

GMS Flash Alert

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United States – Supreme Court Upholds Mandatory Repatriation Tax As Constitutional

On June 20, 2024, the U.S. Supreme Court affirmed a 2022 decision of the U.S. Court of Appeals for the Ninth Circuit upholding the constitutionality of the mandatory repatriation tax (“MRT”) under section 965 of the U.S. Internal Revenue Code (“the Code”). The MRT requires U.S. taxpayers who own at least 10 percent of a controlled foreign corporation (“CFC”) to pay a one-time tax on their share of the corporation's past earnings and profits, regardless of whether such income was distributed to them. In a 7-2 decision authored by Justice Brett M. Kavanaugh, the Supreme Court held in *Moore v. United States*¹ that Congress can attribute an entity's realized and undistributed income to its shareholders or partners and then tax them on that income.

Though the holding by the Supreme Court is a significant victory for the government, the most noteworthy part of the holding may be that it does not address a central question posed by the taxpayers in the case: Is the realization of income a constitutional requirement for an income tax?

WHY THIS MATTERS

If the Supreme Court had ruled that an income tax requires the realization of income for it to be constitutional, such a ruling could have potentially invalidated many other provisions of the Code on the grounds that these provisions also impose income tax in the absence of a realization requirement. These include provisions of relevance to international assignees, such as the taxation of passive foreign investment companies, the taxation of foreign pension plans, and section 877A of the Code, which imposes an expatriation tax on certain individuals who renounce U.S. citizenship or residency status by deeming them to have sold their worldwide assets for fair market value. Furthermore, such a ruling could have potentially jeopardized the constitutionality of a potential wealth tax, such as the one proposed by the Biden Administration.²

If the realization of income is deemed a constitutional requirement for an income tax in a future case, such a ruling could potentially give rise to refund opportunities for international assignees and reduce the tax costs associated with international assignments.

Background

The MRT was enacted as part of the legislation known as the *Tax Cuts and Jobs Act of 2017*.³ It deems the post-1986 deferred foreign income of certain foreign corporations, including CFCs, to be taxable as income in 2017 or 2018, depending on the tax year of the foreign corporation. Thus, the MRT 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 over 10 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, notwithstanding that the earnings were not actually distributed to them.

After unsuccessfully arguing in two lower courts⁴ that the MRT is unconstitutional, the taxpayers petitioned the Supreme Court for a writ of certiorari on June 26, 2023. On June 20, 2024, the Supreme Court upheld the constitutionality of the MRT without having to answer the realization question since, according to the decision authored by Justice Kavanaugh, the MRT “does tax realized income – namely, income realized by the corporation.”

Given that there was no need to resolve the disagreement over realization to decide the case, the Supreme Court concluded that Congress can attribute an entity’s realized and undistributed income to its shareholders or partners and then tax them on that income based on long-standing precedent and congressional practice. However, the Supreme Court’s ruling is narrow in scope, as the decision authored by Justice Kavanaugh explicitly states that it only applies to pass-through entities.

Unresolved Issues

The Supreme Court was able to reach its decision with respect to the constitutionality of the MRT without having to resolve – as noted earlier – the realization question. Nevertheless, the Supreme Court acknowledged that imposing a realization requirement could render vast swaths of the Code unconstitutional and that the constitutionality of a hypothetical wealth tax may depend on, among other things, whether realization is a constitutional requirement for an income tax.

Despite this acknowledgement, the court’s refusal to reach a conclusion with respect to the realization question creates a degree of uncertainty as to the legality of provisions that assess tax on pre-realized income and potentially opens the door to future challenges, especially considering that at least four justices appear to be of the opinion that the realization of income is a constitutional requirement for an income tax.

KPMG INSIGHTS

While the immediate impact of the decision is clear in that the MRT is considered a valid income tax under the U.S. Constitution, its long-term implications for the taxation of individuals and entities remains to be seen given the uncertainty surrounding whether there will be future litigation that requires the Supreme Court to directly address the realization question.

FOOTNOTES:

1 *Moore ET UX. v. United States*, No. 22-800 (S. Ct. June 20, 2024). See:

https://www.supremecourt.gov/opinions/23pdf/22-800_jg6o.pdf .

2 Read a KPMG report that details the income tax proposals contained in the Biden Administration's FY 2025 budget: "[Analysis and observations of tax proposals in Biden Administration's FY 2025 budget](#)".

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

4 For additional details on the taxpayers' arguments and the procedural history of the case, please see [GMS Flash Alert 2023-141](#) (July 17, 2023).

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RELATED RESOURCE

For a related report, see "[U.S. Supreme Court: Mandatory repatriation tax under section 965 held constitutional](#)," published in *TaxNewsFlash-United States* (June 20, 2024), a publication of KPMG LLP in the United States.

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