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Jeffrey N. Schwartz is the founder of Sixteenth Amendment Insights LLC and among those interested persons who have submitted briefs amicus curiae in *Moore*. Before founding Sixteenth Amendment Insights, he practiced trusts and estates law in New York for over 30 years.

In this article, Schwartz explains how, in addition to raising income realization and measurement issues, *Moore* may be understood as raising constitutional due process issues concerning the extent to which income realized by one person may be attributed to another person for federal income tax purposes.

On August 30 Charles and Kathleen Moore filed their brief on the merits in *Moore*[1] challenging the constitutionality of the mandatory repatriation tax (MRT) provisions enacted as part of the Tax Cuts and Jobs Act of 2017. On October 16 the United States filed its brief on the merits defending the constitutionality of the MRT.[2] The Moores filed their reply brief on November 15.[3] Numerous other parties interested in *Moore*, including me,[4] have also filed amicus curiae briefs for possible consideration by the Supreme Court. Oral argument is scheduled for December 5.[5]

The Moores' petition for certiorari presents a technical question framed in terms of realization: whether the 16th Amendment authorizes Congress to tax unrealized sums without apportionment among the states.[6] I filed an amicus brief with Sixteenth Amendment Insights LLC framing the question as whether unrealized incomes at issue in the case were properly

[1] Brief for Petitioners, *Moore v. United States*, No. 22-800 (U.S. Aug. 30, 2023).

[2] Brief for the United States at 47-48, *Moore*, No. 22-800 (U.S. Oct. 16, 2023).

[3] Reply Brief for Petitioners, *Moore*, No. 22-800 (U.S. Nov. 15, 2023).

[4] *See* Brief of Sixteenth Amendment Insights, LLC and Jeffrey N. Schwartz as Amici Curiae in Support of Petitioners, *Moore*, No. 22-800 (U.S. Sept. 6, 2023) (Schwartz brief) (arguing that "the Court should reverse or, at a minimum, vacate the [Ninth Circuit's] decision, confirm its prior analysis of the function of the Sixteenth Amendment reflected in *Brushaber* and *Macomber* and, if the decision is vacated, otherwise remand the case for further analysis, briefing and argument by the parties in a manner that builds upon, and is consistent with, that jurisprudence.").

[5] I have also written a separate realization-focused article that will be published later this month: Jeffrey N. Schwartz, "The Constitutional Significance of Trusts and Estates Fiduciary Accounting Rules: Additional Support for the Taxpayers' Position in *Moore v. United States*," 41 *J. Tax'n Invs.* 23 (Fall 2023) (Schwartz article). That article includes and expands on the analysis of my amicus brief, examining when an individual taxpayer's properly measured unrealized gains may be subjected to federal individual indirect income taxation.

[6] *See* Petition for Writ of Certiorari at i, *Moore*, No. 22-800 (U.S. Feb. 21, 2023).

measured[7] and, if not, what are the constitutional consequences.[8]

Nevertheless, *Moore* may also be understood as a case involving constitutional due process questions concerning the extent to which income realized by one "juridical person" (for example, a state-chartered corporation, limited liability company, limited partnership, or statutory business trust) may be attributed to another juridical person for federal income tax purposes. Those questions include the extent to which income earned by a juridical person properly categorized as a corporation for federal tax purposes may be attributed to another juridical person such as:

- an individual (meaning a "natural" person, also sometimes referred to as a human being) or state-chartered corporation acting in its own individual or corporate capacity for its own benefit;
- an individual or corporate person acting in its fiduciary capacity as the trustee of a common-law trust for the benefit of one or more third parties (with the trust being something other than a juridical person); or
- an individual or corporate person acting as a partner of a common-law general partnership.[9]

In any event, the fact that the Ninth Circuit's decision in *Moore*, as well as the briefs of the parties themselves, do not reflect a proper understanding of the meaning and function of the 16th Amendment (as discussed in my amicus brief and explained below[10]) increases the likelihood that the Supreme Court will remand the case to the lower courts for further consideration. If the case is remanded, however, the Court might still hold that the Ninth Circuit did not properly understand and apply the analysis of *Macomber*[11] as it relates to the Supreme Court's earlier decision in *Brushaber*.[12]

To fully appreciate the potential due process concerns, it is important to keep in mind how the MRT provisions at issue in *Moore* differ significantly from the preexisting rules governing the federal income taxation of shareholders of controlled foreign corporations on CFC passive income. In addition to attributing current-year corporate passive income to relevant shareholders, the MRT imputes additional income to those shareholders in the form of a deemed dividend for income earned and accumulated at the CFC level in prior tax years.

The amicus brief filed by the American Tax Policy Institute contains a helpful summary of the MRT and other changes made by the TCJA to the

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[7]As explained in the statement of interest section of my amicus brief, I am also the author of "The 16th Amendment, a National Wealth Tax, and More" *Tax Notes Federal*, July 29, 2019, p. 663, and am personally interested in *Moore* as it relates to the proper measurement of 16th Amendment "income" as a result of a federal individual income tax refund claim I filed for calendar year 2018 that was granted by the IRS, in full, in March 2023. The refund claim is based on an understanding that "income" within the meaning of the 16th Amendment is to be measured net (and not gross) of a full deduction for state and local taxes on wealth and accessions to wealth. As mentioned in my amicus brief, a redacted version of the SALT deduction refund claim is available through a website maintained by Sixteenth Amendment Insights LLC at www.directtaxrefund.org.

[8]The analysis in my forthcoming article, *supra* note 5, supports the views of those who believe that, absent some realization event, Congress may not impose a federal indirect income tax on an individual taxpayer's unrealized gains, including properly measured unrealized gains, in respect of property held for personal use or investment purposes. It also supports the view that the corresponding nonrecognition of unrealized gains for property owned at death is a necessary element of federal income tax law required to ensure compliance with applicable constitutional limitations on congressional taxing authority.

