What is Income?

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- How do you define income?
- Can the United States tax you for gains you haven't received yet?
- If the United States can tax the Moores for profits an Indian company reinvested in themselves, what else could they tax you for?

There are certain words that are so commonly used we think they have a universal understanding. One of those words is "income". Think about it, what is income? Your paycheck? Dividends on your investments? Profits from your business? When does an increase in the value of something you own become "income"? The answer to that question is important to more than just the parties in the case Moore v. United States, but to just about every American. Can the United States tax, as income, the value of something you have not sold yet?

The Income Tax

Before 1913 and the ratification of the Sixteenth Amendment, the United States had no reason to care how much money you made and what you did with it. The Framers of the Constitution placed the states between the people and the United States when it came to taxes.

Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers, U.S. Constitution, Article I, Section 2, Clause 3

While there were multiple attempts to institute an income tax from the mid-19th century to the early 20th century, it wasn't until 1913 and the Sixteenth Amendment that the United States was legally allowed to create one.

The Congress shall have power 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.

U.S. Constitution, Amendment XVI

For the first time in our history, Congress had the power to directly tax the American people. However, this was limited to taxes on income.

What is Income?

As I said at the opening, income is one of those words most people understand from its common usage.

a gain or recurrent benefit usually measured in money that derives from capital or labor

Income – Merriam-Webster Dictionary Online

As much as you may curse Tax Day, complain about the withholding on your paystub, or dream about abolishing the IRS, the states ratified the Sixteenth Amendment allowing Congress to directly collect taxes on your income. While federal politicians and bureaucrats have tried to tax wealth rather than income in the past, they have never succeeded. Not yet at least.

The word "income" is not an inkblot. "Income" was understood at the time of the Sixteenth Amendment's adoption to refer to gains coming into the taxpayer, like wages, rents, and dividends. Appreciation in the value of a home, a stock investment, or other property is not and never has been taxed as income. The reason is that a gain is not income unless and until it has been realized by the taxpayer. …

It is undisputed that the Petitioners realized nothing from their stock investment. They were taxed not because they had any income but because, in 2017, they happened to own shares in a corporation carrying retained earnings on its books.

This is a tax on the ownership of property. It therefore must be apportioned. …

The Court should reaffirm that there is no income without realization.

Moore v. United States – Oral Arguments

These words of Mr. Andrew Grossman, attorney for Charles Moore, seem to be pretty straightforward. As you would expect, the government of the United States has a different view of income.

The MRT is firmly grounded in the Sixteenth Amendment's text and history. The amendment allows Congress to impose taxes on incomes. That phrase had a well-established meaning drawn from numerous preratification income taxes that Congress enacted before this Court's decision in Pollock.

Several of those taxes were like the MRT in that they taxed shareholders on undistributed corporate earnings, including the income taxes in 1864, 1865, 1867, and 1870. And this Court upheld Congress's power to impose those taxes in Hubbard.

The Sixteenth Amendment's drafters, therefore, would have understood taxes on incomes to include taxes like the MRT.

Moore v. United States – Oral Arguments

Solicitor General Elizabeth Prelogar, arguing for the United States, claims that the MRT, or Mandatory Repatriation Tax, is grounded in the text and history of the Sixteenth Amendment. She points to several taxes that considered undistributed corporate earnings as income. However, each of the taxes she mentions predate the Sixteenth Amendment. She then claims that the drafters of that amendment would have understood income to include such unrealized gains. She claims that such “pass-through” taxation has been passed by Congress on several occasions, and that the courts have limited the case the plaintiffs are relying on, Macomber, to specific dividends.

A stock dividend, evincing merely a transfer of an accumulated surplus to the capital account of the corporation, takes nothing from the property of the corporation and adds nothing to that of the shareholder; a tax on such dividends is a tax an capital increase, and not on income, and, to be valid under the Constitution, such taxes must be apportioned according to population in the several states.

[Eisner v. Macomber]

Gen. Prelogar even makes an interesting claim:

Finally, the Court doesn’t actually need to resolve any fundamental questions in this case about whether the Sixteenth Amendment requires realization. The MRT taxes income that was actually realized by the foreign corporations, and Congress permissibly attributed the tax on that realized income to U.S. shareholders just as it has done in any number of pass-through taxes throughout our nation’s history. The Court could say only that and affirm.

