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If the Moores Raised the Constitutionality of Subpart F, Would The Supreme Court Have Decided Differently?

William Byrnes (Texas A&M University Law) · Friday, June 21st, 2024

At the end of 2017, Congress passed a once-off Mandatory Repatriation Tax (the "MRT") of 8 to 15.5 percent of the undistributed total accumulated income of American-controlled foreign corporations over the past thirty years (since 1987).[1] This accumulated income, if distributed, would be taxed in the hands of the American shareholders. However, because Congress cannot force a foreign corporation to repatriate income, Congress instead imposed the tax by imputing pro rata the accumulated income to American shareholders who owned at least 10 percent of a foreign corporation's shares. Thus, U.S. shareholders subject to such imputation of the pro rata accumulated income owe the MRT but may not, and may never, receive an actual distribution from which to pay the tax. This introduction sets the stage for the case at hand.

The Taxpayer's Investment in the India Farm Equipment Supplier

A couple filing jointly as married taxpayers, Charles and Kathleen Moore (the "taxpayer"), invested in the American-controlled foreign (India) corporation KisanKraft. In 2005, the Moores invested in KisanKraft, a company owned by their friend that supplies modern tools to small farmers in India. The Moores invested $40,000 in return for 11 percent of the common shares.[2] From 2006 to 2017, KisanKraft earned profits supplying farm equipment to customers in India but did not distribute any of it to its American shareholders. KisanKraft reinvested all these earnings as additional shareholder investments in its business.

Taxpayer Arguments

The taxpayer paid the tax and then sued for a refund, alleging that the MRT violated the Direct Tax Clause of the Constitution because the MRT was an *unapportioned direct tax* on their property (being the shares of KisanKraft stock). The taxpayer also argued that income should be 'realized' to be taxed. The taxpayer reasoned that income realization only occurs when gains accrue to the taxpayer's coffers—for example, through wages, sales, or dividends, as distinct from appreciation in the value of a home, stock investment, or other property.[3] The taxpayer contended that the MRT did not tax any income that they have yet realized. The Federal District Court dismissed the taxpayer's suit for which the Ninth Circuit Court of Appeals affirmed that dismissal.

However, the taxpayer conceded that subpart F taxes, albeit also unrealized and imputed, are income taxes that are constitutional and need not be apportioned, noted by the majority opinion and the concurrence opinion of Justices Barrett and Alito.[4] The case decision and analysis would

have been far more interesting had the taxpayer not ceded the constitutionality of subpart F because the concurrence opinion of Justices Barrett and Alito raised that such constitutionality is not necessarily definitive.

Majority Opinion

In Moore v. United States,[5] in a five to two decision, the five Justice majority held the MRT was an *indirect tax* on income and thus constitutional.[6] Justice Kavanaugh authored the 24-page majority opinion, joined by Chief Justice Roberts and the Court's three liberal Justices (Sotomayor, Kagan, and Jackson). Justice Jackson also wrote an ancillary concurring opinion.

The majority opinion found that the MRT taxed the 'realized' income of the underlying foreign corporation KisanKraft which the MRT attributed pro rata to the American shareholders. The five-judge majority stated that the Court's longstanding precedents confirm that Congress may attribute an entity's realized but undistributed income to its shareholders and then tax the shareholders on their portions of that undistributed income. Both the majority and dissent opinions reflected upon the history of federal direct and indirect tax; beginning before the 1787 convention to draft a new federal constitution, through a historical anecdote that Congress passed an 1864 income-tax law that taxed shareholders on "the gains and profits of all companies",[7] the passage of the Sixteenth Amendment, and eventually winding through the seminal cases on income, realization, and attribution, such as Eisner v. Macomber,[8] Burk-Waggoner Oil Assn. v. Hopkins,[9] and Helvering v. National Grocery,[10] among others.