[9]*See* Brief for the American Tax Policy Institute as Amicus Curiae in Support of the Respondent at 2 and 14-19, *Moore*, No. 22-800 (U.S. Oct. 19, 2023) (ATPI brief). The brief states that *Moore* is not about realization, despite the petition's claim that the case "squarely and cleanly" raises that issue. The institute's brief explains that the income taxed by the MRT was "in fact, realized by an Indian limited liability company (KisanKraft) while petitioners owned a stake in it. So the question here is not whether there was realized income, but who can be taxed on it." The brief includes some constitutional due process observations, citing *Burnet v. Wells*, 289 U.S. 670, 677-678 (1933); *Reinecke v. Smith*, 289 U.S. 172, 177-178 (1933); and *Hoeper v. Tax Commission of Wisconsin*, 284 U.S. 206, 218 (1931).

[10]My amicus brief does not directly address matters discussed in this article concerning controlled foreign corporations. It instead cites the Moores' brief on the merits (*supra* note 1) to support the related assertion that "attributing or imputing income earned by an entity or organization that is a partnership, trust or S corporation for Federal tax purposes to its partners, beneficiaries or shareholders, as applicable, is in no way the equivalent of an imputation or attribution of income involving individuals (meaning human beings) who own interests in a company that is not otherwise a 'flow-through' entity or organization for Federal tax purposes." *See* Schwartz brief, *supra* note 4, at 27.

[11]*Eisner v. Macomber*, 252 U.S. 189 (1920).

[12]*Brushaber v. Union Pacific Railroad Co.*, 240 U.S. 1 (1916).

preexisting CFC rules.[13] A more detailed explanation of the MRT and related policy, and other matters taken into consideration in the drafting of the relevant statutory provisions, can be found in the amicus brief filed by George A. Callas and Mindy Herzfeld.[14]

Among other helpful background information, the American Tax Policy Institute brief notes the following:

> Even though, prior to the TCJA, U.S. shareholders generally were not taxed on active income of CFCs until it was distributed, Subpart F carved out an exception from that approach: active income was taxed to U.S. shareholders not only when a CFC distributed the income, but also before that time if the CFC invested it in U.S. property. For decades, Subpart F imposed this tax regardless of when the earnings funding the investment in U.S. property were realized, and regardless of whether the shareholders at the time of the investment in U.S. property had owned their shares at the time the CFC realized the earnings in question or whether those shareholders received any cash or property as a result of the investment in U.S. property. See *Whitlock's Estate v. Comm'r*, 494 F.2d 1297, 1301 (10th Cir. 1974); *Dougherty v. Comm'r*, 60 T.C. 917, 927-930 (1973) (both upholding the constitutionality of section 956).[15]

Of note for the reasons explained below, however, the cited cases appear to involve unusual fact patterns in which the taxpayers were able to exercise significantly more control over the operations of the relevant foreign corporation than minority shareholders like the Moores.[16]

As additional context, it is also helpful to keep in mind how the MRT was intended to modify the preexisting CFC rules to further address broader tax deferral policy issues that are separately addressed under the passive foreign investment company and foreign trust throwback rules applicable to individuals and other taxpayers who are U.S. shareholders of PFICs and U.S. beneficiaries of foreign trusts, respectively.[17] The broader policy issues arise because of the federal government's inability to tax worldwide income of a foreign corporation or foreign trust on a current basis. As a result, earnings accumulated at the level of the foreign corporation or foreign trust not otherwise properly sourced to the United States (as well as earnings properly sourced to the United States that, for nontax policy reasons, are not subjected to federal income tax at the relevant foreign corporate or foreign trust level on a current basis) can grow "federal tax free" at the level of the foreign corporation or foreign trust until distributed to a relevant U.S. shareholder or U.S. trust beneficiary.

The MRT differs from the PFIC and foreign trust throwback rules, however, in that the MRT provisions treat relevant earnings accumulated at the corporate level in prior tax years as a current-year deemed dividend. By contrast, the PFIC and foreign trust throwback rules in certain circumstances impose higher rates of federal individual income tax and related interest charges at the individual U.S. shareholder or beneficiary level for an individual taxpayer's receipt of an actual corporate dividend or actual trust distribution representing a current-year distribution of a prior year's undistributed net income that was accumulated at the level of the relevant foreign corporation or foreign trust in a prior tax year.

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[13] ATPI brief, *supra* note 9. *See also* Brief of Amicus Curiae Professor Amandeep S. Grewal in Support of Respondent at 5 ("In 2017, Congress adopted Section 965(a) as part of a switch to a new international tax framework. Section 965(a), shorn of technical details, increases the amount of income subject to the subpart F regime. That is, under the statute, the shareholder immediately includes in income his share of the foreign corporation's post-1986 accumulated earnings.").

[14] Brief of George A. Callas and Mindy Herzfeld as Amici Curiae in Support of Respondent, *Moore*, No. 22-800 (U.S. Oct. 23, 2023). As explained in the related statement of interest, Callas was intimately involved in the development, design, and drafting of relevant portions of the tax law at issue in *Moore*.

[15] ATPI brief, *supra* note 9, at 17-18.

[16] *See Estate of Whitlock v. Commissioner*, 494 F.2d 1297, 1298 (10th Cir. 1974) (indicating that the only stockholders of the foreign corporation for the relevant tax years were husband and wife, or the wife alone after the death of her husband); and *Dougherty v. Commissioner*, 60 T.C. 917 (1973) (indicating that the foreign corporation had been owned by a sole individual shareholder over an extended period). At the same time, questions have been raised regarding the specific nature and level of involvement the Moores may have had as minority shareholder equivalents. (Related coverage: p. 1881.)

[17] *See* sections 1297, 1298, 665-668.

It is in this context that, in its brief on the merits, the government argues:

> The Sixteenth Amendment authorizes Congress to tax shareholders' pro rata shares of undistributed corporate earnings as income. The Amendment's Framers understood its reference to "taxes on incomes," U.S. Const. Amend. XVI, as permitting taxes on undistributed corporate earnings. From 1864 through 1870, Congress repeatedly enacted income taxes of that nature — and this Court upheld its power to do so. *Collector v. Hubbard*, 79 U.S. 1, 18 (1871). Although the decision in *Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601 (1895), temporarily undermined *Hubbard*, the Sixteenth Amendment overturned *Pollock*, thus reinstating Congress's power to impose the types of income taxes that predated *Pollock*.[18]

