

No. 44766-5-II

COURT OF APPEALS, DIVISION II,
OF THE STATE OF WASHINGTON

SCOTT B. OSBORNE, Personal Representative of
the Estate of Barbara Hagyard Mesdag,

Respondent,

v.


THE DEPARTMENT OF REVENUE OF
THE STATE OF WASHINGTON,
Appellant.

BRIEF OF RESPONDENT

Mark W. Roberts, WSBA #16843
Robert B. Mitchell, WSBA #10874
Peter A. Talevich, WSBA #42644
Attorneys for Respondent
Scott B. Osborne

K&L GATES LLP
925 Fourth Avenue
Suite 2900
Seattle, WA 98104
(206) 623-7580

ORIGINAL

FILED
COURT OF APPEALS
DIVISION II
2013 SEP 17 AM 11:07
STATE OF WASHINGTON
BY  DEPUTY

P/m 9/17/13

TABLE OF CONTENTS

Introduction.....	1
Issues Presented	2
Statement of the Case.....	2
A. Facts.....	2
B. The Parties' Dispute	5
C. Legislative Developments	7
Argument	8
A. <i>Bracken</i> governs this case.	8
B. EHB 2075 does not change the result required by <i>Bracken</i>	10
C. If it would change the result in this case, EHB 2075 is unconstitutional as applied.	15
1. EHB 2075 purports to apply an excise tax to a <i>fictional</i> transfer, but only <i>real</i> transfers may be taxed.	16
2. If read to overturn <i>Bracken</i> , EHB 2075 violates the separation of powers doctrine.	20
3. EHB 2075 violates the Due Process Clause by taxing transactions that predate enactment of the standalone estate tax and by depriving individuals of vested rights.	27
4. EHB 2075 violates the constitutional prohibition upon impairment of contracts.....	36
5. Drawing a distinction between the assets of QTIP trusts and all other trusts violates equal protection principles.	39
D. <i>Bracken</i> was correctly decided.....	41
E. Osborne should be awarded his fees and costs.	49
Conclusion	49

TABLE OF AUTHORITIES

Cases

<i>Bates v. McLeod</i> , 11 Wn.2d 648, 120 P.2d 472 (1941)	29
<i>Beltzer v. United States</i> , 495 F.2d 211 (8th Cir. 1974).....	48
<i>Caritas Servs. Inc. v. Dep't of Social & Health Servs.</i> , 123 Wn.2d 391, 869 P.2d 28 (1994)	33, 35, 36, 37
<i>Carlstrom v. State</i> , 103 Wn.2d 391, 694 P.2d 1 (1985)	38
<i>Cerrillo v. Esparza</i> , 158 Wn.2d 194, 142 P.3d 155 (2006)	15
<i>Chase National Bank v. United States</i> , 278 U.S. 327, 49 S. Ct. 126, 73 L. Ed. 405 (1929)	46
<i>City of Tacoma v. O'Brien</i> , 85 Wn.2d 266, 534 P.2d 114 (1975)	passim
<i>Clemency v. State (In re Estate of Bracken)</i> , 175 Wn.2d 549, 290 P.3d 99 (2012)	passim
<i>Coolidge v. Long</i> , 282 U.S. 582, 51 S. Ct. 306, 75 L. Ed. 562 (1931)	34, 37
<i>Edwards v. Edwards</i> , 1 Wn. App. 67, 459 P.2d 422 (1969)	12
<i>Eisenbach v. Schneider</i> , 140 Wn. App. 641, 166 P.3d 858 (2007)	8
<i>Energy Reserves Grp., Inc. v. Kan. Power & Light Co.</i> , 459 U.S. 400, 103 S. Ct. 697, 74 L. Ed. 2d 569 (1983)	38

<i>Estate of Bonner v. United States</i> , 84 F.3d 196 (5th Cir. 1996).....	19
<i>Fernandez v. Wiener</i> , 326 U.S. 340 (1945)	passim
<i>Hale v. Wellpinit Sch. Dist.</i> , 165 Wn.2d 494, 198 P.3d 1021 (2009)	20
<i>In re Estate of Bodger</i> , 130 Cal. App. 2d 416, 279 P.2d 61 (1955).....	37
<i>In re Estate of Smith</i> , 40 Wn. App. 790, 700 P.2d 1181 (1985)	12, 18, 33
<i>In re F.D. Processing, Inc.</i> , 119 Wn.2d 452, 832 P.2d 1303 (1992)	35
<i>In re Garden City Med. Clinic, PA</i> , 137 P.3d 1058 (Kan. Ct. App. 2006).....	36
<i>In re Marriage of MacDonald</i> 104 Wn.2d 745, 709 P.2d 1196 (1985)	33
<i>In re McGrath's Estate</i> , 191 Wash.496, 71 P.2d 395 (1937), <i>cert. denied</i> , 303 U.S. 651 (1938)	passim
<i>In re Verchot's Estate</i> , 4 Wn.2d 574, 104 P.2d 490 (1940)	19
<i>Kilian v. Adkinson</i> , 147 Wn.2d 16, 50 P.3d 638 (2002)	15
<i>Lawson v. State</i> , 107 Wn.2d 444, 730 P.2d 1308 (1986)	35
<i>Levy v. Wardell</i> , 258 U.S. 542, 42 S. Ct. 395, 66 L. Ed. 758 (1922)	9

<i>Lummi Indian Nation v. State</i> , 170 Wn.2d 247, 241 P.3d 1220 (2010)	16, 25
<i>Lunsford v. Saberhagen Holdings</i> , 166 Wn.2d 264, 208 P.3d 1292 (2009)	43
<i>Misc v. Bldg. Serv. Emps. Health & Welfare Trust</i> , 789 F.2d 1374 (9th Cir. 1986).....	32
<i>Nichols v. Coolidge</i> , 274 U.S. 531, 47 S. Ct. 710, 71 L. Ed. 1184 (1927)	30
<i>Nw. Env. Defense Ctr. v. Brown</i> , -- F.3d --, No. 07-35266, 2013 WL 4618311 (9th Cir. Aug. 30, 2013).....	32
<i>Overton v. Econ. Assistance Auth.</i> , 96 Wn.2d 552, 637 P.2d 652 (1981)	20
<i>Port of Seattle v. Pollution Control Hearings Bd.</i> , 151 Wn.2d 568, 90 P.3d 659 (2004)	20
<i>Prentis v. Atl. Coast Line Co.</i> , 211 U.S. 210, 29 S. Ct. 67, 53 L. Ed. 150 (1908)	25
<i>Rio Rico Props., Inc. v. Santa Cruz County</i> , 834 P.2d 166 (Ariz. Tax Ct. 1992).....	35
<i>Schuchman v. Hoehn</i> , 119 Wn. App. 61, 79 P.3d 6 (2003)	40
<i>Snow's Mobile Homes, Inc. v. Morgan</i> , 80 Wn.2d 283, 494 P.2d 216 (1972)	41
<i>Sofie v. Fibreboard Corp.</i> , 112 Wn.2d 636, 771 P.2d 711, 780 P.2d 260 (1989)	25
<i>State ex rel. Dawes v. Wash. State Highway Comm'n</i> , 63 Wn.2d 34, 385 P.2d 376 (1963)	15

<i>State Highway Comm'n v. Pacific Nw. Bell Tel. Co.</i> , 59 Wn.2d 216, 367 P.2d 605 (1961)	23
<i>State v. Coria</i> , 120 Wn.2d 156, 839 P.2d 890 (1992)	40
<i>State v. Dunaway</i> , 109 Wn.2d 207, 743 P.2d 1237 (1987)	23
<i>State v. Maples</i> , 171 Wn. App. 44, 286 P.3d 386 (2012)	23
<i>State v. Marintorres</i> , 93 Wn. App. 442, 969 P.2d 501 (1999)	40, 41
<i>State v. Pac. Tel. & Tel. Co.</i> , 9 Wn.2d 11, 113 P.2d 542 (1941)	29
<i>Temple Univ. v. United States</i> , 769 F.2d 126 (3d Cir. 1985)	29
<i>Tesoro Ref. & Mktg. Co. v. Dep't of Revenue</i> , 173 Wn.2d 551, 269 P.3d 1013 (2012)	16, 33
<i>Tesoro Refining and Marketing Co. v. Department of Revenue</i> , 159 Wn. App. 104, 246 P.3d 211 (2010), <i>rev'd on other grounds</i> , 173 Wn.2d 551, 269 P.3d 1013 (2012)	32
<i>United States v. Carlton</i> , 512 U.S. 26, 114 S. Ct. 2018, 129 L. Ed. 2d 22 (1994)	passim
<i>United States v. Manufacturers National Bank of Detroit</i> , 363 U.S. 194, 80 S. Ct 1103, 4 L. Ed.2d 1158 (1960)	45, 46
<i>W.R. Grace & Co. v. Department of Revenue</i> , 137 Wn.2d 580, 973 P.2d 1011 (1999)	29
<i>Wash. State Farm Bureau Fed'n v. Gregoire</i> , 162 Wn.2d 284, 174 P.3d 1142 (2007)	20

<i>Wash. State Republican Party v. Pub. Disclosure Comm'n</i> , 141 Wn.2d 245, 4 P.3d 808 (2000)	16
<i>West v. Oklahoma Tax Commission</i> , 334 U.S. 717, 68 S. Ct. 1223, 92 L. Ed. 1676 (1948)	44, 45
<i>Willoughby v. Dep't of Labor & Indus.</i> , 147 Wn.2d 725, 57 P.3d 611 (2002)	35

Statutes

26 U.S.C. § 2044.....	4
26 U.S.C. § 2056(b)(7)	3
EHB 2075.....	passim
IRC § 2001	11
IRC § 2044.....	4, 13, 14, 44
IRC § 2056.....	13, 14, 47
RCW 4.84.185	49
RCW ch. 83.100.....	14, 48
RCW 83.100.020(10).....	14
RCW 83.100.020(11).....	11
RCW 83.100.047	13, 19
RCW 83.100.130	34, 35, 36
RCW 83.100.200	49

Other Authorities

HB 1920.....	7
Restatement (Third) of Trusts § 55(1), “Transfers at Death” (2003)	45

Rules

RAP 2.5..... 26
RAP 18.9..... 26, 49

Regulations

WAC 458-57-105..... 4
WAC 458-57-115..... 4

Constitutional Provisions

U.S. Const. art. I, § 10, cl. 1..... 36
U.S. Const., am. XIV 27
Wash. Const. art. I, § 3..... 27
Wash. Const. art. I, § 12..... 40
Wash. Const. art. I, § 23..... 36

INTRODUCTION

The Estate of Barbara Mesdag seeks a refund of Washington estate tax imposed upon property in a trust set up by Barbara's husband, Joseph. That trust was created and funded in 2002, three years before Washington enacted a standalone estate tax. The Washington Supreme Court ruled unanimously in *Clemency v. State (In re Estate of Bracken)*, 175 Wn.2d 549, 290 P.3d 99 (2012), that the State could not tax such property. But the Department of Revenue has resolutely refused to follow *Bracken*. The question in this case is whether it must.

The Department claims that it "did not err when it denied the Estate's refund claim" (Br., pp. 17-18) because, even though that denial was both contrary to the Department's regulations and illegal under *Bracken*, the Department's error has been "corrected" by the Legislature's recent enactment of a bill (EHB 2075) that purports to reverse *Bracken* and to negate the Department's regulations. The Department also argues that *Bracken* was wrongly decided and should be overruled.

Contrary to the Department's arguments, *Bracken* governs the disposition of this case. The legislation that the Department procured does not change that result. If the legislation is read as the Department urges, it is unconstitutional as applied and therefore invalid.

ISSUES PRESENTED

1. Does the Supreme Court's decision in *Bracken* require that the trial court's judgment be affirmed?
2. Should EHB 2075 be read consistently with *Bracken*?
3. If EHB 2075 is read to be inconsistent with *Bracken*,
 - (a) Does it violate the constitutional requirements for imposing an excise tax?
 - (b) Does it violate the separation of powers doctrine?
 - (c) Does it violate due process?
 - (d) Does it impair contracts?
 - (e) Does it violate equal protection principles?
4. Should *Bracken* be followed by this Court and, if further review is accepted, should it be reaffirmed by the Supreme Court?

STATEMENT OF THE CASE

A. Facts

On November 18, 1994, Joseph Blethen Mesdag ("Joseph") signed his last will. AR 1-8. Joseph left all of his community property to his wife, Barbara Hagyard Mesdag ("Barbara"). AR 1. Joseph established two testamentary trusts to hold and dispose of his separate property: a credit shelter trust and a marital deduction trust. AR 1-3. Joseph directed

that the income from both trusts be paid to Barbara during her lifetime.

AR 2. Upon Barbara's death, Joseph specified, the two trusts were to be jointly distributed to Children's Orthopedic Hospital, Virginia Mason Medical Foundation, Scripps Clinic and Research Foundation, and four nieces and nephews. AR 4-5.

