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Appellate & Constitutional Law and Tax Law Update — June 20, 2024

Supreme Court Holds That 2017 Mandatory Repatriation Tax Does Not Violate The Sixteenth Amendment

***Moore v. United States*, No. 22-800** – Decided June 20, 2024

Today, in a case widely seen as a test of Congress's ability to enact wealth taxes, the Supreme Court held narrowly that Congress did not violate the Sixteenth Amendment by requiring U.S. shareholders to pay a one-time tax on undistributed corporate earnings of controlled foreign corporations.

"[T]he precise and narrow question that the Court addresses today is whether Congress may attribute an entity's realized and undistributed income to the entity's shareholders or partners, and then tax the shareholders or partners on their portions of that income. This Court's longstanding precedents, reflected in and reinforced by Congress's longstanding practice, establish that the answer is yes."

JUSTICE KAVANAUGH, WRITING FOR THE COURT

Background:

The 2017 tax law commonly known as the Tax Cuts and Jobs Act changed the taxation of corporations' foreign earnings from what was largely a deferral system to what is now largely a current-inclusion system. As part of the transition to the new system, Congress enacted a one-time "mandatory repatriation tax" on U.S. shareholders that owned at least 10% of controlled foreign corporations. The tax deemed the corporations' retained earnings going back to 1986 as 2017 income for their U.S. shareholders in proportion to the shareholders' ownership stakes as of 2017. This tax was imposed, at reduced rates, regardless of whether the shareholders themselves had realized any income from the corporation through dividends or other payments.

Charles and Kathleen Moore were minority shareholders in an Indian company. The Moores incurred a $15,000 tax liability under the mandatory repatriation tax, despite having received no dividends or payments from the company. They paid the tax and sued for a refund, claiming that the mandatory repatriation tax violated the Sixteenth Amendment because it was not a tax on income and therefore had to be apportioned among the states according to population to pass constitutional muster. *See* U.S. Const., art. I, § 2, cl. 3; *id.* § 9, cl. 4. The District Court and Ninth Circuit disagreed, holding that the mandatory repatriation tax is a tax on income and that the Sixteenth Amendment permits taxing income that has not been realized.

Issue:

Does the mandatory repatriation tax violate the Sixteenth Amendment because it is not a "tax[] on incomes, from whatever source derived," but instead is a direct tax that must be apportioned?

Court's Holding:

No. The mandatory repatriation tax does not violate the Sixteenth Amendment because Congress could properly attribute the corporation's undistributed income to its U.S. shareholders holding a 10% or greater ownership stake.

What It Means:

- The Supreme Court emphasized that today's holding is "narrow." The Court reasoned that "longstanding precedents" establish that "when dealing with an entity's undistributed income, Congress may tax either (i) the entity or (ii) its shareholders or partners." Because the foreign corporation in this case realized the earnings at issue, the Court held only that Congress could properly attribute that income to the Moores based on their holding a 10% or greater ownership stake.

- In upholding the mandatory repatriation tax, the Court noted that it "operates in the same basic way as Congress's longstanding taxation of partnerships, S corporations, and subpart F income."

- Because the corporate income at issue had been realized, albeit by the corporation, not the Moores, the Court declined to decide whether the Sixteenth Amendment requires income or gain to be realized before it may be taxed. The Court further declined to decide whether the Sixteenth Amendment would permit various "wealth taxes" (*i.e.*, taxes on the unrealized appreciation of property, savings accounts, or retirement plans). The

Court also did not decide whether Congress could tax “both the entity and the shareholders or partners on the entity’s undistributed income.”

- The Court acknowledged that the Due Process Clause limits Congress’s ability to attribute income from one entity or person to another and that Congress may not make “arbitrary” attribution decisions. The Moores did not raise this due process argument at the Supreme Court. It is possible, therefore, that, in future cases, taxpayers may be able to challenge the taxation of attributed income on due process grounds.
- Four Justices would have held that the Sixteenth Amendment requires that income be realized before it may be taxed, a conclusion that would bar direct wealth taxes or other similar taxes on unrealized appreciation. Justice Barrett, joined by Justice Alito, concurred in the judgment upholding the tax because, on the question of attribution, she did not find a meaningful distinction between subpart F (which the Moores did not challenge) and the mandatory repatriation tax. Justice Thomas, joined by Justice Gorsuch, dissented and would have struck down the mandatory repatriation tax on the ground that it “is imposed merely based on the ownership of shares in a corporation,” rather than on income.

Gibson Dunn represented the Small Business and Entrepreneurship Council **as Amicus Supporting Neither Party**.

Gibson Dunn Appellate Honors

The Court’s opinion is available here.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding developments at the U.S. Supreme Court. Please feel free to contact the following practice group leaders:

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