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United States Court of Appeals, Ninth Circuit.

Charles G. MOORE, Kathleen F. Moore, Plaintiffs - Appellants,
v.
UNITED STATES OF AMERICA, Defendant - Appellee.

No. 20-36122.
January 14, 2022.

Oral Argument

Appearances:

[Andrew M. Grossman](#), Baker Hostetler, LLP, Washington, DC for Plaintiffs - Appellants.

Nathaniel S. Pollock, U.S. DEPARTMENT OF JUSTICE, Tax Division/Appellate Section,
Washington, DC for Defendant - Appellee.

Before:

[Ronald M. Gould](#), [Jacqueline H. Nguyen](#), [Mark J. Bennett](#), Circuit Judges.

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JUDGE GOULD: The next case on our docket is *Charles Moore versus USA*. And for appellant, we have Mr. Andrew Grossman and for the US we've got Mr. Nathaniel Pollock. And so, this case, like the last one, is set for 15 minutes per side. And now, we'll start with appellant's argument.

ORAL ARGUMENT OF ANDREW M. GROSSMAN ON BEHALF OF THE PETITIONER

MR. GROSSMAN: Thank you, your Honor. Andrew Grossman for the appellants, Charles and Kathleen Moore. I'd like to reserve 3 minutes for rebuttal. May it please the court. The mandatory repatriation tax required the Moores to pay tax on money that they did not realize in any fashion that they may never realize. Merely because they own shares in a corporation that reinvested its earnings over the past 30 years. They're entitled to a refund of that tax for two reasons. First, is that the MRT is not an income tax authorized by the Sixteenth Amendment, but a direct tax on property that is not apportioned among the states as the Constitution requires. Second, the MRT's unprecedented retroactivity and irrational and arbitrary attribution of income to taxpayers who have no guarantee of ever receiving it violates constitutional due process. Our direct tax argument is straightforward. For over 100 years, the Supreme Court has held in case after case that income under the Sixteenth Amendment requires realization by the taxpayer. No decision by any court at any level has ever called that principle into question, and that principle directly controls this case. It is undisputed that the Moores have not actually or constructively realized a penny of the retained corporate earnings that the MRT treats as their income. The MRT taxes the Moores not because they realized anything, but solely because they own shares in a corporation that capitalize earnings to grow its business. That is a tax on property and the fact that it is not apportioned among the states dooms it.

JUDGE BENNETT: I'm sorry, but wasn't, wasn't the reason that this was taxed was because that the company that they own shares in was making money and it simply hadn't physically distributed it? It wasn't as if there wasn't a good faith, in fact, a compelling basis for deciding that the corporation had made money, right?

MR. GROSSMAN: Your Honor, we recognize that over the period of years, the corporation did have income. That income was reinvested in KisanKraft to grow the business. It wasn't just sitting in a pot somewhere. The problem here is that the Moores never realized any income from the corporation. It was capitalized in the corporation's business. And the government argues that realization by the taxpayer simply doesn't matter, but all of the case law on that specific point is simply - it's crystal clear. If realization didn't matter, realization by the taxpayer didn't matter, then Congress could deem anything to be income and tax it if it's income, but that's never been the law. *Macomber* required that gains be received or drawn by the taxpayer. *Glenshaw Glass* required that gains be clearly realized -

JUDGE BENNETT: But, but, but counsel, you're, you're relying on cases that our court and many other courts have just thoroughly discounted. I mean, I'm looking at our *en banc* decision in *James*

from 1964 where the court said, “But insofar as *Macomber* purported to offer a comprehensive definition of the term income as used in the Sixteenth Amendment, it has been discarded.” Now, maybe Judge Dunaway, writing for the *en banc* panel, was wrong in his view of what had happened to *Macomber*, but we're bound by it. We can't disregard what our *en banc* court wrote 58 years ago.

MR. GROSSMAN: Your Honor, we're comfortable with the standard that was applied in *James*. I want to be crystal clear about that. *James* applied the *Glenshaw Glass* standard. That case involved a widow's allowance, and the court held that, that the allowance, the payment to the widow was income under the *Glenshaw Glass* standard that requires gains be clearly realized by the taxpayer. And in the taxpayer -

JUDGE BENNETT: But you're, you're off - but you're offering *Macomber* as binding current precedent with regard to how one looks at income for the purposes of the Sixteenth Amendment. I think that's a fair reading of your arguments to us. And we discarded that in, if not before, at least by 1964.