Joseph died on April 27, 2002. CP 8, 29. His estate paid all federal and state taxes that were then due. CP 9, 29. The assets in the credit shelter trust were not subject to tax, as that trust was limited to the amount of the unified federal estate tax credit and the then-applicable state death tax credit. *See* AR 1. Joseph's estate made a Qualified Terminable Interest Property ("QTIP") election under 26 U.S.C. § 2056(b)(7) for the marital deduction trust. AR 31; CP 9, 29. As contemplated by Joseph's will, this qualified the assets in the marital deduction trust for the federal marital deduction and deferred federal estate tax on those assets until Barbara's death. *See* AR 3-4, 32. Joseph's estate did not make a similar election for Washington estate tax purposes, as the provision authorizing a Washington QTIP election was not added until 2005. CP 9, 29.

Barbara died on July 4, 2007. AR 51; CP 8, 29. Scott B. Osborne was appointed personal representative of her estate. AR 68. Barbara's estate timely filed a federal estate tax return and paid all the federal estate tax that was due. CP 9-10, 29-30. No federal estate tax was due or paid

on the assets in the credit shelter trust. *See* AR 137. Federal estate tax was paid, in accordance with 26 U.S.C. § 2044, on the assets in the marital deduction trust. CP 10, 28; *see* AR 120-163.

Barbara's estate timely filed a state tax return on October 6, 2008. AR 118-119; CP 10, 30. In accordance with WAC 458-57-115 (2007), entitled "Valuation of property, property subject to estate tax, and how to calculate the tax," Barbara's estate determined the Washington taxable estate on which Washington estate tax is imposed by making prescribed adjustments to the federal taxable estate.¹ As the regulations directed, Barbara's estate subtracted "any amount included in the federal taxable estate pursuant to IRC § 2044 (inclusion of amounts for which a federal QTIP election was previously made)." WAC 458-57-115(2)(d)(vi) (2007); *accord* WAC 458-57-105(3)(q)(vi) (2007).²

¹ "Federal taxable estate" and "Washington taxable estate" are defined in WAC 458-57-105(3)(g) and (3)(q) (2007), respectively. The cited rules, sometimes referred to as "the 2006 regulations" to reflect the year in which they were adopted, are reproduced in the Appendix at A-1 to A-5.

² In 2009 the regulations were amended to limit the subtraction to "any amount included in the federal taxable estate pursuant to IRC § 2044 (inclusion of amounts for which a federal QTIP election was previously made) from a predeceased spouse that died on or after May 17, 2005." (New language underscored.) *See Bracken*, 175 Wn.2d at 561 n.4. There is no contention that the 2009 amendments apply to Barbara's estate.

B. The Parties' Dispute

On December 11, 2008, the Department notified Barbara's estate that, in its view, the assets in the marital deduction trust established by Joseph in 2002 were subject to Washington estate tax and that Barbara's estate owed \$3,103,161.82 in tax and interest. AR 112. On February 26, 2010, Barbara's estate paid the Washington estate tax and interest sought by the Department, but under protest. AR 71-73. Three weeks later Barbara's estate sent the Department a letter and an amended return requesting a refund of Washington estate tax and interest. AR 89-101. On April 5, 2010, the Department denied the refund request with respect to assets in the marital deduction trust. AR 74-77.

On April 30, 2010, Osborne filed a petition for review of the Department's denial in Thurston County Superior Court. CP 4-24. The Department answered. CP 26-35. In August 2010 the parties jointly advised the court that "[a]n identical legal issue is being appealed to the Washington Supreme Court by the Estate of Sharon Bracken," and they asked for a stay pending the decision in that case. CP 37-39. On August 16, 2010, the court struck a scheduled merits hearing and stayed the case until the Washington Supreme Court disposed of the *Bracken* appeal. CP 40-41. Barbara's estate participated in that appeal as amicus curiae. *See Bracken*, 175 Wn.2d at 553.

The Supreme Court issued its decision in *Bracken* on October 18, 2012. The Court held that assets in a QTIP trust established before May 17, 2005, were not subject to state tax, because the standalone Washington estate tax was not in place when the transfer occurred and the tax was not intended to apply retroactively. *Id.* at 554, 575-76. The Court also noted that the Department's "2006 regulations were valid and were justifiably relied upon by the Estates." *Id.* at 570. Three justices concurred in the result on the basis that the regulations mean "that the state estate tax is computed wholly without regard to any federal QTIP election." *Id.* at 588 (Madsen, C.J., concurring and dissenting). The Department sought reconsideration, but the Supreme Court denied that motion on January 10 and issued its mandate on January 14, 2013. CP 48, 73.

The Department refused to stipulate to lifting the 2010 stay that had been entered in this case pending disposition of the *Bracken* appeal and refused to issue a refund. RP 5, 9; *see* CP 58-61. On February 15, 2013, Osborne moved for judgment on the pleadings. CP 42-53. The Department admitted in its opposition that *Bracken* was on all fours but argued that it was wrongly decided and that the Legislature should be given an opportunity to pass legislation to change its result. CP 55. On March 22, 2013, Thurston County Superior Court Judge Gary R. Tabor ordered the Department to "immediately refund to Osborne" the overpaid

Washington estate tax plus interest. CP 97; *see also* RP 15. The Department instead filed a notice of appeal on April 19, 2013. CP 99-105.

C. Legislative Developments

On February 18, 2013, HB 1920 was introduced in the Legislature by request of the Department. CP 76. Section 1 of HB 1920 recited that the Washington Supreme Court in *Bracken* had “narrowly construed the term ‘transfer’ as defined in the Washington estate tax code”; that “[t]he legislature finds that it is well established that the term ‘transfer’ as used in the federal estate tax code is construed broadly *Fernandez v. Wiener*, 326 U.S. 340, 352 (1945)”; and “[t]he legislature further finds that it is necessary to prevent the adverse fiscal impacts of the *Bracken* decision by reaffirming its intent that the term ‘transfer’ as used in the Washington estate and transfer tax is to be given its broadest possible meaning” CP 76-77.

House Bill 1920 was not adopted during the Legislature’s regular session or first special session. Other bills seeking to reverse *Bracken* also failed. But on June 13, 2013, the Legislature passed EHB 2075, which had been read for the first time on June 12, 2013. The floor debate on EHB 2075 appears in the Appendix at A-6 to A-16. The Governor signed the bill in the early hours of June 14th. In accordance with its emergency

clause, EHB 2075 became effective immediately. This was exactly 12 weeks after Judge Tabor had entered judgment for Osborne.

ARGUMENT

A. *Bracken* governs this case.

The Department concedes, as it must, that there is no material difference between the facts of this case and those considered in *Bracken*. As in *Bracken*, a taxpayer (here, Joseph) created a marital deduction (QTIP) trust several years before the standalone Washington estate tax was enacted.³ The trust provided a life estate for his surviving spouse and qualified for the marital deduction, which meant that federal estate tax was deferred. When the surviving spouse died, the assets in the trust went to the remainder beneficiaries, exactly as the person who set up the trust had directed. The question presented is whether the fact that the marital deduction trust qualified for a federal tax deferral and the surviving spouse died after May 17, 2005, means that the trust assets – unlike the assets in all other trusts established before May 17, 2005 – are subject to Washington estate tax. The answer is no.

³ The QTIP provisions have been a part of federal estate tax law since 1981. See *Eisenbach v. Schneider*, 140 Wn. App. 641, 652-53, 166 P.3d 858 (2007).

Bracken rests on two straightforward propositions: first, that the Washington estate tax is a tax on transfers by the decedent; and second, that the standalone estate tax applies prospectively – i.e., to persons dying on or after May 17, 2005. From these two propositions the Court’s conclusion follows directly: Washington estate tax does not apply to the assets in marital deduction trusts created before May 17, 2005, because the transfer of those assets occurred before the Washington estate tax was established.

The *Bracken* Court held, in a section entitled “*Transfer Taxation Requires a Transfer*,” that only “a transfer – a real transfer – is the sanction for the [estate] tax.” 175 Wn.2d at 566. “The requirement for a transfer is constitutionally grounded and long standing.” *Id.* at 564. Its source is the fundamental distinction between an excise tax and a property tax. An excise tax “is levied upon the use or transfer of property . . . ,” whereas a tax “levied upon the property itself” or the income derived from property is a direct tax. *Id.* “If estate taxation cannot be tied to a transfer, it fails as an unapportioned (and therefore unconstitutional) direct tax.” *Id.* at 565 (citing *Levy v. Wardell*, 258 U.S. 542, 42 S. Ct. 395, 66 L. Ed. 758 (1922)).

Bracken held further that QTIP is transferred by the electing spouse, not the surviving spouse. *Id.* at 566. The court stated:

Barbara Nelson, Sharon Bracken, and [their] Estates never transferred, in any manner, the QTIP that passed to the residuary beneficiaries of the QTIP trust. Property is transferred from a trustor when a trust is created, not when an income interest in the trust expires. . . . QTIP does not actually pass to or from the surviving spouse.

Id. (citations omitted). Barbara Mesdag is in precisely the same position as Barbara Nelson and Sharon Bracken. She did not transfer, in any manner, the QTIP in the marital deduction trust that had been set up by Joseph. That transfer occurred in 2002. The assets of **his** marital deduction trust are not taxable in **her** estate.

B. EHB 2075 does not change the result required by *Bracken*.

The Department proposed, and the Legislature approved, changes in two definitional provisions that, the Department asserts, change the outcome in *Bracken*. The Department ignores that *Bracken*'s holding is based upon constitutional requirements that may not be circumvented by legislative tinkering. Even if this fundamental flaw in EHB 2075 is ignored, its definitional changes do not alter the outcome in this case.

EHB 2075 modified the definition of "transfer" to encompass "any shifting upon death of the economic benefit in property or any power or legal privilege incidental to the ownership or enjoyment of property." Laws of 2013, 2d Spec. Sess., ch 2, § 2. The new language adds nothing of substance to the existing language, which defines "transfer" for

purposes of the Washington estate tax as “‘transfer’ as used in section 2001 of the Internal Revenue Code.” RCW 83.100.020(11). It has long been the law that the power of the federal government to impose death taxes “extends to the creation, exercise, acquisition, or relinquishment of any power or legal privilege which is incident to the ownership of property . . . occasioned by death[.]” *Fernandez v. Wiener*, 326 U.S. 340, 352, 66 S. Ct. 178, 90 L. Ed. 116 (1945). *Bracken* says this explicitly.⁴ The Supreme Court’s rejection of the Department’s position in *Bracken* was not based upon a more restrictive reading of “transfer” but rather upon the Court’s determination that the person making the transfer was the person setting up the trust – here, Joseph – and not the surviving spouse, who never owned the trust property. Barbara was not the transferor of Joseph’s trust assets no matter how broadly “transfer” is defined.⁵

⁴ “*Fernandez v. Wiener*, 326 U.S. 340, 352, 66 S. Ct. 178, 90 L. Ed. 116 (1945) recognizes that Congress may tax real estate or personal property ‘if the tax is apportioned’ and, absent apportionment, may tax ‘a particular use or enjoyment of property or the shifting from one to another of any power or privilege incidental to the ownership or enjoyment of property.’” *Bracken*, 175 Wn.2d at 565.

⁵ If a dotting uncle were to designate Mary as the income beneficiary of his trust for two years, after which her sister Susan would become the remainder beneficiary, Mary would not be transferring anything to Susan when the calendar rolled around to the second anniversary of the trust’s creation. The same thing is true if Mary had a life estate and died.

Even if the critical question of **who** made the transfer could be ignored, the question of **when** it occurred looms just as large. Contrary to the Department's apparent claim, property interests do not shift when a lifetime beneficiary dies. That person's life estate and the interests of the remainder beneficiaries were fixed when the trust was established. *See, e.g., In re Estate of Smith*, 40 Wn. App. 790, 796, 797, 700 P.2d 1181 (1985) (remainder beneficiary of testamentary trust granting life estate to testatrix's brother possessed "an indefeasibly vested remainder in the trust," which "vested indefeasibly upon [testatrix's] death"); *Edwards v. Edwards*, 1 Wn. App. 67, 70-71, 459 P.2d 422 (1969) (testatrix created valid testamentary trust by providing life estate with remainder in trust for beneficiaries, as "testatrix created a life estate and a future interest denominated a vested remainder, both interests of which came into being at the time of her death").⁶

The second definitional change in EHB 2075, amending the definition of "Washington taxable estate," does not alter the outcome in this case, either. As before, the Washington taxable estate starts with the

⁶ There can be no credible claim that "transfer" means the mere receipt of property by a remainder beneficiary upon the death of the holder of a life estate. A transfer requires a transferor as well as a transferee.

federal taxable estate, which, the amended statute now says, “includes, but is not limited to, the value of any property included in the gross estate under section 2044 of the internal revenue code, regardless of whether the decedent’s interest in such property was acquired before May 17, 2005.” Laws of 2013, 2d Spec. Sess., ch 2, § 2. This new language changes nothing: the federal taxable estate has, since 1981, included section 2044 property. The amendment goes on to specify adjustments in the federal taxable estate, among them subtraction of “(iii) amounts allowed to be deducted from the Washington taxable estate under RCW 83.100.047.” And RCW 83.100.047 provides for a deduction of section 2044 property in the circumstances present here.