This and other parts of the government's brief on the merits, as well as the briefs submitted by the Moores and others, reflect a basic misunderstanding of the meaning and function of the 16th Amendment and of the earliest decisions of the Supreme Court relating to it. Simply put, the 16th Amendment is not a stand-alone grant of congressional authority to tax the incomes of individuals (or any pro rata share of an individual's share of the current or accumulated income of a corporation as if it were a partnership or trust), and correspondingly, it did not overturn the entirety of the jurisprudence underlying the Supreme Court's decision in *Pollock II.*[19] The Supreme Court instead explained the following in its unanimous *Brushaber* decision, which validated the constitutionality of the first post-16th Amendment federal tax on the incomes of individuals as a properly apportioned federal *indirect* tax in its entirety:

1. The 16th Amendment functions to overturn the result of *Pollock II* by modifying the last, and incremental, element of relevant jurisprudence (a consideration of whether the income being subjected to tax is derived from the mere continued ownership of property). Thus, a post-16th Amendment federal tax on a properly measured amount of "incomes derived from any source whatever" within the meaning of the 16th Amendment[20] must be categorized in its entirety as a tax other than a federal "direct tax" (that is, as a federal indirect tax) for purposes of Article I of the Constitution.[21]
2. Because it functions to overturn the result of *Pollock II* by modifying relevant jurisprudence, the 16th Amendment also implicitly incorporates into the Constitution itself the unmodified jurisprudence (as that jurisprudence existed immediately before the adoption and ratification of the 16th Amendment, taking into account, among other decisions, the Supreme Court's post-*Pollock II* decision in *Knowlton*[22]) as the basis on which to analyze whether a post-16th Amendment federal tax on the ownership of property (for example, a so-called national wealth tax) or on a measurement of the accessions to wealth of an individual that exceed a properly measured amount of 16th Amendment "incomes derived from property or other sources" is to be categorized as either a

[18]Brief for the United States, *supra* note 2, at 9.

[19]*Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601 (1895). The first decision (*Pollock I*) is found at 157 U.S. 429 (1895). Related matters are explained in my amicus brief (*supra* note 4) and the expanded analysis (*supra* note 5).

[20]*See* U.S. Const. Amend. XVI. ("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.").

[21]*See Brushaber*, 240 U.S. at 18-19 (quoted in the appendix). The Court in *Brushaber* also rejected the notion that the 16th Amendment created some new, third category of federal taxation (in addition to direct and indirect taxes) or that it permits a federal direct tax to be imposed without an apportionment among the states by population. *See id.* at 11-12 (quoted in the appendix). Article I of the Constitution refers to capitations and other direct taxes but does not itself use the term "indirect." The 16th Amendment also does not use the terms "direct" or "indirect."

[22]*See Knowlton v. Moore*, 178 U.S. 41, 47 (1900) (explaining in the context of categorizing an inheritance tax as an indirect tax during the drafting of the 16th Amendment that "the public contribution which death duties exact is predicated on the passing of property as the result of death, as distinct from a tax on property disassociated from its transmission or receipt by will or as the result of intestacy," which is a direct tax); and Congressional Research Service, *Constitution Annotated*, "Direct Taxes and the Sixteenth Amendment" (quoted in the appendix).

> direct tax or an indirect tax for Article I purposes.[23]

It is this *Brushaber*-based understanding of the meaning and function of the 16th Amendment that the Supreme Court applied in other early post-16th Amendment decisions concerning the federal income taxation of individuals and corporations,[24] including *Macomber*,[25] as well as in its later decisions.[26]

Correspondingly, contrary to the government's assertions in its brief on the merits in *Moore*,[27] the *Macomber* Court was correct in concluding that: (1) Congress has the power to tax shareholders on their property interests in the stock of corporations because it may in all events lay and collect taxes on that subject in the form of a federal direct tax; and (2) those shareholder property interests might be valued for purposes of a direct tax in view of the company's condition, including its accumulated and undivided profits. But previous decisions of the Court (including *Pollock I*, *Pollock II*, *Knowlton*, *Brushaber*, and *Hornby*[28]) already settled that, unless an accession to the wealth of an individual derived from the mere continued ownership of stock held for personal investment purposes was also "income" within the meaning of the Sixteenth Amendment, this would be taxation of property because of ownership and not, for example, a voluntary action or material change in the ownership or nature of property, and thus be a direct tax requiring apportionment among the states by population.[29] The Court in *Macomber* continued:

> The government relies on *Collector v. Hubbard*, (1870) 12 Wall. 1. . . . Insofar as [*Hubbard* and related provisions of earlier federal income tax laws not contained in the federal taxing statute at issue in *Pollock II*] seems to uphold the right of Congress to tax without apportionment a stockholder's interest in accumulated earnings prior to dividend declared, it must be regarded as overruled by *Pollock v. Farmers' Loan & Trust Co.*, 158 U. S. 601, 158 U.S. 627-628, 158 U.S. 637. Conceding *Collector v. Hubbard* was inconsistent with the doctrine of that case because it sustained a direct tax upon property not apportioned among the states, the

[23] *See Brushaber*, 240 U.S. at 19 (quoted in the appendix).

[24] *See* Schwartz article, *supra* note 5, at 34-43 (including expanded analysis, as well as a discussion of Charles Evans Hughes' views on the 16th Amendment as governor of New York, associate justice on the Supreme Court, and ultimately as chief justice). *See also* Merlo J. Pusey, *Charles Evans Hughes* 253-254 (1951) ("When the scope of the [16th] amendment was tested in the Supreme Court [in *Brushaber*], Chief Justice White chose the Root interpretation and Hughes, then an Associate Justice, assented. In his Chief Justiceship [Hughes] treated the issue [relating to the interpretation of the amendment] as closed by White's opinion[.]"). The Root interpretation reflected in the analysis of *Brushaber* appears to be the one that can be found at 45 *Cong. Rec.* 2539-2540 (1910).

[25] After Hughes resigned from the Supreme Court to run for president, in a race he narrowly lost to Woodrow Wilson, he returned to private practice and represented the ultimately successful taxpayers in both *Macomber* and an earlier related case, *Towne v. Eisner*, 245 U.S. 418 (1918). Like *Macomber*, *Towne* involved the federal income taxation of stock dividends. Interestingly, Hughes and Edwin Seligman were classmates at Columbia Law School and remained close friends thereafter, despite their opposing views on the 16th Amendment. *See* Joseph J. Thorndike, "Moores Lean on 1916 Tax Expert to Argue No Realization Means No Income," *Tax Notes Federal*, Nov. 20, 2023, p. 1356; and Ajay K. Mehrotra, "Edwin R.A. Seligman and the Beginnings of the U.S. Income Tax," *Tax Notes*, Nov. 14, 2005, p. 933.