MR. GROSSMAN: I don't think that's right, your Honor. With respect to the particular aspect of *Macomber* on which we're relying. *Macomber* - I think the cases have put - have really two elements for what constitutes income under the Sixteenth Amendment. One is a gain of some sort, and the other is realization of that gain by the taxpayer. *Macomber* had both of those. It defined income as the proceeds from labor, capital, or both. In other words, that's how it defined the type of gain that qualifies. We freely acknowledge that that portion of *Macomber* has been discarded and was replaced with the broader standard in *Glenshaw Glass*. But *Glenshaw Glass* carried forward *Macomber's* realization requirement and that's what we're relying on from *Macomber* and from *Glenshaw Glass*. If the court doesn't want to rely on *Macomber*, I don't think it makes a dime's worth of difference because the *Glenshaw Glass* standard with respect to realization is exactly the same and it's the one this court applied in *James*. So -

JUDGE BENNETT: Although, although what we also said in *James* with, with regard to *Glenshaw Glass* and the definition of income in *Macomber* was, “No Supreme Court case since *Glenshaw Glass* has cited it for its discussion of the,” meaning *Macomber*, “for its discussion of the income question.”

MR. GROSSMAN: I will note, your Honor, that the *Glenshaw Glass* standard, including specifically the realization requirement that we're relying on in this case, has been applied by the Supreme Court subsequently in cases like *Ja - United States versus James* and in *Kowalski*, so far as I'm aware, every single court to consider the constitutional definition of income under the Sixteenth Amendment for decades at this point has applied the *Glenshaw Glass* standard, including its realization requirement. And it's the realization requirement that in this instance dooms the MRT.

JUDGE GOULD: Counsel, can I interject a question, if I may? The thing that's bothering me is that it seems like an awful lot of courts in this taxing area. We're writing opinion saying the definition stated in an earlier case isn't an all-purpose definition. It's like a definition for that case. And then the next case comes along. It gives a definition, and then someone says, that's not an all-purpose standard. And so, my question is this. I'd like to hear you respond to the government's argument in its brief that the income is being made by this company, and it's just a question of whether, instead of deferring the timing indefinitely, the Congress could pass a law saying you're taxed now. If you could address that, that's sort of the substance of this [inaudible].

MR. GROSSMAN: Yes, your Honor. Thank you, your Honor. The government's deferral argument conflates an accounting concept with the constitutional definition of income. At no point during those years in the past when the income was earned by the corporation, did the Moores or other parties subject to the MRT realize anything. In other words, in all those years they did not realize income. So, if you add up the income to the corporation over those years, it still does not result in income to the shareholders. And in terms of, you know, how this could be taxed, the, the traditional way, the way that the government has always taxed ordinary shareholders on corporate income is through distributions of that income. That's what the, that's what the US tax code has done ever since *Macomber* said that it had to be done that way based on realization and not through attribution to individual ordinary shareholders of corporation's retained earnings. So, in this instance, and I want to say there really is a distinction between those two methods that makes a big difference in this case for both of our arguments. An individual shareholder has no guarantee of ever receiving capitalized earnings that a corporation has obtained. Corporations capitalize those earnings so as to grow the business and to conduct additional business activities. Those - that money simply isn't available for distribution. Corporations go out of business, they get sold, -

JUDGE NGUYEN: Mr. Grossman, I know your time is running short, so if I can interject with a couple of questions. One of the government's argument is that the MRT is just simply a corporate earnings tax on controlled foreign corporations. And if that's true, then any sort of realization requirement would be irrelevant under that analysis. So, I'd like to get your best response to that argument. And then number two, if there's specific authority, the best case that you're relying on for the proposition that a taxpayer can avoid a tax on income that's used to, to make capital investments, I'd like to have an answer to that as well.

