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# SUPREME COURT OF THE UNITED STATES

No. 92–1941

UNITED STATES, PETITIONER *v.* JERRY W. CARLTON

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

[June 13, 1994]

JUSTICE BLACKMUN delivered the opinion of the Court.

In 1987, Congress amended a provision of the federal estate tax statute by limiting the availability of a recently added deduction for the proceeds of sales of stock to employee stock-ownership plans (ESOPs). Congress provided that the amendment would apply retroactively, as if incorporated in the original deduction provision, which had been adopted in October 1986. The question presented by this case is whether the retroactive application of the amendment violates the Due Process Clause of the Fifth Amendment.

Congress effected major revisions of the Internal Revenue Code in the Tax Reform Act of 1986, 100 Stat. 2085. One of those revisions was the addition of a new estate tax provision applicable to any estate that filed a timely return after the date of the Act, October 22, 1986. The new provision, codified as 26 U. S. C. §2057 (1982 ed., Supp. IV),[1] granted a deduction for half the proceeds of "any sale of employer securities by the executor of an estate" to

[1]Section 2057 was repealed for estates of decedents who died after December 19, 1989. See Omnibus Budget Reconciliation Act of 1989, §7304(a), 103 Stat. 2352.

"an employee stock ownership plan." §2057(b).[2] In order to qualify for the deduction, the sale of securities had to be made "before the date on which the [estate tax] return . . . [was] required to be filed (including any extensions)." §2057(c)(1).

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[2]Section 2057(e) defined "employer securities" by reference to §409(*l*) of the Code, which in turn defined the term generally as "common stock issued by the employer (or by a corporation which is a member of the same controlled group) which is readily tradable on an established securities market." 26 U. S. C. §409(*l*)(1) (1982 ed., Supp. IV).

Respondent Jerry W. Carlton, the executor of the will of Willametta K. Day, deceased, sought to utilize the §2057 deduction. Day died on September 29, 1985. Her estate tax return was due December 29, 1986 (after Carlton had obtained a 6-month filing extension). On December 10, 1986, Carlton used estate funds to purchase 1.5 million shares of MCI Communications Corporation for $11,206,000, at an average price of $7.47 per share. Two days later, Carlton sold the MCI stock to the MCI ESOP for $10,575,000, at an average price of $7.05 per share. The total sale price thus was $631,000 less than the purchase price. When Carlton filed the estate tax return on December 29, 1986, he claimed a deduction under §2057 of $5,287,000, for half the proceeds of the sale of the stock to the MCI ESOP. The deduction reduced the estate tax by $2,501,161. The parties have stipulated that Carlton engaged in the MCI stock transactions specifically to take advantage of the §2057 deduction.

On January 5, 1987, the Internal Revenue Service (IRS) announced that, "[p]ending the enactment of clarifying legislation," it would treat the §2057 deduction as available only to estates of decedents who owned the securities in question immediately before death. See IRS Notice 87–13, 1987–1 Cum. Bull. 432, 442. A bill to enact such an amendment to §2057 was introduced in each chamber of Congress on February 26, 1987. See 133 Cong. Rec. 4145 and 4293 (1987).

On December 22, 1987, the amendment to §2057 was enacted. As amended, the statute provided that, to qualify for the estate tax deduction, the securities sold to an ESOP must have been "directly owned" by the decedent "immediately before death." Omnibus Budget Reconciliation Act of 1987, §10411(a), 101 Stat. 1330–432.[3] The 1987 amendment was made

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[3]The amendment also required that employer securities

effective as if it had been contained in the statute as originally enacted in October 1986. §10411(b).

The IRS disallowed the deduction claimed by Carlton under §2057 on the ground that the MCI stock had not been owned by his decedent "immediately before death." Carlton paid the asserted estate tax deficiency, plus interest, filed a claim for refund, and instituted a refund action in the United States District Court for the Central District of California. He conceded that the estate did not qualify for the deduction under the 1987 amendment to §2057. He argued, however, that retroactive application of the 1987 amendment to the estate's 1986 transactions violated the Due Process Clause of the Fifth Amendment. The District Court rejected his argument and entered summary judgment in favor of the United States.

A divided panel of the Court of Appeals for the Ninth Circuit reversed. 972 F. 2d 1051 (1992). The majority considered two factors paramount in determining whether retroactive application of a tax violates due process: whether the taxpayer had actual or constructive notice that the tax statute would be retroactively amended, and whether the taxpayer reasonably relied to his detriment on pre-amendment law. The court concluded that both factors rendered retroactive application of the amendment in this case unduly harsh and oppressive and therefore unconstitutional. Judge Norris dissented. In his view, the 1987 amendment was within the wide latitude of congressional authority to legislate retroactively in regulating economic activity. We granted certiorari, ___ U. S. ___ (1993).

