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INSIGHT: The Proposed Federal Wealth Tax Would Be Unconstitutional

BY MARK E. BERG

At the outset of her candidacy for President of the United States, Senator Elizabeth Warren has proposed a federal wealth tax on households having a net worth of $50 million or more (the "Proposed Wealth Tax"). The tax would be imposed at a rate of 2 percent of household net worth between $50 million and $1 billon and 3 percent on household net worth over $1 billion. It has been reported that economists advising Senator Warren have estimated that the Proposed Wealth Tax would, if enacted and upheld, bring in $2.75 trillion in revenues over 10 years. While it is rare for the introduction of a candidate's tax proposals, however broad and revolutionary, to be accompanied by a defense of their constitutionality, Senator Warren has released two letters, signed by a total of 17 law professors (the "Supporting Letters"), that take the view that the Proposed Wealth Tax would be constitutional.

This article does not address the wisdom of the Proposed Wealth Tax, either as a matter of economics or tax policy, nor does it consider whether the $2.75 trillion revenue estimate is realistic. Rather, after setting out the relevant basic constitutional principles and background, this article assesses the arguments that have been made regarding the constitutionality of a federal wealth tax, including those set forth in the Supporting Letters, and concludes that the Proposed Wealth Tax would clearly be an unconstitutional direct tax. While the focus of this article is on the principles underlying the constitutional impediment to a federal wealth tax, this article also briefly discusses the application of these principles to certain other recently enacted provisions of federal tax law that suffer from the same constitutional malady (and perhaps others), in particular the deemed-repatriation tax under IRC Section 965, enacted in 2017, imposed on certain U.S. shareholders of non-U.S. corporations and the deemed-sale exit tax under IRC Section 877A, enacted in 2008, imposed on individual expatriates and certain others.

The Relevant Constitutional Provisions

The Constitution grants to Congress the "Power To lay and collect Taxes, Duties, Imposts and Excises" (Article I, section 8, clause 1). This broad taxing power is not unlimited, however. Among the limitations on the taxing power are what have become known as the Direct Tax Clauses, which in their original form provided as follows:

"Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers, which shall be determined by adding to the whole Number of free Persons . . . three fifths of all other Persons." (Article I, section 2, clause 3)

"No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken." (Article I, section 9, clause 4)

The Direct Tax Clauses have been modified by two sets of constitutional amendments: First, the 13th and 14th Amendments, ratified in 1865 and 1868, respectively, effectively eliminated the reprehensible three-fifths rule for counting persons other than "free Persons" both by abolishing slavery and by eliminating the references to "free Persons" and "all other Persons." Second, the 16th Amendment, ratified in 1913, empowered Congress "to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

From the text of the Constitution as amended, then, it is clear that if a tax is a "direct Tax," in order to be constitutional it must be either "apportioned" or imposed

on ''incomes,'' a conclusion that the Supreme Court reaffirmed as recently as 2012 in National Federation of Independent Business v. Sebelius (hereinafter, ''*National Federation*'') (the Direct Tax Clauses ''mean[] that any 'direct Tax' must be apportioned so that each State pays in proportion to its population''; ''a direct tax . . . must be apportioned among the several States'').

Defining the Constitutional Terms

Apportionment. In order for a tax to be apportioned among the states for this purpose, the tax rates must be set in such a manner as to ensure that collections of the tax in each state are in proportion to the states' respective populations, taking into account the distribution among the states of the item being taxed. The following extremely simplified example, involving a hypothetical wealth tax that is imposed on every dollar of wealth and assuming full compliance with the tax, illustrates how the concept of apportionment would be applied to a wealth tax and why most taxes could not as a political matter be apportioned:

Example. State A has a population of 5 million with aggregate household wealth of $100 billion, so that its wealth per capita is $20,000. State B has a population of 1 million with aggregate household wealth of $10 billion, so that its wealth per capita is $10,000. Because the population of State A is 5 times the population of State B, a tax that is apportioned as between State A and State B would be required to generate 5 times as much revenue from State A than from State B. A federal wealth tax imposed at a uniform 2 percent tax rate would not be apportioned as between State A and State B because total collections of the tax in State A (2% of $100 billion = $2 billion) would be 10 times, rather than 5 times, total collections of the tax in State B (2% of $10 billion = $200 million).

