Updates

The U.S. Supreme Court held the Mandatory Repatriation Tax (MRT) constitutional in *Moore v. United States*, No. 22-800, 602 U.S. _, decided June 20, 2024.

The MRT requires some American shareholders of American-controlled foreign corporations to pay U.S. taxes on their *pro rata* shares of the corporation's accumulated *but undistributed* income.

What Is the MRT?

Generally, the federal government does not directly tax American-controlled foreign corporations (CFCs) on their income. Instead, the Internal Revenue Code treats those corporations as "pass-throughs" for certain types of income (typically passive income), meaning that the IRS attributes a portion of certain types of the corporation's income to certain U.S. shareholders (those U.S. persons owning 10% or more of the CFC) and then taxes such U.S. shareholders on that income.

In 2017, Congress imposed a one-time tax, the MRT, on some American shareholders of CFCs. I.R.C. §965. The MRT attributed *additional* accumulated income of CFCs to American shareholders and taxed the American shareholders on the *pro rata* shares of this income at a rate between 8% and 15.5%.

While not discussed in the case, the Internal Revenue Code allows U.S. shareholders who recognize income from a CFC to later receive cash from such CFC free of any additional U.S. income tax. *See* I.R.C. §§959, 965(b)(4).

Case Background

According to the Court's recitation of the facts, two American shareholders, Charles and Kathleen Moore, invested $40,000 in a CFC called KisanKraft in exchange for a 13% ownership share. As of 2017, neither the company nor the Moores had paid U.S. taxes on the "great deal of income" that KisanKraft had generated.

The MRT required the Moores to pay $14,729 in taxes on their *pro rata* share of KisanKraft's accumulated income through 2017 ($508,000). The Moores paid the MRT and sued for a refund.

The Moores argued that the MRT was unconstitutional because it was a "direct" tax—a tax on persons or property—on their shares that was not imposed in proportion to each state's population, as the Direct Tax Clause of the U.S. Constitution requires. *See* U.S. Const., Art. I, §9, cl. 4. (Indirect taxes—those imposed on activities or transactions, like income—must be "uniform" but need not be apportioned by state population. U.S. Const., Art. I, §8, cl. 1; Amdt. 16.)

The district court dismissed the suit, and the U.S. Court of Appeals for the Ninth Circuit affirmed the dismissal.

The Court's Holding

The Supreme Court affirmed the dismissal of the Moores' suit in a 7-2 opinion by Justice Brett Kavanaugh. The majority held that the MRT was not a "direct" tax and that the Court's precedents established a "clear rule" that "Congress can choose either to tax the entity on its income or to tax the entity's shareholders or partners on their share of the entity's undistributed income." The Court determined that the Moores had failed to meaningfully distinguish the MRT from similar taxes, such as taxes on partnerships and corporate entities, which the Court had held constitutional. The Court said that its holding was limited to entities that Congress treats as "pass-through."

Justices Clarence Thomas and Neil Gorsuch said in dissent that the MRT was unconstitutional. In their view, the Sixteenth Amendment permits taxes only on *realized* income, and the Moores had not realized any income from KisanKraft.

Takeaways

The Court generally upheld the status quo. Striking down the MRT would have had far-reaching consequences for the U.S. tax code, as the Court observed. In addition, the Court did not discuss the impact of I.R.C. Sections 959 and 965(b)(4), which would allow the Moores to receive distributions from KisanKraft tax-free to the extent of the previously taxed income.

The case, however, indicates that justices disagree about long-standing tax concepts such as "realization." Justices Thomas and Gorsuch argued that the Moores should not have been taxed on the income from the company because their investment gains were never realized. The majority said that the company realized the income, and the IRS attributed that income to the Moores as shareholders.

Authors

Stephanie Loomis-Price

Partner
SLoomisPrice@perkinscoie.com   206.359.3088

Sopen Shah

Partner
SShah@perkinscoie.com   608.663.7480

Thomas (Tommy) Tobin

Counsel
TTobin@perkinscoie.com   206.359.3157

Explore more in

Private Client Services   Appeals, Issues & Strategy

Related insights

Update

[FDA Food Import and Export Updates for Industry]

Update

[CFPB Finalizes Proposed Open Banking Rule on Personal Financial Data Rights]