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qualifying for the deduction must, after the sale, be allocated to participants or held for future allocation in accordance with certain rules.

This Court repeatedly has upheld retroactive tax legislation against a due process challenge. See, *e. g.*, *United States* v. *Hemme*, 476 U. S. 558 (1986); *United States* v. *Darusmont*, 449 U. S. 292 (1981); *Welch* v. *Henry*, 305 U. S. 134 (1938); *United States* v. *Hudson*, 299 U. S. 498 (1937); *Milliken* v. *United States*, 283 U. S. 15 (1931); *Cooper* v. *United States*, 280 U. S. 409 (1930). Some of its decisions have stated that the validity of a retroactive tax provision under the Due Process Clause depends upon whether "retroactive application is so harsh and oppressive as to transgress the constitutional limitation." *Welch* v. *Henry*, 305 U. S., at 147, quoted in *United States* v. *Hemme*, 476 U. S., at 568–569. The "harsh and oppressive" formulation, however, "does not differ from the prohibition against arbitrary and irrational legislation" that applies generally to enactments in the sphere of economic policy. *Pension Benefit Guaranty Corp.* v. *R. A. Gray & Co.*, 467 U. S. 717, 733 (1984). The due process standard to be applied to tax statutes with retroactive effect, therefore, is the same as that generally applicable to retroactive economic legislation:

> "Provided that the retroactive application of a statute is supported by a legitimate legislative purpose furthered by rational means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative and execu-

> tive branches . . . .
>
> "To be sure, . . . retroactive legislation does have to meet a burden not faced by legislation that has only future effects. . . . `The retroactive aspects of legislation, as well as the prospective aspects, must meet the test of due process, and the justifications for the latter may not suffice for the former' . . . . But that burden is met simply by showing that the retroactive application of the legislation is itself justified by a rational legislative purpose." *Id.*, at 729–730, quoting *Usery* v. *Turner Elkhorn Mining Co.*, 428 U. S. 1, 16–17 (1976).

There is little doubt that the 1987 amendment to §2057 was adopted as a curative measure. As enacted in October 1986, §2057 contained no requirement that the decedent have owned the stock in question to qualify for the ESOP proceeds deduction. As a result, any estate could claim the deduction simply by buying stock in the market and immediately reselling it to an ESOP, thereby obtaining a potentially dramatic reduction in (or even elimination of) the estate tax obligation.

It seems clear that Congress did not contemplate such broad applicability of the deduction when it originally adopted §2057. That provision was intended to create an "incentive for stockholders to sell their companies to their employees who helped them build the company rather than liquidate, sell to outsiders or have the corporation redeem their shares on behalf of existing shareholders." Joint Committee on Taxation, Tax Reform Proposals: Tax Treatment of Employee Stock Ownership Plans (ESOPs), 99th Cong., 2d Sess., 37 (Joint Comm. Print 1985); see also 132 Cong. Rec. 14,507 (1986) (statement of Sen. Long) (§2057 "allow[s] . . . an executor to reduce taxes on an estate by one-half by selling the decedent's company to an ESOP"). When Congress initially enacted §2057, it estimated a revenue loss

from the deduction of approximately $300 million over a 5-year period. See 133 Cong. Rec. 4145 (1987) (statement of Rep. Rostenkowski); *id.*, at 4293 (statement of Sen. Bentsen). It became evident shortly after passage of the 1986 Act, however, that the expected revenue loss under §2057 could be as much as $7 billion—over 20 times greater than anticipated—because the deduction was not limited to situations in which the decedent owned the securities immediately before death. *Ibid.* In introducing the amendment in February 1987, Senator Bentsen observed: "Congress did not intend for estates to be able to claim the deduction by virtue of purchasing stock in the market and simply reselling the stock to an ESOP . . . and Congress certainly did not anticipate a $7 billion revenue loss." *Id.*, at 4294. Without the amendment, Senator Bentsen stated, "taxpayers could qualify for the deductions by engaging in essentially sham transactions." *Ibid.*

We conclude that the 1987 amendment's retroactive application meets the requirements of due process. First, Congress' purpose in enacting the amendment was neither illegitimate nor arbitrary. Congress acted to correct what it reasonably viewed as a mistake in the original 1986 provision that would have created a significant and unanticipated revenue loss. There is no plausible contention that Congress acted with an improper motive, as by targeting estate representatives such as Carlton after deliberately inducing them to engage in ESOP transactions. Congress, of course, might have chosen to make up the unanticipated revenue loss through general prospective taxation, but that choice would have burdened equally "innocent" taxpayers. Instead, it decided to prevent the loss by denying the deduction to those who had made purely tax-motivated stock transfers. We cannot say that its decision was unreasonable.

