1-11-2010

Retroactive Estate Tax: Can It Be Made Constitutional?

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Retroactive reimposition of the estate tax raises constitutional questions. After explaining his policy preference for retroactivity, Gans considers these constitutional questions. He then outlines a severability provision that Congress might consider adopting to minimize the risk that retroactivity would be found unconstitutional.

Under legislation enacted in 2001, the estate tax is repealed for individuals dying during 2010. On January 1, 2011, this legislation sunsets, and the estate tax becomes fully operative once again. In the absence of new legislation, a person dying with great wealth in 2010 escapes the estate tax, whereas a person with similar wealth dying in 2009 or 2011 would be subject to the tax. It is difficult to justify that discrimination as a policy matter. *New York Times* columnist Paul Krugman wrote a critical blog post about the legislation shortly after its enactment, entitled ''Throwing Momma From the Train.'' In December 2009 the House passed a bill that would retain the tax during 2010, freezing in place the rates and the exemption amounts that were effective during 2009. Unfortunately, the Senate adjourned at the end of the year without taking up estate tax legislation. It is widely anticipated that the Senate will consider legislation that would extend the tax into 2010 early in the new session. The question that many are asking is whether that legislation can constitutionally be made retroactive to the beginning of the year.

Bracketing the constitutional issue for the moment, I would favor a retroactive approach. To be sure, retroactivity could produce troubling results as a policy matter: A person who had arranged her affairs in reliance on the 2001 legislation and who died before the enactment of the new legislation would obviously be unable to modify her dispositive scheme. Simply put, planning embedded in a will followed by death produces a form of reliance that should not be cavalierly dismissed. Indeed, it is because reliance interests are so strong in this context that courts are reluctant to overrule estate-related precedent. But the inequity that results from permitting a person to escape the tax because of a ''fortuitous'' death in early 2010 is even more troubling. In other words, between these unappealing alternatives, I would choose equity over reliance. While, in the abstract, such a choice would be difficult to make, I find it easy in that I am skeptical about the depth of planning-related reliance on the 2001 legislation. Short of ''suicide in contemplation of repeal,'' planning built on the premise of repeal is likely to be intentionally designed to game the system without much nontax significance hanging in the balance.

My policy preference leads me directly to the constitutional question. I believe that while this question is not entirely free from doubt, Congress could design retroactive legislation that would likely be immune from constitutional attack.

I turn first to the last word from the Supreme Court on the constitutionality of retroactive taxation. In *United States v. Carlton*, 512 U.S. 26 (1994), an executor took advantage of a loophole inadvertently included in 1986 tax legislation. After the decedent's death, he purchased marketable securities on December 10, 1986, and immediately sold them two days later to the issuer's employee stock ownership plan for a price slightly less than cost. When he filed the estate tax return on December 29, 1986, he claimed a deduction under what was then section 2057 of the code in an amount equal to half of the sales proceeds. A few weeks later, on January 5, 1987, the IRS announced that, pending additional legislation, it would not permit such a deduction unless the decedent had owned the stock before death. In February 1987 a bill was introduced that would amend section 2057 to adopt the IRS's view. The senator who introduced the bill indicated that Congress never intended to permit the deduction based on such a postdeath acquisition of stock. On December 22, 1987, approximately one year after the transaction was consummated, Congress enacted the bill and made it retroactive to the date of the 1986 legislation. Not denying the transaction was undertaken for the purpose of taking advantage of the loophole, the executor argued the retroactivity provision was unconstitutional under the due process clause.

The Court rejected the executor's argument and upheld the retroactive application of the amendment. The majority reasoned that under the clause, retroactive legislation does have to satisfy a burden that is not imposed on prospective legislation. It said there must be a ''rational legislative purpose'' that justifies retroactivity. Finding in the circumstances such a legislative purpose, the majority found no constitutional violation. The executor relied on some earlier cases — so-called *Lochner*-era cases — in which the Court had subjected economic legislation to exacting review. The majority first pointed out that the Court no longer applies such an exacting standard of review in the case of economic legislation. It then, most critically, emphasized that the cases have been limited to the retroactive imposition of a ''wholly new tax.'' In *Carlton*, by contrast, the amendment was simply an adjustment to the preexisting estate tax. The majority also emphasized that the period of retroactivity was of modest duration and that Congress was merely trying to fix a mistake that would otherwise cost $7 billion in lost revenue, which was 20 times more than Congress had anticipated.