Section 5 of EHB 2075 added RCW 83.100.047(3), which provides as follows:

(3) Notwithstanding any department rule, if a taxpayer makes an election consistent with section 2056 of the internal revenue code as permitted under this section, the taxpayer’s Washington taxable estate and the surviving spouse’s Washington taxable estate, must be adjusted as follows:

(a) For the taxpayer that made the election

(b) For the estate of the surviving spouse, the amount included in the estate’s gross estate pursuant to section 2044(a) and (b)(1)(A) of the internal revenue code is deducted from, and the value of any property for which an election under this section was previously made is added to, the Washington taxable estate.

Joseph is a “taxpayer” for purposes of this subsection: A “taxpayer” is defined in RCW 83.100.020(10) as “a person upon whom tax is imposed under [chapter 83.100 RCW],” and Joseph paid tax under chapter 83.100 RCW. See AR 46. Joseph also made an election consistent with section 2056. AR 31. Barbara is a surviving spouse. Amounts included in her gross estate under section 2044 are therefore to be deducted from the Washington taxable estate under subsection (3)(b). The outcome is the same as that required under the 2006 regulations and that reached by the Supreme Court in *Bracken*. See 175 Wn.2d at 560-61; *id.* at 588-89 (Madsen, C.J., concurring and dissenting).

The Department fails to explain how the two definitional changes in EHB 2075 alter the result in *Bracken* or how they apply to Barbara’s estate. The two definitions do not affect the bases for the decision in *Bracken* – namely, the Washington estate tax applies only to transfers, and the Washington estate tax applies prospectively to transfers occurring after May 17, 2005.⁷ As the *Bracken* Court held, the only transfer occasioned by a marital deduction trust occurs when the trust is established; there is no transfer when a lifetime beneficiary dies.

⁷ Section 9 of EHB 2075 states that Sections 2 and 5 of the bill “apply both prospectively and retroactively to all estates of decedents dying on or

The Legislature may have thought that it was doing something else when it adopted EHB 2075, but this Court must apply the language that the Legislature chose. A court may not ““add language to an unambiguous statute even if it believes the Legislature intended something else but did not adequately express it.”” *Cerrillo v. Esparza*, 158 Wn.2d 194, 201, 142 P.3d 155 (2006) (quoting *Kilian v. Adkinson*, 147 Wn.2d 16, 20, 50 P.3d 638 (2002)).

The Supreme Court observed in *Bracken* that a “tax statute must be construed most strongly against the taxing power and in favor of the taxpayer.” 176 Wn.2d at 563 (internal quotations and citations omitted). Furthermore, the Legislature is ““presumed to have intended a meaning consistent with the constitutionality of its enactment.”” *Id.* (quoting *State ex rel. Dawes v. Wash. State Highway Comm’n*, 63 Wn.2d 34, 38, 385 P.2d 376 (1963)). As the next section will demonstrate, construing EHB 2075 as the Department urges would render that act unconstitutional.

C. If it would change the result in this case, EHB 2075 is unconstitutional as applied.

If this Court reaches the constitutionality of EHB 2075, it must conclude that the statute as applied here violates both the state and federal

after May 17, 2005.” EHB 2075 does not purport to apply to the estate of taxpayers such as Joseph who died before 2005.

constitutions.⁸ An as-applied challenge “occurs where a plaintiff contends that a statute’s application in the context of the plaintiff’s actions or proposed actions is unconstitutional.” *Lummi Indian Nation v. State*, 170 Wn.2d 247, 258, 241 P.3d 1220 (2010) (quoting *Wash. State Republican Party v. Pub. Disclosure Comm’n*, 141 Wn.2d 245, 282 n.14, 4 P.3d 808 (2000)). A statute held unconstitutional as applied in a particular case “cannot be applied in the future in a similar context, but it is not rendered completely inoperative.” *Id.* (quoting *Wash. State Republican Party*, 141 Wn.2d at 282 n.14).⁹

As read by the Department, EHB 2075 cannot constitutionally be applied to Barbara’s estate because it violates (i) constitutional limits upon imposition of an excise tax, (ii) the separation of powers doctrine, (iii) due process, (iv) the impairment clauses, and (v) equal protections.

1. EHB 2075 purports to apply an excise tax to a fictional transfer, but only real transfers may be taxed.

If EHB 2075 actually brings the assets of Joseph’s marital trust within the scope of the Washington estate tax as applied to Barbara’s estate, it does so by (a) untethering the statutory definition of “transfer”

⁸ Courts ordinarily will decline to address constitutional issues if a case can be resolved on statutory grounds. *See Tesoro Ref. & Mktg. Co. v. Dep’t of Revenue*, 173 Wn.2d 551, 559 n.3, 269 P.3d 1013 (2012).

⁹ A facial challenge would require a holding (not necessary here) that the challenged provision cannot be constitutionally applied in any circumstance. *See Lummi Indian Nation*, 170 Wn.2d at 258.

from the constitutionally required meaning of that term, (b) imposing the estate tax directly upon property without any transfer, or (c) both.

The Department fails to heed what may be the most pointed sentence in *Bracken*:

Faced with arguments by the Estates and amicus that DOR is attempting to tax something other than a transfer, DOR too readily concludes that a fictional or deemed transfer is something that Congress or the legislature can substitute for an actual transfer.

175 Wn.2d at 566. Without “a real transfer,” the Court continues, there is no constitutional authority for the tax. *Id.* No legislative alchemy can turn fiction into reality. And this was clear long before the Court’s decision in *Bracken*.

In 1935 the Legislature enacted a law providing that “[i]nsurance payable upon the death of any person shall be deemed a part of the estate for the purpose of computing the inheritance tax” Chapter 180, Laws of 1935, Section 115, p. 784, quoted in *In re McGrath’s Estate*, 191 Wash. 496, 498, 71 P.2d 395 (1937), *cert. denied*, 303 U.S. 651 (1938). William McGrath, president of the McGrath Candy Company, had eight life insurance policies in force when he died. Three named McGrath Candy Company as the beneficiary. One of the three had been taken out by McGrath himself, and he reserved the right to change the beneficiary. *See id.* at 501. The other two had been taken out by McGrath Candy

Company, which paid all of the premiums and had sole power to designate the beneficiary. *See id.* at 501-02. The trial court held that these two policies lay outside the State's lawful taxing authority, and the Washington Supreme Court agreed.

The Supreme Court observed that an estate tax is "a charge made in exchange for permission to a decedent to pass title to his heirs or legatees." *Id.* at 502-03. It is "impossible for an estate or inheritance tax to be exacted with respect to something in which the decedent did not own or have some kind of right at the time of his death, for in such a case there is no transfer." *Id.* at 503. The rule is that "an estate tax cannot be collected with respect to property unless some right in it be transferred by the death of the decedent." *Id.* With respect to the policies taken out by McGrath Candy Company, as to which the beneficiary corporation retained complete control without Mr. McGrath's consent, the Court observed: "The death of McGrath added nothing to the company's right to the proceeds of the policies, for the right was from the beginning complete and indefeasible." *Id.* at 504.

What was true in *McGrath* is no less true here. The rights of the remainder beneficiaries vested at the time that Joseph's trust was created, and those rights were complete and indefeasible. *E.g., Estate of Smith*, 40 Wn. App. at 797; *In re Verchot's Estate*, 4 Wn.2d 574, 582, 104 P.2d 490

(1940); see also *Black's Law Dictionary*, “Vested Remainder” (9th ed. 2009) (“A remainder that is given to an ascertained person and that is not subject to a condition precedent. **An example is ‘to A for life, and then to B.’**”) (emphasis added). Barbara had no power to alter the beneficiaries’ rights. On the contrary, “[t]he assets in the QTIP trust could have been left to any recipient of [Joseph’s] choosing, and neither [Barbara] nor the estate had any control over their ultimate disposition.” *Estate of Bonner v. United States*, 84 F.3d 196, 198 (5th Cir. 1996) (per curiam).

Bracken and McGrath make plain that, if “transfer” is interpreted as the Department would have it, the estate tax is an unconstitutional direct tax on property rather than a constitutionally permissible excise tax. The same flaw is apparent if the change in the definition of “Washington taxable estate” is read as the Department would have it – namely, as adding (and not allowing the deduction under RCW 83.100.047(3) of) “the value of any property included . . . under section 2044 of the internal revenue code, regardless of whether the decedent’s interest in such property was acquired before May 17, 2005.” Absent a taxable transfer, of which there was none by Barbara, this definition represents the direct taxation of property, and that violates the sine qua non of a permissible excise tax.

2. If read to overturn *Bracken*, EHB 2075 violates the separation of powers doctrine.

Separation of powers underlies our system of government. *See Hale v. Wellpinit Sch. Dist.*, 165 Wn.2d 494, 503-04, 506-07, 198 P.3d 1021 (2009). The separation of powers doctrine “recognizes that each branch of government has its own appropriate sphere of activity” and “ensures that the fundamental functions of each branch remain inviolate.” *Id.* at 504. The judicial function is to interpret the law. *Id.* at 505. Courts “say what the law is,” and once the highest state court construes a statute, “that construction operates as if it were originally written into [the statute].” *Id.* at 506 (internal quotations and citations omitted).

When the Legislature retroactively amends a statute that the Washington Supreme Court has construed, that action must be carefully evaluated to determine whether the Legislature’s action “threatens the independence or integrity or invades the prerogatives of” the Court. *Id.* at 507 (internal quotations and citations omitted).¹⁰ One principle guiding

¹⁰ “[S]eparation of powers problems are raised when a subsequent legislative enactment is viewed as a clarification and applied retroactively, if the subsequent enactment contravenes the construction placed on the original statute by this court.” *Wash. State Farm Bureau Fed’n v. Gregoire*, 162 Wn.2d 284, 304, 174 P.3d 1142 (2007) (quoting *Overton v. Econ. Assistance Auth.*, 96 Wn.2d 552, 558, 637 P.2d 652 (1981)); *see also Port of Seattle v. Pollution Control Hearings Bd.*, 151 Wn.2d 568, 627, 90 P.3d 659 (2004) (“Although the legislature may not retroactively

this evaluation is that “the legislature is precluded by the constitutional doctrine of separation of powers from making *judicial* determinations.” *City of Tacoma v. O’Brien*, 85 Wn.2d 266, 271, 534 P.2d 114 (1975) (emphasis in the original). For example, a legislative finding that contractual performance has been rendered economically impossible invades an exclusively judicial function. *See id.* at 270-72.

The Court in *Bracken* made the following judicial determinations based on the facts in that case, facts that are no different here:

- When a marital deduction (QTIP) trust is established, it is the trustor who transfers the trust assets.¹¹
- The transfer occurs when the trust is established.¹²
- The holder of a life estate who has no power to dispose of trust assets does not transfer them by dying.¹³

overrule a decision of the State’s highest court, the legislature may clarify a law in response to an **administrative** adjudication or **trial court** decision.”) (emphasis added).

¹¹ “Property is transferred from a trustor when a trust is created, not when an income interest in the trust expires.” *Bracken*, 175 Wn.2d at 566.

¹² The “transfers [were] completed by William Nelson and Jim Bracken years ago” *Bracken*, 175 Wn.2d at 554.

¹³ The surviving spouses and their estates “never transferred, in any manner, the QTIP that passed to the residuary beneficiaries of the QTIP trust. . . . QTIP does not actually pass to or from the surviving spouse.” *Bracken*, 175 Wn.2d at 566.

- The estate of someone dying after May 17, 2005, prepares the estate's Washington return and pays state tax in light of the Department's then-applicable regulations.¹⁴

Each of these is an adjudication of fact. Indeed, the *Bracken* decision emphasizes the difference between what actually happens when a trust is created and administered – as reflected in the first three bullets above – and the provisions in federal tax law that permit deferral of federal estate tax on QTIP trusts.¹⁵ On the Department's reading, however, EHB 2075 requires this Court (a) to defer to the Legislature's finding that the Washington Supreme Court has too narrowly construed the term "transfer" and (b) to treat the assets in the marital deduction trust that Joseph created in 2002 as having been transferred by Barbara when she died, regardless of whether she in fact transferred anything. In the words of *O'Brien*, "the legislature has no power to make such a judicial determination." 85 Wn.2d at 270.

¹⁴ "[The Department] appropriately read the Act initially to permit creation of a state QTIP election that would operate only prospectively. . . . [The] 2006 regulations were valid and were justifiably relied upon by the Estates." *Bracken*, 175 Wn.2d at 570.

¹⁵ It is a mistake, the *Bracken* majority states, to rely upon "Ms. Bracken's **fictional** receipt and transfer of property for federal tax purposes to ignore **the fact** that for purposes of imposing a state estate tax, she has not received or transferred the property at all." *Bracken*, 175 Wn.2d at 573 (emphasis added).

Furthermore, the Department's reading of EHB 2075 violates "the bedrock principle that the legislature cannot contravene an existing judicial construction of a statute." *State v. Maples*, 171 Wn. App. 44, 50, 286 P.3d 386 (2012). As the Court observed in *State v. Dunaway*, 109 Wn.2d 207, 216 n.6, 743 P.2d 1237 (1987), "even a clarifying enactment cannot be applied retrospectively when it contravenes a construction placed on the original statute by the judiciary. . . . Any other result would make the legislature a court of last resort." (Internal quotation marks and citations omitted.)