MR. GROSSMAN: Sure, your Honor. The government's argument that this is a CFC tries to take this novel tax, the MRT, and place it within the history of the pre-existing Subpart F regime. But the difference is that Subpart F, which is an incredibly complicated statute, has all of these very specific provisions that address particular instances of tax avoidance where an individual has effectively interposed a corporation between income that is properly regarded as their own. Things like holding companies or where there are related party transactions, things of that sort. And so, in

all of those cases, you have constructive realization of income by the taxpayer. And the only thing standing between the taxpayer and the, and the income is effectively a sham corporation, a sham corporation-type relationship. The difference here is that the MRT doesn't work that way. This isn't income that is properly attributable to the taxpayers because they haven't actually or constructively realized anything. The government recognizes this because it doesn't argue that they did. The government argues that realization is simply unnecessary for a tax - for a taxpayer to have Sixteenth Amendment Argu - Sixteenth Amendment income. But there is simply no case that recognizes that principle. And so far, as we're aware, every case that it's laid out, any definition of income under the Sixteenth Amendment has always typically reciting the language from *Glenshaw Glass* said that realization by the taxpayer is required. And so that's what makes the MRT substantially different, fundamentally different from those pre-existing Subpart F taxes. On your other question, regarding the strongest case for us, regarding, regarding capitalized earnings, I would say that - I would answer that two ways. First is, again, just the *Glenshaw Glass* standard. If it's not clearly realized, it's not income and when money is capitalized by a corporation to carry on its business, it's not realized by the ordinary shareholders in that corporation. Now, if you want the case that holds that specifically, I would say it's *Macomber*. *Macomber* did distinguish between a corporation's capitalized earnings and income, typically through dividends to the shareholders of that corporation. I would note that that holding is not only is not ever been overturned, but the Supreme Court specifically upheld it in *Glenshaw Glass* and the Second Circuit recognized as recently is about 10 years ago that that distinction between cap - between capitalized earnings and capital on the one hand and income to the shareholder on the other hand remains good law as a constitutional matter. So, if this court were to hold otherwise, I'm afraid that would probably create a split with the decision of the Second Circuit in [inaudible]. And I think that gets to really what makes this case fundamentally different from pretty much every other case involving the Sixteenth Amendment that the government cites in its briefing. Pretty much all of those cases were about what counts as realization. And in all of them, the government pointed to some payments or some assets, and they argued that the taxpayer either actually or constructively realized it. That's *Whitlock*. That's *Garlock* - *Garlock*. That's *Eder*. That's *Dougherty*. But that's not the government's argument in this case, because the MRT does not turn on realization. So, all the government can do to defend the MRT is argue that the whole constitutional framework that stood in place for over a century is wrong. And I would respectfully submit that it's an argument for the Supreme Court, not this court. That the court -

JUDGE GOULD: Counsel, you're past the amount of time you wanted for rebuttal. If you want to complete your argument, you can. I'll give you 3 minutes for rebuttal after that.

MR. GROSSMAN: Thank you, your Honor. If the court has no further questions at this time, I would reserve the remainder of my time.

JUDGE GOULD: Okay. Then, then I'll ask the clerk to change the remaining 1 minute to be 3 minutes so you can plan the 3-minute rebuttal argument. And we'll now hear from Mr. Pollock.