In his concurring opinion, Justice Antonin Scalia, joined by Justice Clarence Thomas, made his now-familiar argument that substantive due process is an oxymoron. On this view, the due process clause should not be used to strike down legislation that is substantively unfair. It should instead be confined to cases in which process rights are violated (for example, a person is deprived of property without a hearing). And, of course, the putative deficiency in retroactive taxation is substantive, not procedural. But at the same time, not surprisingly, Justice Scalia acknowledged his distaste for what he called ''bait-and-switch taxation'' — a policy-based objection to the substantive nature of the legislation. In cases involving retroactive taxation, conservative jurists understandably face a difficult choice: acknowledging that the concept of substantive due process has content (which would have implications in terms of personal rights, like abortion or the criminalization of sex between same-sex couples) or instead allowing economic rights to be taken away unfairly (which, as the jurisprudence under the takings clause reflects, is the subject of considerable conservative resistance).

In any event, what does *Carlton* suggest about the constitutional prospects of a retroactive estate tax? It is clear that, as in *Carlton*, early enactment of the legislation would weigh in its favor. But *Carlton* would be distinguishable in important respects. First, unlike in *Carlton*, repeal of the estate tax under the 2001 legislation was not an oversight resulting in a loophole capable of producing an unanticipated loss of substantial revenue. Quite the contrary, Congress in 2001 carefully examined the cost of repeal and made a deliberate choice. Second, in terms of reliance, a person who writes a will based on an understanding about the tax law and then dies is in a vastly different position from the executor in *Carlton*, who after the decedent's death purchased and then sold securities for approximately the same price in order to exploit Congress's drafting error. Third, and most important, the Court in *Carlton* left intact the notion that the retroactive imposition of a ''wholly new tax'' is constitutionally problematic.

Unlike the amendment in *Carlton*, a retroactive imposition of the estate tax might well be seen as a constitutionally defective *new* tax. Indeed, the earlier cases cited in *Carlton* for the new tax principle involved the retroactive imposition of the gift tax. In *United States v. Darusmont*, 449 U.S. 292 (1981), the Court, in explaining these earlier cases, emphasized that the gift tax legislation was not enacted until after the donor had vested ownership in the donee and had surrendered all rights. The question, of course, is whether a retroactive imposition of the estate tax would be viewed by the Court as a new tax given that it was effective in 2009 and will, under current law, become effective again in 2011. The outcome is difficult to predict. Nonetheless, it would not be difficult to imagine a decision striking down retroactive estate tax legislation on the grounds that it imposed a new tax, with the Court analogizing to the earlier gift tax cases and the vested ownership analysis. Indeed, given the distaste for retroactive taxation reflected in Justice Scalia's opinion, it would not be surprising if even he — along with his conservative colleagues — were to conclude, despite the discomfort with substantive due process, that precedent required a rejection of retroactive application of the estate tax on the grounds that it constituted a new tax.

Given this uncertainty, what might Congress do to improve the prospects of retroactive estate tax legislation? The most difficult hurdle for it under the *Carlton* framework is the new tax concept. If this concept could be sidestepped, the probability that the legislation would pass muster would be greatly increased.

To this end, consider the inclusion of a severability provision in retroactive estate tax legislation that would subject the legatee to an income tax on the inheritance if the estate tax were determined to be unconstitutional. More specifically, the legislation could provide that in the event of such a determination, a legatee would not be permitted to exclude the inheritance from income under section 102 of the code. Instead it would be taxed under section 61, just like any other item of income. Congress could even impose a special rate of tax on the legatee for the inheritance — equal to the estate tax rate — and could also provide that the tax would only apply if the decedent died with more than, say, $3.5 million in taxable estate. Making this amendment to section 102 retroactive to the beginning of the year should significantly undermine the constitutional argument inasmuch as it would simply adjust the preexisting income tax and would therefore not violate the new tax principle.

In sum, *Carlton*, as well as *Darusmont*, reflects a willingness to tolerate retroactive changes in the preexisting income tax. The severability provision suggested would offer the advantage of converting the constitutional analysis from a focus on a new transfer tax to a consideration of a change in the income tax. This shift in focus should make the legislation less vulnerable to constitutional attack and thereby make retroactivity more secure.