In order for the wealth tax to be apportioned as between State A and State B, the tax rate in State A would have to reflect the difference in wealth per capita in the two states by being set at one-half the tax rate in State B. Thus, for example, if the tax were imposed at a rate of 1 percent in State A and 2 percent in State B, total collections of the tax in State A (1 percent of $100 billion = $1 billion) would be 5 times total collections of the tax in State B (2 percent of $10 billion = $200 million) and the wealth tax would be apportioned as between State A and State B.

Indeed, it is precisely this counterintuitive, regressive, and politically infeasible aspect of the apportionment requirement—an apportioned tax must be imposed at a proportionately higher rate in states having less per capita of the item being taxed—that has caused many scholars (and some early judges) to look askance at the Direct Tax Clauses by narrowly defining the term direct tax.

Direct Tax. Notwithstanding (or perhaps because) the term ''direct tax'' was central to the infamous three-fifths compromise, it is not apparent that the delegates to the 1787 constitutional convention had a clear or uniform view as to its meaning. Given that what the Direct Tax Clauses proscribe is an unapportioned ''Capitation, or other direct, Tax,'' the text of the Constitution makes it clear that the category must include something in addition to capitations or head taxes.

The Supreme Court was called upon to construe the term direct tax as early as 1796, in Hylton v. United States. *Hylton* involved a constitutional challenge to an unapportioned federal tax on carriages, whether kept for one's own use or hired out. James Madison had been opposed to the passage of the tax on constitutional grounds, but the four justices participating in the decision unanimously upheld the tax, expressing in their seriatim opinions their hostility to the apportionment requirement and their perception that it is absurd. Two of the justices (Samuel Chase and James Iredell) expressed the view that a tax should not be considered a direct tax unless apportionment can be reasonably applied to such tax, with Justice Chase suggesting that apportionment would be unreasonable whenever (as in the above example) it would require different tax rates in different states because the items subject to tax are present in the different states in amounts disproportionate to the states' populations (which approach would apply the apportionment requirement only in cases where it would not make much of a difference). While Justice Chase, in language he expressly stated was *dicta* and therefore of little precedential value, suggested that the only two direct taxes contemplated by the Constitution are capitations that are imposed ''without regard to property, profession, or any other circumstance'' and taxes on land, Justices Iredell and William Paterson expressed doubt that these were the only direct taxes.

For the next 99 years, the Supreme Court followed *Hylton* and upheld numerous taxes that were neither capitations nor taxes on land (although the Court in 1875 in Scholey v. Rew noted that the question of whether there were other types of direct taxes was ''a question not absolutely decided''). All of this changed, however, in 1895 with the Court's two decisions in *Pollock v. Farmers' Loan & Trust Co.* In the first *Pollock* decision, the Court held 6-2 that an unapportioned income tax was a direct tax insofar as it applied to income from real property; in the second, the Court in a 5-4 decision struck down the balance of the income tax on the ground that it was also a direct tax as it applied to income from personal property. The Court distinguished direct taxes from other, indirect taxes as follows: A direct tax is ''a tax upon property holders in respect of their estates, whether real or personal, or of the income yielded by such estates, and the payment of which cannot be avoided,'' whereas indirect taxes are ''all taxes paid primarily by persons who can shift the burden upon someone else, or who are under no legal compulsion to pay them.''

As is well known, the *Pollock* opinions attracted a great deal of criticism, not only from the four dissenters from the second *Pollock* opinion but in later majority opinions of the Court, which cast serious doubt on the conclusion in *Pollock* that taxes on income from property are direct taxes (and thus, ironically, on the need for the 16th Amendment). Indeed, the negative reaction to the holding in *Pollock* that an income tax is a direct tax requiring apportionment was so strong and widespread that as noted, the extraordinary step of overruling this holding by constitutional amendment was taken in 1913.

