

Wye Trust
 16 N Washington Street
 Easton, MD 21601
 Office 410-763-8543
 info@wyefinancial.com
 www.wyetrust.com



The limits of the taxing power

Under the U.S. Constitution, direct taxes must be apportioned among the states. An income tax is a direct tax, and the early attempts to create a federal income tax were declared unconstitutional as they were not apportioned. That’s why a constitutional amendment was needed to create today’s income tax regime. Indirect taxes, such as tariffs, which are passed along to consumers, do not need to be apportioned.

A new case is going to address the limits of the federal taxing power. According to The Wall Street Journal, Charles and Kathleen Moore invested \$40,000 in start-up company that provided better tools to subsistence farmers in India. The company was a huge success, but it reinvested all of its profits in expanding its market. The firm grew to hundreds of employees, thousands of dealers, and millions of customers. The Moores never received a financial return from their investment, but were more than pleased with the success of the company that they helped to fund. The growing success of the Indian farmers was their reward.

In the 2017 Tax Cuts and Jobs Act the taxation of multinational firms was reformed. One element of that change was the imposition of a one-time tax on accumulated foreign earnings. The Moores received a tax bill for \$15,000 on the accumulated but undistributed earnings from their investment.

The couple paid the bill and is suing for a refund. They argue that they have received no financial reward from their investment, no “income” as that term is used in the tax law, and therefore that \$15,000 was effectively a property tax, not an income tax. As such, it would have to be apportioned, and as it was not, the tax itself is unconstitutional.

This may seem like a minor transitory tax problem, as the 2017 imposition was a one-time event. However, should the Moores succeed it could be the death knell for such proposals as Senator Elizabeth Warren’s “wealth tax.” A tax on wealth is very different from a tax on income, and many observers have questioned the constitutionality of it. The Moore litigation may resolve that larger question.

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