

National Tax Association
54th Annual Spring Symposium Program
In Association with the American Tax Policy Institute (ATPI)

The Supreme Court's Examination Of The Authority Of Congress And Federal Agencies To Formulate Tax Law

or

Eat Your Broccoli, EconoBro!



Speakers

Moderator: *Stephen Shay*, Boston College Law School

Panelists:

Brian Galle, Georgetown Law School

Chye-Ching Huang, New York University Law School

Eric Solomon, Ivins, Phillips & Barker

Topics

1. Moore v. United States: the Background
2. More on Moore: the Realization Doctrine, the 16th Amendment to the Constitution and a “Direct” Tax

* * * and now for something really different, saving America from the Deep State

3. Who Interprets the (Tax) Law? Art. III Courts v. Agencies: Chevron Deference, Major Questions and More

4. Tax and the APA.

That’s the Administrative Procedure Act, EconoBro



I thought this panel was on measuring compensated elasticities. How do I leave?

Moore v. United States

The Background

5/8/2024



Tax Nerd: I better take notes.

Moore v. United States

- In this case the judicial branch of our federal government is considering the scope of the power granted to the legislative branch of the government by the U.S. Constitution.

U.S. Constitution

- The federal government, including Congress, has only the powers granted in the Constitution.
- Article I, Section 8: The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, ... but all Duties, Imposts and Excises shall be uniform throughout the United States ...
- Article I, Section 2: Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers ...
- 16th Amendment (1913): The Congress shall have power 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.

Question Presented in the Moore case

- As stated in the Supreme Court summary of the case, the question presented is “Whether the 16th Amendment authorizes Congress to tax unrealized sums without apportionment among the states.”

The Code Section at Issue

- Section 965, the so-called “mandatory repatriation tax” (the “MRT”) was enacted as part of the Tax Cuts and Jobs Act (“TCJA”) in December 2017.
- The MRT was enacted as part of the TCJA’s overall framework for taxing the income of controlled foreign corporations (“CFCs”).
- A CFC is a foreign corporation as to which more than 50% of the vote or value of the stock is owned by U.S. persons who own 10% or more of the vote or value of the CFC’s stock (“United States shareholders”).

Background

- Before 2018, the subpart F regime imposed current taxation on United States shareholders with respect to passive earnings of CFCs, even if the earnings were not repatriated. Passive earnings, once taxed, could be repatriated tax-free. Active earnings of CFCs were not taxed until repatriated as dividends.
- The pre-2018 system created a lock-out effect because active earnings were kept offshore to avoid the tax on repatriation. Approximately \$2 trillion of untaxed earnings were kept offshore.
- The post-2017 system created by the TCJA essentially imposes current taxation on United States shareholders with respect to both passive earnings (under subpart F) and active earnings (under the post-2017 GILTI regime) of CFCs. The income, once taxed, can be repatriated tax-free.

Additional Background

- The drafters of the TCJA had to decide what to do about pre-2018 accumulated active earnings of CFCs that were sitting offshore and had not yet been taxed.
- To deal with these previously untaxed foreign earnings, in the TCJA Congress enacted section 965, which imposed a one-time tax on United States shareholders with respect to post-1986 previously untaxed accumulated earnings.

The Moores' case

- The Moores are United States shareholders of an Indian corporation named KisanKraft Machine Tools Private Limited (“KisanKraft”).
- They paid the MRT with respect to the pre-2018 accumulated earnings of KisanKraft.
- They sued the IRS for a refund of the MRT on the ground that the MRT was unconstitutional.
- The Moores lost in the federal district court and in the Ninth Circuit.
- The Supreme Court granted certiorari.
- The oral argument was held on December 5, 2023.

The Moores' Argument

- The Moores argue that the 16th Amendment did not permit Congress to enact section 965. They argue that section 965 is a direct tax that must be apportioned.
- Relying on the 1920 Supreme Court case Eisner v. Macomber, the Moores argue that the 16th Amendment has an implicit requirement that income must be “realized” to be permissibly taxed. They assert that the realization requirement is not satisfied with respect to section 965.
- The Moores argue that section 965 imposes tax on ownership of stock at the end of 2017. Consequently, it is a direct tax on property that must be apportioned.