But the 16th Amendment did not repeal the Direct Tax Clauses' apportionment requirement for direct taxes, Congress having rejected explicit attempts to do so during the ratification process. And the Supreme Court after *Pollock* and after the ratification of the 16th

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Amendment continued to apply the Direct Tax Clauses, and in the process further refined the definition of ''direct tax.'' Thus, for example, in *Knowlton v. Moore*, a pre-16th Amendment case on which the proponents of the Proposed Wealth Tax focus, the Court in 1900 upheld an unapportioned federal ''succession'' tax on transfers of property at death, but did so explicitly on the ground that the tax was an indirect tax imposed on *transfers* of property at death rather than a direct tax imposed on the ownership of the property itself. The Court in *Knowlton* stated no fewer than three times that a tax ''imposed upon [real or personal] property solely by reason of its ownership'' is a direct tax that must be apportioned in order to be constitutional. In 1920, the Court in *Eisner v. Macomber* confirmed that these principles continued to apply after the 16th Amendment was ratified, stating that the proposition that ''taxation of property because of ownership . . . would require apportionment under the provisions of the Constitution, is settled beyond peradventure by previous decisions of this court.''

In *Bromley v. McCaughn*, the Supreme Court in 1929 held an unapportioned federal gift tax to be an indirect tax on transfers of property rather than a direct tax on the property itself, and further clarified the distinction between direct and other taxes. The Court in *Bromley* defined direct taxes to include ''taxes levied upon or collected from persons because of their general ownership of property'' and taxes that ''fall[] upon the [property] owner merely because he is owner, regardless of the use or disposition made of his property.'' Noting that it might be assumed that ''a tax levied upon all the uses to which property may be put, or upon the exercise of a single power indispensable to the enjoyment of all others over it, would be in effect a tax upon property, and hence a direct tax requiring apportionment,'' the Court held that the gift tax, being a tax on *transfers* of property by gift, was not such a tax but rather fell ''into that category of imposts or excises which, since they apply only to a limited exercise of property rights, have been deemed to be indirect and so valid although not apportioned.''

Under the principles established by cases such as *Knowlton* and *Bromley*, taxes imposed on transfers or other particular uses of real or personal property, such as estate and gift taxes on transfers of property at death or during one's life or excise taxes on the proceeds of a sale, lease, license, or other use of property, are considered indirect taxes that do not require apportionment. By contrast, taxes imposed on the owner of real or personal property solely because he or she is the owner of such property, without regard to any transfer or particular use of that property, are considered direct taxes that require apportionment unless they are imposed on ''incomes'' within the meaning of the 16th Amendment. In 2012, the Supreme Court in *National Federation*, citing *Pollock* and *Macomber* with approval but without mentioning *Knowlton* and *Bromley*, confirmed this distinction by noting that the ''recognized categor[ies] of direct tax'' are capitations and ''tax[es] on the ownership of land or personal property.''

Application of the Direct Tax Clauses to the Proposed Wealth Tax

The Proposed Wealth Tax would, if enacted, be an unapportioned direct tax not imposed on incomes, and therefore would be unconstitutional. It seems relatively uncomplicated to apply the above principles to the Proposed Wealth Tax, assuming it would be imposed annually at a specified rate (the Warren proposal is for a 2-3 percent rate) on the excess of a taxpayer's net worth (presumably defined as the excess of the fair market value of the taxpayer's assets over the face amount of the taxpayer's liabilities, as measured on a measuring date such as the end of each year) over a threshold amount. Putting aside the difficulty of administering any such tax, since such a tax would be imposed solely because the taxpayer owns the assets being valued, without regard to whether the taxpayer exercised a particular ownership right with respect to such assets such as transferring, leasing, or licensing the assets, the Proposed Wealth Tax would be distinguishable from the transfer taxes upheld in cases such as *Knowlton* and *Bromley* and would clearly be considered a direct tax as such term has been defined by the Supreme Court in such cases. Because the tax would not be apportioned and could in no sense be considered a tax on incomes within the meaning of the 16th Amendment, the Proposed Wealth Tax would, if enacted, be unconstitutional.