[26] *See Helvering v. Independent Life Insurance Co.*, 292 U.S. 371, 378-379 (1934). Writing the opinion of a nearly unanimous Court during Charles Evans Hughes's service as chief justice, Justice Pierce Butler explained, "If the statute lays taxes on the part of the building occupied by the owner or upon the rental value of that space, it cannot be sustained, for that would be to lay a direct tax requiring apportionment" (citing, *inter alia*, *Pollock I*, *Pollock II*, *Macomber*, and *Brushaber*). The only justice who expressed views other than those reflected in Butler's opinion was Justice James C. McReynolds, who was of the view that the decision at issue should have been affirmed in favor of the taxpayer instead of having been reversed in favor of the government.

[27] *See, e.g.*, Brief for the United States, *supra*, note 2, at 35 (quoted in the appendix). Some of the Revenue Act of 1894 provisions at issue in *Pollock II* were different from the earlier federal taxes on incomes mentioned in the government's brief, including as they related to the federal income taxation of corporate incomes. The language from *Burnet v. Sanford & Brooks Co.*, 282 U.S. 359 (1931), quoted in the government's brief (and the excerpt thereof included in the appendix) may be understood as a reference to provisions of the Revenue Act of 1894 and any corresponding provisions of earlier federal income tax statutes.

[28] *Lynch v. Hornby*, 247 U.S. 339 (1918).

[29] *See id.*

> government nevertheless insists that the Sixteenth Amendment removed this obstacle, so that now the *Hubbard* case is authority for the power of Congress to levy a tax on the stockholder's share in the accumulated profits of the corporation even before division by the declaration of a dividend of any kind. Manifestly this argument must be rejected, since the amendment applies to income only, and what is called the stockholder's share in the accumulated profits of the company is capital, not income. As we have pointed out, a stockholder has no individual share in accumulated profits, nor in any particular part of the assets of the corporation, prior to dividend declared.
>
> Thus, from every point of view, we are brought irresistibly to the conclusion that neither under the Sixteenth Amendment nor otherwise has Congress power to tax without apportionment . . . accumulated profits . . . as income of the stockholder.[30]

As part of its pre-*Macomber* decision in *Hornby*, upholding the limited retroactivity of the first post-16th Amendment federal tax on the incomes of individuals, the Supreme Court expressly rejected the taxpayer's argument that Congress could not subject dividends paid from corporate surplus earned and accumulated *before* the ratification of the 16th Amendment to federal income tax as post-amendment "income." The Court thereby rejected the application of a conduit, look-through, or tracing approach that might have otherwise been applied to tie the federal individual income taxation of a cash or other dividend directly to corporate earnings (with dividends properly traceable to earnings accumulated before the ratification of the 16th Amendment being exempt from federal individual income taxation) and that, for example, might have affected the proper allocation of an extraordinary cash or other dividend among different beneficiaries for fiduciary accounting purposes.[31]

The Court's unanimous decision in *Hornby* was favorable to the government at the time in that it allowed the federal indirect income taxation of dividends received by an individual shareholder after the ratification of the 16th Amendment in respect of surplus or capital accumulated at the corporate level before ratification. It also represents the foundational break that might have otherwise permitted a post-16th Amendment individual shareholder to be generally attributed corporate earnings as if those earnings were the equivalent of the earnings of a partnership or trust — that is, as if corporate earnings were generally, and not only under special facts and circumstances, to be treated the same as partnership or trust earnings that may be directly attributed to partners and trust beneficiaries on a flow-through or conduit basis.

Correspondingly, although not expressly cited, it is the line of cases including *Pollock I*, *Pollock II*, *Knowlton*, *Brushaber*, and *Hornby* that led the Court in *Macomber* to reach its conclusion that its pre-*Pollock* decision in *Hubbard* was no longer relevant and that, even after the ratification of the 16th Amendment, Congress lacked the ability to impose a federal individual *indirect* income tax, such as the MRT, on an individual stockholder's proportionate share of undistributed corporate earnings accumulated and added to corporate surplus in a prior tax year. Instead, subjecting those accumulated earnings to federal individual *indirect* income taxation requires some voluntary act on the part of an individual stockholder (such as a gift or a sale of the relevant holding) or other material change in the nature of the stock itself.[32]

The analysis of *Macomber* was then applied in *Phellis* to further explain the difference between unrealized gain and "income derived from stock ownership,"[33] and in *Weiss v. Stearn*, dealing with corporate reorganizations.[34]

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[30] *Macomber*, 252 U.S. at 217-219.

[31] *Compare id.* at 234-235 *with Hornby*, 247 U.S. at 344-346 (both quoted in the appendix).

[32] These matters are analyzed in greater detail in the Schwartz article, *supra* note 5. The *Macomber* Court also expressly rejected the notion that its earlier and related decision in *Towne* was based on the fact that the stock dividend at issue in that case involved a dividend charged at the corporate level against pre-16th Amendment earnings. *See Macomber*, 252 U.S. at 203-204 (quoted in the appendix).

[33] *See United States v. Phellis*, 257 U.S. 156, 168-170 (1921) (quoted in the appendix, and with the Court rejecting both like-kind exchange treatment and a broader interpretation of *Macomber*).

[34] *See Weiss v. Stearn*, 265 U.S. 242, 253-254 (1924) (quoted in the appendix).

