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

REPLY BRIEF FOR PETITIONERS

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REPLY BRIEF

The 110 years since adoption of the Sixteenth Amendment have been marked by the unrelenting growth of federal spending and quest for revenue to fund it. Yet Congress has never ventured to tax families on appreciation in their homes, investors on appreciation in their investments, or ordinary shareholders on corporations' retained earnings. That omission reflects not forbearance on Congress's part but the understanding that these enormous pots of potential revenue lie beyond the reach of unapportioned taxation because they are not income.

The Government ignores that central fact in favor of focusing on narrow tax-avoidance measures tailored to target abuses of the corporate form to separate taxpayers from their otherwise-taxable income. Among those is Subpart F, whose reticulated structure can only be understood as an attempt to fit within the limits of the Sixteenth Amendment's exception to apportionment for "taxes on incomes." Yet the Government disavows that Subpart F rests on a theory of constructive realization of income to advance a more ambitious argument: that Congress may tax any "gain" as income, irrespective of taxpayer realization.

That argument is bold in its implications, which would eliminate the central restraint on the federal taxing power by nullifying the apportionment requirement as to taxation of property. Its substance is bolder. The Court rejected the same argument in *Eis-*

ner v. Macomber, 252 U.S. 189 (1920), and its precedent has consistently recognized the necessity of realization. Unlike the last time the Government took a run at *Macomber*, it does not ask the Court to overrule the decision. Instead, it insists *Macomber*'s central holding was "dictum," when the Government has always maintained the opposite, or has been overruled, when it has always been followed. *Macomber* decided the question of realization, decided it correctly, and that holding remains good law.

It controls here. Petitioners Charles and Kathleen Moore realized nothing on the investment for which they were subject to liability under the Mandatory Repatriation Tax. The MRT taxes them and others not because they realized income, but because they owned shares in certain corporations on a certain date. The Government identifies no precedent, legislative or judicial, for the MRT's income-taxation of property because of ownership.

The Court should reverse the decision below and reaffirm that unrealized gains are not income.

I. Sixteenth Amendment "Incomes" Require Realization by the Taxpayer

This case is controlled by precedent, beginning with *Macomber*. *Macomber*'s realization holding was correct: precedent, text, structure, and practice all dictate that Sixteenth Amendment "incomes" require realization.

A. *Macomber* and Its Progeny Are Controlling

Macomber holds realization of gain to be the "characteristic and distinguishing attribute of income" under the Sixteenth Amendment, 252 U.S. at 207, such that mere "enrichment through increase in value of capital investment is not income," *id.* at 214-15. Subsequent precedents have restated and applied that holding for a century. Pet.Br.20-26.

1. The Government contends (at 33-34) that *Macomber*'s interpretation of the Sixteenth Amendment was "dictum" and that its holding is limited to the taxation of stock dividends. This disregards that the *Macomber* Court was compelled to confront the constitutional question, as to both stock dividends and the attribution of corporate earnings to shareholders. The Revenue Act of 1916 declared stock dividends to be taxable, precluding reliance on the contrary statutory holding of *Towne v. Eisner*, 245 U.S. 418 (1918), and squarely presenting the constitutional question of their taxation as income. 252 U.S. at 205. The tax at issue treated the dividend shares as a *pro rata* distribution of the corporation's accumulated earnings, *id.*

at 201, which "gains," the Government argued, were constitutionally taxable as shareholder income, *id.* at 214. The Court disposed of both theories with the same constitutional holding: the tax was not one on income because the shareholder "has not realized or received any income." *Id.* at 212. That was no dictum.

The Government understands that. When it did ask the Court to overrule *Macomber*, the Government stressed the "importance" of "the restriction" *Macomber* "imposes upon the taxation of corporate earnings in the hands of shareholders." Pet.Br.27, *Helvering v. Griffiths*, No. 42-467 (filed Dec. 1942). *Macomber*'s "very heart," it observed, is that "there could be no 'income' constitutionally to the stockholders with respect to the earnings in their corporation until those earnings were distributed." *Id.* at 28-29; *see also id.* at 28 (stating this was "the essence of its holding"). Later, the Government described *Macomber* as being "concerned only with the problem of realization" and that, after *Glenshaw Glass*, the sole "question is whether there has been a realized gain." Pet.Br.39-40, *United States v. Kaiser*, No. 59-55 (filed Oct. 16, 1959). More recently, the Government acknowledged that "*Macomber* established that a mere increase or decrease in the value of property does not constitute a gain or loss, and that some event is required for realization of gain or loss." Resp.Br.21, *Cottage Sav. Ass'n v. Comm'r*, No. 89-1965 (filed Dec. 19, 1990). To this day, Treasury applies the "clearly realized" rule that *Glenshaw Glass* carried forward from *Macomber*. Rev. Rul. 2023-14; Rev. Rul. 2019-24.

