

Whether Moore or Less? Listen to the Oral Argument!

This column provides an informal exchange of ideas, questions, and comments arising in everyday tax practice. Readers are invited to write to the editors: Richard M. Lipton, Senior Counsel, Baker McKenzie, Dallas, Texas, Richard.Lipton@bakermckenzie.com; Daniel Cullen, Partner, Baker McKenzie, Chicago, Illinois, Daniel.Cullen@bakermckenzie.com; and Samuel P. Grilli, Partner, Baker & McKenzie, Chicago, Illinois, Samuel.Grilli@bakermckenzie.com.

Your editors, like most tax practitioners, have been closely following the *Moore* case¹ as it worked its way to the Supreme Court. The controversy is over the scope of the Court's 100-year-old decision in *Eisner v. Macomber*² and whether realization of income is a constitutional requirement. Much has been written about the case and its potential implications, even in mainstream media, and many trees were felled in order to prepare the voluminous amici curiae briefs that were filed. We have no intention to repeat any of that here. But we do believe that it is a public service to the tax bar to urge our readers to listen to the recent oral argument, which is easily accessible on the Supreme Court's website.

As recently recounted in Tax Notes, who named Kathleen and Charles Moore as the Tax Notes Peoples of the Year, Charles Moore was a Microsoft veteran who invested \$40,000 in 2005 in exchange for an 11 percent interest in KisanKraft, an Indian company. The primary owner of KisanKraft was Ravindra Agrawal, who had been Charles' colleague at Microsoft. KisanKraft was formed to supply power tools to small-scale farm operations in India. The Moores never received any dividends from KisanKraft – their "return" on their investment was the intangible benefit of knowing that they were helping the farmers.

Although the Moores never received any dividends, after Congress passed the Mandatory Repatriation Tax (MRT) as part of the Tax Cuts and Jobs Act in 2017, they did get a tax bill. By 2017, their interest in KisanKraft had increased to 12.937 percent, and they were required to include in their income tax return for 2017 their share (\$132,512) of the undistributed retained earnings of KisanKraft, resulting in a tax liability of \$15,130. KisanKraft had significant earnings and profits from the operation of its business between the time the Moores invested in 2005 and the MRT was imposed

in 2017 – but these earnings and profits were never distributed to its shareholders, including the Moores.

The Moores sued for a refund of the tax paid, alleging that the MRT was an unapportioned direct tax that was unconstitutional as a direct tax on capital; they also alleged that the MRT violated their right to due process by imposing a tax retroactively. The district court granted the government's motion to dismiss, concluding that the MRT is a tax on income (and not a direct tax) and pointing out that subsequent decisions had departed from the realization requirement in *Macomber*; the court also rejected the claim that the MRT violated the due process clause because there was a legitimate legislative purpose for the MRT in connection with the reform of international taxation that was encompassed in the TCJA.

The Ninth Circuit used even broader language in re-affirming the district court decision, stating that the constitutionality of a tax does not depend upon whether or not income has been realized, asserting that realization was simply an "administrative convenience." The Ninth Circuit concluded that realization is not required and what constitutes income is "flexible," and under this broad standard, the MRT was clearly permissible. A petition for rehearing en banc was denied, although several judges on the Ninth Circuit would have granted the request.

None of the foregoing surprised most tax practitioners because most tax practitioners had assumed that (or did not bother to question whether) the MRT was constitutional. Arguably, the MRT is an extension of the tax to shareholders on the undistributed income of controlled foreign corporations (CFCs) that has been on the books for a half-century, more or less. If the MRT could not be applied with respect to undistributed earnings, could the shareholders of an S corporation be taxed on its undistributed

earnings? And if the taxation of S corporation shareholders was somehow in jeopardy, what is the constitutional basis for taxing the partners in a partnership on their share of undistributed profits? And what about the various taxes that are imposed on a mark-to-market basis, such as the tax on a dealer's unrealized gain in securities (not held for investment). The potential implications of a successful challenge to the MRT upon many existing tax regimes could be more or less staggering.

As a result, most tax practitioners were surprised when the Court granted the petition for certiorari filed by the Moores and agreed to hear this case. What motivated at least four of the Justices (the minimum required to vote in favor of granting a petition for certiorari) to hear a tax case concerning the constitutionality of the MRT? There was rampant speculation that the conservative justices on the Court might want to broadly enforce the realization requirement that had been enunciated in *Macomber*. Their real concern may be the various recent proposals for a federal wealth tax, such as that put forth by Senator Warren (a tax on property of dubious constitutional validity), and by Senator Wyden (a tax imposed on unrealized gains in accordance with an annual "mark to market" regime on all assets, arguably a slightly less problematic proposal from a constitutional perspective). However, the Justices are not required to state why they grant certiorari, and they did not do so in *Moore*.