Moreover, when the trust throwback rules were first being developed and proposed for adoption, the conduit principle applicable to the federal income taxation of trusts (and partnerships) was expressly distinguished from the principles applicable to the federal income taxation of corporations.[35] Correspondingly, after some fits and starts, the Supreme Court did establish a test for distinguishing between trusts and "associations taxable as corporations."[36] That multifactor test predates the check-the-box rules for categorizing a business entity as a partnership, corporation, or disregarded entity. However, it continues to apply, even after Treasury's adoption of the check-the-box regulations, in determining whether an organization (including a noncorporate juridical person) is properly categorized as a trust for federal tax purposes, presumably including for 16th Amendment purposes.[37]

Because this test is to be applied to the proper categorization of both foreign and domestic organizations as either trusts or associations taxable as corporations (with organizations in the latter category able to choose partnership or disregarded entity status to the extent permitted under the check-the-box regulations),[38] it is difficult to conclude that the analysis of *Macomber* should be applied only to shareholders of domestic corporations, given that *Macomber* involved a domestic corporation.[39] The related difficulty in attributing corporate income to individual shareholders is greatest when the relevant foreign organization that is to be categorized as a corporation for tax purposes under *Morrissey* is also respected as a separate juridical person in its jurisdiction of formation. Correspondingly, that fact pattern is the one in which it would be the most difficult to draw analogies to the so-called grantor trust rules, which may cause the creator of a trust to be treated for federal income tax purposes as the owner of all or a portion of the trust property, including for periods after which the creator has already parted with sufficient dominion and control over the trust property for the initial funding of the trust to have constituted a completed gift for federal gift tax purposes.

Similarly, understandable attempts to support the MRT by indirectly questioning the voluntary nature of a shareholder's election to be subjected to tax on a flow-through basis under the S corporation rules also appear to be ultimately unconvincing.[40] Although shareholders at a particular time make the initial election to be subjected to tax under the special rules of subchapter S, anyone who voluntarily accepts ownership of transferred S corporation stock (whether the transfer is made by gift, bequest, purchase, exchange, or otherwise) has voluntarily agreed to be taxed on a flow-through basis. For example, gifts and bequests can be disclaimed or renounced.

Also of note is that, in situations in which a new owner may not renounce or disclaim a transferred interest under applicable law (such as the executor of the estate of a decedent who owned stock in an S corporation at death), the new owner (the estate or person appointed as the personal representative of the decedent's estate acting in that fiduciary capacity) is effectively bound by the voluntary election of the prior owner. If the new owner is ineligible to own stock in an S corporation under the relevant tax rules and if a reasonable time has passed to allow those shares to be transferred to a new owner both willing and eligible to be taxed on a flow-through

[35] *See* H. Brian Holland et al., "Proposed Revision of the Federal Income Tax Treatment of Trusts and Estates — American Law Institute Draft A," 53 *Colum. L. Rev.* 316, 318, 320-321 (1953) (quoted in the appendix).

[36] The multifactor test can be traced to Hughes's opinion for a unanimous Supreme Court in *Morrissey v. Commissioner*, 296 U.S. 344 (1935) (quoted in the appendix).

[37] *See* Carter G. Bishop, "Forgotten Trust: A Check-the-Box Achilles' Heel," 43 *Suffolk U. L. Rev.* 529 (2010).

[38] *Id.*

[39] This possibility was raised in Donald B. Susswein and Ramon Camacho, "What Did *Macomber* Decide?" *Tax Notes Federal*, Oct. 16, 2023, p. 473. *See also* Michael J. Graetz, "To Avoid the *Moore* Morass, the Court Should DIG It — But It Probably Won't," *Tax Notes Federal*, Nov. 13, 2023, p. 1253 ("The riskiest aspect of the government's brief — and a surprise — was that the government's brief does not distinguish *Macomber* on the ground that in *Macomber* the corporation's income had previously been taxed at the corporate level so the tax on a proportionate stock dividend would have been a second tax on the shareholder's share of the same income.").

[40] *See, e.g.*, ATPI brief, *supra* note 9, at 21 (noting that "S corporation shareholders can be taxed because they elect this treatment. . . . But this is true only of a person who owned shares when this one-time election was made. A subsequent purchaser of shares never makes this election (unless the purchase of shares itself is considered to be an election of sorts).").

basis, the ineligible owner's continued ownership terminates the corporation's S status.[41]

The above analysis raising potential due process (as contrasted to "realization" or "income measurement") concerns regarding the constitutionality of the MRT as applied to individual shareholders should not be viewed as necessarily implying that the MRT should be held unconstitutional as applied to corporate shareholders[42] or that other rules generally applicable to individual shareholders of CFCs are unconstitutional.[43] If presented with a choice, some individual taxpayers might prefer to continue being subjected to tax under the CFC rules rather than potentially being made subject to the PFIC rules, perhaps even retroactively.

However, a full analysis of the constitutionality of all the rules applicable to the federal income taxation of individual CFC shareholders[44] should consider *Garlock*,[45] which upheld the constitutionality of such a regime. That 1973 decision by the Second Circuit appears to rely, at least in part, on the analysis of *Mellon*.[46] The opinion of the *Mellon* Court, written by Justice Louis D. Brandeis, who was among those writing in dissent in *Macomber*, cites early federal income tax provisions that subjected individual shareholders of a corporation to federal individual indirect income taxation on "improperly accumulate[ed] gains and profits" to support applying conduit principles to the federal indirect income taxation of the partners of a partnership.[47] Accordingly, that decision (because it involved the attribution of partnership earnings and referred to statutory provisions concerning an *improper* accumulation of corporate earnings at the corporate level) appears to have limited precedential value as support for the proposition that Congress has a general ability to attribute the undistributed earnings of a corporation to its shareholders for federal individual indirect income tax purposes.

Appendix

This appendix provides the text of certain materials cited in the footnotes.

Note 21: *Brushaber v. Union Pacific Railroad Co.*, 240 U.S. 1, 18-19 (1916):

> The command of the Amendment that all income taxes shall not be subject to apportionment by a consideration of the sources from which the taxed income may be derived, forbids the application to such taxes of the rule applied in the Pollock Case by which alone such taxes were removed from the great class of excises, duties and imposts subject to the rule of uniformity [generally referred to as "indirect" taxes] and were placed under the other or direct class. This must be unless it can be said that although the Constitution as a result of the Amendment in express terms excludes the criterion of source of income, that criterion yet remains for the purpose of destroying the classifications of the Constitution by taking an excise out of the class to which it belongs and transferring it to a class in which it cannot be placed consistently with the requirements of the Constitution. Indeed, from another point of view, the Amendment demonstrates that no such purpose was intended and on the contrary shows that it was drawn with the object of maintaining the limitations of the

[41] *See* section 1362(f) and reg. section 1.1362-4.