The Legislature also purports to overrule the Supreme Court on a question of constitutional law. The requirement that an estate tax may lawfully be imposed only on transfers "is constitutionally grounded and long standing." *Bracken*, 175 Wn.2d at 564. The Legislature has no authority to alter the constitutional requirement of an actual transfer as the sine qua non for imposing an excise tax. "The construction of the meaning and scope of a constitutional provision is exclusively a judicial function." *State Highway Comm'n v. Pacific Nw. Bell Tel. Co.*, 59 Wn.2d 216, 222, 367 P.2d 605 (1961).

These violations of separation of powers doctrine are more than sufficient to invalidate EHB 2075, but the Legislature goes even further: It directs this Court to rewrite history. In *Bracken* the Supreme Court

described the regulatory context in which the estates there – and Barbara’s estate here – prepared their tax returns by calculating the Washington taxable estate:

In April 2006, DOR adopted regulations to create the state QTIP election and provide guidance on the application and interpretation of the new Act. *See* ch. 458-57 WAC. . . . **The 2006 regulations also set forth the manner in which the Washington taxable estate is to be calculated. . . . The 2006 regulations provide for a series of adjustments to the federal taxable estate by which the effect of federal QTIP elections is canceled out.**

175 Wn.2d at 560-61 (emphasis added). Section 5 of EHB 2075, however, states that the Washington taxable estate is now to be calculated “[n]otwithstanding any department rule.”

The Department’s reason for seeking this extraordinary provision is plain: Every justice who heard the *Bracken* case found that the Department’s position was contradicted by its own rules (i.e., the 2006 regulations). Directing courts to treat those rules as if they never existed is the ultimate in revisionist history; it is also unconstitutional. In *O’Brien* the Court pointed out the crucial temporal dimension of judicial vs. legislative determinations:

“A judicial inquiry investigates, declares and enforces liabilities as they stand on present or past facts and under laws supposed already to exist. . . . Legislation on the other hand looks to the future and changes existing conditions by making a new rule to be applied thereafter.”

85 Wn.2d at 272 (quoting *Prentis v. Atl. Coast Line Co.*, 211 U.S. 210, 226, 29 S. Ct. 67, 53 L. Ed. 150 (1908)). If, as *O'Brien* teaches, it is contrary to separation of powers principles to direct this Court to disregard historical facts, it is no less a constitutional violation to instruct this Court to make a decision in light of only part of the governing law. “Any legislative attempt to mandate legal conclusions would violate the separation of powers.” *Sofie v. Fibreboard Corp.*, 112 Wn.2d 636, 654, 771 P.2d 711, 780 P.2d 260 (1989).

The Department argues that EHB 2075 does not violate separation of powers doctrine because it does not affect any final judgment or dictate how a court should decide any factual issue. The Department’s view of constitutional doctrine is far too cramped: “Retroactive amendments to the law may violate separation of powers by disturbing judgments, interfering with judicial functions, or cause manifest injustice.” *Lummi Indian Nation*, 170 Wn.2d at 261. The Department does not address interference with judicial functions or manifest injustice, even though both are present. Regardless, EHB 2075 fails even the narrow tests posited by the Department.

With respect to final judgments, the Department cites Section 10:

This act does not affect any final judgment, no longer subject to appeal, entered by a court of competent

jurisdiction before the effective date of this section [June 14, 2013].

The Thurston County Superior Court entered a final judgment in this case on March 22, 2013. CP 97. The superior court is “a court of competent jurisdiction.” Whether its judgment was subject to appeal is governed by the Rules of Appellate Procedure.¹⁶ An appeal may be initiated by filing a notice of appeal; it may be dismissed if the notice of appeal is not timely or if the appeal is frivolous or solely for the purpose of delay. RAP 18.9(b), (c). Osborne moved for dismissal because the Department’s appeal was frivolous and solely for the purpose of delay. Given that there was no valid basis to ask this Court to overrule the Washington Supreme Court and no other basis for an appeal under then-current law, Osborne believes that the superior court’s judgment was not properly subject to appeal. This makes EHB 2075 inapplicable by its terms.

Whatever the Legislature meant to achieve by excluding final judgments in Section 10 of EHB 2075 is negated by Section 9:

Sections 2 and 5 of this act apply both prospectively and retroactively **to all estates of decedents dying on or after May 17, 2005.**

¹⁶ A judgment is properly subject to appeal only if there is a basis for saying that the trial court erred. *See, e.g.*, RAP 2.5(a).

(Emphasis added.) Either Section 9 is true and Section 10 false, or vice versa. They cannot both be true.

Quite apart from the uncertain impact of EHB 2075 upon final judgments, the Department's assertion that EHB 2075 affects no factual determinations is simply wrong. The conflict between EHB 2075 and separation of powers principles is manifest when one considers that EHB 2075 purports to overrule *Bracken* on the very judicial determinations that lie at its heart: the Court's adjudications of (a) who makes a transfer when a trust with a life estate is established, (b) when that transfer takes place, (c) the difference between transferring assets and simply dying, and (d) the regulatory context in which state tax returns were prepared between 2006 and 2009.

Legislative actions that violate the separation of powers doctrine are void. *O'Brien*, 85 Wn.2d at 272. If EHB 2075 requires this Court to reach a different result here than the Court did in *Bracken*, it is invalid.

3. EHB 2075 violates the Due Process Clause by taxing transactions that predate enactment of the standalone estate tax and by depriving individuals of vested rights.

If EHB 2075 applies to the assets in Joseph's marital deduction trust, it violates state and federal constitutional due process protections¹⁷

¹⁷ U.S. Const., am. XIV; Wash. Const. art. I, § 3.

by taxing transfers that occurred long before the effective date of the standalone Washington estate tax. Although legislative tax decisions may be entitled to deferential review, such deference does not extend to the retroactive reach of EHB 2075. Nor does it permit retroactive taxation that impairs vested rights.

The retroactive impact of EHB 2075 is not limited to the eight-year period emphasized by the Department. To be sure, Section 9 of the statute states that Sections 2 and 5 “apply both prospectively and retroactively to all estates of decedents dying on or after May 17, 2005.” But EHB 2075 actually reaches back 32 years to 1981, when the federal QTIP provisions were enacted – for, as the Department interprets it, the statute redefines “Washington taxable estate” in a manner that converts the donating spouse’s transfer of QTIP property **at any time in the past** into a taxable event **today**. This includes Jim Bracken’s transfer of QTIP property in 1984, *see* 175 Wn.2d at 554-55, and Joseph’s transfer of QTIP property in 2002.

The Department provides a string of citations referencing various periods of retroactivity to justify an eight-year retroactive period – that is,

from June 14, 2013 to May 17, 2005.¹⁸ Even the most extreme example that the Department gives does not come close to EHB 2075's 32-year reach. The Legislature's attempt to tax transfers occurring long before the effective date of the statute violates the due process requirements of the state and federal constitutions. See *McGrath*, 191 Wn.2d at 510.

In addition to examining duration, courts consider "the nature of the tax and the circumstances in which it is laid" in determining the constitutional boundaries of retroactivity. *W.R. Grace & Co. v. Department of Revenue*, 137 Wn.2d 580, 602, 973 P.2d 1011 (1999) (citing *Temple Univ. v. United States*, 769 F.2d 126, 135 (3d Cir. 1985)). Here, too, EHB 2075 fails the test of a valid taxing statute.

United States v. Carlton, 512 U.S. 26, 114 S. Ct. 2018, 129 L. Ed. 2d 22 (1994), on which the Department relies, involved a retroactive amendment clarifying a federal estate tax deduction for the sale of employer securities to an employee stock ownership plan. The Court

¹⁸ Other Washington cases conclude that shorter retroactive periods do not withstand constitutional scrutiny. See *Bates v. McLeod*, 11 Wn.2d 648, 657, 120 P.2d 472 (1941) (imposition of three-month retroactive tax on privilege of employing others, "the exercise of which had formerly been freely enjoyed," violated due process clause); cf. *State v. Pac. Tel. & Tel. Co.*, 9 Wn.2d 11, 17, 113 P.2d 542 (1941) (in case involving use tax, approximately four-year retroactive period could not be sustained; retroactive tax could only apply to "prior but recent transactions") (internal quotations omitted).

applied various factors in evaluating whether retroactivity was permitted under the Due Process Clause. The Court upheld retroactivity because (a) Congress's purpose was not illegitimate or arbitrary, and (b) Congress "acted promptly and established only a modest period of retroactivity," in accordance with the traditional practice of confining retroactive tax legislation "to short and limited periods required by the practicalities of producing national legislation." *Id.* at 32-33.¹⁹ In *Carlton*, and in stark contrast to the 32-year effective reach of EHB 2075, the "modest period of retroactivity" was slightly greater than a year. *See id.* at 33.²⁰

Raising revenue for education is an appropriate legislative purpose, no doubt, but it cannot justify arbitrary action. And whatever else might be said of EHB 2075, it does not represent prompt action, nor does it establish only a modest level of retroactivity. Seven years ago, in 2006,

¹⁹ As Justice O'Connor noted in her concurrence, every case in which the Court has upheld a retroactive federal tax statute against due process challenge has involved a short period of retroactivity, measured in months. "A period of retroactivity longer than the year preceding the legislative session in which the law was enacted would raise, in my view, serious constitutional questions." *Carlton*, 512 U.S. at 38 (O'Connor, J., concurring).

²⁰ *Carlton* distinguished one prior case that held for the taxpayer as inapposite because it "involved a novel development in the estate tax which embraced a transfer that occurred 12 years earlier." 512 U.S. at 34 (citing *Nichols v. Coolidge*, 274 U.S. 531, 543, 47 S. Ct. 710, 71 L. Ed. 1184 (1927)). Save one year, that is precisely the effect of EHB 2075 as applied to the transfer of Joseph's property in 2002.

the Department adopted regulations excluding Joseph's 2002 marital deduction trust from Barbara's Washington taxable estate. Six years ago, when the *Bracken* litigation was filed, the Department was put on notice that taxpayers so understood and applied those regulations. The Department knew from the tax return filed on behalf Barbara's estate in 2008 that Osborne asserted the 2002 QTIP trust assets were not subject to tax in her estate. The Department changed its regulations in 2009, tacitly acknowledging correctness of Osborne's deduction of Joseph's pre-2005 QTIP trust assets. But rather than seek legislation to address a potential "leak in the public treasury," the Department simply continued to collect taxes, illegally, on pre-2005 trusts.

Only in 2013 – eleven years after Joseph's 2002 QTIP trust was established, seven years after the Department adopted regulations exempting pre-2005 QTIP trusts, six years after the *Bracken* refund suit was filed, five years after Osborne filed the estate tax return for Barbara's estate in compliance with then-existing statutes and regulations, and three years after Osborne was forced to pay the disputed taxes under the Department's threat of additional penalties and interest – did the Department seek a change in the law. EHB 2075 is not a prompt remedial measure, and its period of retroactivity (32 years) is decidedly immodest.

The circumstances surrounding the enactment of EHB 2075 also undermine its validity. EHB 2075 was passed with the specific purpose of avoiding the payment of refunds that the Legislature knew were imminent.²¹ This is strikingly similar to *Tesoro Refining and Marketing Co. v. Department of Revenue*, 159 Wn. App. 104, 110, 246 P.3d 211 (2010), *rev'd on other grounds*, 173 Wn.2d 551, 559 n.3, 269 P.3d 1013 (2012),²² in which this Court found the retroactive effect of a B&O tax amendment violated constitutional due process requirements:

And, unlike in *Carlton*, here the legislative history of the 2009 act shows the recent amendment was in direct response to Tesoro's refund request. . . . The direct references to Tesoro's lawsuit and the fact that the 2009 act became effective the day before trial was set to begin evidences the type of improper taxpayer targeting identified by the *Carlton* Court. 512 U.S. at 32-33, 114 S. Ct. 2018. There is no colorable argument to suggest a legislative act creating a 24-year retroactive tax period is "prompt" or establishes a "modest period of retroactivity." *Carlton*, 512 U.S. at 32-33, 114 S. Ct. 2018

²¹ App. A-14 (Senate Floor Debate, June 13, 2013) (Statement of Sen. Nelson) ("[I]n eight hours and fifteen minutes without this legislation we begin to refund to the wealthiest estates in Washington. We begin to mail out checks for funds that could be used for our kindergartners . . .").

²² Although this Court's decision was reversed on other grounds, the due process analysis in *Tesoro* remains a valid constitutional interpretation. See Order, *Nw. Env. Defense Ctr. v. Brown*, -- F.3d --, No. 07-35266, 2013 WL 4618311, at *1 (9th Cir. Aug. 30, 2013) (citing *Misic v. Bldg. Serv. Emps. Health & Welfare Trust*, 789 F.2d 1374, 1379 (9th Cir. 1986) (when the U.S. Supreme Court reverses the federal court of appeals on other grounds, "it leaves unchanged the law of this circuit on issues not reached by the Court"))).

159 Wn. App. at 118-119. Still less colorable is any claim that a 32-year retroactive tax period reflects prompt action or modest scope.

