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Retroactive Federal Tax Legislation and Due Process

Federal tax statutes [routinely](#) have effective dates that precede their dates of enactment. The Supreme Court has stated that this “[customary congressional practice](#)” generally “has been confined to short and limited periods required by the practicalities of producing national legislation.” Some taxpayers have challenged the [retroactive application](#) of federal tax legislation based on the Fifth Amendment’s [Due Process Clause](#).

Courts [generally](#) rely on the Supreme Court’s seminal decision from 1994, *United States v. Carlton*, to determine whether the retroactive application of tax legislation violates the Fifth Amendment’s Due Process Clause. In *Carlton*, the Court [upheld](#) a tax statute with a retroactive period slightly more than a year. Applying a two-part test, the Court held that the retroactive tax statute was consistent with the Due Process Clause because it (1) was “[rationally related to a legitimate legislative purpose](#)” and (2) had “[only a modest period of retroactivity](#).” While courts continue to apply the rational basis standard in the first part of the test, it is [unclear](#) whether the second part of the test, the “modest period” limitation, is a [dispositive factor](#).

This In Focus provides an overview of due process, summarizes *Carlton*, discusses due process arguments based on notice and reliance and the length of a retroactive period, and concludes with considerations for Congress.

Due Process

The Fifth Amendment’s [Due Process Clause](#) provides that “no person” shall “be deprived of life, liberty, or property, without due process of law.” The Supreme Court [has](#) long recognized that a statute that claims to tax can be “so arbitrary . . . that it was not the exertion of taxation but a confiscation of property.” The Court has established that the due process standard that applies to retroactive tax legislation [does not](#) focus “exclusively on” notice and reliance—whether a taxpayer had adequate notice of a tax statute’s retroactive application and whether a taxpayer detrimentally relied on federal tax laws prior to amendment. The [same](#) deferential rational basis review that is “generally applicable to retroactive economic legislation” applies to retroactive tax legislation. Accordingly, the Court “[repeatedly has upheld](#)” federal retroactive tax legislation against due process claims.

United States v. Carlton

In October 1986, Congress [amended](#) an [estate tax](#) provision, Internal Revenue Code (IRC) Section 2057, [to allow](#) estates to deduct half the proceeds from securities sales made by an executor to an [Employee Stock Ownership Plan](#) (ESOP). Under the 1986 statute, “any estate” [could](#) reduce, or potentially eliminate, its estate tax liability by buying securities and “immediately reselling [them] to an ESOP” before the estate tax return due date. By January 1987, the

Internal Revenue Service (IRS) [issued](#) a [notice](#) announcing that, pending legislation, the ESOP deduction would only be available to “estates of decedents who owned the securities in question immediately before death.” In February 1987, Members of Congress [introduced bills](#) restricting the ESOP deduction to that effect. Then, in December 1987, an [amendment](#) to the ESOP deduction was enacted [to limit](#) the deduction to securities sold to an ESOP that were “directly owned” by the decedent “immediately before death.” The 1987 amendment [was](#) retroactive to the [date](#) the ESOP deduction was originally enacted in October 1986.

In *Carlton*, an executor of an estate [sought](#) to take advantage of the new ESOP deduction. [He](#) bought 1.5 million shares of MCI Communications Corporation stock on December 10, 1986, for \$11,206,000 and sold the stock two days later to MCI’s ESOP for \$10,575,000. The [estate](#) then claimed a \$5,287,000 deduction on its estate tax return, which reduced its estate tax by \$2,501,161. The IRS [disallowed](#) the estate’s deduction based on the 1987 amendment. The estate paid the tax and filed an action [challenging](#) the retroactive application of the 1987 amendment on due process grounds.

When the case reached the Supreme Court, the Court [held](#) that the retroactive application of the 1987 amendment to the executor’s 1986 transaction was “consistent with the Due Process Clause” because it was “rationally related to a legitimate legislative purpose.” There [were](#) two main reasons why the Court upheld the 1987 amendment. First, the Court [determined](#) that “Congress’ purpose in enacting the amendment was neither illegitimate nor arbitrary.” The Court [concluded](#) that Congress was “correct[ing] what it reasonably viewed as a mistake in the original 1986 provision that would have created a significant and unanticipated revenue loss.” In the Court’s view, there [was](#) “no plausible contention” that Congress’s motive was “improper.” Congress’s [choice](#) to “target[] estate representatives” that engaged in “purely tax-motivated” transactions was not “unreasonable.” [Second](#), shortly after Congress learned of the tax savings strategy, there was a legislative fix with “only a modest period of retroactivity.” The Court [highlighted](#) that the 1987 amendment’s retroactive period was “slightly” more than one year and an amendment to the ESOP deduction was proposed by Congress a few months after the deduction’s enactment.

Notice and Reliance Arguments

In *Carlton*, the Supreme Court [rejected](#) a stricter due process standard for retroactive tax legislation that focuses “exclusively on . . . notice and reliance.” Persons with due process claims have [argued](#) that retroactive tax legislation should be invalidated if (1) they do not have “actual or constructive notice that [a] tax statute would be

retroactively amended” or (2) they “reasonably relied” on tax laws pre-amendment to their “detriment.” The Court has [explained](#) that these notice and detrimental reliance arguments are not dispositive in many tax contexts.