The Government's criticisms of *Macomber*'s realization holding (at 34-35) are mistaken. That holding was hardly an invention of the Court but drawn from prior decisions and supported by ratification-era dictionaries, as well as the Sixteenth Amendment's text. 252 U.S. at 207-08. It is telling that the Government favors Justice Holmes's position in dissent that the Amendment should be applied not according to its terms but simply "to get rid of nice questions as to what might be direct taxes"—even for taxes on things that are "not income." *Id.* at 219-20 (Holmes, J., dissenting). The Court long ago rejected that atextual approach in favor of following "the commonly understood meaning" of the Amendment's text. *Merchants' Loan & Trust Co. v. Smietanka*, 255 U.S. 509, 519 (1921).

The Government's criticism of *Macomber*'s treatment of *Collector v. Hubbard*, 79 U.S. 1, 18 (1871), also misses the mark. Put aside, for the moment, that the Government mischaracterizes *Hubbard* as upholding Congress's power to tax shareholders on corporations' retained earnings. Even if one accepts that characterization *ad arguendo*, it was overruled by *Pollock*'s holding that taxes on personal property like investments are direct taxes that must be apportioned, as *Macomber* concluded. 252 U.S. at 218-19. As the Government conceded below, Dist.Ct.Doc.26 at 16, that aspect of *Pollock* has not been overruled, *see also Nat'l Fed'n of Indep. Bus. v. Sebelius*, 567 U.S. 519, 571 (2012). Both *Brushaber v. Union Pacific*

Railroad Co., 240 U.S. 1, 19 (1916), and *Macomber* reject the Government's premise that the Sixteenth Amendment revived the narrower conception of direct taxes, excluding those on personal property, last expressed in *Springer v. United States*, 102 U.S. 586 (1880).

Finally, the Government's attempted cabining of *Macomber* to the taxation of "paper" stock dividends makes no sense. If Congress cannot income-tax recipients of such dividends because they realized nothing, then what basis does it have to income-tax shareholders who haven't received even a piece of paper? The Government has no explanation.

2. *Macomber*'s realization holding has not been overruled or "abrogated." *See* U.S.Br.35. The Government runs through essentially the same cases as the Ninth Circuit but ignores petitioners' discussion of those authorities' consistent application of *Macomber*'s realization rule. Pet.Br.40-43. Like the Ninth Circuit, the Government (at 35-36) cites decisions approving taxation of shareholders on dividends that convey new property to them without ever suggesting that shareholders could be taxed in the absence of such a realized gain. *See* Pet.Br.20-22. It similarly relies (at 36-37) on decisions like *Helvering v. Bruun*, 309 U.S. 461 (1940), and *Helvering v. Horst*, 311 U.S. 112 (1940), that approved taxation of income *because* there was realization. *See* Pet.Br.23-24. It relies on *Helvering v. Griffiths*, 318 U.S. 371 (1943), where the Court rejected the Government's bid to

overrule *Macomber*.[1] And, counterintuitively, it relies (at 37-38) on *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955), which carried forward *Macomber*'s view that income must be "clearly realized." While some of these decisions clarified or limited other aspects of *Macomber*'s income definition—such as *Glenshaw Glass*'s clarification that income need not be sourced from capital or labor—none dispense with the principle that income need be realized.[2]

Several of these decisions specifically approve *Macomber*'s application to questions of investment income. *Bruun*, for example, recognizes that *Macomber*'s language about shareholders' gains being "separate from the capital and separately disposable" clarifies when shareholders have realized taxable income. 309 U.S. at 468-69. *Glenshaw Glass* similarly states that *Macomber*'s income definition serves to "distinguish[] gain from capital" and thereby determine whether there has been a taxable "realized gain to the shareholder." 348 U.S. at 430-31; *see also*

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[1] Contrary to the Government's insinuation (at 27), the statement in *Griffiths*, 318 U.S. at 375, that *Koshland v. Helvering*, 298 U.S. 441 (1936), limited *Macomber* "to the kind of dividend there dealt with" refers to *Macomber*'s application to stock dividends, not its realization holding.