Enough has already been said to doom EHB 2075 on due process grounds, but there are two independent bases to reach the same conclusion – namely, that the statute deprives the beneficiaries of their vested right to the remainder of Joseph’s trust and deprives Barbara’s estate of its vested right to a refund. “Due process is violated if the retroactive application of a statute deprives an individual of a vested right.” *Caritas Servs. Inc. v. Dep’t of Social & Health Servs.*, 123 Wn.2d 391, 413, 869 P.2d 28 (1994) (quoting *In re Marriage of MacDonald*, 104 Wn.2d 745, 750, 709 P.2d 1196 (1985)). A vested right “must be something more than a *mere expectation* based upon an anticipated continuance of the existing law; *it must have become a title, legal or equitable, to the present or future enjoyment of property, a demand, or a legal exemption from a demand by another.*” *Id.* at 414 (quoting *MacDonald*, 104 Wn.2d at 750) (emphasis in the original).

In this case, the rights of the beneficiaries to inherit the remainder of Joseph’s marital deduction trust vested immediately upon creation of the irrevocable trust. *See, e.g., Smith*, 40 Wn. App. at 796-97. These rights, therefore, were a “title, legal or equitable, to the . . . future enjoyment of property,” *Caritas*, 123 Wn.2d at 414, and as such are

protected by the due process clause from divestment by retroactive legislation. See *McGrath*, 191 Wash. at 508-09 (noting that life insurance policies had fully vested before inheritance tax was enacted, and tax on right to receive proceeds of policies “would conflict with the due process clause of the Fourteenth Amendment”), citing *Coolidge v. Long*, 282 U.S. 582, 51 S. Ct. 306, 75 L. Ed. 562 (1931) (enforcement of tax on fully vested trusts created before Massachusetts inheritance tax “would be repugnant to . . . the due process clause of the Fourteenth Amendment.”). The Department points out that a taxpayer does not have a vested right in the tax code (see *Carlton*, 512 U.S. at 33), but the beneficiaries of Joseph’s marital trust have an entirely distinct vested right – namely, the right to receive the corpus of the Joseph’s marital trust, a right that has been fully vested for over a decade. The Legislature is barred by the due process clause from impairing that vested right.

The Department’s refund obligation to Barbara’s estate had also moved far beyond a mere expectancy by the time that the Legislature acted. As the Department admits, Osborne timely filed a refund request. CP 9-10, 29-30. Under RCW 83.100.130, the Department had the mandatory statutory duty to pay the refund, plus interest, when it received Osborne’s request and determined that Barbara’s estate had overpaid taxes. Washington courts have found vested rights in similar state-created

property rights. *See Caritas*, 123 Wn.2d at 414 (right to reimbursement of Medicaid payments under existing statutory methodology vested upon performance of contracts governed by statutory methodology); *Willoughby v. Dep't of Labor & Indus.*, 147 Wn.2d 725, 733, 57 P.3d 611 (2002) (vested right in L&I disability payments that are mandated by statute); *In re F.D. Processing, Inc.*, 119 Wn.2d 452, 463-64, 832 P.2d 1303 (1992) (statute providing priority lien in favor of milk producers could not be applied retroactively, as it would upset bank's vested, competing security interest in liened collateral); *see also Lawson v. State*, 107 Wn.2d 444, 453, 730 P.2d 1308 (1986) (reversionary interest in railway easement, effective upon termination of use as railroad, was vested right that could not be altered by legislation without constituting taking).

No principled distinction exists between the vested rights recognized by Washington courts, such as reimbursement under an existing statutory formula or L&I payments under the existing statutory scheme, and the vested right of Barbara's estate to recover overpaid taxes under RCW 83.100.130's refund directive. Courts in other jurisdictions have recognized that a refund right to overpaid taxes arises upon filing of a statutory refund request. *E.g., Rio Rico Props., Inc. v. Santa Cruz County*, 834 P.2d 166, 176-77 (Ariz. Tax Ct. 1992) (retroactive amendment of property tax statute, passed during pendency of suits for

refunds of erroneously paid property taxes, violated Arizona and federal due process protections by depriving taxpayer of right that vested upon claim against taxing authority for refund); *In re Garden City Med. Clinic, PA*, 137 P.3d 1058, 1063-65 (Kan. Ct. App. 2006) (retroactive legislation reducing refund period for unpaid taxes from three years to one year, passed after refund request had been made for amounts collected during retroactive period, violated due process by depriving taxpayer of right that vested upon refund application). As interpreted by the Department, EHB 2075 abrogates the vested right of Barbara’s estate to receive a refund under RCW 83.100.130. It also impairs the vested right of the beneficiaries to receive the full trust remainder. It therefore violates due process.

4. EHB 2075 violates the constitutional prohibition upon impairment of contracts.

EHB 2075 violates the impairment of contracts clauses of the state and the federal constitutions.²³ The impairment clauses are implicated when (a) a contractual relationship exists and (b) legislation substantially impairs the contractual relationship. *Caritas*, 123 Wn.2d at 402-03.

²³ Wash. Const. art. I, § 23 (no “law impairing the obligations of contracts shall ever be passed”); U.S. Const. art. I, § 10, cl. 1 (“No State shall . . . pass any . . . Law impairing the Obligation of Contracts.”).

Interests in trusts have long been treated as contractual rights for impairment clause purposes. *See Coolidge*, 282 U.S. at 594-95 (“The trust deeds are contracts within the meaning of the contract clause of the Federal Constitution. They were fully executed before the taking effect of the state law under which the excise is claimed. The commonwealth was without authority by subsequent legislation, whether enacted under the guise of its power to tax or otherwise, to alter their effect or to impair or destroy rights which had vested under them.”); *McGrath*, 191 Wash. at 507-08 (quoting *Coolidge*’s analysis of impairment of trusts with approval, and concluding that taxation of indefeasible insurance policies purchased before the state death taxes applied would violate the contracts clauses of the state and federal constitutions); *see also In re Estate of Bodger*, 130 Cal. App. 2d 416, 424, 279 P.2d 61 (1955) (declaration of trust is “a contract between the trustor and the trustee for the benefit of a third party”).

EHB 2075 impairs the contractual rights of the beneficiaries with respect to the QTIP trust by “alter[ing] its terms, impos[ing] new conditions, or **lessen[ing] its value.**” *Caritas*, 123 Wn.2d at 404 (emphasis added). The value of the beneficiaries’ rights to the QTIP trust has been substantially devalued by retroactive imposition of the Washington estate tax. *See McGrath*, 191 Wash. at 508-09 (“[A]ny

subsequent statute passed during the existence of the contracts providing for taxation of that right would, if enforced, impair the obligation of these contracts, for the McGrath Candy Company would then receive less than it was entitled to receive according to the terms thereof.”).

Although the United States Supreme Court has applied a more deferential standard to legislation that abrogates private contracts, EHB 2075 runs afoul of the impairment clauses. A private contract may be impaired if “the state has a significant and legitimate public purpose behind the regulation, such as the remedying of a broad and general social or economic problem,” and the “adjustment of ‘the rights and responsibilities of contracting parties [is based] upon reasonable conditions and [is] of a character appropriate to the public purpose justifying [the legislation’s] adoption.’” *Energy Reserves Grp., Inc. v. Kan. Power & Light Co.*, 459 U.S. 400, 412, 103 S. Ct. 697, 74 L. Ed. 2d 569 (1983) (internal citation and quotation omitted).

“Financial necessity, though superficially compelling, has never been sufficient of itself to permit states to abrogate contracts.” *Carlstrom v. State*, 103 Wn.2d 391, 396, 694 P.2d 1 (1985). The Department’s attempt to extract revenue by altering contracts created years before any standalone estate tax existed in Washington is not legitimate under any standard. EHB 2075 violates the state and federal impairment clauses.

5. Drawing a distinction between the assets of QTIP trusts and all other trusts violates equal protection principles.

One peculiarity of EHB 2075 as applied here is that it distinguishes between the life estate established under the terms of Joseph's marital deduction trust and the life estate established under the terms of his credit shelter trust. According to the Department, the assets of the marital deduction trust are subject to Washington estate tax upon the death of Barbara, but the assets of the credit shelter trust are not – this despite the fact that the terms of the two trusts are virtually identical, their beneficiaries are the same, and the life estate that Barbara enjoyed in both trusts terminated in exactly the same way: She died.

There is, of course, no basis to contend that Barbara transferred the assets in the credit shelter trust that had been established by Joseph's will, any more than that she transferred the assets in the marital deduction trust. The Department concedes the point with respect to the credit shelter trust, as indeed it does for life estates in every kind of trust save one – namely, a trust qualifying for QTIP treatment when the first spouse died.²⁴ On the face of things, this is irrational. There is no revenue-enhancing rationale

²⁴ Thus, for example, a trust established by a single person that gave a life estate to someone dying after May 17, 2005, is not within the scope of EHB 2075. The statute isolates for unfavorable treatment the surviving

for sparing all trusts established before May 17, 2005, except QTIP ones, from taxation upon the death of the holder of a life estate. There is no distinction that can be drawn between the tax consequences to Joseph's estate of a credit shelter trust and a QTIP trust, for he paid federal estate tax on neither. The only distinction that exists is that the QTIP trust qualified for the federal marital deduction, and federal law provides a mechanism for collection of deferred federal estate tax. Neither that federal-law mechanism nor hostility to the federal marital deduction can provide a legitimate basis for subjecting the assets in QTIP trusts, alone among trusts created before 2005, to state estate tax after 2005.

Our state's equal protection clause (Const. art. I, § 12) and the Fourteenth Amendment to the United States Constitution require that "persons similarly situated with respect to the legitimate purpose of the law must receive like treatment." *State v. Marintorres*, 93 Wn. App. 442, 450, 969 P.2d 501 (1999) (quoting *State v. Coria*, 120 Wn.2d 156, 169, 839 P.2d 890 (1992)). Economic legislation that neither sets up a suspect class nor affects a fundamental right is subject to the rational basis test. *Schuchman v. Hoehn*, 119 Wn. App. 61, 68, 79 P.3d 6 (2003). The test under rational basis "is not whether the *law* being challenged has a rational

spouses of persons who, before the statute's effective date, established

basis; it is whether there is a rational basis for the *classification* embodied by the legislative scheme.” *Marintorres*, 93 Wn. App. at 451 (citations omitted, emphasis in original).

To pass muster as rational, a classification must (a) apply alike to all members within the designated class; (b) be based on reasonable distinctions between those within and those outside the class; and (c) bear a rational relationship to the purpose of the legislation. *Id.* (statute requiring interpreter reimbursement for hearing-impaired convicts, but not non-English speaking convicts, was irrational and violated equal protection as applied). Tax statutes are analyzed the same way. *See Snow’s Mobile Homes, Inc. v. Morgan*, 80 Wn.2d 283, 287, 494 P.2d 216 (1972) (distinction between similarly situated taxpayers, based only upon timing of assessment for taxation, would constitute denial of equal protection; “[i]t is fundamental that all persons within the same class must be treated equally”). For this reason, too, EHB 2075 is unconstitutional.

D. *Bracken* was correctly decided.

The Department devotes a third of its brief, and nearly half of its argument, to attacking *Bracken* and asking the Washington Supreme Court to overturn it – this despite the fact that the Court’s decision is less than a

trusts that qualified for the federal marital deduction.

year old. No justice accepted the Department's position in *Bracken*,²⁵ and the Court denied the Department's motion for reconsideration just a few months ago. The Department's refusal to admit error and to accept the Court's judgment may explain (though it cannot justify) forcing Osborne to move for relief that should have been provided by agreed order, then filing an appeal solely for the purpose of delay. Regardless, this argument implicitly concedes the futility of the Department's legislative gambit. If EHB 2075 were effective to change the outcome in this case, the decision in *Bracken* would be of historical interest only. But it is far from that.

The Department's argument ignores the important values that stare decisis serves:

In Washington, stare decisis protects reliance interests by requiring **a clear showing** that an established rule is incorrect and harmful before it is abandoned. . . . The constraints of stare decisis prevent the law from becoming subject to incautious action or the whims of current holders of judicial office. . . . Although stare decisis limits judicial discretion, it also protects the interests of litigants by providing clear standards for determining their rights and the merits of their claims. Therefore, overruling prior precedent should not be taken lightly.

²⁵ The concurrence/dissent is no less emphatic than the majority: “[I]t is absurd to conclude that the federal QTIP property should be included in the surviving spouse’s estate to enable imposition of a state tax where there was no deferral of state estate taxation on any QTIP property.” *Bracken*, 175 Wn.2d at 594 (Madsen, C.J., concurring and dissenting).

Lunsford v. Saberhagen Holdings, 166 Wn.2d 264, 278, 208 P.3d 1292 (2009) (emphasis added; internal quotations and citations omitted). The Department does not and cannot make the clear showing required for the Washington Supreme Court to overrule *Bracken*.²⁶

Although the Department claims that the Supreme Court in *Bracken* construed “transfer” too narrowly, this claim ignores both the Court’s acceptance of the Department’s primary authority on the scope of “transfer,” *Fernandez v. Wiener* (see 175 Wn.2d at 565), and the Court’s point: The crucial issue is not **what** constitutes a transfer but **who** makes it and **when**. If there is no transfer by the decedent, there is no constitutional sanction for an estate tax. See 175 Wn.2d at 566-68.

