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IDEAS

The Supreme Court Takes On Yet Another Made-Up Controversy

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By Conor Clarke

Illustration by Matteo Giuseppe Pani. Source: Getty.

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The Supreme Court rarely hears tax cases, and tax cases rarely threaten to affect the public at large. *Moore v. United States*, to be argued tomorrow, is that rare exception. The case raises an issue at once beguilingly simple and oddly difficult: What does *income* mean? This is a question with ramifications for virtually every area of American taxation; depending on how the Court answers it, *Moore* could produce a chaotic ruling that casts constitutional doubt on huge swathes of the tax system. But it's also a question that the Court doesn't need to answer, and one that it shouldn't. The issue teed up in *Moore* may be so intellectually stimulating that nobody seems to have noticed that the case has been fundamentally misframed.

The story of *Moore* starts in 2017, when President Donald Trump signed the Tax Cuts and Jobs Act. The law aimed to minimize the incentive for U.S. corporations to hoard money overseas by reducing certain taxes on foreign earnings. But, in exchange, U.S. investors would have to pay a onetime tax on accumulated foreign profits going back several decades—the so-called transition tax. Charles and Kathleen Moore are among the Americans affected by the change. In 2006, they invested $40,000 in KisanKraft, an Indian company owned by a friend. They allege that they never received any payments from the company because all of its profits were reinvested. The transition tax nevertheless stuck the Moores with a $15,000 tax bill based on the company's retained earnings. The Moores countered that the transition tax is unconstitutional because it exceeds Congress's power under the Sixteenth Amendment. That amendment, ratified in 1913, explicitly empowers Congress to tax incomes. But the Moores argue that unrealized gains aren't income at all.

The Sixteenth Amendment itself was a response to a constitutional controversy. The original text of the Constitution requires that "direct taxes" be "apportioned" among the states. If you're wondering what "direct tax" means, you're in good company: James Madison's notes on the constitutional convention suggest that the drafters didn't know what those words meant, and Alexander Hamilton later considered it "a matter of regret that terms so uncertain and vague in so important a point are to be found in the Constitution." But "apportioned" is clear. It means that the burden of a tax must be proportional to each state's population, in the same manner that congressional representatives are apportioned. A state with a quarter of the national population should pay no more and no less than a quarter of the national burden of any "direct" tax. In 1895, in a case called *Pollock v. Farmers' Loan & Trust Company*, the Supreme Court held that the federal income tax was, in fact, direct—and, because it wasn't apportioned, unconstitutional. Indeed, an apportioned income tax is hard to

imagine: It would require higher tax rates in poorer states. (Just think of two states with exactly the same population—so they must pay exactly the same aggregate amount—but with hugely unequal incomes. To produce the same amount of revenue, the percent rate would have to be higher in the state where incomes are lower.)

Evelyn Douek and Genevieve Lakier: The Supreme Court seems poised to decide an imaginary case

The Sixteenth Amendment effectively overruled *Pollock* by giving Congress the power to collect income taxes "without apportionment." But the Moores contend that the transition tax isn't really a tax on "income" at all, because they personally never realized any income from KisanKraft. The company might have become more valuable over time, but the cash was retained and reinvested in the firm. If there's no income, they argue, the Sixteenth Amendment doesn't apply, and the tax can't be imposed unless it's apportioned among the states. The potential sweep of this claim is hard to overstate. The United States already taxes a great deal of business profits, regardless of whether those dollars are distributed to individuals. Partnerships and S corporations are taxed this way, and such businesses now earn trillions of dollars each year. None of those tax regimes is, or plausibly could be, apportioned. So a victory for the Moores could suddenly jeopardize much of the federal government's ability to raise revenue.

Luckily, the Court can easily avoid that result without even touching the income question. This is because the Constitution gives Congress a separate power to enact unapportioned taxes: It can impose "duties" and "excises" under Article I Section 8. The duty-and-excise power is far less famous than the Sixteenth Amendment, but it has long been the unsung workhorse of American taxation. The gift tax, estate tax, and corporate tax, for example, were all upheld by the Supreme Court not as taxes on income but as a duty or excise. And that is by far the best way to frame the transition tax at issue in *Moore*. The Supreme Court has long held that the duty-and-excise power extends to cases in which the government taxes the "doing of business in a certain way," and the transition tax is fundamentally a tax on a certain kind of business activity—namely, doing business through a foreign firm.

This isn't some 21st-century rationalization guaranteed to alienate originalists on the Supreme Court. In 1794, for example, Congress imposed a special duty on retailers of "foreign distilled spirituous liquors." Our economy has come a long way since the

Whiskey Rebellion, but the principle remains the same. Long before the great legal showdown over the personal-income tax, Congress had been taxing business owners and operators in all sorts of ways, largely without controversy. Even in *Pollock*, the Supreme Court blessed the many cases in which "taxation on business, privileges, or employments has assumed the guise of an excise tax and been sustained as such." (I explore this argument at greater length in a forthcoming article in the journal *Tax Notes*.)

And yet the government has barely mentioned this history in its defense of the transition tax. It devoted only one paragraph to an "excise" theory in its court-of-appeals brief and a few short pages at the very end of its Supreme Court brief, almost as an afterthought. This has created the unsettling impression that the Court needs to say something about the income question. But the Court shouldn't decide a more difficult constitutional question with sweeping and unpredictable consequences when a narrower and more solid path is available. Rather than upset the apple cart, the Court should send the case back for the lower court to consider the transition tax as akin to every other federal tax on business activities: justified not since 1913 as a tax on income but since 1789 as a commercial duty or excise.

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