

# Awaiting the Wealth Tax

December 13, 2023

Take-Away: We may soon learn if it is constitutional for Congress to tax unrealized appreciation, aka impose a *wealth tax*.

Background: Last week the U.S. Supreme Court heard oral arguments on the constitutionality of the 2017 Tax Act which contains a provision to tax unrealized capital gains. Interestingly enough, while the dispute is over a major constitutional issue, the amount in controversy is only \$14,729 taxes owed by a billionaire. The upshot of this Court decision will be whether the Constitution effectively prevents Congress from taxing stock holdings, real estate, and other types of accumulated wealth. This case stems from a provision in the 2017 Tax Act that aims to collect billions of dollars on earnings that are earned overseas and held by large multinational companies. The 2017 Tax Act's provision is called the 'mandatory repatriation tax.'

*Moore v. United States, 22-800:*

Facts: Charles and Kathleen Moore invested \$40,000 about two decades ago in a company called KisanKraft Machine Tools Private, Ltd., an Indian company that supplies tools and equipment to farmers. The Moores acquired 13% of the company's common shares. Over the years KisanKraft steadily grew. However, the company reinvested its earnings rather than distribute the earnings to its shareholders as dividends. Charles was a director of KisanKraft for five years. In addition, he received thousands of dollars in travel-reimbursement payments. Moreover, there were other transactions that suggest that Charles was more of an insider rather than a passive outside investor in the company, i.e., possibly he earned those financial benefits and not as a passive investor.

Dispute: Is it a *wealth tax*?

Taxpayer: The Moores contend that they cannot be taxed since they never realized any gain from their investment in KisanKraft. Specifically, the

Moore's claim that the Sixteenth Amendment to the Constitution, adopted in 1913, only gives a narrow power to Congress to levy an income tax, only on realized income, but not accumulated wealth. The Sixteenth Amendment authorizes Congress "*to lay and collect taxes on income, from whatever source derived, without apportionment among the several states.*"

Treasury: The Solicitor General, Elizabeth Prelogar, argues that the Court can uphold the mandatory repatriation tax without making any judgment on a hypothetical wealth tax. She quoted from a 1942 Supreme Court decision that the Court "*does not decide whether a tax may constitutionally be laid until it finds that Congress has laid it.*" In addition, she argues that "*a wealth tax, which would be levied on assets at a particular point in time, would be 'fundamentally distinct' from an income tax, which targets economic gains over a period of time.*" She contends that undistributed corporate earnings constitute *income* under the Sixteenth Amendment. In short, the Sixteenth Amendment does not use the word *realized* to qualify the word *income*.

Decision: It is expected that the Supreme Court will release its decision at the end of its term in late May or June 2024.

Observation: Both Senators Elizabeth Warren and Bernie Sanders have run for President pressing for the imposition of a wealth tax to address the government deficit. In President Biden's 2024 Budget he requested a 'billionaire minimum tax.' While the President has rejected the imposition of a flat *wealth tax*, his proposal is a bit scaled back from one, in that it would require a taxpayer worth more than \$100 million to pay a minimum of 25% on their capital gains each year, whether the taxpayer sold assets for profit (*realized* the gain) or continues to hold them (and did not *realize* the gain.)

Side Note: And just to make things even more interesting, one of the attorneys representing the Moores interviewed Justice Alito and then wrote a highly favorable article in the Wall Street Journal about the Justice. Democrats then

clamored for the Justice to recuse himself from the Moore case. The Justice issued his own statement in which he concludes “*there was nothing out of the ordinary about the interviews in question.*” Justice Alito participated in the oral arguments.

Conclusion: However the Justices decide this case, it will send shockwaves. Many other provisions of the Tax Code could be affected if the Court rules in favor of the Moores, leading to an avalanche of litigation. Conversely, a ruling against the Moores could also lead to a Democrat-controlled Congress to enact a *wealth tax* on billionaires, or maybe even millionaires. One thing for certain is that something is going to have to be done by way of revenue generation to deal with the deficit and the near-insolvency of Social Security and Medicare.