Majority Restricts Opinion

Also very interesting is what the Court did not decide upon. The Supreme Court limited its holding only to entities treated as pass-throughs. Specifically, the Court stated that the opinion does not authorize a hypothetical congressional effort to tax an entity and its shareholders on the same undistributed income realized by the entity. Also, the Court cautioned that its decision does not address the parties' disagreement over whether realization is a constitutional requirement for an income tax.

A Loaded Concurrence by Justices Barrett and Alito?

Justice Barrett, joined by Justice Alito, authored a 17-page concurring nonconcurrence that concurs because, specifically, *the taxpayer did not challenge the constitutionality of Subpart F*. Justice Thomas wrote a 33-page dissenting opinion joined by Justice Gorsuch. Had the taxpayer challenged the constitutionality of Subpart F, this may have been a 5 to 4 split decision (presumably dissenting would be Justices Barrett, Alito, Thomas, and Gorsuch) that set up a future constitutional challenge of subpart F imputation of income wherein the taxpayer prevails.

Could it have gone the other way? Doubtful. Chief Justice Roberts who does not like to rock the jurisprudential boat, realistically, would not have found subpart F unconstitutional. Justice Kavanaugh authored the majority opinion and thus, presumably, would unlikely have switched sides. The issue, had it been raised, would have made for more interesting discussions in chambers.

Regardless, Justice Barrett's concurrence presented contrarian arguments that will certainly be the focus of many tax professors' wrath and scowls, most relevant: "Subpart F and the MRT may or may not be constitutional, nonarbitrary attributions of closely held foreign corporations' income to their shareholders."[11] The Justice first parsed the terms "derived" and "realized".[12] She then

diverged to set up the contrarian argument that perhaps lays the groundwork for reevaluating subpart F's constitutionality in a future case. The concurrence states that the government conceded "…that a tax on the "total value of" the shares "at a particular point [in] time" is a "quintessential tax on property" that must be apportioned." She continued with the government's approach:

> "… looking at property value across two points in time makes a difference, … because then the tax targets appreciation rather than the asset's value. As the Government sees it, Congress may tax without apportionment "all economic gains" measured "'between two points in time.'" And the increase in value between Time A and Time B is "income.""

At this point, Justice Barrett delivers her punch line: "The Government is unable to cite a single decision upholding an unapportioned tax on appreciation. … That is no surprise, because our precedent forecloses the Government's argument." Then she lays out the contrarian argument:[13] "In upholding the tax, the Ninth Circuit opined that "[w]hether the taxpayer has realized income does not determine whether a tax is constitutional." In its view, the "Supreme Court has made clear that realization of income is not a constitutional requirement." ***The Ninth Circuit misread our cases***. Contrary to its assertion, this Court has "never abandoned the core requirement that income must be realized to be taxable without apportionment." [cites omitted]

Justice Barrett concludes: "In sum, realization may take many forms, but our precedent uniformly holds that it is required before the Government may tax financial gain without apportionment. … None of these cases contradicts *Macomber*'s admonition that ***Congress cannot "look upon stockholders as partners . . . when they are not"***; Congress may not "indulge the fiction that they have received and realized a share of the profits of the company" when they have not."[14]

The Dissenting Opinion

Justice Thomas, as the author of the 33-page dissent, is pointed: "…the majority's "attribution" doctrine is an unsupported invention."[15] He analyzes attempts to pass federal tax laws and their constitutionality from the nation's founding through the Sixteenth Amendment, finding that Sixteenth Amendment "income" is only *realized* income. He states in pertinent part: "The Court strains to uphold the Mandatory Repatriation Tax without addressing whether the Sixteenth Amendment includes a realization requirement, the question we agreed to answer in this case. The majority starts by surveying a scattered sampling of precedents—mostly about tax avoidance—to invent an "attribution" doctrine that sustains the MRT."

