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Congress of the United States

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ROBERT P. HARVEY
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October 3, 2023

Honorable Richard E. Neal
U.S. House of Representatives
372 Cannon House Office Building
Washington, D.C. 20515

Dear Ranking Member Neal:

This letter responds to your request for a delineation of present law provisions of the Internal Revenue Code of 1986, as amended (the “Code”), that could be affected by a ruling for the petitioners in *Moore*,¹ which is currently before the Supreme Court. The question presented in *Moore* is whether the one-time transition tax imposed under section 965 (referred to in the petition for writ of certiorari as the “mandatory repatriation tax” or “MRT”)² is unconstitutional because it is an unapportioned direct tax and is not an income tax under the meaning of the Sixteenth Amendment.

According to the petition for writ of certiorari, the question presented for the court is “[w]hether the Sixteenth Amendment authorizes Congress to tax unrealized sums without apportionment among the states.”³ By contrast, the brief of the United States in opposition to certiorari frames the question for the court as “[w]hether the MRT is a ‘tax[] on incomes, from whatever source derived,’ within the meaning of the Sixteenth Amendment.”⁴

¹ *Moore v. United States*, No. C19-1539-JCC (unpublished, W.D. Wash. 2020), *aff’d*, 36 F.4th 930 (9th Cir. 2022), *reh’g denied*, 53 F.4th 507 (9th Cir. 2022), *cert. granted*, No. 22-800 (U.S. 2023).

² Unless otherwise stated, all section references are to the Code.

³ Petition for writ of certiorari, *Moore*, No. 22-800 (S. Ct. May 16, 2023) (the “Petition”).

⁴ Brief of the United States in opposition to certiorari, *Moore*, No. 22-800 (S. Ct. May 16, 2023) (the “Opposition Brief”) (citations omitted). The Sixteenth Amendment authorizes Congress “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.”

Congress of the United States

JOINT COMMITTEE ON TAXATION

Washington, DC 20515-6453

Honorable Richard E. Neal
U.S. House of Representatives

Page 2

The petitioners assert that the MRT is a tax on unrealized income and that Congress for purposes of the Sixteenth Amendment cannot tax unrealized income. They rely primarily on *Eisner v. Macomber*, 252 U.S. 189 (1920), which the lower court found inapplicable to the Moores' case.⁵ The Government, in turn, asserts that the Constitution "does not restrict Congress to taxing only realized gains" and that, even if it did, the MRT is a tax on realized income.⁶ The Court may leave unanswered the question of whether the Constitution imposes a realization requirement if it finds that the MRT is a tax on realized income. This letter describes several types of present law provisions that may be implicated if the Court adopts certain definitions of realization suggested in the Petition or the petitioners' reply brief,⁷ along with a nonexhaustive set of examples of each type.

Commentators have asked whether the MRT and other tax proposals are direct taxes and therefore (if they are not income taxes for purposes of the Sixteenth Amendment) unconstitutional because they are not apportioned among the States or, instead, excise taxes not subject to apportionment.⁸ This letter focuses instead on the Sixteenth Amendment issue argued by the parties in their briefs.

⁵ In *Macomber*, the Court ruled that the receipt of a *pro rata* stock dividend did not qualify as income under the Sixteenth Amendment because it did "not alter the pre-[e]xisting proportionate interest of any stockholder or increase the intrinsic value of each share." *Macomber*, pp. 210-211. The lower court found *Macomber* inapplicable to the Moores' case because "the Supreme Court, [the Ninth Circuit], and other courts have narrowly interpreted *Macomber* and *Glenshaw Glass*," the *Macomber* definition of income was not meant to provide a "universal definition" of income, and "holding that Subpart F is unconstitutional would also call into question the constitutionality of many other tax provisions that have long been on the books." Petition, pp. 14-16.

⁶ Opposition Brief, pp. 11-12.

⁷ Petitioners' reply brief in *Moore*, No. 22-800 (S. Ct. May 30, 2023) (the "Reply Brief").

