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The Economic Implications of *Moore v. United States*

Moore v. United States (henceforth referred to as *Moore*) is a legal case that challenges the constitutionality of the "transition tax" imposed with the change in the international tax system that was included in P.L. 115-97 (commonly called the Tax Cuts and Jobs Act or TCJA). The case is currently before the U.S. Supreme Court. The transition tax is levied on the undistributed profits accrued by U.S. controlled foreign corporations (CFCs) between 1986 and the end of 2017. The plaintiffs in the case argue that the taxation of unrealized income violates the Sixteenth Amendment's Apportionment Clause. This In Focus does not discuss the constitutional issues presented in *Moore*, but instead focuses on the economic implications presented by the case.

What Types of Income Could be Affected by *Moore*?

While the plaintiffs in *Moore* are asking for a narrow ruling about a specific tax provision, several long-standing tax provisions also tax unrealized income and could potentially be affected depending on the wording of a decision in favor of the plaintiffs. According to a letter from the Joint Committee on Taxation (JCT), the potentially affected provisions could be grouped into two broad categories: look-through realization and deemed realization.

Look-through realization provisions are those where the taxpayer is taxed on income received by an entity that is owned in full or in part by that taxpayer. The most common example is that partners are taxed on their share of partnership earnings even if earnings are not distributed to partners. If the court rules that taxpayers must either personally participate in a transaction or receive something of value in the tax year for the income to be taxable, look-through realizations provisions that could be impacted, according to the JCT, include Subpart F, Global Intangible Low Taxed Income (GILTI), Subchapter K (Partnerships), Subchapter S, and Real Estate Mortgage Investment Conduits (REMICs).

Deemed realization provisions are those where income is recognized for tax purposes but has not been received. They could be affected if the court rules that a transaction must actually occur or the taxpayer must receive something of value in the tax year for the income to be taxable. According to JCT, relevant deemed realization provisions could include the original issue discount rule and below-market and short-term loans, mark-to-market for securities dealers, mark-to-market for regulated futures contracts, imputed rental income, and Subchapter L mark-to-market for life insurance companies. In addition, JCT also identified the mark-to-market exit tax for expatriates as a deemed realization provision for income accrued in prior taxable years.

Economic Implications

If current tax rules are overturned by the decision, federal revenues would decline significantly. A recent study by Eric Toder of the Tax Policy Center (TPC) reported estimated revenues raised by some of these provisions for 2024 and 2028, some of which are cited below.

International Tax Provisions

Three provisions that fall in the look-through category affect the international tax system and involve the tax treatment of CFCs, which are foreign corporations that are owned at least 50% by U.S. persons that each own 10%. Prior to the TCJA, owners of CFCs were taxed on income when repatriated (paid as a dividend less a credit for income taxes imposed by foreign countries). The TCJA eliminated the tax on dividends and imposed a minimum tax aimed at income from intangibles, known as GILTI. The tax on GILTI is estimated by the TPC to raise $15 billion in 2024 and $27 billion in 2028 (as the tax rate increases).

Even before the TCJA changes, the United States, as with most other countries, had anti-abuse provisions (Subpart F) that taxed certain types of income that is easily shifted into low-tax countries. This provision has been in the tax law since 1962, and is estimated by the TPC to raise $8 billion in 2024 and $9 billion in 2028. The provisions before and after TCJA are explained in more detail in CRS Report R45186, *Issues in International Corporate Taxation: The 2017 Revision (P.L. 115-97)*, by Jane G. Gravelle and Donald J. Marples.

As part of the transition to the new system, there was a one-time tax at a lower rate on the accumulated unrepatriated income, which is the tax at issue in *Moore*. This tax was originally estimated to raise $346 billion, and could be paid in installments over eight years.

Passthrough Provisions: Partnership, Subchapter S, and REMIC

Passthrough businesses, unlike corporations, are not subject to tax at the entity level. Rather, all income is passed through and taxed to the owners. Passthrough businesses include sole proprietors, partnerships, and Subchapter S corporations (corporations with a limited number of shareholders that elect to be taxed as a passthrough). The owners of partnerships and S corporations are taxed on earnings even if all of the earnings are not distributed.

The TPC study estimated revenue from undistributed partnership and S corporation income at $37 billion in 2024 and $57 billion in 2028. Some of this revenue would be recouped as capital gain on the sale of interests in the business, which would offset these loses and lead to a net loss of $23 billion in 2024 and $39 billion in 2028. The study states that this is a conservative estimate because it may understate the share of partnership income that is retained.