Justice Thomas' opinion constructs a narrow meaning for the Sixteenth Amendment: "The only thing the Amendment changed about the Constitution was to abolish *Pollock*'s rule that an income tax is a direct tax if a tax on the source of the income would be a direct tax. The Sixteenth Amendment left everything else in place, including the federalism principles bound up in the division between direct and indirect taxes."[16] In this vein, he holds that the Sixteenth Amendment "points to the concept of realization, as the Court explained that concept in *Macomber*. The Amendment is clear that the word "income" refers to something that is "derived."" Justice Thomas' point is mentioned favorably in Justice Barrett's concurrence opinion.

Justice Thomas delivers his punchline: "The majority's Sixteenth Amendment "attribution" doctrine is a new invention. The majority justifies its creation by plucking superficially supportive

phrases from an eclectic selection of tax cases. But, none of the cases supports the proposition that the Sixteenth Amendment empowers Congress to freely attribute income to any taxpayer it reasonably chooses."[17]

But Justice Thomas does not require that Justice Barrett's issue of subpart F's constitutionality be addressed to conclude that the MRT is not. He distinguishes the MRT from subpart F based on the timing of attribution. Subpart F attributes the foreign corporation's "earning of the money being taxed with the shareholder's control in the same year."[18]

> "… the MRT "tags a shareholder with taxable 'income' even if " he purchased shares "long after the corporation earned the sums being taxed," and it imposes no liability on taxpayers who owned shares for years of retained earnings but sold them before the MRT's trigger date. Subpart F includes some minimal requirements to ensure that taxable "income" belongs to the shareholder in some way; the MRT abandons that effort entirely."[19] [citation omitted]

Moreover, Justice Thomas' opinion states that he has not concluded that the MRT is unconstitutional. Rather, he reasons: "… the MRT is undeniably novel when compared to older income taxes, and many of those differences are constitutionally relevant. Because the MRT is imposed merely based on ownership of shares in a corporation, it does not operate as a tax on income." Consequently, had he been in the majority, Justice Thomas would have addressed the constitutionality of the MRT, the Sixteenth Amendment, income realization, and timing but would have likely left subpart F alone.

What if?

Speculatively, suppose the concurring Justices Barrett and Alito would push to analyze the constitutionality of subpart F in the context of the Sixteenth Amendment and income 'realization'? In a forthcoming case, for example. The Supreme Court rules require 4 of the 9 justices to vote to accept a case (colloquially called 'granting cert', cert formally meaning a Writ of Certiorari). To form a majority, Justices Barrett, Alito, Thomas, and Gorsuch would need to pry away a fifth justice to join them. As mentioned above in the 'Loaded Concurrence' section, it is far-fetched. For the sake of argument, though, let's say Justice Kavanaugh is convinced to join these four. Take my speculation commentary with a grain of salt because I am not a constitutional jurisprudence scholar and do not study the historical reasonings and alliances of justices about specific issues brought before the Court.

Even with a fifth joining justice to form a majority in this hypothetical universe of a future case, the Sixteenth Amendment and a realization requirement in taxing shareholders for imputed corporate earnings may remain unresolved and perhaps an even murkier quagmire for future cases. Why? Like with the case at hand, five justices signed unto the majority opinion of Justice Kavanaugh, but two more filed a separate concurrence that, as I discuss above, seems to undercut the majority's rationale. Thus, while the case looks like a 7 to 2 decision, it is more of a 5 to 4 split with a signal for future litigants. But still, five signed the majority opinion. That's a clear majority.

But what if, in this hypothetical universe of a future case, the decision majority can only generate plurality opinions that, when taken together, establish a majority. What do I mean? After many years of deliberation, the *en banc* Tax Court issued merely a plurality-signed decision with two

separate concurrence opinions to form a nine-to-eight split 3M decision (in all, six opinions, three in the majority of nine, and three among the dissenting eight judges). That majority decision upheld the IRS' 1994 blocked income regulations in light of constitutional and procedural challenges.[20] However, with six different opinions, each with its own analyses and with different judges signing onto one or more of one side's opinions, the 3M decision certainly did not 'settle' its issue. However, an Appellate Court panel of three judges has the insight of these six opinions for its decision.

