



GMS Flash Alert

2023-141 | July 17, 2023



United States - Supreme Court to Hear Case Challenging Mandatory Repatriation Tax

On June 26, 2023, the U.S. Supreme Court granted a taxpayer's petition for a writ of certiorari in the case of *Moore v. United States*,¹ in which taxpayers are challenging the constitutionality of the mandatory repatriation tax under section 965 of the U.S. Internal Revenue Code ("the Code"). The Supreme Court will hear the case during its next term, which commences in October 2023, and is likely to issue its ruling no later than the end of that term in late June 2024.

WHY THIS MATTERS

If the Supreme Court rules in favor of the taxpayers, this would invalidate the mandatory repatriation tax under section 965 and could also invalidate many other provisions of the Code on the grounds that these provisions also impose income tax in the absence of a realization requirement. This would have a far-reaching impact on the taxation of individuals and entities with cross-border income. In the short term, it could give rise to refund opportunities for many corporate and individual taxpayers and in the longer term it would cause multinational corporations to re-assess many aspects of their operations, including their international assignment programs, given that some tax costs for international assignees could be reduced or eliminated.

Background

The section 965 transition tax was enacted as part of the legislation known as the *Tax Cuts and Jobs Act of 2017*.² It deems the post-1986 deferred foreign income of certain foreign corporations, including controlled foreign corporations (CFCs), to be taxable as income in 2017 or 2018, depending on the tax year of the foreign corporation. Thus, section

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965 imposes tax on income that was earned by a foreign corporation in prior years and was not distributed to its U.S. shareholders.

The taxpayers in this case, Charles and Kathleen Moore, are a couple who owned 11 percent of a CFC in India that supplied farming tools to small farmers in that country. In 2017, the CFC had \$508,000 of retained earnings and the taxpayers were therefore subject to tax on their proportionate share of this amount, resulting in an increase to their U.S. income tax liability of approximately \$15,000.

The taxpayers filed suit in the U.S. District Court for the Western District of Washington, challenging the tax on the grounds that it is a direct tax that is not an income tax and it therefore violates the apportionment clause of the Sixteenth Amendment to the U.S. Constitution. The taxpayers' argument is that because the CFC's income had not been distributed to them, it had not been "realized," and that unrealized income was not included in the common understanding of "income" at the time of the adoption of the Sixteenth Amendment. Alternatively, the taxpayers claim that the tax violates the due process clause of the Fifth Amendment.

The U.S. District Court granted the government's motion to dismiss the taxpayers' complaint. On appeal, the Court of Appeals for the Ninth Circuit affirmed the District Court, and the taxpayers' motion for rehearing was denied. Both the District Court and the Appeals Court relied on authorities that have upheld the constitutionality of taxing undistributed corporate and partnership income on the grounds that realization of income is not a constitutional requirement and that the concept of taxable gain for purposes of the Sixteenth Amendment should be broadly construed. These courts also held that the tax does not violate the due process clause because it serves a legitimate legislative purpose of preventing CFC shareholders who had not yet received distributions from obtaining a financial windfall by never having to pay taxes on their offshore undistributed earnings and does so by rational means.

The taxpayers then petitioned the U.S. Supreme Court for a writ of certiorari, and this has now been granted.

KPMG INSIGHTS

KPMG will continue to monitor the progress of this litigation and its potential impact on corporations and individuals with cross-border income. Many provisions in the Code that affect individuals on inbound assignments to the United States are based on concepts of deemed disposition of accumulated income and could therefore be held to be invalid under the Constitution if the Supreme Court rules in favor of the taxpayers and imposes a strict realization requirement. These include the provisions relating to the taxation of passive foreign investment companies (PFICs) and the taxation of foreign pension plans. Section 877A of the Code, which imposes an expatriation tax on certain individuals who renounce U.S. citizenship or green card status by deeming them to have sold their worldwide assets for fair market value could also be affected.

FOOTNOTES:

1 *Moore v. United States*, Docket no. 22-800 (cert. granted June 26, 2023). See the Supreme Court's [orders list](#).

2 Pub. L. 115-97, sec. 14103(a).

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