⁸ See, e.g., John R. Brooks & David Gamage, "*Moore v. United States* and the Original Meaning of Income," July 2, 2023, p. 5, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4491855 (arguing that the MRT, like several other taxes including the income tax, is an excise tax, rather than a direct tax); Bruce Ackerman, "Taxation and the Constitution," *Columbia Law Review*, vol. 99, January 1999, p. 1 (arguing that modern caselaw has, and should continue, to narrowly interpret "direct" taxes and that neither a flat tax nor a wealth tax would be a direct tax); Calvin H. Johnson, "Apportionment of Direct Taxes: The Foul-Up in the Center of the Constitution," *William & Mary Bill of Rights Journal*, vol. 7, 1998, p. 1 (arguing that the direct taxes clause should be construed narrowly so as not to apply to a variety of types of taxes); Dawn Johnsen and Walter Dellinger, "The Constitutionality of a National Wealth Tax," *Indiana Law Journal*, vol. 93, Winter 2018, p. 111 (arguing that a wealth tax would be a constitutional indirect tax); Eric Jensen, "The Apportionment of 'Direct Taxes': Are Consumption Taxes Constitutional?" *Columbia Law Review*, vol. 97, December 1997, p. 2334 (arguing that certain

Congress of the United States

JOINT COMMITTEE ON TAXATION

Washington, DC 20515-6453

Honorable Richard E. Neal
U.S. House of Representatives

Page 3

The facts of the case require the Court to decide whether the MRT is unconstitutional as applied to individuals, not to corporations or other persons. If the Court were to strike down the tax as applied to individuals, a question might arise as to whether Congress would be constitutionally permitted to apply the MRT to corporate shareholders of controlled foreign corporations (“CFCs”).

A. Strict Realization

The Petition includes suggestions that the realization requirement can be satisfied only by the receipt of cash or by a liquidity event without the receipt of cash.⁹ This letter assumes that the Court will not apply either of these strict definitions of income for purposes of the Sixteenth

consumption taxes such as a flat tax or an unlimited savings allowance tax are direct taxes, whereas a VAT or a sales tax would be an indirect tax not subject to apportionment).

⁹ For example, the Petition notes that the Moores “hadn’t received a penny from the company and likely wouldn’t for some time, if ever” and argues that the receipt of cash is required for a realization event. Petition, pp. 4-5, 17-18 (citing *Maryland Cas. Co. v. United States*, 52 Ct. Cl. 201, p. 209 (Ct. Cl. 1917) for the statement that “the word ‘income’...has a settled legal meaning” which “include[s] only the receipt of actual cash as opposed to contemplated revenue due but unpaid,” and *United States v. Schillinger*, 27 F. Cas. 973, p. 973 (C.C.S.D.N.Y. 1876) for the statement that “income must be taken to mean money, and not the expectation of receiving it, or the right to receive it, at a future time.”). See also Petition, pp. 10-12 (citing *Macomber*, p. 207 for the proposition that realization requires that the taxpayer receive “a ‘gain,’ ‘profit,’ or other thing of value” and *Helvering v. Bruun*, 309 U.S. 461, pp. 468-69 (1940) for the proposition that “‘income’ requires ‘realization of gain’ through the ‘exchange of property, payment of the taxpayer’s indebtedness, relief from a liability, or other profit realized from the completion of a transaction.’”).

However, the petitioners concede that, in the case of a tax on what petitioners characterize as unrealized income, generally as long as a taxpayer may elect out of such tax and instead pay a tax on realized income (even subject to an interest charge and other requirements), such a tax falls within the Sixteenth Amendment and so does not violate the apportionment clause. Reply Brief, p. 8 (discussing the taxation of S corporations and section 877A, which is discussed further below).

Congress of the United States

JOINT COMMITTEE ON TAXATION

Washington, DC 20515-6453

Honorable Richard E. Neal
U.S. House of Representatives

Page 4

Amendment,¹⁰ but it considers the possible implications for present law if the Court were to attribute significance to a doctrine that the Petition refers to as “constructive realization.”¹¹

B. Look-Through Realization

Recognizing that “constructive” or “deemed” realization constitutes realization for purposes of the Sixteenth Amendment, petitioners argue that realization requires the taxpayer (not an entity in which the taxpayer holds an interest, absent special circumstances, such as “entire identity” between an entity and its owner) to participate in a transaction or to receive something of value during the relevant taxable period.¹² This requirement would call into question provisions of the Code that generally treat “look through” entities as separate from their owners for Federal tax purposes and tax each of the entity’s owners on its share of the entity’s income, without regard to whether the income is distributed to the taxpayer.¹³

¹⁰ As an example of a present law provision that might be subject to challenge under a strict definition of realization, one commentator has described section 1259, which taxes constructive sales of appreciated financial positions. Robert Goulder, “SCOTUS Crystal Ball: Predicting *Moore's* Future,” *Tax Notes International*, vol. 110, July 24, 2013, p. 480.