[2] *Cottage Savings Ass'n v. Commissioner* recognizes no more than that the policy objective of "administrative convenience" may be relevant to interpretation of the Tax Code, without addressing any constitutional issue. 499 U.S. 554, 559, 565-66 (1991). It also contradicts the Government's characterization of *Macomber*'s "classic treatment of realization." *Id.* at 563.

Nathel v. Comm'r, 615 F.3d 83, 92 (2d Cir. 2010). *Macomber*'s realization holding clearly applies to the taxation of gains on stock investments.

Finally, the Government has no real response on the significance of *Commissioner v. Indianapolis Power & Light Co.*, 493 U.S. 203, 210 (1990), which held that a utility realized no income on refundable customer deposits because it had no "guarantee that [it] will be allowed to keep the money." A stock investor similarly has no guarantee that she will receive any portion of a corporation's earnings. The Government observes that *Indianapolis Power* involved "economic gains far afield from those at issue here," U.S.Br.38, but the basic principle is identical: "a taxpayer does not realize taxable income from every event that improves his economic condition." 493 U.S. at 214. Instead, what is required are "'undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion.'" *Id.* at 209 (quoting *Glenshaw Glass*, 348 U.S. at 431).

3. *Hubbard* is the centerpiece of the Government's argument (at 32-33) that this Court upheld Congress's power to tax shareholders on corporations' retained earnings. But the Government's refrain (at 9-10, 13-14, 19, 22-23, 32-33, 35, 42) that *Hubbard* held as much is belied by the decision. The taxpayer there brought a refund action for tax paid on the undivided profits of two corporations in which he owned majority shares. 79 U.S. at 9-11. The Court held the suit statutorily barred for failure to pursue administrative remedy. *Id.* at 14-15. It then considered the

hypothetical circumstance that the merits were properly before it. *Id.* at 16 ("Suppose, however, that the rule is overwise…."). It concluded that the taxpayer's liability was authorized by the Revenue Act of 1864 because it defined a person's taxable "gains, profits, or income" specifically to include "the gains and profits, of all companies, whether incorporated or partnership…, whether divided or otherwise." *Id.* at 16, 18.

Even if one overlooks the Court's tip-off that what followed was *dicta*, *Hubbard*'s reasoning on the merits stands for nothing much today. The case presented no constitutional question. *Id.* at 5-6 (reporting taxpayer's statutory argument). And the Court decided none, instead reasoning that, whatever the logic of the statute's approach, it was the one "that Congress did direct," *Id.* at 18. *Hubbard* does not say that undivided corporate earnings are shareholder "income" but "property of the shareholder" that, as "gains and profits," were taxed by the statute. *Id.* at 18; *cf. Southern Pac. Co. v. Lowe*, 247 U.S. 330, 336 (1918) (declining to follow *Hubbard* in addressing question of "income"). If one goes so far as to spot the Government that *Hubbard* rendered a decision on Congress's taxing power—one bereft of any reasoning or reference to pertinent authority—that holding failed to survive *Pollock*, as *Macomber* held in rejecting the same argument. *See supra* § I.A.2. There is no support for the Government's backwards notion that repudiated *dicta* controls over subsequent decisions.

The Government's other authorities contradict its position. *See* U.S.Br.33. *Taft v. Bowers*, 278 U.S. 470, 481 (1929), recites and applies *Macomber*'s realization holding. And while *Commissioner v. Banks*, 543 U.S. 426, 433 (2005), glosses the Tax Code's "gross income" definition as reaching "all economic gains not otherwise exempted," it undertakes a standard realization analysis, holding that litigation-settlement proceeds directed to attorneys were taxable as income to the plaintiffs because they "diverted…income…to another party, and realized a benefit by doing so," *id.* at 435.

B. Original Meaning Requires Realization

By its terms, the Sixteenth Amendment carves out an exception to Article I's apportionment requirement limited to "taxes on incomes, from whatever source derived," thereby expressing the "fundamental conception" of income as gains "coming in" to the taxpayer with the "conciseness and lucidity" typical of constitutional text. *Macomber*, 252 U.S. at 207-08. Common usage, court decisions, and learned commentary from before and after the Amendment's ratification are aligned in understanding that income consists of realized gains. Pet.Br.26-33.