ORAL ARGUMENT OF NATHANIEL S. POLLOCK ON BEHALF OF THE RESPONDENT

MR. POLLOCK: Thank you, Judge Gould. May it please the court. The transition tax, which avoids what would otherwise be a massive windfall for US corporate shareholders, congress used that transition tax and it's constitutional both because it fits easily within Congress' taxing power, and it also accords with due process. Both because it's not retroactive at all and because, even if it were, it's rationally based. Start with the taxing power, there are at least two paths that this court could go down to reach the conclusion that Congress acted within its constitutional authority when it opposed - imposed this tax without apportionment. The first path is to say that the transition tax is an income tax on a deemed dividend that represents the value of the tax, the increase in the earnings and profits accumulated by a foreign corporation that the taxpayer partly owns. Those accumulated earnings and profits are in accession to the taxpayers as well, for the taxpayer's gain. And there's no constitutional requirement that income must always be realized before it's taxed. And I'll return to that in just a second. But just to say very briefly, there's also a second path that this court could go down, and that's to say that the transition tax is, is a tax that reasonably Congress chose to disregard the distinction between a corporation and its shareholders. There's also no constitutional requirement that compels Congress always, in every instance, to regard corporations as separate entities from their shareholders for taxation purposes. And the transition tax adds to the already existing Subpart F framework that, that Congress has already made that judgment and, and disregarded that distinction for certain purposes. Returning to the, to the realization question that, that was the focus of the opening argument, I think it's critical that the court see that this court's decision in *James*, as, as Judge Bennett, you were pointing out, that concludes that *Macomber* essentially is only good law as to its narrow holding. And it's, it's not the case that *Macomber* was only dealing with part of - that that *James* was only dealing with part of the *Macomber* decision. It's, it's also, it also dealt with the realization principle. And that's on, right, right after the *Macomber* decision on page 751 of the *James* decision, it quotes at length the realization principle from, from *Macomber*. Then when it's going through sort of why subsequent Supreme Court law should be understood as backing away from the *Macomber* definition. It cites *Bruun* among other cases. In - and discusses *Bruun* as a, as a case that, that deals with that question of realization. And, and so I think it's absolutely correct that, that *James* conflicts with the notion that *Macomber* establishes this inviolable realization principle. I also want to draw this court's attention to the Supreme Court's decision in *Cottage Savings*. In *Cottage Savings*, the Supreme Court said that one of the realization principle which is a principle of taxation, that's normally how things work.

MR. POLLOCK: That's normally how the tax code works. It says, it concluded that that was the requirement was implicit in the tax code and co-founded on administrative convenience. And that wasn't throwaway language in private savings. In *Cottage Savings*, the, the issue was - is a, is an exchange of a group of financial institutions interest in residential mortgages for another economically identical exchange - group of, of interest in residential mortgages. Is that enough of a - is that an event that allows Congress to tax? And the court rejected the government's position that an economically real exchange is required for, for - not for constitutional purposes, but for statutory realization purposes because it said no, the purpose of this, of the realization requirement, is administrative convenience and even a non-economically significant exchange satisfies that administrative convenience rationale. It also deferred to the commissioner's regulatory interpretation of what realization means. That deferral, we submit, would obviously not be appropriate if the - if realization was a constitutional requirement. And I also want to, in particular, draw this court's attention to *Cottage Savings* discussion of *Macomber* itself. I think it's very revealing. When - this is at pages 63 - 563, 564 of the *Cottage Savings* decision. The court discusses *Macomber* and then it says - it discusses subsequent Supreme Court cases, including *United States versus Phellis*, *Marr versus United States*, and *Weiss v. Stearn*. And it says that those cases refined, quote, refined *Macomber's* conception of realization. And, and it describes the decisions in *Phellis* and *Marr* standing - as standing for the proposition that an exchange of old stock representing an equivalent proportional interest in the new corporation. So, those cases are cases where - that a company is reorganized essentially just to change states of incorporation. Nothing is, nothing is realized by the taxpayer in the sense of - in the *Macomber* sense of being available for their separate use and benefit. And - but the court says that's enough. And, and income, income that's appropriate to, to, to tax as a, as a component of the income tax. There are other cases as well that, that negate the notion that realization is this inviolable principle. I would just want to mention to this idea that the Supreme Court and this court have cited *Glenshaw Glass* for the principle that there must always be realization. This is not, this is not accurate. I don't think there are any - there are cases cited on page 7 of Mr. Grossman's reply brief that the three cases that cited *Glenshaw Glass*, none of those cases stand for the proposition that there always has to be realization. And in fact, the *United States versus Burke*, which is the third case cited, cites *Glenshaw Glass* for the proposition that, quote, Section 61, which is the gross income statute, intends to "bring within the definition of income any accession to wealth." So, I mean, it doesn't go into the, the, the question of realization wasn't an issue there.