Evaluating the constitutional arguments made by supporters of the Proposed Wealth Tax. Prior to the Supreme Court's 2012 decision in *National Federation*, scholars (including certain of the signers of the Supporting Letters) defending the constitutionality of a federal wealth tax had questioned the continuing vitality of the Direct Tax Clauses in light of their provenance as part of the infamous three-fifths compromise at the founding involving the status of slaves as well as the transformative nature of the 13th-16th Amendments. See, e.g., Bruce Ackerman, *Taxation and the Constitution*, 99 Colum. L. Rev. 1 (1999); Calvin H. Johnson, *Apportionment of Direct Taxes: The Foul-Up in the Core of the Constitution*, 7 Wm. & Mary Bill Rts. J. 1 (1998). The Supreme Court in *National Federation*, however, dashed these hopes by confirming in 2012 that the Direct Tax Clauses continue to require that direct taxes that are not imposed on incomes within the meaning of the 16th Amendment must be apportioned, stating that the Direct Tax Clauses ''mean[] that any 'direct Tax' must be apportioned so that each State pays in proportion to its population'' and that ''a direct tax . . . must be apportioned among the several States.''

Once the Supreme Court in *National Federation* had reaffirmed the continuing vitality of the Direct Tax Clauses, proponents of a federal wealth tax shifted their focus to arguing that such a tax would not be a direct tax. For a recent, thoughtful, and influential example of this approach, see Dawn Johnsen & Walter Dellinger, *The Constitutionality of a National Wealth Tax*, 93 Ind. L. J. 111 (2018) (hereinafter, ''Johnsen & Dellinger'').

Thus, the first Supporting Letter, which is signed by 6 law professors including Bruce Ackerman, argues that the Proposed Wealth Tax would be ''plainly constitutional'' on the basis of the interplay among *Pollock*, *Knowlton*, and the 16th Amendment. Taking the view that *Knowlton* ''dramatically narrowed the scope'' of *Pollock* by holding that ''an inheritance tax that directly hit the property itself'' was not a direct tax, the letter argues that it was because *Knowlton* had so ''sharply cut back on [*Pollock's*] broad interpretation of 'direct' taxation'' that the framers of the 16th Amendment found it sufficient to ''correct the Court's blunder with a narrow

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amendment focused on the income tax'' rather than to repeal the Direct Tax Clauses outright. From this, the letter concludes that ''[g]iven *Knowlton's* role in framing the debate surrounding the passage of the Sixteenth Amendment, no thoughtful 'originalist' can conclude that *Pollock's dicta*, announcing a broad reading of the 'direct' taxation clause, has survived the constitutional decision by the American People to repudiate *Pollock* in 1913.''

This author, whether or not a ''thoughtful originalist,'' begs to differ. To be sure, the Supreme Court in post-*Pollock* cases such as *Knowlton* ''narrowed the scope'' of *Pollock* by calling into question the holding in *Pollock* that an income tax is a direct tax, a holding that was in any event overruled by the 16th Amendment. But to find that an *income tax* is not a direct tax is neither to abandon Pollock's general approach to direct taxes nor to embrace the principles enunciated in *Hylton* that a tax that cannot be justly or sensibly apportioned is not a direct tax, and the Court in *Knowlton* and later cases did no such thing. To the contrary, the Court in these cases *followed* the general approach of *Pollock* and distinguished between indirect taxes on transfers or other uses of property and direct taxes on the owner of property solely because he or she owned the property, holding that inheritance and gift taxes are taxes on transfers of property and thus are indirect taxes not subject to the apportionment requirement.

Thus, the superficial similarity noted in the first Supporting Letter between an inheritance tax such as that upheld in *Knowlton* and a wealth tax—both taxes are *computed by reference to* the value of the property—does not mean that the two taxes are *imposed on the ownership of* the property or require that they be treated as equivalent for constitutional purposes: An inheritance tax is as noted imposed on transfers of property and thus is not a direct tax, whereas a wealth tax is imposed not on transfers of property but rather on the owner of property solely because of his or her ownership and thus is clearly a direct tax under the principles enunciated in cases such as *Pollock*, *Knowlton,* and *Bromley*. Consequently, with all due respect to the signers of the first Supporting Letter, *Knowlton* is simply not authority for the constitutionality of a wealth tax, nor can its holding be cited as the reason the 16th Amendment did not, as some of its proponents wished, repeal the Direct Tax Clauses outright.