[42] *See* Schwartz brief, *supra* note 4, at 7 n.8 (noting that "reversal may not require related statutory provisions to be stricken as they relate to all taxpayers who, like the Moores, are non-controlling, minority shareholder equivalents" (quoting section 7852(a) and citing *Flint v. Stone Tracy Co.*, 220 U.S. 107 (1911), and *Stanton v. Baltic Mining Co.*, 240 U.S. 103 (1916)).

[43] *See, e.g.*, Schwartz article, *supra* note 5, nn. 78 and 79 (observing how focusing on some of the *Phellis* analysis (*see supra* note 33 and the appendix) might be helpful in drawing conceptual distinctions between (1) attributing *income of a corporation* to its relevant shareholders and (2) under appropriate circumstances, attributing *the activities of a corporation* to its relevant shareholders so that a share of the income derived from those current operations can be attributed to relevant shareholders on a periodic, current basis).

[44] That analysis is beyond the scope of this article.

[45] *Garlock v. Commissioner*, 489 F.2d 197 (2d Cir. 1973).

[46] *Heiner v. Mellon*, 304 U.S. 271 (1938). *See Garlock*, 489 F.2d at 203 n.5 ("Appellant argues that the 'constitutional' issues presented in *Eder* were in fact 'apparently' waived in that case and that, therefore, Eder does not control our decision here. We disagree with appellants' reading of *Eder* and note particularly Judge Frank's explicit reference to and paraphrase of *Heiner v. Mellon*, 304 U.S. 271, 281 [1938]. . . . Whatever may be the continuing validity of the doctrine of *Eisner v. Macomber*, 252 U.S. 189 [1920], . . . as applied to the facts in this case it has no validity under *Mellon*. See also cases cited 138 F.2d at 29 n. 2.").

[47] *See Mellon*, 304 U.S. at 280-281 (quoted in the appendix).

Constitution and harmonizing their operation.

Note 21: *Brushaber*, 240 U.S. at 11-12:

The confusion is not inherent, but rather arises from the [erroneous] conclusion that the Sixteenth Amendment provides for a hitherto unknown power of taxation, that is, a power to levy an income tax which, although direct, should not be subject to the regulation of apportionment applicable to all other direct taxes. . . . But it clearly results that the proposition and the contentions under it, if acceded to, would cause one provision of the Constitution to destroy another; that is, they would result in bringing the provisions of the Amendment exempting a direct tax from apportionment into irreconcilable conflict with the general requirement that all direct taxes be apportioned. Moreover, the tax authorized by the Amendment, being direct, would not come under the rule of uniformity applicable under the Constitution to other than direct taxes, and thus it would come to pass that the result of the Amendment would be to authorize a particular direct tax not subject either to apportionment or to the rule of geographical uniformity, thus giving power to impose a different tax in one state or states than was levied in another state or states. This result, instead of simplifying the situation and making clear the limitations on the taxing power, which obviously the Amendment must have been intended to accomplish, would create radical and destructive changes in our constitutional system and multiply confusion.

Note 22: Congressional Research Service, *Constitution Annotated*, "Direct Taxes and the Sixteenth Amendment":

After the *Pollock* decision, taxpayers challenged numerous taxes that Congress had treated as excises subject to the rule of uniformity as unconstitutional direct taxes. The Court, however, distinguished taxes levied "because of ownership" or "upon property as such" from those laid upon "privileges." The Court sustained as "excises" a tax on sales of business exchanges, a succession tax construed to fall on the recipients of the property transmitted rather than on the estate of the decedent, and a tax on manufactured tobacco in the hands of a dealer, after an excise tax had been paid by the manufacturer. In *Thomas v. United States*, the Court sustained a stamp tax on sales of stock certificates based on the definition of "duties, imposts and excises." The Court explained that these terms "were used comprehensively to cover customers and excise duties imposed on importation, consumption, manufacture and sale of certain commodities, privileges, particular business transactions, vocations, occupations and the like." On the same day, the Court ruled in *Spreckels Sugar Refining Co. v. McClain* that an exaction on the business of refining sugar and measured by gross receipts was an excise and properly levied under the rule of uniformity. Likewise, in *Flint v. Stone Tracy Co.*, the Court held a tax on a corporation that was measured by income, including investment income, to be a tax on the privilege of doing business as a corporation rather than an income tax. [Footnotes omitted.]

Note 23: *Brushaber*, 240 U.S. at 19:

The Amendment contains nothing repudiating or challenging the ruling in the Pollock Case that the word direct had a broader significance since it embraced also taxes levied directly on personal property because of its ownership, *and therefore the Amendment at least impliedly makes such wider significance a part of the Constitution* — a condition which clearly demonstrates that the purpose was not to change the existing interpretation [under relevant jurisprudence, including *Pollock I*, *Pollock II*, and *Knowlton*] except to the extent necessary to accomplish the result intended, that is, the prevention of the resort to the sources from which a taxed income was derived in order to cause a

> direct tax on the income to be a direct tax on the source itself, and thereby [on the basis of the source of properly measured income] to take an income tax out of the class of excises, duties, and imposts [referred to as indirect taxes], and place it in the class of direct taxes. [Emphasis added.]

Note 27: Brief for the United States at 35, *Moore v. United States*, No. 22-800 (U.S. Oct. 16, 2023):

> The *Macomber* Court also misunderstood the historical practice. It recognized that *Hubbard* had upheld taxes on shareholders' portions of undistributed corporate earnings, but it concluded that *Hubbard* "must be regarded as overruled by *Pollock*." *Macomber*, 252 U.S. at 218. That reasoning ignores that the Sixteenth Amendment overturned *Pollock* and "forbids" applying that decision to income taxes. *Brushaber*, 240 U.S. at 19. Under the *Macomber* Court's apparent view, the Sixteenth Amendment negated *Pollock*'s income-tax holding *except* as applied to the income taxes at issue in *Hubbard*. Nothing in the Amendment's text or history supports that understanding. To the contrary, the Sixteenth Amendment authorized precisely those income taxes — like those taxing undistributed corporate earnings from 1864 through 1871 — that "had been in actual operation within the United States before its adoption." *Burnet*, 282 U.S. at 365.

