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WOULD RETROACTIVE REINSTATEMENT OF THE FEDERAL ESTATE TAX BE CONSTITUTIONAL?

By Randy Spiro

The perfect storm for estate planning arrived on January 1, 2010 when the federal estate tax was repealed, but only for persons dying on and after January 1, 2010 but no later than December 31, 2010. Adding to the mystery is Senate Finance Committee Chairman Max Baucus' pledge that the Senate will pass a bill reinstating the tax, which legislation the House of Representatives previously passed on December 3, 2009. But would a retroactive reinstatement pass constitutional muster for persons dying on and after January 1, 2010 and before the date of the bill's passage and signing by the President?

In U.S. v Carlton, 512 U.S. 26 (1994), Mr. Carlton died on September 29, 1985. On December 10, 1986, his estate purchased shares of a corporation which it two days later sold to an ESOP. On December 29, 1986, the estate claimed a deduction on its estate tax return under IRC § 2057 for half the proceeds of the sale. But on January 5, 1987, the IRS announced that it would grant the deduction only when the securities were owned before the person's death and on December 22, 1987 an amendment to this effect was enacted and made effective as if it were contained in the statute enacted on October 1, 1986. The Supreme Court concluded that the retroactive amendment met the requirements of due process.

In Nationsbank of Texas, N.A. v. U.S., 269 F3d 1332 (Fed.Cir.2001) the U.S. Court of Appeals for the Federal Circuit dealt with the estate tax where the top rate dropped from 55% in 1992 to 50% in 1993. Mr. Garwood died in March 1993, but on August 10, 1993 President Clinton signed OBRA, a part of which increased the top rate to 55% and made it effective for persons dying on or after January 1, 1993. The court held this retroactive legislation survived several constitutional attacks, including under the due process clause of the Fifth Amendment.

In our case, the fact that the Senate would be completing a process started by the House prior to January 1, 2010 would be an argument in favor of constitutionality. But the fact that the estate tax was completely repealed on January 1, 2010 rather than merely having its rate lowered by 5% would be an argument against constitutionality.

The fact that the Supreme Court in *Carlton* was giving deference to Congress' attempt to clarify its prior legislative intent would be an argument that could be used to distinguish the holding in *Carlton* from a retroactive reinstatement in 2010. But in today's case, if the Senate acts quickly there will only be a modest period of retroactivity, which would bolster the argument that the retroactive legislation is constitutional.

It would be foolish to conclude that the *Carlton* and *Nationsbank* cases are controlling on the issue of constitutionality, but it would be equally foolish to believe that the Supreme Court will treat these cases as irrelevant. Rather, this situation presents an excellent law school exam question where there is merit on both sides. If the estate tax is retroactively reinstated, affected taxpayers will not find it amusing that Congress has created a great law school exam question.