The Government's Argument

- The Government argues, and particularly did so in the Supreme Court oral argument, that whether or not the 16th Amendment has a realization requirement does not need to be decided in this case.
- The Government argues that there was realization of income – at the CFC level, just like there is under subpart F and many other Code provisions that impose tax on the owners of an entity with respect to earnings of the entity, such as subchapter K (partnerships) and subchapter S.

The Government's Argument (cont'd)

- The Government argues that the real question in this case is whether the earnings of the CFC can be attributed to its owners, which is a due process question.
- Due process is satisfied if there is a rational basis for attribution, which is satisfied in this case (just as it is satisfied in subpart F) because the Moores are United States shareholders of KisanKraft (*i.e.*, they own 10% or more of the KisanKraft stock).

Key Questions Discussed at the Oral Argument

- At the oral argument, the Justices and litigants focused on the following questions:
 - Does the 16th Amendment have a realization requirement?
 - Would a decision for the Moores undermine large parts of the Internal Revenue Code?
 - What implications will the decision in this case have regarding a tax on appreciation or a wealth tax?
 - Is attribution the real issue in this case?
 - Are there due process limits on the ability to attribute income to owners of an entity that earns the income?



More on Moore

The Realization Doctrine, the 16th
Amendment to the Constitution and a
“Direct” Tax



Really?

Moore, Moore, Moore (v. United States): How Do You Like It?



TCJA and the Definition of “Income” (and “Direct Tax”?)

- Section 965: One-time tax on undistributed post-1986 earnings & profits of active foreign business held by 10% U.S. shareholder
- Imposed in 2017
- Payable over 8-year period
- “ No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or enumeration herein before directed to be taken.” – Art. I Sec. 9 Cl. 4
- “The Congress shall have power 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.”
– 16th Am.

Is There a Constitutional Realization Requirement, and If So What Is It?

- *Eisner v. Macomber*: “enrichment through increase in value of capital investment is not income”
- “*Macomber* dies a slow death” – *Helvering v. Griffiths* (1943) (Douglas, J., dissenting)



JUSTICE SOTOMAYOR: You started by suggesting a narrow ruling. I think there are two ways to narrowly rule. Tell me if one is better than the other if at all, okay, but, first, we can say there is a realization requirement, and, here, it was realized because the corporation realized it. You have to deal

JUSTICE SOTOMAYOR: But the bottom line, we could rule that way, or we could do it the way Justice Kavanaugh started his question, which is we assume that there's a realization requirement and -- and it was met here.

GENERAL PRELOGAR: It would be critically important for the Court to do it through Justice Kavanaugh's approach. That is, I don't think the Court needs to resolve anything about whether the Sixteenth Amendment requires realization. Here, we happen to have

The Two Paths and...Sub-Part F and PFIC

- Sub-Part F seems fine, indistinguishable from 965
- The Altria litigation and the open due process issue: is the Court going to second-guess 10%?
- PFICs don't necessarily have realized income inside the foreign entity
 - More on a later slide!

...and complex financial instruments (and the viability of capital gains taxation?)

- 1256
 - “each section 1256 contract [e.g., futures contract] held by the taxpayer at the close of the taxable year shall be treated as sold for its fair market value on the last business day of such taxable year”
- 1259
 - “If there is a constructive sale of an [appreciated financial position](#)—(1)the taxpayer shall recognize gain as if such [position](#) were sold, assigned, or otherwise terminated at its fair market value on the date of such constructive sale....”
- Kavanaugh path (“there is a realization requirement”) is trouble for these provisions
 - 1256 and Moores’ brief (clearing requirements; not applicable to foreign currency)
 - 1259 and the pledge cases (e.g., Calloway v. Comm’r, 691 F.3d 1312 (11th Cir. 2012) (holding that a pledged security in which t/p held no remaining chance of gain or loss was “sold”)) → but see JCT (1997)

...and taxes based on financial-reporting income?