From my academic perspective, the sparring analyses in 3M and in Moore are interesting, and discussing 'realization' in my basic federal income tax course is always an engaging exercise for the students to think about the accounting and tax concepts of 'income'. While I have empathy for the Moores' situation (more so for U.S. ex-pats living overseas for many years who may have had a similar situation), practically speaking, it would be (very) bad fiscal and economic policy to incentivize U.S. persons to shift income outside the U.S. by lack of an anti-deferral 'level' the playing field regime. Albeit our anti-deferral regime has, since its inception, incentivized U.S. persons to move their business and corresponding jobs that generate income outside the U.S. anyway. At least the regime generates substantial employment for tax professionals, thus, my graduating tax students.

[1] I.R.C. §§965(a)(1), (c), (d).

[2] Moore v. United States, 36 F.4th 930, 932, 2022 U.S. App. LEXIS 15612 (9th Cir. 2022).

[3] Moore v. United States, No. 22-800, 2024 U.S. LEXIS 2711, at *18 (June 20, 2024).

[4] Moore v. United States, No. 22-800, 2024 U.S. LEXIS 2711, at *30 (June 20, 2024).

[5] Moore v. United States, No. 22-800, 2024 U.S. LEXIS 2711 (S.Ct. June 20, 2024) (slip opinion from Court's website here).

[6] U.S. Const. §8, cl. 1 and Sixteenth Amendment.

[7] Rev. Act of 1864, § 117, 13 Stat. 282.

[8] *Eisner* v. *Macomber,* 252 U.S. 189, 40 S. Ct. 189,1920 U.S. LEXIS 1605 (1920).

[9] *Burk-Waggoner Oil Assn. v. Hopkins, 269 U.S. 110, 46 S. Ct. 48, 1925 U.S. LEXIS 12 (1925).*

[10] Helvering v. Nat'l Grocery Co., 304 U.S. 282, 58 S. Ct. 932 (1938).

[11] Moore v. United States, No. 22-800, 2024 U.S. LEXIS 2711, at *66-67 (June 20, 2024).

[12] Moore v. United States, No. 22-800, 2024 U.S. LEXIS 2711, at *49 (June 20, 2024).

[13] Moore v. United States, No. 22-800, 2024 U.S. LEXIS 2711, at *52-53 (June 20, 2024).

[14] Moore v. United States, No. 22-800, 2024 U.S. LEXIS 2711, at *60-61 (June 20, 2024).

[15] Moore v. United States, No. 22-800, 2024 U.S. LEXIS 2711, at *69 (June 20, 2024).

[16] Moore v. United States, No. 22-800, 2024 U.S. LEXIS 2711, at *95-96 (June 20, 2024).

[17] Moore v. United States, No. 22-800, 2024 U.S. LEXIS 2711, at *103 (June 20, 2024).

[18] Moore v. United States, No. 22-800, 2024 U.S. LEXIS 2711, at *110 (June 20, 2024).

[19] Moore v. United States, No. 22-800, 2024 U.S. LEXIS 2711, at *111 (June 20, 2024).

[20] William Byrnes, *The 3M Decision: Did Treasury or Congress Overturn Past Jurisprudence*? Kluwer International Tax Blog (February 11, 2023).

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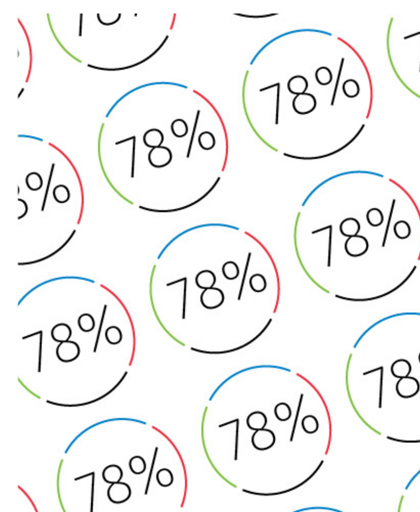

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