The cases discussed by the Department do not suggest a different conclusion. At issue in *Fernandez v. Wiener* was whether community property could be subjected to federal estate taxation when the marital community was terminated by the death of Mr. Wiener. So long as he was alive, Mr. Wiener had both the ability and the authority to direct how that

²⁶ As the argument that follows will demonstrate, the Department’s oft-repeated criticisms of *Bracken* lack merit. As for harm, the Department appears to take the position that it should not have to repay illegal taxes because the State needs the money. The Legislature’s chronic failure to make ample provision for the education of all Washington children, which is its paramount duty under the Washington Constitution, can in no way justify the Department’s retention of monies that it had no right to collect.

property would be used. Both died when he did. The court concluded that “the death of the insured, since it ended his control over the disposition of the proceeds, and gave his wife the present enjoyment of them, may be constitutionally made the occasion for the imposition of an indirect tax measured by the proceeds themselves.” 326 U.S. at 363. This suggests that the federal government could constitutionally tax Joseph’s property when he died, and indeed this is the basis for the deferred tax that is imposed under I.R.C. § 2044. *Fernandez v. Wiener* does not suggest any basis for Washington to tax Barbara on the assets in Joseph’s trust.

The central issue in *West v. Oklahoma Tax Commission*, 334 U.S. 717, 68 S. Ct. 1223, 92 L. Ed. 1676 (1948), was whether the property of an Osage Indian was immune from state taxation because legal title was held by the federal government. The Court said no. Federal law authorized the decedent to dispose of his estate, including trust funds from which restrictions on alienation had not been removed, in accordance with Oklahoma law. *Id.* at 722. The Court observed:

An inheritance or estate tax is not levied on the property of which an estate is composed. Rather it is imposed upon the shifting of economic benefits and the privilege or transmitting or receiving such benefits. . . . In this case, for example, the decedent had a vested interest in his Osage headright; and he had the right to receive the annual income from the trust properties and to receive all the properties at the end of the trust period. **At his death, these interests and rights passed to his heir.** It is the transfer of these

incidents, rather than the trust properties themselves, that is the subject of the inheritance tax in question.

Id. at 727 (citations omitted; emphasis added).²⁷ Barbara, unlike the taxpayer in *West*, did not transfer any of the assets in Joseph’s marital deduction trust when she died.

The question in *United States v. Manufacturers National Bank of Detroit*, 363 U.S. 194, 80 S. Ct 1103, 4 L. Ed. 2d 1158 (1960), was whether Congress could tax the proceeds of insurance policies payable to the wife of the insured if the insured paid the premiums but assigned the policy rights to his wife. The Court held that it could, observing that the occasion for the tax is the maturing of the beneficiaries’ right to the proceeds upon the death of the insured, this being the last step in a testamentary disposition that “began with the payment of premiums by the insured.” *Id.* at 198.²⁸ The Department omits from its description of this

²⁷ *Cf.* Restatement (Third) of Trusts § 55(1), “Transfers at Death” (2003): “If the interest of a deceased beneficiary of a trust does not terminate or fail by reason of the beneficiary’s death, the interest devolves by will or intestate succession” As Comment *a* to Section 55 notes, the interest of a trust beneficiary does **not** survive death if the beneficiary “has only an interest for life” Comment *a* continues: “The rule of this Section has no application to interests of this type.”

²⁸ Completion of the insured’s testamentary disposition by his death, the Court continued, “creates a genuine enlargement of the beneficiaries’ rights. It is the ‘generating force’ of the full value of the proceeds.” 363 U.S. at 198. In our case, by contrast, Barbara’s death did nothing to enlarge the rights of the beneficiaries that Joseph had designated.

case the crucial fact that the insured paid the premiums. The Department also fails to complete the Court's quotation from *Chase National Bank v. United States*, 278 U.S. 327, 337, 49 S. Ct. 126, 73 L. Ed. 405 (1929), about the nature of a "transfer" – namely, that it must "include the transfer of property procured through expenditures by the decedent with the purpose, effected at his death, of having it pass to another." *Manufacturers Nat'l Bank*, 363 U.S. at 199. This describes Joseph, not Barbara.

The Department argues (Br., pp. 34-36) that *McGrath* supports its analysis. The Department notes that it was the shifting of economic benefit in one insurance policy over which Mr. McGrath retained the power to change the beneficiary that was the basis for taxation. It is precisely because Mr. McGrath did **not** have that power in the case of two other policies that the Court held their proceeds to be beyond the power of the State to impose a tax. As the Court held in *Bracken*, a life estate held by a surviving spouse who lacks **any** power to change the beneficiaries designated by the person who set up the trust – here, Joseph – is just like those non-taxable insurance policies. *McGrath* fully supports *Bracken* and, as shown above, requires the same result in this case.

The Department next attacks the Court’s analysis of federal QTIP principles, arguing that property in a QTIP trust transfers twice. Not so.²⁹ There is but one transfer, which occurs when the trust is created and funded. Federal law treats the trust property as if it had passed (in toto) to the surviving spouse and then from the surviving spouse to the remainder beneficiaries. These fictions permit the value of the property to be treated as qualifying for marital deduction treatment, while ensuring that the deferred federal estate tax is paid when the second spouse dies. But neither fiction should be confused with the reality of what happens when a trust is created. Nor can they obscure the absence of any comparable state arrangement for a trust that, in this case, was established in 2002.

As the Court noted in *Bracken*, inclusion of QTIP in the federal taxable estate of the surviving spouse is the quid pro quo for excluding it from the federal taxable estate of the first to die. *See* 175 Wn. at 568-69. The duty of consistency supports this treatment, just as the Court states. Contrary to the Department’s argument, that duty does not apply only to omissions or misrepresentations. *See, e.g., Beltzer v. United States*, 495

²⁹ The Department elsewhere mischaracterizes I.R.C. § 2056(b)(7)(B)(i) as requiring that property “pass from the decedent to the surviving spouse.” Br., p. 11. The statute actually requires that QTIP property “pass from the decedent.” I.R.C. § 2056(b)(7)(B)(i)(I).

F.2d 211, 212-13 (8th Cir. 1974) (taxpayer disagreed with older brother over values shown in earlier estate tax return).

According to the Department, the death of the surviving spouse “is the generating event causing a shift of interests in the property.” Br. at 36.

To describe death by itself as a “generating event” is paradoxical at best.

The penultimate paragraph of *McGrath* flatly rejects this notion:

[H]ere, the decedent never had any ownership or right of any kind in the policies in question or in the proceeds thereof. He had no vestige of control over them. He did not take them out. He did not pay the premiums. As the trial judge somewhat whimsically, but very pertinently, remarked in his memorandum opinion, he furnished nothing except the death.

191 Wash. at 510. Like Mr. McGrath, Barbara had no vestige of control over the marital trust. It was created by Joseph and funded by him, for the benefit of persons chosen by him. All of this happened years before the adoption of the standalone Washington estate tax. Given that statute’s clear directive that it applies only to the estates of persons dying after May 17, 2005, there was no basis for imposing the tax on marital trust assets in *Bracken*, and there is none here.

Finally, the Department’s argument for overturning *Bracken* nowhere mentions the rules and regulations that were in force when the decedents there died. Those regulations, which “have the same force and effect as if specifically set forth in [ch. 83.100 RCW] . . .” (RCW

83.100.200), supported the estates' position in *Bracken* and were flatly inconsistent with the Department's argument. See 175 Wn.2d at 560-61; *id.* at 588 (Madsen, C.J., concurring and dissenting) ("The rule provides for removal of the effect of any federal QTIP elections, whether currently made by this decedent or made by a predeceased spouse. . . . This means that the state estate tax is computed wholly without regard to any federal QTIP election."). The same regulations were in force when Barbara died and Osborne filed her Washington estate tax return. Just as those regulations belied the Department's contentions in *Bracken*, they do so here. They may not be ignored.

E. Osborne should be awarded his fees and costs.

For the reasons set forth above, in addition to those presented in Osborne's Motion to Dismiss under RAP 18.9(c) and Motion to Modify Commissioner's Ruling, Osborne asks for an award of reasonable attorney fees and expenses under RCW 4.84.185 and RAP 18.9(a).

CONCLUSION

The Supreme Court's decision in *Bracken* is correct as well as binding on this Court, and it is determinative of the issues in this case. The statute that the Department sought and the Legislature enacted to reverse *Bracken* does not require a different outcome. If it does, the statute is unconstitutional as applied: It violates the constitutional

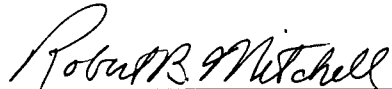
underpinnings of an excise tax by taxing property rather than a transfer, and it violates the separation of powers doctrine, due process, the impairment clauses, and equal protections.

The superior court's judgment should be affirmed.

DATED this 16th day of September 2013.

Respectfully submitted,

K&L GATES LLP

By 
Mark W. Roberts, WSBA #16843
Robert B. Mitchell, WSBA # 10874
Peter A. Talevich, WSBA # 42644
Attorneys for Respondent
Scott B. Osborne

COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

SCOTT B. OSBORNE, Personal
Representative of the Estate of
Barbara Hagyard Mesdag,

Respondent,

v.

THE DEPARTMENT OF
REVENUE OF THE STATE OF
WASHINGTON,

Appellant.

No. 44766-5 II

CERTIFICATE OF SERVICE


I, Suzanne M. Petersen, declare as follows:

I am and at all times hereinafter mentioned was a citizen of the United States, a resident of the State of Washington, over the age of 21 years, competent to be a witness in the above action, and not a party thereto; that on the 16th day of September, 2013, I caused to be served true copies of the following documents: (1) Brief of Respondent and (2) this Certificate of Service via email upon Charles Zalesky and David

Hankins, counsel to the Department, as permitted by the parties' service agreement.

I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct:

DATED this 16th day of September, 2013 at Seattle, Washington.

By  _____
Suzanne M. Petersen

APPENDIX

existed January 1, 2005. Federal estate tax law changes enacted after January 1, 2005, do not apply to the reporting requirements of Washington's estate tax. The department will follow federal Treasury Regulations section 20 (Estate tax regulations), in existence on January 1, 2005, to the extent they do not conflict with the provisions of chapter 83.100 RCW or 458-57 WAC. For deaths occurring January 1, 2009, and after, Washington has different estate tax reporting and filing requirements than the federal government. There will be estates that must file an estate tax return with the state of Washington, even though they are not required to file with the federal government. The Washington state estate and transfer tax return and the instructions for completing the return can be found on the department's web site at <http://www.dor.wa.gov/> under the heading titled forms. The return and instructions can also be requested by calling the department's estate tax section at 360-570-3265, option 2.

(b) **Lifetime transfers.** Washington estate tax taxes lifetime transfers only to the extent included in the federal gross estate. The state of Washington does not have a gift tax.

(3) **Definitions.** The following terms and definitions are applicable throughout chapter 458-57 WAC:

(a) "Absentee distributee" means any person who is the beneficiary of a will or trust who has not been located;

(b) "Decedent" means a deceased individual;

(c) "Department" means the department of revenue, the director of that department, or any employee of the department exercising authority lawfully delegated to him by the director;

(d) "Escheat" of an estate means that whenever any person dies, whether a resident of this state or not, leaving property in an estate subject to the jurisdiction of this state and without being survived by any person entitled to that same property under the laws of this state, such estate property shall be designated escheat property and shall be subject to the provisions of RCW 11.08.140 through 11.08.300;

(e) "Federal return" means any tax return required by chapter 11 (Estate tax) of the Internal Revenue Code;

(f) "Federal tax" means tax under chapter 11 (Estate tax) of the Internal Revenue Code;

(g) "Federal taxable estate" means the taxable estate as determined under chapter 11 of the Internal Revenue Code without regard to:

(i) The termination of the federal estate tax under section 2210 of the IRC or any other provision of law; and

(ii) The deduction for state estate, inheritance, legacy, or succession taxes allowable under section 2058 of the IRC.

(h) "Gross estate" means "gross estate" as defined and used in section 2031 of the Internal Revenue Code;

(i) "Internal Revenue Code" or "IRC" means, for purposes of this chapter, the United States Internal Revenue Code of 1986, as amended or renumbered on January 1, 2005;

(j) "Person" means any individual, estate, trust, receiver, cooperative association, club, corporation, company, firm, partnership, joint venture, syndicate, or other entity and, to the extent permitted by law, any federal, state, or other governmental unit or subdivision or agency, department, or instrumentality thereof;

(k) "Person required to file the federal return" means any person required to file a return required by chapter 11 of the

WAC 458-57-105 Nature of estate tax, definitions. (1)

Introduction. This rule applies to deaths occurring on or after May 17, 2005, and describes the nature of Washington state's estate tax as it is imposed by chapter 83.100 RCW (Estate and Transfer Tax Act). It also defines terms that will be used throughout chapter 458-57 WAC (Washington Estate and Transfer Tax Reform Act rules). The estate tax rule on the nature of estate tax and definitions for deaths occurring on or before May 16, 2005, can be found in WAC 458-57-005.

(2) **Nature of Washington's estate tax.** The estate tax is neither a property tax nor an inheritance tax. It is a tax imposed on the transfer of the entire taxable estate and not upon any particular legacy, devise, or distributive share.