1. The Government provides scant support for its view that "income" was understood to include unrealized gains. Against petitioners' survey of the era's dictionaries, Pet.Br.28-29, the Government points (at 14) to two legal dictionaries that do not substantiate its point. The first refers to "income" as "private reve-

nue," indicating the necessity of receipt, and then proceeds (on the same page) to define an "income tax" as one on "yearly profits," confirming as much. 1 Stewart Rapalje & Robert L. Lawrence, A Dictionary of American and English Law 644 (1883). The second, a work cited by no reported decision, likewise refers to "profit." Charles E. Chadman, A Concise Legal Dictionary 199 (1909).

The Government argues (at 17) that several of petitioners' cited dictionary definitions employing the words "derived" and "proceeds" are indeterminate as to realization. But "derive" meant, in its relevant sense, "[t]o receive, as from a source or origin; to obtain by descent or by transmission; to draw," while "proceed" meant "[t]o issue or come forth as from a source or origin." Webster's Revised Unabridged Dictionary 395, 1141 (1913). Both words denote transfer, not growth.

And the Government simply ignores that, in common usage, "income" was "universally used to refer to a gain attached to a realization event," according to a comprehensive and methodical analysis of period texts. Profs.Of.Law.And.Linguistics.Amicus.Br.16. Moreover, contemporaneous writings consistently "used terms other than 'income(s)' to describe unrealized gains." *Id.* at 17. It is difficult to conceive a more conclusive demonstration that "'income(s)' in its ordinary, common, and natural sense referred to a realized gain." *Id.* at 21. The Government provides no evidence that its open-ended gloss on "income" as in-

cluding unrealized gains was "the commonly understood meaning…in the minds of the people." *Merchants' Loan*, 255 U.S. at 519.

The Government downplays the significance of the Amendment's recognition that "incomes" are "derived" from a "source." U.S.Br.17-18. But "derive" was understood to mean "receive." Webster's, *supra*. And in common usage reference to "income" being "derived" meant realization, Profs.Of.Law.And.Linguistics.Amicus.Br.22. The point is not that the text "from whatever source derived" serves to "restrict" Congress, U.S.Br.18, but that this language further confirms that "incomes" refers to realized gains through ordinary meaning and repetition of the same words that *Pollock* employed to distinguish between a "source" like property and "income" like rents "derived" from it, Pet.Br.27.

The Government's sole judicial authority on this point, *Trefry v. Putnam*, 116 N.E. 904 (1917), contradicts its argument. While the Government quotes (at 15) *Trefry*'s reference to "'gain,' 'profit,' [and] 'revenue'" as being synonyms of "income," the decision identifies the term's "ordinary and popular meaning" as being "the amount of actual wealth *which comes to a person* during a period of time." *Id.* at 907 (emphasis added). *Trefry* goes on to hold that shareholders could be income-taxed on dividends paid out of profits earned prior to enactment of the statute in question because it was only upon realization that they became shareholder income. *Id.* at 912. *Trefry* also holds that a taxpayer may be income-taxed on "gains arising

from the increase in value of investments and realized by sale," which it distinguishes from taxation of "gains on the value of property, which have not been realized by sale and which would be known in common speech as mere paper profits." *Id.* at 908-09.

Similarly unsupportive are the Government's two "contemporaneous tax experts." U.S.Br.15. The Government quotes William Hewett's economists' definition of income but neglects to mention Hewett's repeated observation that the term "customarily means money receipts." William Hewett, The Definition of Income and Its Application in Federal Taxation 33 (1925); *see also id.* at 11 ("The essential nature…is the acquisition of money gain…."); *id.* at 22 ("…when he gains possession…"). And Hewett's survey of the era's case law identified as the first "essential attribute[]" of taxable income that "it must be *realized*." *Id.* at 59. Robert Murray Haig likewise recognized that the law did not embrace his preferred definition, which derived not from legal sources or common usage but his impression of "the economics of the problem." Robert Murray Haig, Income—Economic and Legal Aspects 1, 24, *reprinted in* The Federal Income Tax (1921). Haig made "[n]o attempt" to engage the meaning of income based "on legal and constitutional principles." *Id.* at 1.

