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Supreme Court Affirms Mandatory Repatriation Tax

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The Supreme Court recently issued a 7-2 majority opinion in *Moore v. United States* that the Tax Cuts and Jobs Act's (TCJA) mandatory repatriation tax (MRT) under Section 965 of the Internal Revenue Code does not violate the Direct Tax Clause of the U.S. Constitution.

The ruling was decided on narrow grounds that relate specifically to entities treated as "pass-throughs" and did not address the broader questions of the limits of Congress' taxing authority or the meaning of the term "realized" as it applies to undistributed foreign income.

Background

This case was brought on appeal from the U.S. Court of Appeals for the Ninth Circuit by Charles and Kathleen Moore. The Supreme Court was asked to decide whether the MRT violated the Direct Tax Clause of the Constitution because the MRT was an unapportioned direct tax on their shares of foreign stock.

The MRT was enacted by Congress as part of the TCJA to shift the current tax system to a territorial tax system that excludes foreign earned income from domestic taxation. The MRT required U.S. shareholders owning 10% by vote or value of a Controlled Foreign Corporation (CFC), as defined under Section 951 of the Code to pay a one-time transition tax in a deemed repatriation of realized but undistributed income of the CFC in 2017. U.S. shareholders were able to defer taxation on realized but undistributed income prior to the enactment of the MRT.

The Moores challenged the MRT after they were assessed with a $14,729 tax bill for 2017 as a result of the TCJA, which required them to pay the MRT based on the undistributed earnings allocable to them from an India-based CFC called KisanKraft. The attorneys for the Moores argued that they should not be liable for tax for foreign income that was never received or realized income from their shares in KissanKraft.

The Supreme Court upheld the ruling of the lower appellate court and found that the MRT appropriately taxes realized income because the realized income was that of the corporation, KissanKraft. Because of this, the mere fact that the Moores hadn't received the income as a distribution was not enough to keep it from being unrealized and therefore untaxable under the MTA.

This decision is significant because it upholds the right of Congress to tax U.S. shareholders on realized undistributed income of their foreign corporations, but the Supreme Court failed to address the constitutional issue of when income is "realized." This creates the possibility of future challenges before the Supreme Court to argue that Congress cannot simultaneously tax the same corporation's or entity's income for both the entity and the owners. It also creates uncertainty surrounding how the Supreme Court will rule on certain types of taxes such as the wealth tax proposed by the Biden administration.

What are the Implications Going Forward from the *Moore* Case?

While the Supreme Court recognized the inherent danger to the U.S. tax system had it struck down the repatriation tax, it also signaled a majority opinion that Congress does not have unlimited taxing power. It recognized that longstanding tax rules were generally acceptable, but that Congress and the administration should be very careful when enacting new tax laws such as a wealth tax, taxes on unrealized "paper" profits of high-net-worth individuals as was outlined in the latest Biden tax plan, or taxes designed to tax an entity and its owners on the same income without an actual dividend or other distribution.

The *Moore* decision upheld Congress' right to tax under the MTA without ruling on many of the important questions on realization and general Congressional taxing powers. The narrow ruling all but guarantees that there will be additional cases in the future to seek clarity on these and other important tax issues.