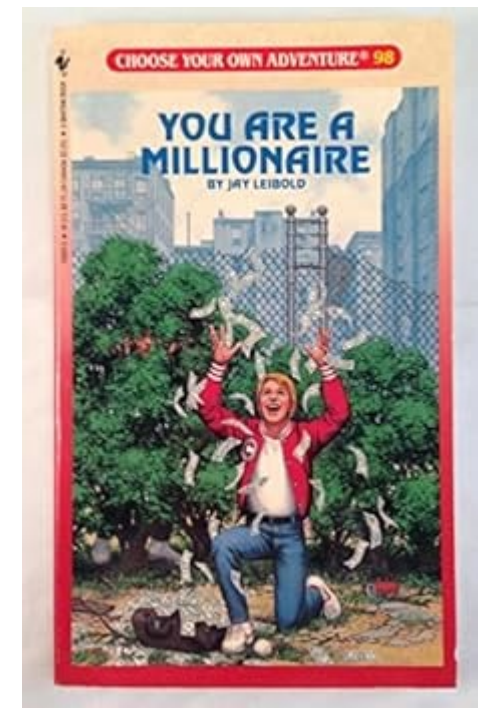
- Pillar Two and CAMT
- GAAP and IFRS are not always realization-based
 - E.g., GAAP & marketable securities; impairment losses in long-lived assets
- *Moore* is probably irrelevant to business taxes
 - the *Stone Tracy* case (1911): corporate taxes are not “direct”
 - *Altria* plaintiffs have a contrary argument that makes no sense
 - Could still matter for personal-level taxes on business income, e.g., Swiss wealth tax formulaic method (*cf.* CATEW)

...and wealth / MtM taxation?

- 2018-era Warren wealth tax proposals
 - Kavanaugh & Prelogar colloquy could support dicta suggesting these don't work (unless apportioned, see [Gamage & Brooks 2022](#))
- Wyden's [Billionaires Income Tax](#)
 - Mandatory MtM for tradable assets; deferred tax + interest charge for non-traded assets
 - 1259 but not this?
 - Prelogar suggests “history and tradition”
 - 1864 income tax has mark-to-market rules
 - Anti-avoidance exception? Justice Barrett: “That’s a *constitutional* principle?”

Choosing Your Own Tax Adventure: BMIT and PFIC

- Billionaire Minimum Income Tax, H.R. 8558 (117th Cong.)
 - MtM with phase-in > \$100M net worth (for married households)
 - Allows applicable taxpayers to elect to defer payment until actual realization, plus an (economically accurate) interest charge, but subject to interim withholding payments against ultimate tax liability (see [Galle, Gamage, & Shanske 2023](#) for detail)
 - Recent Warren wealth-tax bills have similar features
- PFIC
 - Passive foreign account holders taxed on MtM basis (or for some as-if a U.S. RIC)
 - Unless electing a “punitive” option to pay later (ordinary rates, interest charges, no losses)



Who Interprets the (Tax) Law? Art. III Courts v. Agencies

Chevron Deference, Major
Questions and More

5/8/2024



EconoDad

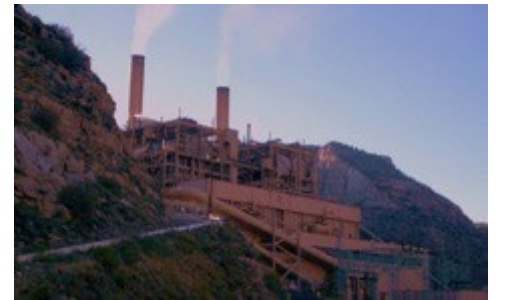
Who interprets and applies the (tax) law?
Article III courts v. agencies

1. Conceptual overview

2. *Chevron* deference, *Loper Bright*, *Relentless*

3. “Major questions,” *West Virginia v. EPA*

4. Now what? So what?



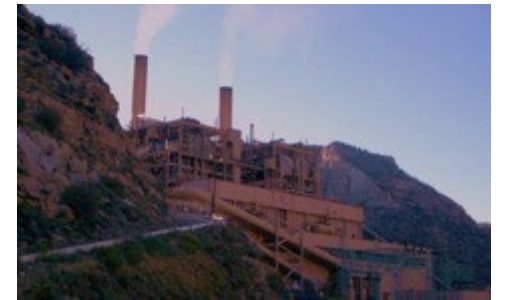
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Who interprets and applies the (tax) law?