The Government's criticisms of petitioners' cited commentators fare no better. The same page of Thomas Cooley's treatise that the Government cites (at 17 n.3) indicates that the concept of income

"com[ing] in" applies to both businesses and individuals, for whom "income" "expresses the same idea that revenue does when applied to the affairs of government." Thomas Cooley, Law of Taxation 160 n.1 (1876). Elsewhere Cooley explains that income does not include unrealized gains in property. *Id.* at 20. Henry Campbell Black likewise recognized the necessity of realization to income. Henry Campbell Black, A Treatise on the Law of Income Taxation Under Federal and State Laws 1, 73, 77, 110 (1913). That includes the definition cited, but not quoted, by the Government—"all that a man receives in cash during the year…"—which summarizes the preceding survey of practice and law. *Id.* at 78. While the Government contends (incorrectly) that subsequent cases rejected Edwin Seligman's understanding of income as requiring realization, U.S.Br.22, it does not question the representative nature of his view or popularity of his works, Pet.Br.30-31.

2. Having little to say about the Amendment's text, the Government instead focuses on "historical context." U.S.Br.12. Missing from its discussion is the most obvious contextual clue: the 1894 income tax that *Pollock* disapproved. It taxed income "received" by taxpayers. 28 Stat. 509, 553 (1864). If the Amendment's effect was "reinstating Congress's power" to impose the sort of tax *Pollock* rejected, U.S.Br.9, then the 1894 income tax is the clearest indication of the Amendment's reach. And that tax reached only realized gains.

The Civil War-era taxes on which the Government rests its argument were different beasts. The Revenue Act of 1864 (and its successors) embodied no consistent theory of income but instead listed out taxable items, 13 Stat. 223, 281-82—an approach one of the Government's commentators characterized as "groping in the dark toward what [Congress] sensed to be equitable as a basis of taxation" and "somewhat confusing" in its implications. Hewett, *supra*, at 41. The reason for that imprecision was that these taxes "were classed under the head of excises, duties, and imposts because it was assumed that they were of that character," *Brushaber*, 240 U.S. at 15. That assumption relieved Congress of the need to distinguish among the objects of taxation. *Id.* at 14-15.

Among those objects were "the gains and profits of all companies, whether incorporated or partnership," which were taxed to corporate shareholders "whether divided or otherwise." 13 Stat. at 282. That provision was controversial. *See, e.g.*, Ltr. to Comm'r of Int. Rev. from Charles Davis, Assessor 1st Mass. Dist. (1865), *reprinted in* The Internal Revenue Recorder & Customs Journal, June 10, 1865 (reporting it "occasions great embarrassment, and many questions arise under it"). But it was of a piece with the haphazard provisions of broad emergency taxing legislation that reached beyond income to tax certain items of "property." *Hubbard*, 79 U.S. at 18.

The Government's argument hinges on the notion that *Hubbard* "sustained Congress's power to enact" this provision. U.S.Br.13-14. As shown, that premise

is incorrect and irrelevant. This argument is, in fact, the same one considered and rejected by *Macomber*. *Compare* 252 U.S. at 219 ("the government nevertheless insists that the Sixteenth Amendment removed this obstacle"), *with* U.S.Br. 9 ("the Sixteenth Amendment…reinstat[ed] Congress's power"). Its force is not enhanced by the passage of a century.

Finally, the corporate excise tax of the Revenue Act of 1909 does not aid the Government. *Contra* U.S.Br.16. That Act defined "income" by reference to the amount "received…from all sources," without exception. 36 Stat. 11, 112-13 (1909); *see also Flint v. Stone Tracy Co.*, 220 U.S. 107, 146-47 (1911).

4. The Government has only a hollow response to the point that dispensing with the need for realization of income would render Article I's apportionment requirement a dead letter. *See*.Pet.Br.34-36. Without disclaiming any possible object of unapportioned taxation, the Government allows only that "a tax must in fact target income," for which it refuses to identify any limiting principle. U.S.Br.18-19. If the government may tax as "income" a person's "gain 'between two points of time,'" U.S.Br.19, then nothing prevents it from setting the initial point decades in the past, just as the MRT does—even at birth, which would render all an individual's property taxable "income." Nor does the Government disavow any of the less extreme implications of its position, including unapportioned taxation on appreciation of a home, the rental value of land, contingent or uncertain gains that may never come to fruition, or even the gains that accrue to all

from government programs. Pet.Br.35-36. To dispense with the need for realization of income is to eviscerate the apportionment requirement.

