Pet. Br. 46), the history of the law shows that Congress sought to avoid a windfall and ensure equal treatment of all foreign earnings under the new system:

> The Committee believes that many domestic companies were reluctant to reinvest foreign

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[14] Like the 2011 Discussion Draft, the 2014 draft and the TCJA received robust public comment. *E.g.*, Statement of Jonathan Talisman Before the Senate Finance Committee, Comprehensive Tax Reform: Prospects and Challenges (July 18, 2017), https://www.taxnotes.com/tax-notes-today-federal/alternative-minimum-tax/talisman-details-major-impetuses-tax-reform-hearing/2017/07/19/1vwr5?highlight=camp%20reform%20lock-out%20comments; SIFMA Submits Tax Reform Recommendations to Senate Finance Committee, TaxNotes (July 17, 2017), https://www.taxnotes.com/tax-notes-today-federal/tax-reform/sifma-submits-tax-reform-suggestions-finance-committee/2017/07/19/1vws6?highlight=camp%20reform%20lock-out%20comments; Comments of National Association of Manufacturers Submitted to the Senate Finance Committee International Tax Working Group, TaxNotes (Apr. 15, 2015), https://www.taxnotes.com/tax-notes-today-federal/tax-reform/nam-calls-corporate-tax-relief-territorial-system/2015/05/04/ft6d?highlight=camp%20reform%20lock-out%20comments; Statement of the U.S. Chamber of Commerce to U.S. Senate Committee on Finance Tax Reform Working Groups (Apr. 15, 2015), https://www.taxnotes.com/tax-notes-today-federal/tax-reform/us-chamber-urges-simultaneous-individual-business-tax-reform/2015/05/04/ft61?highlight=camp%20reform%20lockout%20comments.

> earnings in the United States, when doing so would subject those earnings to high rates of corporate income tax rates. Accordingly, the Committee is aware that such companies have accumulated significant untaxed and undistributed foreign earnings as a result. The Committee is also aware that such companies are eligible for a 100-percent dividend-received deduction with respect to any distributions made under the new participation exemption system. To avoid a potential windfall for corporations that deferred income, and to ensure that all distributions from foreign subsidiaries are treated in the same manner under the participation exemption system, the Committee believes that it is appropriate to tax such earnings as if they had been repatriated under present law, but at a reduced rate.

Report of the Committee on Ways and Means on H.R. 1, *supra*, at 375.

Accordingly, the Committee decided that the 10 percent shareholders of a foreign entity should be subject to U.S. tax on a portion of their pro rata share of that entity's earnings without requiring an actual distribution, with the exact portion of those earnings subject to tax depending on how the earnings were deployed: "The Committee believes the tax on accumulated foreign earnings should apply without requiring an actual distribution of earnings, and further believes that the tax rate should take into account the liquidity of the accumulated earnings." *Id.* The bill therefore established a bifurcated deduction, with a higher rate for earnings held in liquid form and a

lower rate for earnings that were reinvested in the foreign subsidiary's business. *Id.*

The design and implementation of Section 965 demonstrates it is a tax on income and not property. A CFC that owns significant assets but lacks earnings and profits due to prior distributions is not subject to Section 965. Section 965 taxes realized income earned by a CFC, and it does so by including income for which Congress had previously granted a deferral benefit. Curtailing a deferral benefit does not mean Congress is now taxing property. Rather, Congress has decided, for sound policy reasons, to start including such income as taxable income.

## CONCLUSION

The judgment of the court of appeals should be affirmed.

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