Note 31: *Compare Eisner v. Macomber*, 252 U.S. 189, 234-235 (1920) (Brandeis, J., writing separately), describing three fiduciary accounting rules, including:

> the so-called Pennsylvania rule . . . that where a stock dividend is paid, the court shall inquire into the circumstances under which the fund had been earned and accumulated out of which the dividend, whether a regular, an ordinary or an extraordinary one, was paid. If it finds that the stock dividend was paid out of profits earned since the decedent's death, the stock dividend belongs to the life-tenant; if the court finds that the stock dividend was paid from capital or from profits earned before the decedent's death, the stock dividend belongs to the remainderman.

with Lynch v. Hornby, 247 U.S. 339, 344-346 (1918):

> That the retroactivity of the act from the date of its passage (October 3, 1913) to date not prior to the adoption of the amendment was permissible is settled by *Brushaber v. Union Pacific R. Co.*, 240 U.S. 1. And we deem it equally clear that Congress was at liberty under the amendment to tax as income, without apportionment, everything that became income, in the ordinary sense of the word, after the adoption of the amendment, including dividends received in the ordinary course by a stockholder from a corporation, even though they were extraordinary in amount and might appear upon analysis to be a mere realization in possession of an inchoate and contingent interest that the stockholder had in a surplus of corporate assets previously existing. . . . In the more recent Income Tax Acts, provisions have been inserted for the purpose of excluding from the effect of the tax any dividends declared out of earnings or profits that accrued prior to March 1, 1913. This originated with the Act of September 8, 1916, and has been continued in the Act of October 3, 1917. . . . We are referred to the legislative history of the Act of 1916, which it is contended indicates that the new definition of the term "dividends" was intended to be declaratory of the meaning of the term as used in the 1913 Act. We cannot accept this suggestion, deeming it more reasonable to regard the change as a concession to the equity of stockholders granted in the 1916 act, in view of constitutional questions that had been raised in this case, in the companion case of *Lynch v. Turrish*, and perhaps in other cases. These two cases were commenced in October 1915, and decisions adverse to the tax were rendered in the district court in January 1916, and in the circuit court of appeals September 4,

1916. We repeat that, under the 1913 Act, dividends declared and paid in the ordinary course by a corporation to its stockholders after March 1, 1913, whether from current earnings or from a surplus accumulated prior to that date, were taxable as income to the stockholder.

Note 32: *Macomber* 252 U.S. at 203-204:

The fact that the dividend [in *Towne*] was charged against profits earned before the Act of 1913 took effect, even before the amendment was adopted, was neither relied upon nor alluded to in our consideration of the merits in that case. Not only so, but had we considered that a stock dividend constituted income in any true sense, it would have been held taxable under the Act of 1913 notwithstanding it was based upon profits earned before the amendment. We ruled at the same term, in *Lynch v. Hornby*, 247 U.S. 339, that a cash dividend extraordinary in amount, and in *Peabody v. Eisner*, 247 U.S. 347, that a dividend paid in stock of another company, were taxable as income although based upon earnings that accrued before adoption of the amendment.

Note 33: *United States v. Phellis*, 257 U.S. 156, 168-170 (1921):

The act under which the tax now [at issue] was imposed (Act of October 3, 1913, c. 16, 38 Stat. 114, 166, 167) declares that income shall include, among other things, gains derived "from interest, rent, dividends, securities, or the transaction of any lawful business carried on for gain or profit, or gains or profits and income derived from any source whatever."

Disregarding the slight looseness of construction, we interpret "gains profits, and income derived *from* . . . dividends," etc., as meaning not that everything in the form of a dividend must be treated as income, but that income derived *in the way of* dividends shall be taxed. Hence, the inquiry must be whether the shares of stock in the new company received by claimant as a dividend by reason of his ownership of stock in the old company constituted (to apply the tests laid down in *Eisner v. Macomber*, 252 U.S. 189, 252 U.S. 207), a gain derived from capital, not a gain accruing to capital, nor a growth or increment of value in the investment, but a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital however invested, and coming in — that is, received or drawn by the claimant for his separate use, benefit, and disposal.

Claimant's capital investment was represented by his New Jersey shares. Whatever increment of value had accrued to them prior to September 30, 1915, by reason of the surplus profits that theretofore had been accumulated by the company was still a part of claimant's capital, from which as yet he had derived no actual and therefore no taxable income so far as the surplus remained undistributed. As yet, he had no right to withdraw it or any part of it, could not have such right until action by the company or its proper representatives, and his interest still was but the general property interest of a stockholder in the entire assets, business, and affairs of the company — a capital interest, as we declared in *Eisner v. Macomber*, *supra*, p. 252 U.S. 208.

Upon the face of things, however, the transfer of the old company's assets to the new company in exchange for the securities issued by the latter, and the distribution of those securities by the old company among its stockholders, changed the former situation materially. . . . When this common stock was distributed among the common stockholders of the old company as a dividend, then at once — unless the two companies must be regarded as substantially identical — the individual stockholders of the old company, including claimant, received assets of exchangeable and actual value severed from their capital interest in the old company, proceeding from it as the result of a division of former

> corporate profits, and drawn by them severally for their individual and separate use and benefit. Such a gain resulting from their ownership of stock in the old company and proceeding from it constituted individual income in the proper sense.

Note 34: *Weiss v. Stearn*, 265 U.S. 242, 253-254 (1924):

> Applying the general principles of *Eisner v. Macomber*, it seems clear that, if the National Acme Manufacturing Company had increased its capital stock to $25,000,000, and then declared a stock dividend of 400 percent, the stockholders would have received no gain — their proportionate interest would have remained the same as before. If, upon the transfer of its entire property and business for the purpose of reorganization and future conduct, the old corporation had actually received the entire issue of new stock and had then distributed this pro rata among its stockholders, their ultimate rights in the enterprise would have continued substantially as before — the capital assets would have remained unimpaired, and nothing would have gone therefrom to any stockholder for his separate benefit. The value of his holdings would not have changed, and he would have retained the same essential rights in respect of the assets.
>
> We cannot conclude that mere change for purposes of reorganization in the technical ownership of an enterprise, under circumstances like those here disclosed, followed by issuance of new certificates, constitutes gain separated from the original capital interest. Something more is necessary — something which gives the stockholder a thing really different from what he theretofore had. *Towne v. Eisner*, 245 U.S. 418; *Southern Pacific Co. v. Lowe*, 247 U.S. 330; *Gulf Oil Corp. v. Lewellyn*, 248 U.S. 71. The sale of part of the new stock and distribution of the proceeds did not affect the nature of the unsold portion; when distributed, this did not in truth represent any gain.
>
> Considering the entire arrangement, we think it amounted to a financial reorganization under which each old stockholder retained half of his interest and disposed of the remainder. Questions of taxation must be determined by viewing what was actually done, rather than the declared purpose of the participants, and when applying the provisions of the Sixteenth Amendment and income laws enacted thereunder we must regard matters of substance, and not mere form.