C. Congress Consistently Observed the Necessity of Realization

Congress's post-ratification practice up to the MRT comports with the need for realization. Pet.Br.37-40. The Government's cited provisions do not demonstrate otherwise.

1. Following the Sixteenth Amendment's text, the 1913 income tax was laid only upon income "derived" by taxpayers, 38 Stat. 114, 167 (1913). The Government does not dispute, or even acknowledge, that Treasury understood this tax to reach only realized gains. Pet.Br.32-33. It focuses instead (at 23) on a provision authorizing the taxation of shareholders on undivided earnings of corporations "formed or fraudulently availed of for the purpose of [income-tax avoidance]." 38 Stat. at 166. Not only does this provision track petitioners' position—taxpayers' interposing a corporation between themselves and their otherwise-taxable income is *the* classic example of constructive realization, Pet.Br.48-49—but it was structured on *that very basis* by the first Congress to legislate under the Sixteenth Amendment, Pet.Br.32.[3] The Government cannot minimize the import of this evidence by waving away the views of some of the Amendment's

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[3] To correct a typographical error, the first citation of that discussion should be to volume 50 of the *Congressional Record*.

leading congressional advocates, *id.*, or misstating petitioners' position as advocating a "categorical realization requirement" limited to actual receipt of cash, *contra* Pet.Br.47.

2. The Government's attempt to analogize the taxation of shareholders to that of partners, U.S.Br.24-26, disregards that *Macomber* rejected the same argument, refusing to "look upon stockholders as partners, when they are not such." 252 U.S. at 214; *contra id.* at 231 (Brandeis, J., dissenting). It was long settled by the time of the Amendment's ratification that, unlike with partnerships, a corporation's earnings are ordinarily not its shareholders' income. This Court in 1890 recited the "familiar and well settled" principle that a corporation's earnings "remains the property of the corporation, and does not become the property of the stockholders, unless and until it is distributed." *Gibbons v. Mahon*, 136 U.S. 549, 557–58 (1890). It necessarily followed that "accumulated earnings" are shareholder "capital, and not income." *Id.* That was the understanding of the Congress that enacted the 1913 income tax, as evidenced by its general treatment of corporate earnings as taxable to the corporation, not shareholders.

This Court regarded that principle as beyond dispute in applying the 1913 Act. *Towne*, 245 U.S. at 426 (holding that share dividend was not taxable as shareholder income because it took "'nothing from the property of the corporation'"); *Lynch v. Hornby*, 247 U.S. 339, 344 (1918) (holding that accumulated earn-

ings became income to shareholder only upon distribution). And it prevailed in what remains the leading precedent in this field. *Moline Properties, Inc. v. Comm'r*, 319 U.S. 436, 438-39 (1943).

Had *Macomber* not already disposed of the Government's partnership-analogy argument, the Court today would be constrained to reach the same result as a matter of original meaning and longstanding precedent.[4]

3. Congress's measures addressing tax avoidance through use of foreign corporations do not support the Government's argument for taxation of unrealized gains but instead rely on the concept of constructive realization articulated by precedent. *Contra* U.S.Br.26-29. Subpart F, like the "Foreign Personal Holding Company" provisions that preceded it, rests on the same basic rationale as the 1913 Act's undivided-earnings provision: that taxpayers may not escape taxation of income properly regarded as theirs by sheltering it in a corporation. *See* Boris Bittker & Lawrence Lokken, Federal Taxation of Income, Estates and Gifts § 69.1 (quoting Joint Committee on Taxation analysis).

Subpart F is tailored to that end in three respects. First, it applies only to foreign corporations majority-

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[4] Taxation of employee-shareholders on the earnings of personal service corporations, as in the Revenue Act of 1918, 40 Stat. 1057, 1059, 1070, has been justified on constructive-realization principles, *see* J. Timothy Philipps, James McNider, & Daniel Riley, The History of the Personal Service Corporation, 40 Wash. & Lee L. Rev. 433, 442 (1983); *contra* U.S.Br.24.

controlled by U.S. shareholders and attributes corporate income only to those shareholders owning at least 10 percent of the voting stock. While the Government contends (at 28) that 10-percent ownership is inadequate to manifest the requisite control, Congress (on Treasury's advice) regarded it as sufficient to "restrict[] the controlling group to a small enough number that it would be sufficiently cohesive" to exercise control. *Hearings Before House Committee on Ways and Means on the Tax Recommendations of the President Contained in His Message Transmitted to the Congress*, 87th Cong., 1st Sess., at 314 (1961); *see also id.* at 316-17 (surveying statutes employing similar thresholds).