Judicial review of agency decisions

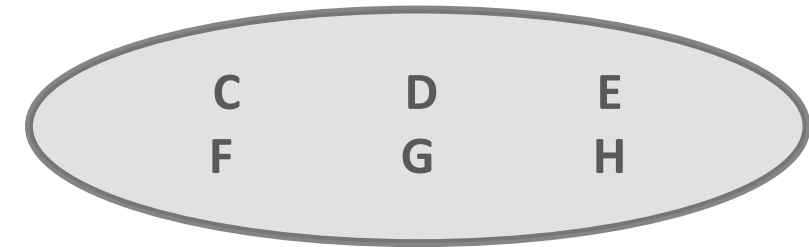
What the statute means

- *Chevron* (for days or weeks)
- *West Virginia v. EPA* “Major questions”

A?

B?

Z? Zone of discretion for agency to choose:



Judicial review of agency decisions

What the statute means

- *Chevron* (for days or weeks)
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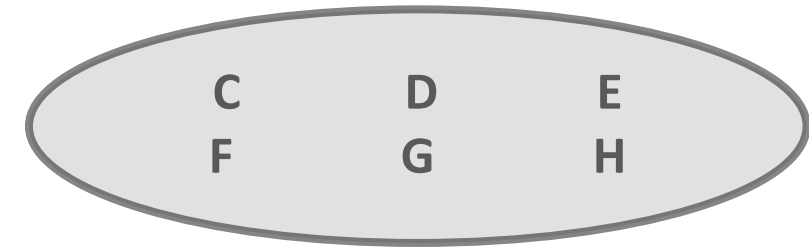
Agency exercise of discretion delegated by the statute:

- Reasoned decision making
- Arbitrary and capricious review (*State Farm*)
- Administrative Procedure Act

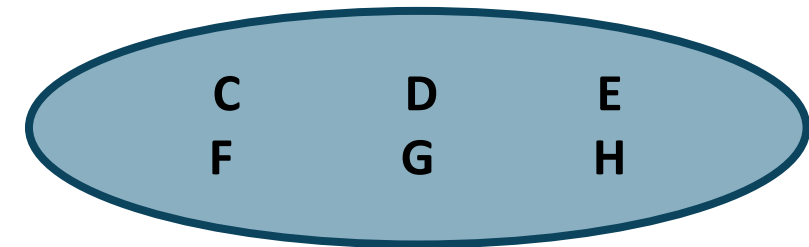
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If the statute means Z, how and what to choose?



Judicial review of agency decisions

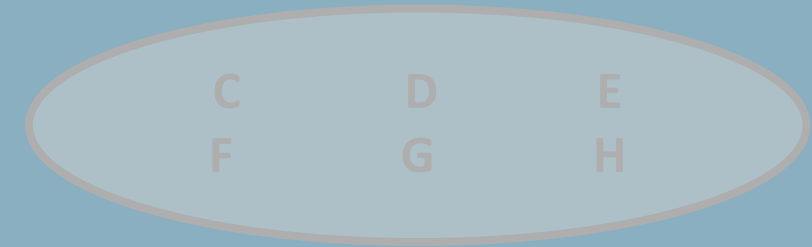
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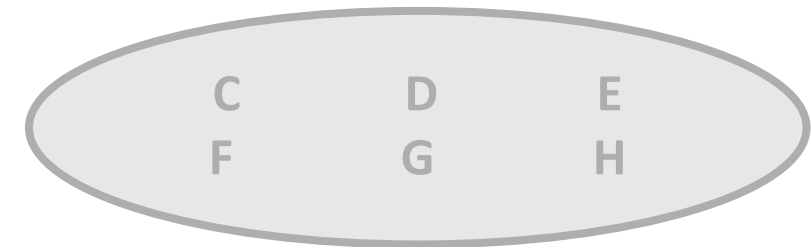
Z? Zone of discretion for agency to choose:



Agency exercise of discretion delegated by the statute:

- Reasoned decision making
- Arbitrary and capricious review (*State Farm*)
- Administrative Procedure Act

If the statute means Z, how and what to choose?



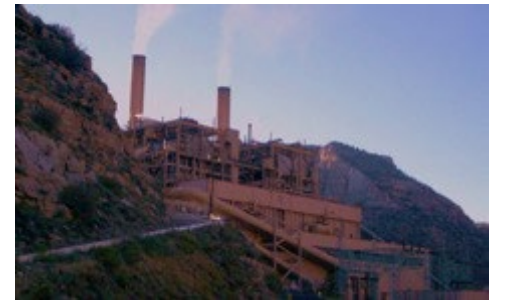
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Chevron deference

***Chevron* (1984)**

Step One: Has Congress directly spoken to the precise question at issue?