REMICs are one of several ways of holding assets indirectly. Income from REMICs flows through to the shareholder to be taxed even if some of it is retained and reinvested. Other types of passthroughs, including Regulated Investment Companies (RICs, such as mutual funds) and Real Estate Investment Trusts (REITS) generally distribute all of their income to shareholders.

The TPC study did not provide estimates for REMICs. The Federal Reserve publishes data on the size of assets held by issuers of asset-backed securities that indicates about $900 billion of mortgage-backed securities (Table L127). Mortgage-backed securities are estimated to earn a rate of around 5%, suggesting interest income of around $45 billion. All of that interest, however, does not go to taxable entities, as many of the assets are held in tax-exempt retirement accounts.

Based on data from the National Income and Product Accounts (Table 7.11), individuals received $629 billion in interest income ($1,510 trillion in total personal interest income less $881 billion in imputed interest income), compared with $194 billion reported on individual tax returns. Applying the Congressional Budget Office's tax rate on interest of 27%, if all interest were retained, the cost is around $4 billion. Using the 10% retention rate for Subchapter S in the TPC study, the cost would be around $0.4 billion to $0.6 billion; using the share retained by corporations of about one-third of the cost would be $1.3 billion, but even this amount would be offset by a lower basis and increased capital gains.

Deemed Realization Provisions

These provisions include the imputed interest on original discount (zero coupon bonds, OID), imputation of interest for below-market rates, mark-to-market of assets for securities deals, imputation of rent for prepaid or deferred rent, mark-to-market for certain futures contracts, and the exit tax on accrued income for individuals who renounce their U.S. citizenship.

The TPC estimates that the OID provision increases revenue by $26 billion in 2024 and $39 billion in 2028. In present-value terms this amount is offset by the tax on redemption reducing the cost to $4 billion-$5 billion if taxed as ordinary income and $9 billion-$14 billion if taxed as a capital gain.

The JCT estimates that the cost of allowing 60% of the gain on Section 1256 (regulated futures) contracts as long-term gains is $2 billion. Assuming gains would otherwise be short term, that estimate implies that 60% of the income times the capital gains/ordinary income differential (0.17 at top rates), and applying a top ordinary rate of 37% leads to an estimated yield of $7.25 billion (0.37*2)/(0.6*0.17). This amount would be smaller if gains were eventually realized.

The new corporate alternative minimum tax might also be affected since some of the differences in tax base reflect timing and the base includes foreign source income.

Revenues and Behavioral Responses

The revenue losses associated with these provisions (around $100 billion for those estimated) would likely increase after considering behavioral responses. For example, there would be an incentive to locate more profits in low-tax countries, to retain more earnings in partnerships and Subchapter S corporations. Partnerships in particular could be used to extend tax relief to individuals, since control and asset ownership can easily be separated in a partnership.

The revenue and behavioral responses would also be affected depending on whether control affects whether deemed realization can occur. For example, a more than 50% owned foreign subsidiary may be taxed to the shareholder on income earned abroad while a minority shareholder may not. A control issue would also affect partnerships with a controlling partner and would presumably prevent sole proprietorships from taking on a minority partner to avoid the tax on retained earnings.

Interaction with the Proposed Global Minimum Tax, Pillar 2

Were GILTI and Subpart F invalided by a *Moore* decision, the United States could not conform to the OECD/G20 global minimum tax and could not tax income of foreign subsidiaries. As a result, the profits of U.S. controlled foreign subsidiaries could be taxed by other countries where their related foreign subsidiaries are located. See CRS Report R47174, *The Pillar 2 Global Minimum Tax: Implications for U.S. Tax Policy*, by Jane G. Gravelle and Mark P. Keightley for a discussion of Pillar 2.

Changes in the Tax Law

Some changes in the tax law might be used to recoup the lost revenues from finding certain laws invalid. For international operations, a return to the prior system where dividends are taxed when they are paid from a CFC to its U.S. parent is an option. The United States could also engage in more aggressive pursuit of profit shifting, for example, by limiting cost sharing as discussed in CRS In Focus IF12524, *Corporate Taxation: Profit Shifting, Transfer Pricing, and Cost Sharing*, by Jane G. Gravelle. Laws could also be enacted that disallow the deduction of interest that is not commensurate with the worldwide share of profits. Such a proposal was included in the House-passed version of the Build Back Better Act (H.R. 5376, 117th Congress).

Subchapter S provisions could be eliminated or the number of shareholders allowed significantly reduced. Large partnerships could be treated as corporations and taxed at the entity level. Alternatively, partnerships and Subchapter S corporations, as well as REMICs could be modeled on the treatment of RICs (mutual funds) where all earnings could technically be distributed but partners and shareholders could agree to a reinvestment of part of earnings.

The corporate alternative minimum tax could be modified by imposing it on a broadened taxable income.

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