[Moore v. United States – Oral Arguments]

It appears Gen. Prelogar doesn’t think the court needs to decide the question of realization because the tax being challenged is against income realized by a third party. To understand this, we need to learn a little more about corporations.

Corporations

While there are numerous forms of corporations, each with their own specific definitions and limitations, in general a corporation is:

an organization formed with state governmental approval to act as an artificial person to carry on business (or other activities), which can sue or be sued, and (unless it is non-profit) can issue shares of stock to raise funds with which to start a business or increase its capital.

Corporation – The Free Legal Dictionary

A corporation is a separate entity, an artificial person. The purpose of a corporation is to separate, and thereby shield, the owners from liability for the actions of this artificial person. For example, if a corporation makes a defective product, you don't sue the owners of the corporation, but the corporation itself. Similarly, when a corporation makes money it is not the shareholders who are taxed, but the corporation. At least, that's how it's supposed to work. In response to a question by Justice Thomas about "realized" gains, Gen. Prelogar said:

I think that this is a paradigmatic case of realization, Justice Thomas, insofar as the thing that's being taxed, the underlying tax base for the MRT, are the earnings that actually were – came into the corporation, the foreign corporation's coffers.

So the tax base here was the substantial ordinary business income that the foreign corporation generated through its operations in the foreign country and that has to date been subject to tax deferral.

That income has never been taxed at the corporate or entity level. Instead, what Congress did in the MRT is enact a pass-through tax that attributed the liability on that actual income that was realized to the U.S. shareholders.

Moore v. United States – Oral Arguments

I think what we're seeing here is the greed of Congress. Remember, the purpose of the Mandatory Repatriation Tax is to tax funds earned overseas back to the United States. In this case, the Moores invested in an Indian startup company known as KisanKraft in 2006. As I believe is common with many startups, the company's earnings were reinvested in the company. In other words, the Moores did not realize any income, since the earnings were reinvested in the company. Then, in 2018, under the recently passed MRT, the Moores were expected to pay taxes on the reinvested earnings going all the way back to their original investment. However, since the corporation in question is domiciled in India, not the United States, any earnings are taxed under Indian law. Since the income to a foreign corporation, for its operations in a foreign country, was subject to that country's tax deferrals, no taxes had been collected. Not only did Congress want to tax the Moores for income to a foreign corporation they had not received, they wanted to do so ex post facto, or after the fact, violating Article I, Section 9 clause 3 of the Constitution as well.

No Bill of Attainder or ex post facto Law shall be passed.

U.S. Constitution, Article I, Section 9, Clause 3

Conclusion

We'll have to wait for the justices' decision on this case, but this is what I've found so far. There are several issues with the Mandatory Repatriation Tax, or MRT.

First, the MRT taxes one party for the income of another. The entire purpose of a corporation is to separate the owners from the corporation for tax and legal purposes. If Congress can simply decide to breech that legal divide for whatever purpose they want, then corporations are useless.

Second is the apportionment problem. Since the Moores, as far as I know, did not receive any earnings from KisanKraft, they have no income to be taxed. Therefore, they are being taxed on the value of their property. Legally, how is this any different than you being taxed on the increase in value of your home or stock portfolio? The answer is, it isn't. This is a tax on the value of property, a wealth tax collected directly from the people, so it must be apportioned to the states under Article I, Section 2, Clause 3.

Lastly, since the legislation that created the MRT wishes to collected taxes on the increase in value of the Moores stocks since before the tax went into effect, it's an ex post facto law, and thereby a violation of Article I, Section 9 of the Constitution of the United States.

Why should you pay very close attention to this case? Because, as a direct tax on something other than income, a wrong opinion from the court could open up a deluge of new direct federal taxes on everything from your home, investments, even your childhood Baseball Card collection. Before you dismiss this last statement as fear mongering, remember both Bernie Sanders and Elizabeth Warren have called for wealth taxes at the federal level. While they claim these taxes would be limited to the very wealthy, remember the same was said about the income tax back in 1913. How has that worked out for the American people every April 15th?

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