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# A Transition to What? SCOTUS Set to Decide the Fate of IRC 965

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The U.S. Supreme Court (“SCOTUS”) has decided to hear a case (*Moore v. U.S.*, [No. 22-800](#)) where individual taxpayers owned shares in a controlled foreign corporation (“CFC”) and were subject to the so-called “transition tax” of IRC Sec. 965.



As many commenters have noted, the issue presented to SCOTUS is whether the transition tax represents an unconstitutional wealth tax.

For those who do not know, IRC Sec. 965 was created as part of the Tax Cuts and Jobs Act of 2017 (PL 115-97) and applies generally to U.S. taxpayers (both corporate and individual) who own 10% or more of the stock of a CFC as of December 31, 2017. This one-time tax was designed to make these taxpayers pay tax on their pro rata share of a CFC’s accumulated (and otherwise properly tax-deferred) earnings, but at a reduced rate of tax (15.5% on cash and other liquid assets and 8% on non-liquid assets – rates that were drafted in terms of corporate taxation but were able to be computed for individuals).

With this in mind, and given that the tax in question is called a transition tax, it is also important to understand to what the law transitioned. Conceptually, IRC Sec. 965 was designed to transition foreign corporations to a territorial tax system. This was achieved by: (a) disallowing indirect foreign tax credits for eligible corporate owners (changing IRC Sec. 902); and (b) not taxing dividends received from a foreign corporation by eligible corporate shareholders through the creation of a dividends received deduction (creating IRC Sec. 245A). As a result, in the context of a domestic parent and a foreign subsidiary, the income of the foreign subsidiary would “only” be taxed in the jurisdiction in which it was located (assuming other

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anti-deferral tax regimes, including GILTI as introduced in 2017, do not otherwise apply). As the changes in the law did not “transition” individual owners of foreign corporations to similar rules – remember, the transition tax was even written in the context of corporate tax rates – many commenters have questioned the Congressional intent in the context of individuals.

Based on the above, many individual taxpayers, such as the Moore’s in the case before SCOTUS, were subjected to the transition tax, and, in some situations, those individuals were unable to receive any cash from the foreign corporation in order to pay the tax due. This simple situation is a clear example of how the issue before SCOTUS can be phrased such that the transition tax is a form of wealth tax (as it can be argued that there was not a “realization event”, such as an actual distribution, yet there was taxation based on ownership of a company).

Putting aside the Constitutional, fairness and equitable arguments, an issue of which SCOTUS may not be aware, or may not consider in the analysis, is the administrative issues that may result from a determination that IRC Sec. 965 is unconstitutional. In this regard, finding IRC Sec 965 to be unconstitutional will raise the following questions (and many more):

- How many refund claims will arise? How much will have to be refunded (plus interest)?
- Are some or all of the refund claims barred by the statute of limitations? How will those taxes paid be treated?
- Should protective refund claims be filed?
- How will cash actually repatriated (which was repatriated tax-free after the application of IRC Sec. 965) be taxed?
- How will this impact filed and pending streamlined or other voluntary compliance submissions?
- How will this impact other aspects of the CFC taxation regime?
- How does this impact outbound tax planning for structures in the interim?
- Could this have an even broader impact on the U.S. Federal tax law?

As it is impossible to know how SCOTUS will rule, taxpayers and their advisors would be prudent to consider the potential impact of a ruling that IRC Sec. 965 is unconstitutional. We would be glad to discuss our views on the issues raised above if you have, may have, or are otherwise in need of assistance in this regard.

## Related People



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