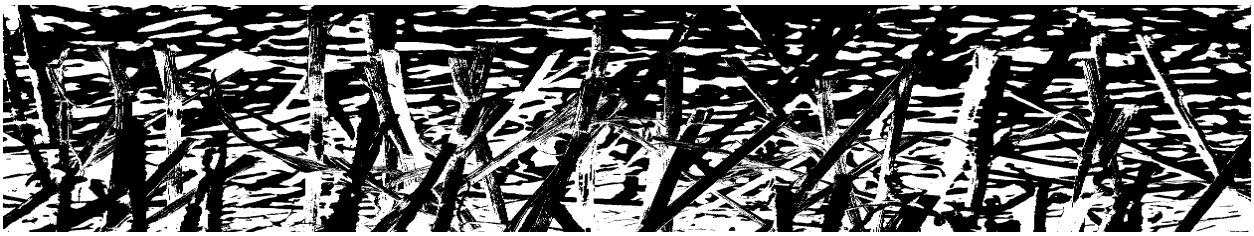

Jack Straw Fortnightly*

closeout

The Straw has been shall we say sporadic over the past couple of years, but we yet again have good intentions for the coming year, albeit vague, the road is paved,

and so we thought we might close out calendar 2024 with a brief look at some items we would have covered in more detail awhile back had we kept a bit more current.

At the end of seven comma one,[1] we mentioned that your correspondent had already written

> draft text discussing the Supreme Court decisions in *Moore* and *Connelly*, the denial of cert in Quinn, [and] the ongoing saga in *Jarrett*[,]

so let's start there. And probably finish there.

belated realization

By now most readers will have read much of what they care to read about the decision in *Moore*, and what it does or does not imply.

At issue was the "transition tax" under section 965, enacted as part of the 2017 tax bill, which imposes a one time excise on accumulated post-1986 deferred income held by a controlled foreign corporations.

Called a "transition tax" because starting in 2018, domestic corporations are to be allowed a dividends received deduction for distributions from their foreign subsidiaries.[2]

In effect, the tax is on a deemed repatriation of the post-1986 accumulations. Throughout the Court's opinion the phrase "mandatory repatriation tax" is used, though of course no actual repatriation need occur, which is part of what the Moores were ostensibly complaining about.

Of course the petitioners kind of gave away the game when they openly conceded in oral argument that their issue was not with subpart F as a whole, which already attributes income of controlled foreign corporations to their shareholders. Much in the manner of passthroughs from S corporations.

A majority of the Court ruled the transition tax is constitutional, rejecting the Moores' argument that

the 16th amendment requires at least what they termed "constructive realization."

Five justices joined in the opinion authored by Justice Kavanaugh, but Justice Jackson filed a separate concurring opinion,

> underscoring the point that the Court's 1919 opinion in *Macomber*, on which the taxpayers had relied, did not actually require that a taxpayer "be able to sever the gain from his original capital."[3]

At issue in *Macomber* was a stock dividend, and while there is quite a bit of language in the opinion about "realization," this is all technically what the lawyers call "dictum," not necessary to the holding.

Because a stock dividend is not an accession to wealth, realized or no.

a nonevent

In *Connelly v. IRS*, the taxpayer was seeking review of a decision of the 8th Circuit federal appeals court, affirming a district court order granting IRS summary judgment on the question

> whether proceeds of a policy of insurance on the life of a deceased shareholder in a closely held corporation, intended to fund a redemption of the decedent's stock, are includible in the estate tax value of the corporate stock, without offset for the liability.

This result was admittedly in conflict with the 2005 decision of the 11th Circuit federal appeals court in *Estate of Blount*, reversing a memorandum opinion of the Tax Court, but in opposing the petition for cert, the government argued not only that *Blount* was poorly reasoned, [4] but also that the petitioner's situation could easily have been avoided by better planning.

Which may be true, but that does not answer the question whether the corporation's obligation to redeem the decedent's stock should not offset the inclusion of the insurance proceeds in its value.[5]

Still, Jack did take the point that this is not a question that requires attention from the Court, and he anticipated the petition would be denied.

No such luck. Instead we ended up with a unanimous opinion authored by Justice Thomas that includes a closing footnote clouding the issue.

Along the way, Jack was dismayed to see an amicus brief filed by the Chamber of Commerce, which thankfully the Court altogether ignored, making an almost astonishingly disingenuous argument that the IRS' position in the case was not due any deference at all because, quote,

> [it] has shifted repeatedly over decades. The only apparent constant is that the IRS will pursue whichever position maximizes tax liability. That inconsistency undermines the plausibility of the agency's position and has deprived taxpayers of fair notice

and so on.

Jack says to accept the Chamber's argument would require that you not actually read any of the cited

decisions or distinguish among their quite varied facts.