The Court [has concluded](#) that persons challenging retroactive tax legislation had received [notice when](#) legislative proposals debated by Congress included a retroactive effective date. In *Milliken v. United States*, a 1931 case concerning a due process challenge to a federal [gift tax](#) increase, the Supreme Court [stated](#) 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.” The Court in *Carlton* [stated](#) that “[t]ax legislation is not a promise, and a taxpayer has no vested right in the Internal Revenue Code.” In Fifth Amendment due process [challenges](#), the Court has also [looked](#) to its reasoning in *Welch v. Henry*, a 1938 case addressing a [Fourteenth Amendment](#) due process challenge to state tax legislation. The *Welch* Court [declared](#),

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.

Multiple Supreme Court cases [suggest](#) that taxpayers challenging a “wholly new tax” that is applied retroactively may have stronger due process claims. In the late 1920s, in *Blodgett v. Holden* and *Untermeyer v. Anderson*, the Court held that the retroactive application of the first gift tax was invalid under the Due Process Clause. In *Untermeyer*, the Court [concluded](#) that “[t]he taxpayer may justly demand to know when and how he becomes liable for taxes—he cannot foresee.” The Court [has](#) since limited the reach of *Untermeyer* and *Blodgett* because they were decided around the [early twentieth century](#) during the era in which the Court applied a heightened level of review to economic legislation.

Length of Retroactive Period Arguments

Retroactive tax statutes [typically](#) address a person’s current tax period or a tax period immediately preceding the current period. Taxpayers with due process claims have [long contended](#) that the length of a retroactive period can invalidate a tax statute. The Supreme Court [has](#) “consistently” held that an income tax statute that is retroactive to a date earlier in the current calendar year “does not *per se* violate the Due Process Clause of the Fifth Amendment.” In *Carlton*, the Court applied a two-part test to [conclude](#) that a tax statute with a retroactive period slightly over a year satisfied the Due Process Clause. The Court upheld the retroactive tax statute in *Carlton* [due to](#), in part, the statute’s “modest period of retroactivity.” It is [unclear](#) if or when the length of a retroactive period alone can trigger a due process violation.

In 2022, in *Moore v. United States*, taxpayers [challenged](#) the Mandatory Repatriation Tax (MRT) on the grounds that it violated the Constitution’s [Apportionment Clause](#) and the Fifth Amendment’s Due Process Clause in the U.S. Court

of Appeals for the Ninth Circuit (Ninth Circuit). In 2017, P.L. 115-97 (commonly referred to as the Tax Cuts and Jobs Act [TCJA]) [added](#) the “one-time, backward-looking” tax. The MRT [required](#) U.S. shareholders of “[specified foreign corporations](#)” to pay a tax on their pro-rata share of the corporation’s post-1986 untaxed foreign earnings as if the earnings were repatriated to the United States. Taxpayers [paid](#) the MRT when they filed their 2017 tax returns or elected to pay the tax in installments over eight years.

After “[assum\[ing\]](#)” the MRT was retroactive, the Ninth Circuit [held](#) that the MRT did not violate either the Apportionment Clause or the Due Process Clause. Applying the rational basis standard, the court [upheld](#) the MRT’s 30-year repatriation period on due process grounds because it fulfilled a “legitimate purpose by rational means.” The court [observed](#) that the TCJA made “significant change[s]” to the IRC’s international tax provisions. Based on those changes, U.S. shareholders of specified foreign corporations “[would have](#) been able to avoid taxation indefinitely on [their pro-rata share of] pre-2018 earnings.” The court [concluded](#) that the MRT served the legitimate purpose of preventing U.S. shareholders “from obtaining a windfall by never having to pay taxes on their offshore earnings.” The court [decided](#) that this legitimate purpose was achieved by rational means because the MRT “[accelerat\[ed\]](#) the effective repatriation date . . . to a [single repatriation] date following passage of the TCJA.”

In reaching its holding, the Ninth Circuit [reasoned](#) that the length of the retroactive period was not determinative. It [explained](#) that the taxpayers could not “cite a bright-line rule regarding how long ago a retroactive tax can apply because courts deferentially review tax legislation’s purpose on a case-by-case basis.” In the Ninth Circuit’s view, courts have [regarded](#) the period of retroactivity as “one, non-dispositive consideration.” The Ninth Circuit [cited](#) the 2015 decision of the U.S. Court of Appeals for the Federal Circuit in *GPX International Tire Corporation v. United States*, as an example. In *GPX*, the Federal Circuit [considered](#) the length of retroactivity as one of “five considerations” in determining whether retroactive countervailing duties violated the Due Process Clause.

Considerations for Congress

On appeal, in *Moore*, the Supreme Court [upheld](#) the Ninth Circuit’s ruling that the MRT did not violate the Apportionment Clause, but [declined](#) to address the Due Process Clause ruling because the taxpayers had not sought review on that issue. Absent further instruction from the Court, Fifth Amendment Due Process Clause challenges to federal retroactive tax legislation may have [viability](#), specifically in the context of [new taxes](#) and tax legislation with [extended periods of retroactivity](#). When drafting retroactive federal tax legislation, Congress might consider ensuring that the legislation is rationally related to a legitimate legislative purpose and reviewing whether a court has upheld analogous tax legislation with a similar retroactive period.

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