¹¹ Petition, p. 9; Reply Brief, p. 5. One commentator attributes petitioners’ use of the term “constructive realization” to a misinterpretation of the doctrine of constructive receipt, as used to uphold a constitutional challenge to section 1256. He points out that that doctrine does not apply to many United States shareholders of controlled foreign corporations, since the threshold of ownership for United States shareholders is only 10 percent, which is generally insufficient for purposes of forcing a dividend. Reuven S. Avi-Yonah, “If *Moore* Is Reversed,” *Tax Notes International*, vol. 111, June 26, 2023, p. 1728.

¹² Reply Brief, p. 5 (“... as *Macomber* recognizes, it is proper to ‘look through the form of the corporation’ in circumstances where shareholders have ‘received income,’ such as where there is ‘entire identity between them and the company’... [b]ut that exception has never been thought to reach ordinary shareholders, which would swallow the general rule. It also does not support the MRT, which taxes shareholders like Petitioners irrespective of whether they realized anything.”).

¹³ Describing what the petitioners argue are the negative consequences of upholding the MRT and the lower court decision, the Petition argues that “... the decision below spells out what the MRT implies, holding that nothing prohibits Congress from ‘attributing a corporation’s income pro rata to its shareholders’ and then taxing them on it.” Petition, p. 23.

Congress of the United States

JOINT COMMITTEE ON TAXATION

Washington, DC 20515-6453

Honorable Richard E. Neal
U.S. House of Representatives

Page 5

Look-through provisions that a taxpayer might challenge if the Court finds that looking through an entity is constitutionally impermissible include the following present law rules:

- Subpart F and GILTI. Under the subpart F and global intangible low-taxed income (“GILTI”) regimes,¹⁴ United States shareholders of a CFC are subject to tax each year on certain types of income of the CFC.¹⁵ These regimes impose U.S. taxation on United States shareholders in a taxable year even if there is no transaction or other income realization event at the level of the United States shareholder in that year. Instead, certain income earned by a CFC is deemed to be income of the United States shareholders of the CFC on a current basis.
- Subchapter K.¹⁶ Under subchapter K,¹⁷ partners of a partnership are generally taxed currently on their distributive shares of the partnership’s income.¹⁸
- Subchapter S. Under subchapter S,¹⁹ shareholders of S corporations are taxed on their pro rata share of the S corporation’s items of income.²⁰

¹⁴ Secs. 951-960.

¹⁵ Opposition Brief, p. 10.

¹⁶ Opposition Brief, p. 10.

¹⁷ Secs. 702-704.

¹⁸ There are certain exceptions to this rule, including when a partnership is treated for certain Federal income tax purposes as a separate entity, rather than as an aggregate of its partners. For example, a partnership is generally responsible for paying tax if it has underreported its income in a prior taxable period, known as an “imputed underpayment,” unless the partnership meets certain requirements and makes an election.

¹⁹ Secs. 1361-1368.

²⁰ The Opposition Brief asserts that, under the petitioners’ argument, Subchapter S would be unconstitutional. Opposition Brief, p. 11. The Reply Brief counters that, because shareholders must unanimously elect to be taxed under subchapter S, shareholders of S corporations have “conced[ed] that its income is theirs.” Reply Brief, p. 8. A question might arise regarding whether other elective look-through provisions, such as the qualified electing fund (“QEF”) election rules under sections 1293-1295 and mark-to-market election under section 1296 for passive foreign investment companies (“PFICs”) may also be implicated insofar as there are limitations on reversing either election.

Congress of the United States

JOINT COMMITTEE ON TAXATION

Washington, DC 20515-6453

Honorable Richard E. Neal
U.S. House of Representatives

Page 6

- REMICs. The income of real estate mortgage investment conduits (“REMICs”) is generally taxed to the holders of its residual interests.²¹

Commentators have generally not described the possible implications of a Supreme Court decision for the rules for real estate investment trusts (“REITS”), regulated investments companies (“RICs”), and other trusts, even though, as with partnerships, S corporations, and REMICs, there is generally a single level of taxation at the owner (or beneficiary) level for income derived by these entities. Unlike partnerships, S corporations, and REMICs, generally, taxation at the owner (or beneficiary) level of REITS, RICs, and other trusts occurs only when there is a distribution to the owner (often a required distribution).

C. Deemed Realization

As an alternative to the look-through approach, the petitioners suggest that the Court could conclude that the Sixteenth Amendment requires that a transaction be undertaken or something of value be received during the taxable year.²² This framework might call into question the constitutionality of provisions that deem a taxpayer to have received an amount or to have engaged in a transaction giving rise to income.