The second Supporting Letter, signed by 11 law professors including the authors of Johnsen & Dellinger and Laurence Tribe, states that the signers ''believe [the Proposed Wealth Tax] is constitutional.'' Referring the reader to the reasoning set out in Johnsen & Dellinger, the letter asserts that the Proposed Wealth Tax is not a direct tax because ''Constitutional text and history demonstrate that 'direct' tax is best interpreted as a narrow category that would not include a net worth tax.'' While a brief summary of Johnsen & Dellinger cannot of course do it full justice and a full critique of its arguments in support of its conclusion that an unapportioned federal wealth tax would be constitutional is beyond the scope of this discussion, the thrust of their argument is that the Court in *Pollock* and *Macomber* incorrectly repudiated the *Hylton* approach that taxes that cannot justly and reasonably be apportioned are not direct taxes, that *Pollock* and *Macomber* themselves were later repudiated, and that because an apportioned wealth tax would unjustly and absurdly require a higher tax rate in states with relatively low per capita wealth, such tax should not be considered a direct tax and therefore need not be apportioned in order to be constitutional.

While it is true that certain aspects of the Supreme Court's decisions in *Pollock* and *Macomber* have been repudiated or at least undermined by later cases (and, in the case of *Pollock*, overruled by the 16th Amendment), as demonstrated above the Court has never repudiated the general approach of *Pollock* and *Macomber* to direct taxes or the Court's deviation in those cases from the principle enunciated by some of the justices in *Hylton* that a tax that could not be sensibly or justly apportioned is not a direct tax, and indeed the Court has expressly confirmed this approach in cases such as *Knowlton*, *Bromley*, and *National Federation*. However anachronistic and unseemly the Direct Tax Clauses' limitation on Congress' power to tax may appear to some in light of its provenance, and however ironic and unjust it might seem to some that the Constitution requires that a wealth tax be imposed at higher rates in relatively less wealthy states, the fact remains that the Proposed Wealth Tax fits squarely within the Supreme Court's definition of direct taxes and is not a tax on incomes, and as a result would be unconstitutional unless it were apportioned.

Application of the Direct Tax Clauses to Certain Other Federal Taxes

Real property tax. Were Congress to impose a tax on the assessed value of a taxpayer's real property, such as the *ad valorem* real property taxes commonly imposed by municipalities, such a tax would fit squarely within virtually every accepted definition of direct tax, including that set forth by the Supreme Court in 2012 in *National Federation*. As a result, irrespective of the difficulty or perceived injustice and absurdity of apportioning a federal real property tax, an unapportioned federal real property tax would be unconstitutional.

Taxes on deemed sales such as the exit tax under IRC Section 877A. Rather than taxing the value of one's assets each year, suppose Congress were to impose a tax only on the appreciation in value of one's assets from one measuring date to another, that is, on a mark-to-market or deemed-sale basis. Congress has in fact enacted such taxes in limited circumstances, including the mark-to-market regime for futures contracts under IRC Section 1256, the mark-to-market regime for certain securities dealers under IRC Section 475 and the deemed-sale exit tax imposed on expatriates and certain others by reason of IRC Section 877A. Unlike a federal wealth tax, which as demonstrated above would be considered a direct tax and therefore would be unconstitutional unless it were apportioned, unapportioned deemed-sale taxes have a second bite at the constitutional apple: Even if such a tax were considered a direct tax, it would nonetheless be constitutional if it were considered to be imposed on ''incomes'' within the meaning of the 16th Amendment.

A full presentation of the argument that unapportioned deemed-sale taxes such as that imposed on expatriates and certain others by reason of IRC Section 877A are direct taxes that are not imposed on incomes and therefore are unconstitutional may be found in Mark E. Berg, *Bar the (Exit) Tax! Section 877A, the*

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Constitutional Prohibition Against Unapportioned Direct Taxes and the Realization Requirement, 65 Tax Lawyer 181 (2012), and Mark E. Berg, *Determining Which Taxes Are Prohibited Direct Taxes After NFIB*, 138 Tax Notes 205 (Jan. 14, 2013). (The IRC Section 877A exit tax on expatriates and others also raises additional constitutional objections including violations of the due process and equal protection guarantees and infringement of the fundamental right of a U.S. citizen to leave the country.) For present purposes, the following summary will suffice:

Prior to *National Federation*, it seemed clear that deemed-sale taxes such as the exit tax under IRC Section 877A would be considered direct taxes because they are imposed on one's property without regard to any actual transaction entered into with that property, on the basis of a deemed sale that did not actually occur. Given the distinction the Supreme Court has drawn between direct taxes imposed solely because one owns property and indirect taxes imposed on transfers or other uses of property, it seems axiomatic that Congress cannot eviscerate this distinction by transmuting a direct tax into an indirect tax through the expedient of deeming there to have been a transfer of property that did not in fact occur.