Second, Subpart F applies not to all earnings but instead focuses on categories "Congress found subject to tax haven manipulation," such as "passive investment income" and income from related-party transactions. Bittker & Lokken, *supra*, at § 69.1. While ancillary provisions address several other categories, U.S.Br.28, Subpart F's core targets the shifting of income to corporate subsidiaries in low-tax jurisdictions. *Id.*

Third, and crucially, Subpart F imposes tax liability only upon a realization event *in the current tax year* involving the controlling U.S. shareholders—either the corporation's earning of covered income, or investment in U.S. assets, *while subject to the control of those shareholders*. Bittker & Lokken, *supra*, at § 69.1. That temporal nexus between the receipt or distribution of earnings at the corporate level and

shareholder control is what justifies taxation of the controlling shareholders.

4. The other taxing provisions cited by the Government do not support its congressional-practice argument.

a. The pass-through tax treatment of "S corporations" is justified by their owners' election. The significance of election is not shareholders' "consent," U.S.Br.29, but concession that the business is organized and operated such that its income is theirs, Pet.Br.51-52.

b. Contrary to the Government's discussion (at 30), the Court recognized in *United States v. Safety Car Heating & Lighting Co.* that taxation based on accrual-method accounting is consistent with and subject to its Sixteenth Amendment realization precedents. 297 U.S. 88, 99 (1936) (citing *Macomber*, 252 U.S. at 206-07). Accrual accounting affects not the need for realization, but its timing. *Id.* at 94, 99; *see also* Berg.Amicus.Br. 25-26.

c. The tax on relinquishment of citizenship permits deferral of liability until realization through sale. 26 U.S.C. § 877A(b)(1). While the mechanics of this tax may be novel, U.S.Br.30-31, that novelty, in an obscure tax dating to 2008, demonstrates nothing about "longstanding historical practice," U.S.Br.11. The Government does not even dispute that this may not be an "income tax" at all. *See* Pet.Br.52 n.11.

d. Nor does the Government dispute that the various "mark-to-market" taxes it cites (at 31) may be

best characterized as excises on "doing business in a certain way," *Flint*, 220 U.S. at 150, and, in addition, target narrow circumstances where assets are treated by their owners as the equivalent of cash, *see* Pet.Br.53. The "original issue discount" tax on bonds that sell at a discount to their face value is an accrual-accounting rule, Bittker & Lokken, *supra*, at § 53.1, and is justified anyway as an excise on the purchase or receipt of such bonds, *see Thomas v. United States*, 192 U.S. 363, 370 (1904).

II. Petitioners Realized No Income

As this case comes to the Court, it stands undisputed that the Moores realized nothing on the investment taxed by the MRT. Pet.7. The Court therefore need go no further than to decide the question presented.

There is also no merit to the Government's insistence that the MRT is a tax on realized income. By the Government's description, the MRT taxes shareholders on corporations' accumulated earnings. U.S.Br.41. But a "stockholder's share in the accumulated profits of the company is capital, not income." *Macomber*, 252 U.S. at 219.

The Government suggests that the MRT could be justified under a theory of constructive realization because it is "indistinguishable" from Subpart F. U.S.Br.11, 28-29, 42-43. That is wrong. One distinction the Government ignores is that Subpart F's focus is movable income particularly susceptible to tax avoidance, whereas the MRT targets everything *but*

that. Pet.Br.45-46. And, critically, Subpart F liability is triggered by a realization event: the corporation's earning of income or *de facto* distribution of earnings while subject to shareholder control. MRT liability, by contrast, is triggered by ownership of shares on a particular date in 2017, irrespective of any event by which the shareholders might have realized anything. Pet.Br.50-51.

The Government's claim (at 43) that this distinction relates only to the "time periods" each provision covers—with Subpart F operating on current income, and the MRT reaching back 30 years—misses the point entirely. The MRT by its terms takes no account of whether a shareholder had any interest or control when the corporation made the earnings that it attributes to her; all that matters is ownership of the requisite number of shares in 2017. Subpart F, by contrast, aligns the corporation's earning of the money being taxed with the shareholder's control *in the same year*, employing the "familiar practice" of annual accounting "as had been in actual operation within the United States before [the Sixteenth Amendment's] adoption." *Burnet v. Sanford & Brooks Co.*, 282 U.S. 359, 365 (1931).