Second, Congress acted promptly and established

only a modest period of retroactivity. This Court noted in *United States* v. *Darusmont*, 449 U. S., at 296, that Congress "almost without exception" has given general revenue statutes effective dates prior to the dates of actual enactment. This "customary congressional practice" generally has been "confined to short and limited periods required by the practicalities of producing national legislation." *Id.*, at 296–297. In *Welch* v. *Henry*, 305 U. S. 134 (1938), the Court upheld a Wisconsin income tax adopted in 1935 on dividends received in 1933. The Court stated that the "recent transactions" to which a tax law may be retroactively applied "must be taken to include the receipt of income during the year of the legislative session preceding that of its enactment." *Id.*, at 150. Here, the actual retroactive effect of the 1987 amendment extended for a period only slightly greater than one year. Moreover, the amendment was proposed by the IRS in January 1987 and by Congress in February 1987, within a few months of §2057's original enactment.

Respondent Carlton argues that the 1987 amendment violates due process because he specifically and detrimentally relied on the pre-amendment version of §2057 in engaging in the MCI stock transactions in December 1986. Although Carlton's reliance is uncontested—and the reading of the original statute on which he relied appears to have been correct—his reliance alone is insufficient to establish a constitutional violation. Tax legislation is not a promise, and a taxpayer has no vested right in the Internal Revenue Code. Justice Stone explained in *Welch* v. *Henry*, 305 U. S., at 146–147:

> "Taxation is neither a penalty imposed on the taxpayer nor a liability which he assumes by contract. It is but a way of apportioning the cost of government among those who in some measure are privileged to enjoy its benefits and must bear its burdens. Since no citizen enjoys

> immunity from that burden, its retroactive imposition does not necessarily infringe due process . . . ."

Moreover, the detrimental reliance principle is not limited to retroactive legislation. An entirely prospective change in the law may disturb the relied-upon expectations of individuals, but such a change would not be deemed therefore to be violative of due process.

Similarly, we do not consider respondent Carlton's lack of notice regarding the 1987 amendment to be dispositive. In *Welch* v. *Henry*, the Court upheld the retroactive imposition of a tax despite the absence of advance notice of the legislation. And in *Milliken* v. *United States*, the Court rejected a similar notice argument, declaring that a taxpayer "should be regarded as taking his chances of any increase in the tax burden which might result from carrying out the established policy of taxation." 283 U. S., at 23.

In holding the 1987 amendment unconstitutional, the Court of Appeals relied on this Court's decisions in *Nichols* v. *Coolidge*, 274 U. S. 531 (1927), *Blodgett* v. *Holden*, 275 U. S. 142 (1927), and *Untermyer* v. *Anderson*, 276 U. S. 440 (1928). Those cases were decided during an era characterized by exacting review of economic legislation under an approach that "has long since been discarded." *Ferguson* v. *Skrupa*, 372 U. S. 726, 730 (1963). To the extent that their authority survives, they do not control here. *Blodgett* and *Untermyer*, which involved the Nation's first gift tax, essentially have been limited to situations involving "the creation of a wholly new tax," and their "authority is of limited value in assessing the constitutionality of subsequent amendments that bring about certain changes in operation of the tax laws." *United States* v. *Hemme*, 476 U. S., at 568. *Nichols* involved a novel development in the estate tax which embraced a transfer that occurred 12 years earlier. The

amendment at issue here certainly is not properly characterized as a "wholly new tax," and its period of retroactive effect is limited. Nor do the above cases stand for the proposition that retroactivity is permitted with respect to income taxes, but prohibited with respect to gift and estate taxes. In *Hemme* and *Milliken*, this Court upheld retroactive features of gift and estate taxes.

In focusing exclusively on the taxpayer's notice and reliance, the Court of Appeals held the congressional enactment to an unduly strict standard. Because we conclude that retroactive application of the 1987 amendment to §2057 is rationally related to a legitimate legislative purpose, we conclude that the amendment as applied to Carlton's 1986 transactions is consistent with the Due Process Clause.

The judgment of the Court of Appeals is reversed.

*It is so ordered.*