Your correspondent was a co-presenter at a breakfast meeting of the local "tax study group" a few days after the decision came down. Excerpts from his contributions to the slide deck detailing the "bad facts" and analyzing the prior caselaw are posted to the Jack Straw landing page.

still dormant

In *Quinn v. Washington*, the taxpayers sought review of the opinion of a divided Washington state supreme court, reversing a trial court decision invalidating that state's recently enacted tax on capital gains in excess of 250k per year.[6]

The taxpayers had made three alternative arguments to the state supreme court, but only one raised a federal question which could serve as the basis for a writ of certiorari, and that was

> whether the state could impose the tax on transactions occurring outside the state, involving only "out-of-state property," that is, real property or tangible personal property.

A dormant commerce clause question.

A majority of the state supreme court found that the tax met all four requirements set by the Supreme Court in its 1977 opinion in *Complete Auto*, *i.e.*, that the tax

> (1) 'applied to an activity with a substantial nexus with the taxing State,
> (2) was 'fairly apportioned.
> (3) was nondiscriminatory with respect to interstate commerce, and
> (4) 'fairly related to the services provided by the State,'

Jack says the fourth criterion is almost a throwaway, as we are talking about imposing a tax on a resident of the state, and in fact the taxpayer had conceded this issue.

Some readers may recall that four years ago Jack had been hoping the Court would remand *Kaestner Trust* and *Fielding* for further briefing on the dormant commerce clause, see two comma six.

But Jack felt *Quinn* would not be a suitable vehicle for this discussion, he expected the Court to deny cert, and they did.

crypto night

In August 2023, the 6th Circuit federal appeals court affirmed the district court in dismissing as moot a taxpayer's claim for a refund of income tax he had paid on Tezos tokens he had received in a "staking" transaction.

Moot because the government had tendered a refund check rather than litigate the merits. We had discussed this case briefly in five comma three.

Within a few says after oral argument in the appeals court, but before the decision came down, IRS issued Rev. Rul. 2023-14, stating its position that

> [i]f a cash-method taxpayer stakes cryptocurrency native to a proof-of-stake blockchain and receives

> additional units of cryptocurrency as rewards when validation occurs, the fair market value of the validation rewards received is included in the taxpayer's gross income[,]

etc., citing *Glenshaw Glass*, to the effect that any "accession to wealth, clearly realized" is taxable as income.[7]

That word "realized" again.

So the Jarretts amended their 2020 return, claiming a refund, waited out the six months, and filed another petition in federal district court, this time citing the revenue ruling as a hedge against getting mooted out again.

At this writing, the government has not yet filed an answer.

Meanwhile, another taxpayer has filed a petition with the Tax Court to redetermine a deficiency assessed with respect to a series of "hard forks," which they say they did not "access" or "claim."

Most filings are not linked to the court's online docket, but we will try to follow this case as it develops.

particles

[1]

Strategically posted the fifth of November, election day, or if you prefer, Guy Fawkes Night.

[2]

Also enacted as part of the 2017 tax bill is section 951A, imposing on shareholders a tax on the "global intangible low-taxed income" of controlled foreign corporations, acronym GILTI,

to which presumably the Moores are also subject, but which for some reason they are not complaining about here.

Actually, Jack has an idea why they are choosing their targets, and the reader might reason to a similar conclusion by starting from the observation that the tax liability at issue here was only about 15k.

Anyway, this is as far as we are going to go down the substantive tax rabbit hole. Jack's focus is on the constitutional question.

[3]

The majority had dodged this point, see footnote 3 on page 12 of the opinion, and Justice Thomas in dissent, joined by Justice Gorsuch, had seized on it.

Justice Barrett, joined by Justice Alito, concurring in the result only, held open the question, saying the Moores had conceded the point.

So we do not as yet have an answer whether the Congress can tax wealth as such, or unrealized appreciation, see footnote 2 on page 8, which of course was indirectly the target here. But watch this space.

[4]

and that a 1999 decision from the 9th Circuit cited by the petitioner

as also supposedly in conflict is in fact not apposite,

[5]

In the particular case, the situation was potentially complicated by what the lawyers call "bad facts." These are detailed in the slide deck linked elsewhere in this newsletter.

But in order to reach the substantive question, each of the courts that dealt with this case pretended the insurance proceeds had in fact been paid out in exchange for the decedent's stock.

[6]

It might be noted here that the state of Washington does not have an income tax, in fact the state constitution forbids it.

The gains tax is styled as an excise on the sale transaction, albeit measured by the amount of the gain. The two judges dissenting from the majority opinion in the state court took the view that the gains tax is an income tax.

[7]

In the cited case, punitive damages awarded in a lawsuit.

she'll have fun til her daddy takes the T-bird away