To be sure, the Court in *National Federation* held that a penalty-like exaction for failure to obtain health insurance is not a tax on the ownership of property and therefore is not a direct tax, and one could argue that if a penalty imposed for failure to obtain health insurance is not a direct tax, a tax imposed on one who gives up U.S. citizenship or ceases to be a long-term U.S. green card holder is also not a direct tax. But the Court in *National Federation* did not disturb the distinction it has long drawn in cases such as *Pollock*, *Macomber*, *Knowlton*, and *Bromley* between direct and indirect taxes, which looks not to whether the taxpayer had engaged in any activity at all, but rather to whether the taxpayer did something with the property being taxed, such as used it, transferred it, or sold it, and indeed, the Court in *National Federation* cited *Pollock* and *Macomber* with approval in the context of their general approach to defining direct taxes.

Viewed in this light, a mark-to-market, deemed-sale tax, whether imposed across the board on every taxpayer having property that has appreciated above its value on an earlier measuring date or imposed only in limited circumstances such as expatriation, is properly considered a direct tax as it is imposed irrespective of whether the taxpayer transferred or otherwise used the property. (That the exit tax under IRC Section 877A is imposed not only on an expatriate's personal property that he or she moves to a location outside the U.S. but also on his or her real property located in the U.S., real property located outside the U.S. and personal property that is not moved in connection with the expatriation makes it clear that this tax is a direct tax imposed solely on the basis of ownership, and without regard to any particular transfer or other use of the property.)

As noted, even if an unapportioned tax is considered a direct tax, it can constitutionally be imposed if it is a tax on ''incomes'' within the meaning of the 16th Amendment. *Macomber*, an early case interpreting the 16th Amendment, is central to this question as well, having articulated what has become known as the realization principle. Under this principle, gain must be *realized* in order to be considered income within the meaning of the 16th Amendment, so that unrealized gain (*i.e.*, mere appreciation in value) does not, in the Court's words, ''answer[] the description.'' While the Supreme Court in the years since *Macomber* has refined the realization principle and identified categories of 16th Amendment income other than gain—such as accessions to wealth—to which the realization principle has less relevance, causing some commentators to conclude that the realization principle is no longer a constitutional requirement, the core teaching of *Macomber* that unrealized gain is not income within the meaning of the 16th Amendment has never been repudiated or overruled. *Cf. Helvering v. Independent Life Insurance Co.* (post-16th Amendment case in which the Supreme Court noted that a tax on deemed rental income from a building occupied by the owner would be a direct tax not imposed on incomes). As a result, while perhaps not quite as clear a case as a federal wealth or property tax, there is a very strong argument that an unapportioned federal deemed-sale tax such as that imposed by reason of IRC Section 877A is an unconstitutional direct tax that is not imposed on income.

The deemed-repatriation tax under IRC Section 965. Prior to the 2017 tax legislation, U.S. shareholders of a controlled foreign corporation (''CFC'') generally were not subject to tax on their shares of the CFC's active business income unless and until such income was repatriated to them in the form of dividends. Congress changed this longstanding rule in 2017 by enacting IRC Section 965, pursuant to which certain U.S. persons that are direct or indirect shareholders of specified non-U.S. corporations (including CFCs and certain other corporations) are required to include in their income for their taxable year that includes the last taxable year of the corporation that begins before Jan. 1, 2018, their pro rata shares of 100 percent of the previously deferred post-1986 foreign earnings of those corporations as if those amounts had been repatriated. Under IRC Section 965, those shareholders are subject to tax currently on those amounts at a reduced tax rate, but may elect to pay the tax over eight years. The legislative history of this provision suggests an intention to impose tax on a ''deemed repatriation'' of the corporation's prior earnings.