(a) **Relationship of Washington's estate tax to the federal estate tax.** The department administers the estate tax under the legislative enactment of chapter 83.100 RCW, which references the Internal Revenue Code (IRC) as it

Internal Revenue Code, such as the personal representative (executor) of an estate;

(l) "Property," when used in reference to an estate tax transfer, means property included in the gross estate;

(m) "Resident" means a decedent who was domiciled in Washington at time of death;

(n) "State return" means the Washington estate tax return required by RCW 83.100.050;

(o) "Taxpayer" means a person upon whom tax is imposed under this chapter, including an estate or a person liable for tax under RCW 83.100.120;

(p) "Transfer" means "transfer" as used in section 2001 of the Internal Revenue Code. However, "transfer" does not include a qualified heir disposing of an interest in property qualifying for a deduction under RCW 83.100.046;

(q) "Washington taxable estate" means the "federal taxable estate":

(i) Less one million five hundred thousand dollars for decedents dying before January 1, 2006, or two million dollars for decedents dying on or after January 1, 2006;

(ii) Less the amount of any deduction allowed under RCW 83.100.046 as a farm deduction;

(iii) Less the amount of the Washington qualified terminable interest property (QTIP) election made under RCW 83.100.047;

(iv) Plus any amount deducted from the federal estate pursuant to IRC § 2056 (b)(7) (the federal QTIP election);

(v) Plus the value of any trust (or portion of a trust) of which the decedent was income beneficiary and for which a Washington QTIP election was previously made pursuant to RCW 83.100.047; and

(vi) Less any amount included in the federal taxable estate pursuant to IRC § 2044 (inclusion of amounts for which a federal QTIP election was previously made).

[Statutory Authority: RCW 83.100.047 and 83.100.200. 06-07-051, § 458-57-105, filed 3/9/06, effective 4/9/06.]

WAC 458-57-115 Valuation of property, property subject to estate tax, and how to calculate the tax. (1) Introduction. This rule applies to deaths occurring on or after May 17, 2005, and is intended to help taxpayers prepare their return and pay the correct amount of Washington state estate tax. It explains the necessary steps for determining the tax and provides examples of how the tax is calculated. The estate tax rule on valuation of property etc., for deaths occurring on or before May 16, 2005, can be found in WAC 458-57-015.

(2) Determining the property subject to Washington's estate tax.

(a) **General valuation information.** The value of every item of property in a decedent's gross estate is its date of death fair market value. However, the personal representative may elect to use the alternate valuation method under section 2032 of the Internal Revenue Code (IRC), and in that case the value is the fair market value at that date, including the adjustments prescribed in that section of the IRC. The valuation of certain farm property and closely held business property, properly made for federal estate tax purposes pursuant to an election authorized by section 2032A of the 2005 IRC, is binding on the estate for state estate tax purposes.

(b) **How is the gross estate determined?** The first step in determining the value of a decedent's Washington taxable estate is to determine the total value of the gross estate. The value of the gross estate includes the value of all the decedent's tangible and intangible property at the time of death. In addition, the gross estate may include property in which the decedent did not have an interest at the time of death. A decedent's gross estate for federal estate tax purposes may therefore be different from the same decedent's estate for local probate purposes. Sections 2031 through 2046 of the IRC provide a detailed explanation of how to determine the value of the gross estate.

(c) **Deductions from the gross estate.** The value of the federal taxable estate is determined by subtracting the authorized exemption and deductions from the value of the gross estate. Under various conditions and limitations, deductions are allowable for expenses, indebtedness, taxes, losses, charitable transfers, and transfers to a surviving spouse. While sections 2051 through 2056A of the IRC provide a detailed explanation of how to determine the value of the taxable estate the following areas are of special note:

(i) **Funeral expenses.**

(A) Washington is a community property state and under *Estate of Julius C. Lang v. Commissioner*, 97 Fed. 2d 867 (9th Cir. 1938) affirming the reasoning of *Wittwer v. Pemberton*, 188 Wash. 72, 76, 61 P.2d 993 (1936) funeral expenses reported for a married decedent must be halved. Administrative expenses are not a community debt and are reported at 100%.

(B) **Example.** John, a married man, died in 2005 with an estate valued at \$2.5 million. On Schedule J of the federal estate tax return listed following as expenses:

SCHEDULE J - Funeral Expenses and Expenses Incurred in Administering Property Subject to Claims			
Item Number	Description	Expense Amount	Total Amount
1	A. Funeral expenses: Burial and services	\$4,000	
	(1/2 community debt)	(\$2,000)	
	Total funeral expenses		
	B. Administration expenses:		
	1. Executors' commissions - amount estimated/agreed upon paid. (Strike out the words that do not apply).		\$10,000
	2. Attorney fees - amount estimated/agreed upon/paid. (Strike out the words that do not apply).		\$5,000

The funeral expenses, as a community debt, were properly reported at 50% and the other administration expenses were properly reported at 100%.

(ii) **Mortgages and liens on real property.** Real property listed on Schedule A should be reported at its fair market value without deduction of mortgages or liens on the property. Mortgages and liens are reported and deducted using Schedule K.

(iii) **Washington qualified terminable interest property (QTIP) election.**

(A) A personal representative may choose to make a larger or smaller percentage or fractional QTIP election on the Washington return than taken on the federal return in order to reduce Washington estate liability while making full use of the federal unified credit.

(B) Section 2056 (b)(7) of the IRC states that a QTIP election is irrevocable once made. Section 2044 states that the value of any property for which a deduction was allowed under section 2056 (b)(7) must be included in the gross estate of the recipient. Similarly, a QTIP election made on the Washington return is irrevocable, and a surviving spouse who receives property for which a Washington QTIP election was made must include the value of the remaining property in his or her gross estate for Washington estate tax purposes. If the value of property for which a federal QTIP election was made is different, this value is not includible in the surviving spouse's gross estate for Washington estate tax purposes; instead, the value of property for which a Washington QTIP election was made is includible.

(C) The Washington QTIP election must adequately identify the assets, by schedule and item number, included as part of the election, either on the return or, if those assets have not been determined when the estate tax return is filed, on a statement to that effect, prepared when the assets are definitively identified. Identification of the assets is necessary when reviewing the surviving spouse's return, if a return is required to be filed. This statement may be filed with the department at that time or when the surviving spouse's estate tax return is filed.

(D) **Example.** A decedent dies in 2009 with a gross estate of \$5 million. The decedent established a QTIP trust for the benefit of her surviving spouse in an amount to result in no federal estate tax. The federal unified credit is \$3.5 million for the year 2009. In 2009 the Washington statutory deduction is \$2 million. To pay no Washington estate tax the personal representative of the estate has the option of electing a larger percentage or fractional QTIP election resulting in the maximization of the individual federal unified credit and paying no tax for Washington purposes.

The federal estate tax return reflected the QTIP election with a percentage value to pay no federal estate tax. On the Washington return the personal representative elected QTIP treatment on a percentage basis in an amount so no Washington estate tax is due. Upon the surviving spouse's death the assets remaining in the Washington QTIP trust must be included in the surviving spouse's gross estate.

(iv) **Washington qualified domestic trust (QDOT) election.**

(A) A deduction is allowed for property passing to a surviving spouse who is not a U.S. citizen in a qualified domestic trust (a "QDOT"). An executor may elect to treat a trust as

a QDOT on the Washington estate tax return even though no QDOT election is made with respect to the trust on the federal return; and also may forgo making an election on the Washington estate tax return to treat a trust as a QDOT even though a QDOT election is made with respect to the trust on the federal return. An election to treat a trust as a QDOT may not be made with respect to a specific portion of an entire trust that otherwise would qualify for the marital deduction, but if the trust is actually severed pursuant to authority granted in the governing instrument or under local law prior to the due date for the election, a QDOT election may be made for any one or more of the severed trusts.

(B) A QDOT election may be made on the Washington estate tax return with respect to property passing to the surviving spouse in a QDOT, and also with respect to property passing to the surviving spouse if the requirements of IRC section 2056 (d)(2)(B) are satisfied. Unless specifically stated otherwise herein, all provisions of sections 2056(d) and 2056A of the IRC, and the federal regulations promulgated thereunder, are applicable to a Washington QDOT election. Section 2056A(d) of the IRC states that a QDOT election is irrevocable once made. Similarly, a QDOT election made on the Washington estate tax return is irrevocable. For purposes of this subsection, a QDOT means, with respect to any decedent, a trust described in IRC section 2056A(a), provided, however, that if an election is made to treat a trust as a QDOT on the Washington estate tax return but no QDOT election is made with respect to the trust on the federal return:

(I) The trust must have at least one trustee that is an individual citizen of the United States resident in Washington state, or a corporation formed under the laws of the state of Washington, or a bank as defined in IRC section 581 that is authorized to transact business in, and is transacting business in, the state of Washington (the trustee required under this subsection is referred to herein as the "Washington Trustee");

(II) The Washington Trustee must have the right to withhold from any distribution from the trust (other than a distribution of income) the Washington QDOT tax imposed on such distribution;

(III) The trust must be maintained and administered under the laws of the state of Washington; and

(IV) The trust must meet the additional requirements intended to ensure the collection of the Washington QDOT tax set forth in (c)(iv)(D) of this subsection.

(C) The QDOT election must adequately identify the assets, by schedule and item number, included as part of the election, either on the return, or, if those assets have not been determined when the estate tax return is filed, or a statement to that effect, prepared when the assets are definitively identified. This statement may be filed with the department at that time or when the first taxable event with respect to the trust is reported to the department.

(D) In order to qualify as a QDOT, the following requirements regarding collection of the Washington QDOT tax must be satisfied.

(I) If a QDOT election is made to treat a trust as a QDOT on both the federal and Washington estate tax returns, the Washington QDOT election will be valid so long as the trust satisfies the statutory requirements of Treas. Reg. Section 20.2056A-2(d).

(II) If an election is made to treat a trust as a QDOT only on the Washington estate tax return, the following rules apply:

If the fair market value of the trust assets exceeds \$2 million as of the date of the decedent's death, or, if applicable, the alternate valuation date, the trust must comply with Treas. Reg. Section 20.2056A-2 (d)(1)(i), except that: If the bank trustee alternative is used, the bank must be a bank that is authorized to transact business in, and is transacting business in, the state of Washington, or a bond or an irrevocable letter of credit meeting the requirements of Treas. Reg. Section 20.2056A-2 (d)(1)(i)(B) or (C) must be furnished to the department.

If the fair market value of the trust assets is \$2 million or less as of the date of the decedent's death, or, if applicable, the alternate valuation date, the trust must comply with Treas. Reg. Section 20.2056A-2 (d)(1)(ii), except that not more than 35 percent of the fair market value of the trust may be comprised of real estate located outside of the state of Washington.

A taxpayer may request approval of an alternate plan or arrangement to assure the collection of the Washington QDOT tax. If such plan or arrangement is approved by the department, such plan or arrangement will be deemed to meet the requirements of this (c)(iv)(D).

(E) The Washington estate tax will be imposed on:

(I) Any distribution before the date of the death of the surviving spouse from a QDOT (except those distributions excepted by IRC section 2056A (b)(3)); and

(II) The value of the property remaining in the QDOT on the date of the death of the surviving spouse (or the spouse's deemed date of death under IRC section 2056A (b)(4)). The tax is computed using Table W. The tax is due on the date specified in IRC section 2056A (b)(5). The tax shall be reported to the department in a form containing the information that would be required to be included on federal Form 706-QDT with respect to the taxable event, and any other information requested by the department, and the computation of the Washington tax shall be made on a supplemental statement. If Form 706-QDT is required to be filed with the Internal Revenue Service with respect to a taxable event, a copy of such form shall be provided to the department. Neither the residence of the surviving spouse or other QDOT beneficiary nor the situs of the QDOT assets are relevant to the application of the Washington tax. In other words, if Washington state estate tax would have been imposed on property passing to a QDOT at the decedent's date of death

but for the deduction allowed by this subsection (c)(iv)(E)(II), the Washington tax will apply to the QDOT at the time of a taxable event as set forth in this subsection (c)(iv)(E)(II) regardless of, for example, whether the distribution is made to a beneficiary who is not a resident of Washington, or whether the surviving spouse was a nonresident of Washington at the date of the surviving spouse's death.

(F) If the surviving spouse of the decedent becomes a citizen of the United States and complies with the requirements of section 2056A (b)(12) of the IRC, then the Washington tax will not apply to: Any distribution before the date of the death of the surviving spouse from a QDOT; or the value of the property remaining in the QDOT on the date of the death of the surviving spouse (or the spouse's deemed date of death under IRC section 2056A (b)(4)).

(d) **Washington taxable estate.** The estate tax is imposed on the "Washington taxable estate." The "Washington taxable estate" means the "federal taxable estate":

(i) Less one million five hundred thousand dollars for decedents dying before January 1, 2006, or two million dollars for decedents dying on or after January 1, 2006;

(ii) Less the amount of any deduction allowed under RCW 83.100.046 as a farm deduction;

(iii) Less the amount of the Washington qualified terminable interest property (QTIP) election made under RCW 83.100.047;

(iv) Plus any amount deducted from the federal estate pursuant to IRC § 2056 (b)(7) (the federal QTIP election);

(v) Plus the value of any trust (or portion of a trust) of which the decedent was income beneficiary and for which a Washington QTIP election was previously made pursuant to RCW 83.100.047; and

(vi) Less any amount included in the federal taxable estate pursuant to IRC § 2044 (inclusion of amounts for which a federal QTIP election was previously made).