Note 35: H. Brian Holland et al., "Proposed Revision of the Federal Income Tax Treatment of Trusts and Estates — American Law Institute Draft A," 53 *Colum. L. Rev.* 316, 318, 320-321 (1953):

> Whatever might be the merits of the double tax in the corporate relationship, they clearly do not extend to situations where present and future interests in property are created and the property itself placed in the hands of a caretaker.
>
> . . .
>
> Trust [accounting] income under state law may exceed the trust's gross income [for federal tax purposes]. Suppose that the $10,000 of trust income is composed entirely of interest on state bonds. The trust will have no taxable gross income, but the beneficiary will receive $10,000. It is arguable that this is $10,000 of trust income, that the source of the dollars in the trust's hands is irrelevant when the dollars become the beneficiary's dollars and the beneficiary therefore has $10,000 taxable income. [footnote 9: A corporate shareholder would be familiar with this argument, for a corporate dividend is taxable even though it is traceable to tax-exempt income.] But this argument essentially runs counter to the conduit principle adopted to prevent double taxation in the trust field. That principle essentially treats the trust as a conduit through which items pass to the

beneficiary. It would seem a corollary of the conduit principle that the tax exemption accorded to the trust because of the character of its income should accompany the dollars of trust income when they are distributed to the beneficiary. At least in the case of tax-exempt bond interest this corollary seems clear. Also, if under the trust instrument capital gains of the trust are to be distributed to the beneficiary as trust income, they should continue to be regarded as capital gains in his hands. Where, however, the trust has received a tax-exempt common stock dividend on common stock, but state law or the trust instrument requires its distribution to the beneficiary, one might say that the reason for tax exemption to the trust — the continued ownership of the same interest in the corporation — is not applicable when the dividend is distributed to the beneficiary. The trust's proportionate stock interest in the corporation necessarily changes when it is required to give up the dividend stock. [footnote 10: *McCullough v. Commissioner*, 153 F.2d 345 (2d Cir. 1946) taxed the beneficiary on the stock dividend. The Bureau takes the other view and regards the dividend as exempt in the beneficiary's hands. Special Ruling, 5 CCH 1952 Fed. Tax Rep. 6157 (letter of Dep'ty Comm'r 1952).] But the pull of the conduit principle is sufficiently strong to cover this case as well. Hence to coordinate our trust income test with the basic premise of the conduit principle, we must exclude from the beneficiary's taxable income those items which under tax law are excluded from the gross income of the trust. Also, items which remain in gross income but with a special status, such as partially tax-exempt interest or capital gains, must retain that special status in the hands of the beneficiary.

Note 36: *Morrissey v. Commissioner*, 296 U.S. 344, 359-360 (1935):

What, then, are the salient features of a trust — when created and maintained as a medium for the carrying on of a business enterprise and sharing its gains — which may be regarded as making it analogous to a corporate organization? A corporation, as an entity, holds the title to the property embarked in the corporate undertaking. Trustees, as a continuing body with provision for succession, may afford a corresponding advantage during the existence of the trust. Corporate organization furnishes the opportunity for a centralized management through representatives of the members of the corporation. The designation of trustees, who are charged with the conduct of an enterprise, who act "in much the same manner as directors," may provide a similar scheme, with corresponding effectiveness. Whether the trustees are named in the trust instrument with power to select successors, so as to constitute a self-perpetuating body, or are selected by, or with the advice of, those beneficially interested in the undertaking, centralization of management analogous to that of corporate activities may be achieved. An enterprise carried on by means of a trust may be secure from termination or interruption by the death of owners of beneficial interests, and, in this respect, their interests are distinguished from those of partners, and are akin to the interests of members of a corporation. And the trust type of organization facilitates, as does corporate organization, the transfer of beneficial interests without affecting the continuity of the enterprise, and also the introduction of large numbers of participants. The trust method also permits the limitation of the personal liability of participants to the property embarked in the undertaking.

It is no answer to say that these advantages flow from the very nature of trusts. For the question has arisen because of the use and adaptation of the trust mechanism.

The suggestion ignores the postulate that we are considering those trusts which have the distinctive feature of being created to enable the participants to carry

> on a business and divide the gains which accrue from their common undertaking, trusts that thus satisfy the primary conception of association and have the attributes to which we have referred, distinguishing them from partnerships. In such a case, we think that these attributes make the trust sufficiently analogous to corporate organization to justify the conclusion that Congress intended that the income of the enterprise should be taxed in the same manner as that of corporations.

Note 47: *Heiner v. Mellon*, 304 U.S. 271, 280-281 (1938):

> *Fifth.* The Mellons contend that, under the law of Pennsylvania, no distribution of profits could lawfully have been made by the surviving partners as liquidating trustees until all debts and liabilities, contingent or otherwise, had been paid or satisfied, and the partners' capital returned, and that, although the business of the partnerships had been carried on after dissolution precisely as before, and the partnership accounts for the year 1920 showed large profits earned, their respective shares of them were not distributable, and could not be deemed taxable income of the partners.
>
> Section 218(a) of the Revenue Act of 1918 provides that
>
> "There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year. . . ."
>
> If "distributive" meant "currently distributable under state law," the contentions made by the Mellons might have some force. But it does not. Article 322 of Regulations 45 (and corresponding articles of subsequent Regulations) defines "distributive" as meaning "proportionate." *Compare Earle v. Commissioner*, 38 F.2d 965, 967, 968. And *section 220 of the Revenue Act of 1918, 40 Stat. 1072, taxing to the shareholders the income of a corporation improperly accumulating its gains and profits for the purpose of avoiding surtax*, assumes that the two words are synonymous. The tax is thus imposed upon the partner's proportionate share of the net income of the partnership, and the fact that it may not be currently distributable, whether by agreement of the parties or by operation of law, is not material. [Some emphasis added, and some citations omitted.] ■