MR. POLLOCK: But, but the - I think that - and there's a later Supreme Court case that talks about besides *Glenshaw Glass* for the proposition that gross income extends broadly to all economic gains. So, it's not - it's - I just think it's not a correct characterization of how *Glenshaw Glass* has been interpreted. And, of course, as we say in our brief *Glenshaw Glass*, nothing about there's no realization question in *Glenshaw Glass* that, that to be decided. I want to also talk just briefly. I mean, I think that's a completely sufficient basis for the court to reject the, the taxing power argument. I just want to mention also that in alternative ground, to the extent that there was

any question about whether Congress has the authority to impose a tax on what is clearly the taxpayer's gain, absent realization in the *Macomber* sense of separate - separation from the asset and availability for benefit use and control is that I think is that it can also be understood as part of Subpart F and Subpart F has been considered as a corporate look through statute and there's simply no constitutional principle that prevents Congress from looking through a corporation to tax individuals on their - the gains of the corporation. And this - in Subpart F is a context in which Congress has found that to be appropriate. I think the, the tax court's decision in *Dougherty* about why that's true is, is potentially helpful. The tax court said Congress determined that it was appropriate to bypass the corporate form. This is talking about Subpart F. One, because that CFCs, Controlled Foreign Corporations, have frequently been used as tax avoidance vehicles. That's not to say that they're always used as tax avoidance vehicles, but they have been. And then two, the shareholders have a high degree of control. So, this is a, this is a tax that applies to shareholders that have more than 10% interest in a more than 50% US owned corporation. And so, Congress made a, made a determination. That's a high enough degree of control and that's appropriate to, to look through the corporate form to tax directly certain earnings and profits of the corporation in that instance. I'll also just - unless the court has questions, I can, I'll move to the, the due process issue briefly. But we think it's, it's clear that no matter how you look at this tax, it's not retroactive. If you look at it as an income tax on a deemed dividend, it's a tax that is - the taxable event in the future after the, after the law was passed. That's the same thing. In that regard, we would cite *Prescott* where there was a deemed liquidation that happened in the future. And -

JUDGE NGUYEN: Counsel, let me, let me ask you a question on your retroactivity argument for a moment, because there's really no dispute that prior to the MRT, the plaintiffs really would have no tax liability so long as there's no distribution. And now post-MRT, they have tax liability for the same conduct. Right? So, is your best argument then in reliance on *Prescott*?

MR. POLLOCK: I would say there are - I think *Prescott* is, is a good case for us because that's another case where we're talking about earnings and profits that were earned prior to the law's enactment. But the taxable event was after the deemed liquidation in that case after the loss and -

JUDGE NGUYEN: What's the, what's the, what's the rationale that *Prescott* relied on? I didn't see a lot of analysis that would be applicable.

MR. POLLOCK: It's, it's true that there's not a lot of analysis in *Prescott*. I think the *Dougherty* is, is essentially on, in the same vein. I mean, in *Dougherty*, the, the amounts that were earned, the earnings and profits were accumulated before the enactment of the part of Subpart F that treats investment in US property as an occasion for a deemed dividend for, for US shareholders of CFCs. And the fact that the deemed dividend was in the future was - that was the taxable event. Even though, to be clear, it is a deemed event. It's not a, it's a, it's a deemed dividend triggered by an investment in US property. And the investment in US property -

JUDGE BENNETT: You're, you're talking about the *Dougherty* language where the court set facts that the taxable event here in an increase in earnings invested in US property occurred during a year subject to the operation of the statute, and then Congress has the power to tax income is the court's essential rationale for its holding that it wasn't retroactive there?

MR. POLLOCK: Exactly. And it didn't matter that the earnings and profits that had been used to make that investment were earned prior to the laws enactment is the other point. But I would say, also, even, even supposing it were the appropriate or the best way to look at the statute was to see it as a tax on, on prior earnings and profits, if, if you were to look at it that way, I think that under the Subpart F regime, you should look at it as a system of tax deferral. In Subpart F asserts a right of current taxation over portions of CFC's earnings and profits and defers taxation over other portions of CFC's earnings and profits. And so, what we've - the move that we've made with the new law is from a system where the deferral is of an uncertain period triggered by a number of possible events, it could be an actual distribution or an investment in US property or some other event that would trigger taxation to a system where there is a date certain at which the deferral is going to end. And we submit that our, our 401K example is really precisely on point. You know, the - Mr. Grossman points out, well, you know, the right example should have been if, if there was a - if there was a taxation on amounts that were not distributed. That is the example. If, if, if you don't take the consequence of not taking a mandatory distribution when it's required to be taken is that your - that a tax is imposed on that amount that had to be distributed. And so, I think that, that that example works. And then I would simply end by saying, even if, your Honors, think that that is retroactivity, this statute clearly satisfies rational basis. I mean, there's, there's a very strong, legitimate purpose. So, the rational basis requires a legitimate purpose and rational means. The strong, legitimate purpose here was to preserve the status quo of taxation of all, you know, more than \$2 trillion in amassed foreign corporate earnings and profits and allowing all those earnings and profits to be repatriated tax free. But it would be a major change in the status quo. And in order to make the transition from one system of taxing CFCs to a different system of taxing CFCs something like this transition tax was needed in order to - unless you wanted to have this very, very significant corporate windfall. So, it's submit - and the period of retroactivity directly relates to that and it's rationally based, based on that very legitimate purpose. I see my time is up and I don't want to test the court's patience, but if there are any further questions, any questions, I'm happy to answer those or else I'll submit.

