



# TaxNewsFlash

## United States



No. 2022-356  
November 22, 2022

## Ninth Circuit: Rehearing en banc denied in section 965 case

The U.S. Court of Appeals for the Ninth Circuit today denied the taxpayer's petition for a rehearing en banc of the Ninth Circuit's [decision](#) [PDF 218 KB] affirming the federal district court's dismissal of an action seeking to invalidate the mandatory repatriation tax under section 965 on the grounds that it violates the Constitution's Apportionment Clause and Fifth Amendment's Due Process Clause.

The case is: *Moore v. United States*, No. 20-36122.

Judge Bumatay, joined by Judges Ikuta, Callahan, and VanDyke, dissented from the denial of rehearing en banc. Judge Bumatay stated that the panel erred in disregarding the realization requirement of the Sixteenth Amendment, by allowing an unapportioned direct tax on unrealized income—undistributed earnings of a foreign corporation owned by a U.S. taxpayer—without offering any other limiting principle. Judge Bumatay further stated that the Ninth Circuit's decision opens the door to new federal taxes on other types of wealth and property being categorized as an "income tax" without the constitutional requirement of apportionment. Read Judge Bumatay's dissenting [opinion](#) [PDF 207 KB]

### Background

The taxpayers challenged the constitutionality of subpart F's ability to permit taxation of the post-1986 income of a controlled foreign corporation (CFC) through the mandatory repatriation tax under section 965. The district court dismissed the action for failure to state a claim, denied the taxpayers' cross-motion for summary judgment, and the taxpayers appealed.

The Ninth Circuit held that, given the background of the government's power to lay and collect taxes, the mandatory repatriation tax under section 965 is consistent with the Apportionment Clause, which requires that a direct tax be apportioned so that each state pays in proportion to its population. The Ninth Circuit observed that courts have consistently upheld the constitutionality of taxes similar to the mandatory repatriation tax notwithstanding any difficulty in defining income, that the realization of income does not determine the tax's constitutionality, and that there is no constitutional ban on Congress disregarding the corporate form to facilitate taxation of shareholders' income. The court explained that subpart F only applies to U.S. persons owning at least 10% of a CFC, the mandatory repatriation tax builds upon a pre-existing liability attributing a

CFC's income to its shareholders, and the taxpayers were, and continue to be, treated as individuals who have some ability to control distribution.

The Ninth Circuit also held that, assuming without deciding that the mandatory repatriation tax is retroactive, the tax does not violate the Fifth Amendment's Due Process Clause. The court explained that the mandatory repatriation tax serves the legitimate purpose of preventing CFC shareholders who have not yet received distributions from obtaining a windfall by never having to pay taxes on their offshore earnings that have not yet been distributed. The mandatory repatriation tax accomplishes this legitimate purpose by rational means by accelerating the effective repatriation date of undistributed CFC earnings to a date following passage of the 2017 legislation known as the "Tax Cuts and Jobs Act" (TCJA). Read [TaxNewsFlash](#)

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