- OID rules and below-market and short-term loans. Under the original issue discount (“OID”) rules, holders of debt instruments that pay no interest until maturity, or less than a certain minimum level of yearly interest, are taxed on a deemed interest amount each year.²³ Similarly, interest payments are imputed on “below-market” loans.²⁴ Certain amounts are also included in income before the receipt of any payments on short-term obligations.²⁵

²¹ Secs. 860B and 860C.

²² See Reply Brief, p. 7.

²³ Sec. 1272.

²⁴ Sec. 7872.

²⁵ Sec. 1281.

Congress of the United States

JOINT COMMITTEE ON TAXATION

Washington, DC 20515-6453

Honorable Richard E. Neal
U.S. House of Representatives

Page 7

- Mark-to-market for securities dealers. Securities held by dealers in securities are deemed to be sold for their fair market value (that is, it is “marked to market”) each taxable year, and holders of these assets are taxed on the resulting gain or loss under section 475(a).²⁶
- Mark-to-market for regulated futures contracts. Regulated futures contracts are similarly marked to market on the last business day of each taxable year, and holders of these contracts are taxed on the resulting gain or loss under section 1256.²⁷
- Imputed rental income. Imputed rental income is taxed when a rental agreement provides for prepaid rent, deferred rent, or increasing or decreasing rent.²⁸
- Subchapter L mark-to-market. Life insurance companies are similarly taxed on mark-to-market gains or losses of any segregated assets they hold each year under section 817A.²⁹

D. Deemed Realization of Income Accrued in Prior Taxable Years

The petitioners argue that, even if the Sixteenth Amendment permits taxation of shareholders on corporate earnings or unrealized appreciation in value and allows deemed realization at the end of the taxable year, income taxed under principles of “constructive” or “deemed” realization should be limited to earnings from or appreciation in value attributable to the current period.³⁰ If the Court were to adopt this reasoning, its decision would make present

²⁶ Similar to the PFIC elections described above in note 20, a question might arise as to whether the election under section 475 for dealers in commodities and traders of commodities and securities is constitutional.

²⁷ Opposition Brief, p. 11. The Reply Brief counters that section 1256 is based on the theory of constructive receipt, “rely[ing] on the fact that the contracts are settled daily and give the taxpayer ‘the right to withdraw cash from... his futures trading account on a daily basis,’ which Congress regarded as manifesting realization.” Reply Brief, p. 8.

²⁸ Sec. 467.

²⁹ Opposition Brief, p. 11.

³⁰ Reply Brief, pp. 7, 11 (“[Subpart F]’s provisions predating the MRT all turn on events of [*sic*] that Congress identified as manifesting constructive realization of corporate income by shareholders, whereas the MRT simply attributes a foreign corporation’s income going back thirty years to its shareholders...” and “...even if the Government is right that the decision below does not authorize an outright federal property tax without apportionment...that limitation could be trivially overcome by taxing any asset’s earning capacity or year-past appreciation to achieve the same numerical result.”); Petition, pp. 5, 10 (“The MRT taxes shareholders irrespective of whether they owned shares at the time the corporation made the earnings on which they’re being taxed...” and

Congress of the United States

JOINT COMMITTEE ON TAXATION

Washington, DC 20515-6453

Honorable Richard E. Neal
U.S. House of Representatives

Page 8

law provisions that are similar to the MRT subject to challenge. One example is the mark-to-market exit tax of section 877A.

Section 877A generally taxes an individual who either renounces her United States citizenship or who loses her status as a permanent resident on a deemed sale of her property (with some exceptions).³¹ This deemed sale taxes expatriating individuals on gains and losses accumulated over the holding periods of their property, not just the current taxable period.³²

I hope this information is helpful to you. If we can of further assistance in this matter, please let me know.

Sincerely,



Thomas A. Barthold

“What led *Macomber* to confront the constitutional question of realization was the Government’s contention—just as in this case—that the Sixteenth Amendment permits it to tax, without apportionment, ordinary shareholders on a corporation’s retained earnings.”).

³¹ Opposition Brief, p. 11. An individual may elect to defer payment of the tax by posting security for the tax, waiving certain treaty rates, and subjecting herself to an interest charge when she eventually pays the tax. Sec. 877A(b).

³² Even though the tax under section 877A applies to unrealized gains accumulated during taxable years preceding the expatriation, the Reply Brief argues that this tax comports with the Sixteenth Amendment because of the election permitting the taxpayer to defer the tax until a later realization date. Reply Brief, p. 8; see also Opposition Brief, p. 11.