

Macomber: We Can't Treat Domestic Shareholders as Partners

To the Editor:

In *Eisner v. Macomber*,¹ the Supreme Court stated that the government could not constitutionally tax the shareholders of Standard Oil either on a stock dividend (because it was a worthless piece of paper that did not distribute anything to the shareholders) “or” on the “accumulated profits behind it” — that is, the previously realized corporate operating income advertised, announced, or highlighted by the stock dividend, which also had not been actually distributed. The Court stated in the last paragraph of its opinion:

Thus, from every point of view we are brought irresistibly to the conclusion that neither under the Sixteenth Amendment nor otherwise has Congress power to tax without apportionment a true stock dividend made lawfully and in good faith, or the accumulated profits behind it, as income of the stockholder. The Revenue Act of 1916, in so far as it imposes a tax upon the stockholder because of such dividend, contravenes the provisions of article 1, section 2, cl. 3, and article 1, section 9, cl. 4, of the Constitution, and to this extent is invalid, notwithstanding the Sixteenth Amendment.

The opinion’s second holding appears to be a rejection of the government’s fallback argument that it could impute the corporation’s previously realized income to the shareholders, as if they were partners in a partnership. The Court held that “we cannot . . . treat the entire organization as unreal, look upon stockholders as partners, when they are not such.”²

The Court’s analysis of the requirements of the 16th Amendment concerning Standard Oil may not apply, however, to the mandatory repatriation tax, subpart F, or other situations involving

foreign-source income of a foreign corporation not subject, at the foreign corporate level, to any U.S. entity-level tax. The Court said that it was compelled to treat Standard Oil (a domestic corporation equivalent today to a C corporation) as separate from its shareholders to preserve the functioning of the two-tier corporate tax, once when income was realized by the entity and “additionally” (as the Court explained it) when it was distributed. If the corporation was viewed for tax purposes as an alter ego, agent, or nominee of the shareholder (like partnerships then and still, essentially, now), the second tax upon an actual distribution could not be imposed, “any more than if one’s money were to be removed from one pocket to another.”³

Those considerations — protecting or enforcing the two-tier tax system — do not apply at all to the foreign-source income of a foreign corporation (or the income reached by the mandatory repatriation tax or subpart F) that is ostensibly subject only to a single-level tax, only at the level of the “shareholder” (whatever form their units, certificates, or equity interests may have under local law). In this way, *Macomber* (which involved a domestic corporation) is entirely consistent with *Eder*⁴ or *Garlock*,⁵ which allowed current taxation of shareholders of foreign corporations with respect to their share of the income of the corporation that was generally not subject to current U.S. tax.

Thus, *Macomber* may stand, and still stand, for an important constitutional (not only statutory) “realization” requirement under the 16th Amendment, for shareholders of domestic corporations, but one that has no application to the mandatory repatriation tax, subpart F, or similar imputation regimes. *Macomber* certainly does not challenge the treatment of partnerships (foreign or domestic) that are not classified as C corporations under the applicable classification rules. The principles in *Macomber* also do not seem

³ *Id.*

⁴ *Eder v. Commissioner*, 138 F.2d 27 (2d Cir. 1943).

⁵ *Garlock Inc. v. Commissioner*, 489 F.2d 197 (2d Cir. 1973), *cert. denied*, 417 U.S. 911 (1974).

¹ *Eisner v. Macomber*, 252 U.S. 189 (1920).

² *Id.* at 214.

to be inconsistent with the accrual method or the original issue discount rules under which (unlike a potential future corporate dividend) there is a binding contract to pay an amount, even if it has not yet been paid in cash.⁶

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Sept. 5, 2023 ■

A One-Time Tax on Unrealized Gains Would Make Our System Fairer

To the Editor:

Opinions vary as to what constitutes a fair tax structure. At one extreme, many Republicans want a national sales tax, which would shift more of the burden to poor and middle-class taxpayers from those with high incomes and wealth. A more common view is that the tax system should take the same percentage of income from taxpayers at all income levels. Another view holds that higher-income people should pay a larger percentage since the next dollar of income is not nearly as valuable to them as it is to someone who is struggling to make ends meet.

Sen. Rick Scott, R-Fla., thinks that everyone should pay some federal income tax regardless of income. He evidently believes that the failure of nearly half of families to pay this tax due to low income is unfair. He apparently fails to consider several other taxes that the majority has to pay. These taxes, such as sales, property, gas, and payroll taxes, are regressive — that is, the lower your income becomes, the greater percentage of it you pay in these taxes. A study by Emmanuel Saez and Gabriel Zucman concluded that when all forms of taxation are considered, everyone pays approximately the same percentage of income in taxes.¹ This study has been widely accepted as the final word on tax burden.

A major problem with the conclusions of the Saez and Zucman study was revealed by ProPublica in 2021. New information revealed that Jeff Bezos paid no income tax from 2007 through 2011 while his wealth increased by billions. We already knew that Donald Trump was paying only \$750 a year while living a lavish lifestyle. What ProPublica revealed was that the extremely wealthy were not paying anywhere near their fair share in taxes. Since these people have great wealth, instead of selling assets and creating taxable gains, they borrowed on those assets to pay for their personal expenses because the interest cost was far less than the taxes would have been. However, there is an even larger

⁶The opinions expressed are solely the authors' and are not tax advice or advice of any kind.

¹Saez and Zucman, *The Triumph of Injustice: How the Rich Dodge Taxes and How to Make Them Pay* (2019).