As noted above, this Shop Talk column is not intended to reiterate all of the arguments and counterarguments made in *Moore* by either the parties or the amicus briefs. Rather, we are writing to urge our tax brethren to listen to the oral argument before the Court. It will take two hours of your time, but it will likely help restore your faith in the Court and the way it operates.

At the threshold, it was evident that the Justices were as well prepared for the oral argument as any observer could possibly ask of those who are not tax specialists. Their "record" in tax cases has been somewhat sketchy, but at the oral argument for *Moore* the Justices were impressive in their knowledge of the Code and the case law concerning income taxation, stretching all the way to cases decided as far back as the Civil War! The Justices asked sharp questions and challenging hypotheticals. The oral argument was analytically rigorous of impressive caliber whilst being interesting and stimulating.

The Justices were concerned and intently focused, with the prospect of either upending much of the Court's long-standing jurisprudence or vast segments of the tax code. As a result, many of the Justices seemed intent on not ruling broadly in *Moore*. They repeatedly pressed counsel (both for the taxpayer and the government) on how their decision could be limited to the case before them. They did not seem interested in wreaking any havoc on the long-standing system of tax rules that apply to CFCs, S corporations and partnerships. They also referred favorably several times to market-to-market tax regimes, such as the taxation of dealers in securities, and appeared more or less to have no desire to question that approach on a constitutional basis, either.

Hearing the Justices grapple with the complex and unwieldy landscape that is current federal income tax law was also satisfying. You can hear the Justices try to keep track of and conceptualize this landscape into a logical framework. The ever blurring line between pass-through and corporate taxation was a leitmotif that vexed such efforts to draw clear legal lines about realization. The Justices pressed both sides to explain how the MRT could be distinguished from the tax rules that otherwise apply to CFCs, S corporations and partnerships.

The Solicitor General, Elizabeth Prelogar, was superb. It is worth your time to listen

to the oral argument just to hear her performance. She started her presentation by emphasizing that the Court did not need to resolve any fundamental questions in this case concerning whether the 16th Amendment requires realization of income. The MRT only taxes income that was actually realized by the foreign corporation, and Congress has long had the ability to attribute the tax on that income to the U.S. shareholders of the foreign corporation that realized the income. According to the Solicitor General, the Court could simply conclude its decision in those few words – this case simply involved the validity of the attribution of the income of a CFC to its shareholders, and does not raise any constitutional questions. Even if you disagree with the government's arguments, you cannot disagree that Elizabeth Prelogar's oral advocacy skills were extraordinary. The session presents a worthwhile opportunity to learn from the best, whether or not the Court's eventual ruling is broad or narrow.

So what was the Court's motivation in granting certiorari in *Moore*. Some of your editors think the final decision in *Moore* will be "Moore or less" underwhelming in light of the hype. The Court will simply uphold the MRT, without raising constitutional inquiry, and otherwise limit the scope of the opinion. The Solicitor General did concede in her oral argument that an unapportioned federal wealth tax would be unconstitutional, but that question is not directly before the Court in *Moore*. If this direction is taken then the ultimate decision from the Court will likely follow the narrow line that the Solicitor General recommended, although there could be some dicta implicating potential future wealth taxes. It will be interesting to see if there are concurring or dissenting opinions that take a different tack. But in the estimation of these editors it seemed pretty clear from the oral argument that most or all of the Justices would prefer a limited approach in this case. It is possible, of course, that the Justices will attempt

to clarify a constitutional limit on the government's taxing power, although given the narrow scope of the facts in *Moore*, this case may not be the ideal vehicle to do so.

However, one of your editors is of the belief that the Justices had some particular goal in mind when granting certiorari in *Moore*, and it is possible that they were working on "realizing" principled distinctions between the facts in *Moore* and other situations in which there is a limit on the government's taxing power. If this editor's view is correct, then the final decision might take a more sweeping approach than the one recommended by the Solicitor General, although most observers of the oral argument do not share this expectation.

Throughout the oral argument a remarkably civil and respectful level of decorum was consistently maintained, including a handful of instances of humor and laughter, all of which enhanced and enriched the highest levels of authentic legal rigor witnessed – notwithstanding the gravity of the legal questions under consideration by the Justices and the consequences of the Court's decision. The rule of law relies upon the people's "realization" that this is the proper manner in which to resolve the toughest legal questions. Even if the MRT passes constitutional muster, the approach the Court uses to "realize" such ruling will affect whether more or less will be said about the case in the future. Regardless of the outcome, after reading this column it is our hope that our readers "realize" that they should listen to the oral argument and, it may "Moore or less" restore some of your confidence in our legal institutions.

We welcome our readers' thoughts on this important topic.

End Notes

¹ *Moore v. U.S.*, U.S. Sup. Ct., No. 22-800, oral argument on December 5, 2023.

² 3 AFTR 3020 (40 Sup. Ct. 189), March 8, 1920.