Step Two: If Congress has not directly spoken to the question at issue, courts will generally defer to a reasonable agency interpretation of the statutory text

***Mayo Foundation* (2011):** *Chevron* applies in tax

Applying *Chevron*

What's direct, precise, unambiguous?

Does it matter whether the agency recognized ambiguity?

What's a "reasonable" interpretation? (Is this the only question?)

What evidence is relevant?

What if Congress intended to delegate to agencies?

Chevron's likely demise

Supreme Court hasn't used it to uphold an agency interpretation for about 5 years

Justice Gorsuch: *Chevron* "deserves a tombstone no one can miss"

Loper Bright, Relentless



Loper Bright, Relentless

“Whether the Court should overrule *Chevron* or at least clarify that statutory silence concerning controversial powers expressly but narrowly granted elsewhere in the statute does not constitute an ambiguity requiring deference to the agency.”



What next?



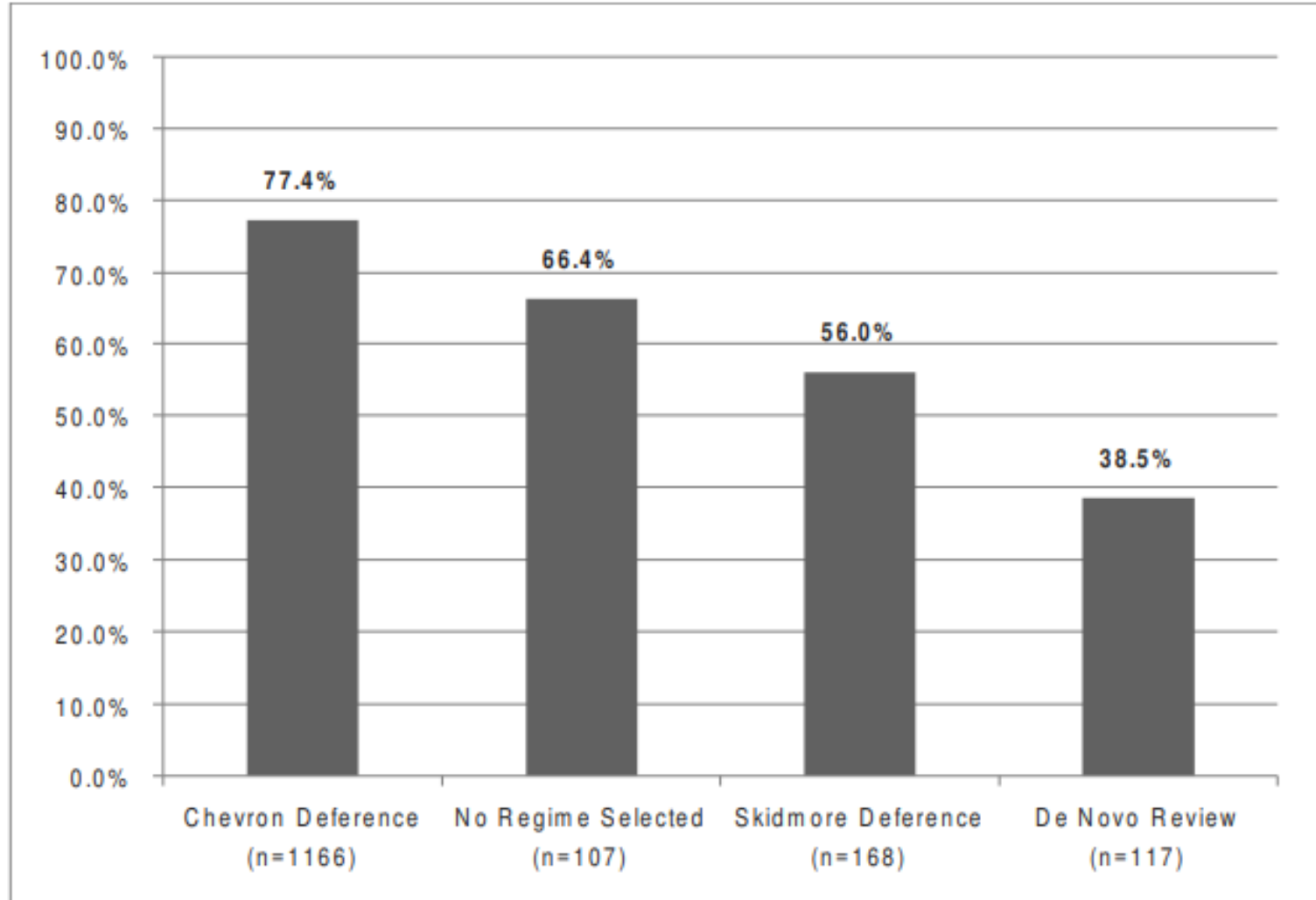
Auer and Kisor (on agency interpretations of regulations):