JUDGE GOULD: Thank you, Mr. Pollock. I have no questions. Judge Nguyen?

JUDGE NGUYEN: No, thank you.

JUDGE GOULD: We have no questions. So, we'll return to Mr. Grossman, who's got 3 minutes for his rebuttal.

REBUTTAL ARGUMENT OF ANDREW M. GROSSMAN ON BEHALF OF PETITIONER

MR. GROSSMAN: Thank you, your Honor. Just a few points. First, I think it's reflected in my friend's argument that for the government to avail on the direct tax issue, the court would have to hold that realization in any form is not required for there to be taxable Sixteenth Amendment income. This Court would be the first Court, since the enactment of the Sixteenth Amendment to hold that. There is case law directly addressing that issue in the pertinent Supreme Court cases. And we think that, that the Supreme Court's consistent recognition of that principle, as well as the consistent recognition of that principle by the lower courts, should govern here. Second, on that point, my friend mentioned *Dougherty*. I will note that *Dougherty* found on the facts of the case there that there was a constructive dividend to the shareholder in - when the foreign corporation, which was a foreign holding corporation, invested its earnings in U.S. property. In other words, it was just as good as distributing the money to the shareholder. The MRT doesn't take measure of anything like that. It doesn't turn out a constructive dividend or any type of constructive or actual realization whatsoever. And the same distinction holds for all of the other Subpart F cases that my friend refers to, and that is cited in the governance brief. Though in every single one, the courts recognized that there was a realization requirement and then they found it satisfied based on actual, constructive or in some cases actual realization by the taxpayer. In this case, there is no actual realization. There is no constructive realization. The statutory language itself turns on ownership of the shares and not whether the owner of those shares received anything whatsoever, in any way whatsoever. Third, my friend discussed *James*, and I think the discussion in *James* is actually very helpful for us because it does go through the different definitions that courts have applied to Sixteenth Amendment income over the years, and it recognizes that in all of them, there is a realization requirement. It points to the relevant language, and it actually applies a realizational, a realization standard and holds that the, that the payments at issue, in that case the widow's allowance, was income because it was a gain realized by the widow. Applying that same standard in this case leads to the inexorable result that the MRT simply does not tax the income of the taxpayer. Again, the Moores, like other subject to the MRT, simply haven't received anything. Finally, I'd like to address my friend's point that the MRT is rational. It is not. There is no dispute here that Congress could have taxed this exact - these same corporate earnings prospectively if and when they're actually distributed to shareholders. The Congress wanted the revenue now and so it retroactively tax shareholders reaching back an unprecedented 30 years on money that these taxpayers have not received and may never receive. We would respectfully submit that that is irrational. If the court has no further questions, we would ask that the court reverse. Thank you.

JUDGE GOULD: Thank you, Mr. Grossman. I have no more questions. Judge Nguyen, Judge Bennett?

JUDGE NGUYEN: No, thank you.

JUDGE BENNETT: No.

JUDGE GOULD: We hear no questions. So, this rather challenging case shall now be submitted, and the parties will hear from us in due course. You, both of the advocates, you've made excellent arguments to us. They've been highly skilled and very informative, and we will take your arguments into account as we try to address this area of the law. So, without more discussion, the Moore case shall now be submitted with our thanks.

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