The Government's assumption that any "time period" passes muster is badly mistaken. It was settled by the time of the Amendment's adoption that earnings "held and invested by the corporation" in its business are "capital, and not income," to shareholders. *Gibbons*, 136 U.S. at 558; *see supra* § I.C.2. Subpart F

and its ilk act only on current-year earnings, consistent with the Court's approval of a year-based income-tax system grounded in historical practice and "capable of practical operation." *Burnet*, 282 U.S. at 365. Nothing supports reaching back to long-closed tax years to recharacterize as income what all precedent, experience, and expectation hold to be capital. It is unprecedented.

III. The MRT Is Not an Excise

The Government's argument (at 46-49) that the MRT may be upheld as an excise clashes with longstanding precedent and constitutional structure and clearly has no application to the Moores.

A. This argument is twice waived. First, it is not "fairly included" in the question presented, S. Ct. R. 14.1(a), which both the petition and brief in opposition framed as limited to the Sixteenth Amendment's reach. Nor is it important in its own right; there is no conflict in the lower courts on whether mere ownership of property may be subject to excise. *Compare Yee v. Escondido*, 503 U.S. 519, 537-38 (1992). Second, this argument was not raised below. The Government's motion to dismiss instead challenged *Pollock*'s holding that taxes on personal property must be apportioned. Dist.Ct.Doc.26 at 16.[5] And the portion of its appeal brief cited by the Government (at 46 n.5) argued that Congress may "look[] through the corporate form" and tax "shareholders directly on [corporate]

[5] Nor did it raise the issue in opposition to the Moores' motion for summary judgment. *See* Dist.Ct.Doc.33.

earnings," CA9.Doc.21 at 45-47, without referring to an "excise" or the Government's authorities on that point. The Government's decision not to press this issue below reflects, as next explained, a fair assessment of its merit.

B. The MRT is not an excise because it is "imposed upon property simply because of its ownership." *Flint*, 220 U.S. at 150. *Flint* distinguished such a tax, which *Pollock* held to be direct and require apportionment, from an excise that is measured by income but "not payable unless there be a carrying on or doing of business in the designated capacity." *Id.* The key difference is "between the mere ownership of property and the actual doing of business in a certain way," such as "in a corporate capacity, *i.e.*, with the advantages which arise from corporate…organization." *Id.* at 150-51. The MRT, by its terms, taxes shareholders solely because of their ownership of shares, without regard to any business or activity in which they are engaged or any use they have made of that property. 26 U.S.C. § 956(a). This is not an excise on use of property but "direct taxation upon property solely because of its ownership," *Flint*, 220 U.S. at 150.

The Government attempts (at 47-48) to recharacterize the MRT as an excise on shareholders' "privileges of 'doing business' through a CFC." That is untenable, given that MRT liability turns on nothing more than ownership and takes no account of the taxpayer's activities. *Cf. Ivan Allen Co. v. United States*, 422 U.S. 617, 633-34 (1975) (distinguishing *Macomber* where accumulated earnings tax on corporation did not tax

"unrealized appreciation" of investment securities held by corporation). This applies equally to corporate as to individual taxpayers.

The Government's argument also runs headfirst into *Pollock*'s still-good holding that taxes on "invested personal property," including "bonds, stocks, investments of all kinds," are not excises but direct taxes requiring apportionment. *Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601, 635, 637 (1895). This argument would apply with equal force to all investors in stocks or bonds, effectively abrogating the entire body of the Court's Sixteenth Amendment decisions on investor income, from *Macomber* on down. The staggering breadth of this argument is matched only by its disregard for long-settled precedent.

C. If the Moores prevail on the question presented, then they are entitled to reversal. The Government's request (at 49) for remand instead of reversal relies on the premises that its excise-tax argument was preserved and provides a plausible basis for upholding the MRT. Neither premise holds. Remand would serve only to delay the Moores the refund they are due.[6]

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[6] The Government's contention that reversal "could cost…approximately $340 billion" cannot be squared with its admission that most MRT refund claims would present "statute-of-limitations and administrative-exhaustion issues." *See* U.S.Br.49.

CONCLUSION

The judgment below should be reversed.

Respectfully submitted,

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