- **Following application of the traditional tools of statutory construction**, the court must find that the regulation is genuinely **ambiguous**
- The agency's interpretation must fall within the bounds of **reasonable** interpretation
- The agency's interpretation must implicate its substantive expertise

Skidmore (pre-*Chevron* standard advanced by plaintiffs in *Loper Bright/Relentless*; currently applies agency interpretations that don't receive heightened deference)

“The weight of such a judgment in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.”

FIGURE 1. AGENCY-WIN RATES BY DEFERENCE STANDARD (n=1558)



Barnett and Walker, *Chevron* in the Circuit Courts, Mich. L. Rev. (2017).

Circuit court decisions on agency action involving interpretations of law from 2003-2013.

Chevron used framework used 75% of the time; agencies won 70% of the time.

Who interprets and applies the (tax) law?
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“Major Questions” – *West Virginia v. EPA*

Supreme Court has rejected agency claims of regulatory authority under the “major questions doctrine” when

1. The underlying claim of authority concerns an issue of “vast ‘economic and political significance,’” and
2. Congress has not clearly empowered the agency



Who interprets and applies the (tax) law? Article III courts v. agencies

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Recapping

What the statute means

Article III courts more likely to

- Assert their preferred meaning rather than respecting an agency's alternative interpretation
- Reject meanings that delegate a zone of discretion to agencies

How to exercise discretion delegated to an agency under the statute:

Article III courts more likely to:

- Impose more control over process and substantive choices
- Including through stricter application of Administrative Procedure Act requirements

Now what? So what?

- Continued: Search for the best meaning
- More Article III judicial control over the broad contours and details of tax law?
- What will be the role of economic analysis?
- (Un)certainty: Agencies or courts overturning longstanding interpretations?
- Coordination issues?
- Less notice and comment? More fighting over legislative/interpretative?
- Legislative reaction? (But, fights over congressional control of constitutional taxing powers e.g. *Moore*)
- Research gaps?
- It's all about institutional competence.

Sources

Atlantic herring, Clupea harengus by Gervais et Boulart, 1877.

Castle Gate Power Plant, Utah 2007 by David Jolley at the English Wikipedia, 2007.

Eric Solomon, David Kamin, Thalia Spinrad for select adapted slides (errors mine).

Figure 1. Agency-Win Rates by Deference Standard (n=1558) from Barnett and Walker, *Chevron* in the Circuit Courts, Mich. L. Rev. (2017).

Tax and the Administrative Procedure Act (APA)*



* Shay thanks Clint Wallace for sharing his August, 2022 presentation to IRS on Major Questions About Tax Administration

Tax and the APA

- *Mayo* (2011): “not inclined to carve out an approach to administrative review good for tax law only,” absent some “justification”. APA applies to tax.
- Taxpayer with standing may make an APA challenge to validity of a regulation (distinct from challenging the regulation’s interpretation of the statute) if the regulation was not issued in accordance with APA procedures.
- Very generally, agency issuing guidance carrying the “force of law” must follow notice and comment procedures: (1) give notice; (2) accept and consider comments; (3) issue final rule with “concise general statement” explaining basis. [Procedures are condition for *Chevron* deference.]
 - *Mead* (2001): Force of law exists where “it appears that Congress has delegated” such authority, and that the agency action was, in turn, “promulgated in the exercise of that authority.”
 - *State Farm* (1983) “Hard look”: Agencies must engage in “reasoned decision making,” which includes requirements to “examine the relevant data and articulate a satisfactory explanation.”