The tax imposed by reason of IRC Section 965 raises the constitutional issues addressed in this article because it is imposed on certain U.S. shareholders of foreign corporations not because of actual transactions engaged in by those shareholders on which they in fact realized income or gain—such as selling their shares or receiving actual distributions in respect of their shares—but rather on income they are *deemed* to have realized on a deemed repatriation of earnings (and, of course, the tax is not apportioned). For a full presentation of the argument that the tax imposed by reason of IRC Section 965 is an unapportioned direct tax not imposed on incomes and therefore is unconstitutional (as well as equal protection objections to such tax as applied in certain circumstances), see Mark E. Berg & Fred Feingold, *The Deemed Repatriation Tax—A Bridge Too Far?*, 158 Tax Notes 1345 (Mar. 5, 2018). The argument may be summarized as follows:

While *Macomber* has been held by lower courts (the Supreme Court has not addressed this issue) not to preclude the attribution of certain of a CFC's current earnings to its controlling U.S. shareholders under Subpart F, the income inclusion under IRC Section 965 is not

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limited to *current* earnings but rather can arise when the foreign corporation has accumulated earnings but no current earnings (and even where there are neither current nor accumulated earnings) and can require an income inclusion by non-controlling U.S. shareholders. As a result, IRC Section 965, unlike Subpart F, squarely raises the *Macomber* issue of whether any income has been realized and therefore may be constitutionally taxed.

As noted above, it is self-evident that Congress cannot by fiat eviscerate both the distinction between direct and indirect taxes and the language of the 16th Amendment by legislatively deeming both the occurrence of the transaction that causes the tax to be considered an indirect tax and the realization of the income that causes the tax to be permitted by the 16th Amendment. Rather, there must be some rational basis for deeming the relevant event to have occurred. The furthest the courts appear to have gone in this regard is the U.S. Tax Court's opinion in *Dougherty v. Commissioner*, in which the court found a combination of the CFC's investment in U.S. property in the current year and the U.S. shareholders' control over the CFC to be a rational basis for the deemed distribution of pre-enactment accumulated earnings under IRC Section 956.

IRC Section 965 has ventured well beyond the limits of *Dougherty*, there being no actual event in the current year, however tangentially related to the deeming of a distribution by the foreign corporation, that could be said to provide a rational basis for the deemed repatriation. This leaves defenders of the tax imposed by reason of IRC Section 965 with the argument that, at least where the tax is imposed on controlling U.S. shareholders, the tax is justified as a means to combat the perceived abuse from the retention by non-U.S. corporations of their deferred earnings rather than distributing them to their U.S. shareholders. But control by U.S. shareholders, even coupled with perceived abuse, has not been considered a sufficient rational basis for a deemed distribution of accumulated profits, any more than a taxpayer's control over other property owned by the taxpayer has been considered a sufficient rational basis for a deemed sale of that property. As a result, there is a very strong argument that the deemed-repatriation tax imposed by reason of IRC Section 965 is an unconstitutional direct tax that is not imposed on income.

Conclusion

For the reasons discussed above, the Proposed Wealth Tax fits squarely within the definition of ''direct tax'' as articulated by the Supreme Court over the last 120-plus years, including as recently as 2012, and is unquestionably neither ''apportioned'' nor imposed on ''incomes'' within the meaning of the 16th Amendment. As a result, the Proposed Wealth Tax would, if enacted, violate the Direct Tax Clauses and therefore be unconstitutional. Other recently enacted federal taxes that are imposed on the basis of transactions that are deemed to occur but do not actually occur, such as the deemed-repatriation tax under IRC Section 965, enacted in 2017, and the deemed-sale exit tax on expatriates and certain others under IRC Section 877A, enacted in 2008, also squarely implicate the Direct Tax Clauses and thus are vulnerable to challenge under these as well as other provisions of the Constitution. Given the large amounts potentially at stake, particularly in the case of the Proposed Wealth Tax (which as noted has been estimated to yield revenues of $2.75 trillion over 10 years) and the deemed-repatriation tax under IRC Section 965 (which the Joint Committee on Taxation projected will yield nearly $340 billion in revenues over the next 10 years), it seems inevitable that the constitutionality of these taxes will be challenged and that the courts will be called on to determine whether Congress has exceeded the limits of its broad taxing power.

Mark E. Berg is a partner in Feingold & Alpert, L.L.P., a New York City law firm that concentrates its practice on federal, international, state and local tax and related fiscal matters. *The author gratefully acknowledges the invaluable comments of his partner Fred Feingold.*

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