Tax and the APA

- Barriers to challenging tax agency determinations
 - Standing doctrine: Case and controversy.
 - [Tax] Anti-Injunction Act (AIA): §7821(a) Except as provided in sections 6015(e), 6212(a) and (c), 6213(a), 6232(c), 6330(e)(1), 6331(i), 6672(c), 6694(c), 7426(a) and (b)(1), 7429(b), and 7436, no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed.
 - But, *CIC Services* (2021) held “suit ... to enjoin a standalone reporting requirement, whose violation may result in both tax penalties and criminal punishment” is not a suit “for the purpose of restraining the [IRS’s] assessment or collection” of a tax, “and so does not trigger the Anti-Injunction Act.”

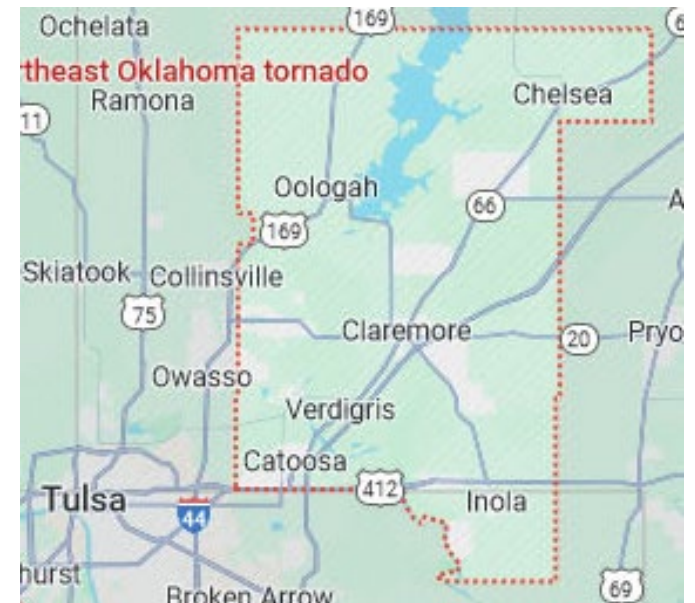
Tax and the APA

- APA challenges subject to general 6-year statute of limitations. Supreme Court considering this term in *Corner Post* whether the statute starts with the promulgation of the regulation or with the plaintiff's claimed injury. There is a split of Circuit court opinions and small government advocates found favorable facts to argue for 6 years from injury.
- Numerous taxpayer challenges to (very) old regulations went forward because DOJ did not raise the SOL issue:
 - *Altera* challenged 2003 regulations requiring inclusion of stock option costs in cost sharing pool under *State Farm* . Government ultimately won in 9th Cir. overruling Tax Court.
 - Susquehanna International in *SIH Partners* challenged a 50-year old regulation that treated a CFC's earnings as repatriated if the CFC is a guarantor of the US shareholder debt. Government won in 3rd Cir., upholding Tax Court.

Tax and the APA

- Government has split circuits in decisions regarding APA validity of conservation easement regulations dating from 1986.
 - *Hewitt* (2021) in 11th Cir. held for taxpayer, reversing Tax Court, unsatisfied with regulatory preamble's response to a comment questioning regulation's conditions for conservation easement deduction.
 - *Oakbrook* (2022) in 6th Cir. held for gov't, upholding Tax Court, on the same issue.
 - Tax Court recently reversed itself to follow *Hewitt* in a conservation easement decision in *Valley Green* that holds the regulation invalid (but don't worry, 46.76 acres in Rogers Cnty. OK purchased in 1998 for \$91,610 only yielded 2016 easement deduction of \$14.8 million).

Rogers County, OK



Tax and the APA

- APA challenges now are large component of IRS Chief Counsel's docket – you can see why. Savvy investors from Mr. Yass (the Susquehanna/TikTok libertarian) to the happy *Valley Green* taxpayers find it pays (on a risk adjusted basis).
- This is a one-way ratchet. A regulation that gives away money will not be challenged. Galle & Shay, *Admin Law and the Crisis of Tax Administration*, 101 N.C. L. Rev. 1645 (2023).
- If upcoming *Corner Post* extends the general statute's accrual date beyond reg issuance date – all tax regs are open to potential challenge.
- APA challenges are “foot fault” victories that can be “reversed” through re-issuance of a regulation, subject to loss of revenue for period of defect. (See Liberty Global and the temporary “doughnut hole” regulation fixing the mismatch of effective dates for foreign dividend exemption and GILTI; but see economic substance attack on prior transaction.)