(e) **Federal taxable estate.** The "federal taxable estate" means the taxable estate as determined under chapter 11 of the IRC without regard to:

(i) The termination of the federal estate tax under section 2210 of the IRC or any other provision of law; and

(ii) The deduction for state estate, inheritance, legacy, or succession taxes allowable under section 2058 of the IRC.

(3) **Calculation of Washington's estate tax.**

(a) The tax is calculated by applying Table W to the Washington taxable estate. See (d) of this subsection for the definition of "Washington taxable estate."

Table W

Washington Taxable Estate is at Least	But Less Than	The Amount of Tax Equals Initial Tax Amount	Plus Tax Rate %	Of Washington Taxable Estate Value Greater Than
\$0	\$1,000,000	\$0	10.00%	\$0
\$1,000,000	\$2,000,000	\$100,000	14.00%	\$1,000,000
\$2,000,000	\$3,000,000	\$240,000	15.00%	\$2,000,000
\$3,000,000	\$4,000,000	\$390,000	16.00%	\$3,000,000
\$4,000,000	\$6,000,000	\$550,000	17.00%	\$4,000,000
\$6,000,000	\$7,000,000	\$890,000	18.00%	\$6,000,000
\$7,000,000	\$9,000,000	\$1,070,000	18.50%	\$7,000,000
\$9,000,000		\$1,440,000	19.00%	\$9,000,000

(b) Examples.

(i) A widow dies on September 25, 2005, leaving a gross estate of \$2.1 million. The estate had \$100,000 in expenses deductible for federal estate tax purposes. Examples of allowable expenses include funeral expenses, indebtedness, property taxes, and charitable transfers. The Washington taxable estate equals \$500,000.

Gross estate	\$2,100,000
Less allowable expenses deduction	- \$100,000
Less \$1,500,000 statutory deduction	- \$1,500,000

Washington taxable estate	\$500,000
---------------------------	-----------

Based on Table W, the estate tax equals \$50,000 (\$500,000 x 10% Washington estate tax rate).

(ii) John dies on October 13, 2005, with an estate valued at \$3 million. John left \$1.5 million to his spouse, Jane, using the unlimited marital deduction. There is no Washington estate tax due on John's estate.

Gross estate	\$3,000,000
Less unlimited marital deduction	- \$1,500,000
Less \$1,500,000 statutory deduction	- \$1,500,000

Washington taxable estate	\$0
---------------------------	-----

Although Washington estate tax is not due, the estate is still required to file a Washington estate tax return along with a photocopy of the filed and signed federal return and all supporting documentation.

[Statutory Authority: RCW 83.100.047 and 83.100.200.06-07-051, § 458-57-115, filed 3/9/06, effective 4/9/06.]

**Washington State House Floor Debate on Engrossed House Bill 2075
2013 Special Session for June 13, 2013**

[Transcribed from TVW PLAYER BEGINNING MINUTE 5 15]

Forum: Washington State House of Representatives Floor Session on Pending Legislation
(2nd day of 2013 Second Special Session)

<u>Members Speaking</u>	<u>District</u>
Rep. Reuven Carlyle	36
Rep. Terry Nealey	16
Rep. Drew MacEwen	35
Rep. Gary Alexander	2
Rep. Maureen Walsh	16
Rep. Matt Shea	4
Rep. Jamie Pedersen	43

House Speaker: Sixth order of business. Consent of the House, House will now consider House Bill 2075. Hearing no objection, so ordered. House Bill 2075, Clerk will read.

[. . . regarding amendments, remarks, technical amendments, reservation of comment]

Speaker: . . . Engrossed House Bill 2075 will be advanced to third reading. Hearing no objections, so ordered. Engrossed House Bill 2075 on third reading and final passage. Remarks. The gentleman from the 36th District, Representative Carlyle.

Carlyle: Thank you so much, Mr. Speaker. I rise for the third time in three legislative sessions, Mr. Speaker, to ask you once again to stand in support of the 2006 voter-supported estate tax in Washington State. It was a technical glitch of a lawsuit that had the effect of eliminating the estate tax for married couples only, not for single individuals, and I think that we can all accept that we needed to move forward with a responsible and thoughtful resolution to this particular court case. That's what this legislation accomplishes in order to invest in public education. I'm very appreciative of the hard work from the other side of the chamber to come to a resolution regarding a way to expand the eligibility for an additional deduction for family-owned small businesses. The Senate felt very strongly that that was an important part of a broader package and we were willing to engage with them in a meaningful way so long as we could do so in a way that would make it limited to truly small family-owned businesses, and we came to consensus. I would note that in accepting the Senate's suggestion that we raise the rate on the four highest rates in the estate tax in Washington State in order to make this a revenue-neutral proposal, we did feel that there was value for those small family-

owned businesses that's substantial given the fact that some businesses, warehousing or trucking or capital-intensive businesses, may not have the resources in order to pay the estate tax if that were the case. So this does help small family-owned businesses. It's responsible. It's thoughtful. We worked very hard to come to resolution and I appreciate the acknowledgment of so many members that, that this issue touches a sensitivity on some levels but there is a very real recognition that this investment in public education is essential. This is maintaining the status quo. This is in no way a tax increase in the aggregate level from the current status quo of how our estate tax has been operating for many, many years. We're merely fixing a technical lawsuit and I think we're doing it in a responsible way and, again, I appreciate the hard work of members of the Senate to try to find policy resolution on this issue. Thank you, Mr. Speaker. And I strongly ask for your support.

Speaker: Thank you. Any further remarks. Gentleman from the 16th District, Representative Nealey.

Nealey: Thank you, Mr. Speaker, and I still have some concerns about this matter. And the – I want to acknowledge that the bill has been improved. There has been a lot of work, especially in the last day or so between the Senate and the gentleman from the 36th and myself in trying to come to a better solution. It was well-stated that the changes to this bill does help small businesses even though there still some, I think, some problem with the language. We come across many small businesses that have capital, for example, buildings, assets and so forth, but not enough cash to pay the bill, to pay the tax bill, and this should help that situation out. However, Mr. Speaker, I still have very grave concerns about this bill's being retroactive. It reaches far back and affects taxes that would be owed from years ago and the problem is that those refunds are due to be paid out very soon. And according to the Supreme Court decision those are rightfully due to those estates. I think that we are bordering on the line of unconstitutionality if this bill passes. And if that were to occur and further lawsuits were to come against the Department of Revenue, i.e., the State of Washington, then we'd not only have to pay those refunds back but with interest and with attorneys' fees. It's been mentioned that these funds go into education. All of the budgets presented in this session fully fund the *McCleary* decision. We don't need this particular amount of funding to come from the *Bracken* decision to fund education, Mr. Speaker. That's a separate issue. What I'm concerned about here is the retroactivity and unconstitutionality of what we're doing today, and for that reason I would urge a no vote. Thank you.

Speaker: Thank you. Any further remarks? Representative Van De Wege.

Van De Wege: Thank you, Mr. Speaker. Please excuse Representative Farrell, Representative Hudgins, and Representative Santos.

Speaker: Members are excused. The gentleman from the 35th District, Representative MacEwen.

MacEwen: Thank you, Mr. Speaker. Please excuse Representatives Condotta, Crouse, Harris, Holy, Overstreet, Parker, Pike and Rodne.

Speaker: Members are excused. The gentleman from the 2nd District, Representative Alexander.

Alexander: Thank you, Mr. Speaker. Mr. Speaker, I share the concerns about the retroactivity probably as much as anybody about – I don't like to see decisions made retroactive that basically change the laws and the rules that are being governing our decisions. Now, Mr. Speaker, I am going to support this legislation today for one reason and one reason only. I believe we're going to have to reach some amount of give-and-take to get a budget resolved and out of this body and out of the Senate body. And I've been working with both sides and I believe that a number of the concerns of the Senate regarding this bill have been addressed in this particular striker and I think if this bill goes forward, not just the question of saving, the fact that tomorrow we pay off some paychecks – or some checks, not paychecks but checks, big checks by the way – but, more importantly, if this helps get to a resolved consensus without requiring new tax obligations on our, on our citizens that affect their daily lives then I think it's a move that out to be supported, so thank you, Mr. Speaker.

Speaker: Thank you. Any further remarks? Lady from the 16th District, Representative Walsh.

Walsh: Thank you, Mr. Speaker. And I certainly appreciate the sentiments from the previous speaker and have tremendous respect for him and all the work that he's done trying to get us out of here this year. But I also think there's a tremendous inherent unfairness with this bill. I just read an article about a family who had \$700,000 taken from – after their mother passed away in 2008. Now they have a son who's recently lost his wife to cancer and he's disabled and they really need the money. We did not take this money lawfully from these people. This money came because somebody boo-boomed. I don't care – it was somebody's fault in government, Department of Revenue, but the reality is this money was not obtained lawfully from these families. This money – and my understanding, simplistic as it is, is that it was somewhere hovering around 160 million bucks to take care of this, to nip this in the bud, to be done with this. You know what? Maybe it's rainin'. Maybe it's a rainy day. Maybe we ought to just take 160 million dollars, pay back these families who we took this money from and be done with this. Because guess what? Constitutional issues and everything else aside, reality is this money belongs to those families because it was not lawfully taken from them in the first place. And guess what? We have seen lawsuits increased exponentially in

this place. I've been here 20 years and the amount of lawsuits against this state because of misinterpreted statutes or what have you has really grown exponentially and is *huge* right now. We need to step up, take care of this, pay back these families, and be done with this and not have this issue rear its ugly head continually as these families continue to come back and sue the state because we're going against a decision made by the Supreme Court to refund these families. That's what we should do. We should be done with this. I don't know why we're playing around and saying it's in the interests of education. We're all here for the interests of education and we're all going to do a good job to take care of education again because of a lawsuit! Why do we need to continue to step into this? We need to step away, refund these families, and be done with this for good. This is gonna keep coming back at us, folks. Let's just take care of it and call 'er good.

Speaker: Thank you. Any further remarks. Gentleman from the 4th District, Representative Shea.

Shea: Thank you, Mr. Speaker, and I also rise in opposition to the bill today for a couple reasons. Number one, this is isn't the government's money. And number two, we took an oath, Mr. Speaker, we took an oath to defend the state constitution and there's been a long-standing principle in America that we don't pass laws retroactively to hold people accountable for something they never knew they would be accountable for. And, Mr. Speaker, this is about people. If we pass this we are going to be sued as the State Washington. We are going to lose and not only are we going to have to pay back the money for all of that, we are going to have to pay attorneys' fees and we are gonna have to pay interest on that money. And you know where that money's gonna come from? It's gonna come from our children. It's gonna come from our disabled. It's gonna come from our future, Mr. Speaker. And I think that the solution to this entire dilemma is pretty simple. We should just fund education with our first dollar instead of our last dubious penny. Please vote no. Thank you.

Speaker: Thank you. Any further remarks? Gentleman from the 43rd District, Representative Pedersen.

Pedersen: Thank you, Mr. Speaker. You know, I actually agree with the gentleman from the 4th District about a number of things that he said. This is about people, this is about expectations, and this is about funding education. We're talking today about a group of roughly 70 families who met with their lawyers and made a very deliberate decision to form Qualified Taxable Investment Property Trusts so that they could delay payment of the estate taxes with the full understanding that on the death of the second spouse for federal estate tax purposes the estate tax would be payable with those trust assets. These are people who made very conscious planning decisions to defer payment of the estate tax, not to escape it entirely. Now, it's unfortunate, but not

unprecedented, that in the Legislature in developing the 2005 estate tax legislation that was ultimately approved, as my colleague from the 36th noted, by a substantial majority of the voters that there was a technical glitch. And as a result we have a system set up in which we have a profound inequity in treatment between married couples and unmarried individuals – a planning opportunity, my colleagues in estate planning would call it. That means that unless we make some change we're going to be in a situation in our state when only single people need to pay the estate tax because any married couple with the assets will be able to escape our estate tax entirely. And so this bill is about expectations and it's about, in terms of the retroactivity, weighing the expectations of those 70 families that planned to pay the estate tax later against the expectations of more than a million children whose education depends, depends on our doing a better job of funding it. I take issue with the remarks of the gentleman from the 16th District who says that we are fully funding education in this budget. We are doing nothing close to funding education amply. We need a lot more money, not just this money, to be applied to education but we'll take this as a step toward that day. On Monday morning I had the pleasure of going with my partner Eric to meet with the principal of Stevens Elementary School where our son Trig will be starting this fall. Our other three sons will be starting in two years. That system needs our help because those kids, like all of the other kids headed to school this fall, need our help. They need us to be doing more to support them. And this is an inadequate small step, but a step in the right direction, toward compliance with our constitutional obligations under the *McCleary* decision to make sure that all Washington kids have a good education. I urge your support.

Speaker: Thank you. Any further remarks? Seeing none, the question before the House is final passage of Engrossed House Bill 2075. The speaker's about to open the roll call machine. [*bell tolls*] The speaker has opened the roll call machine. Has every member voted? Does any member wish to change his or her vote? Speaker's about to lock the roll call machine. Representative Kretz, how do you vote? [*Inaudible*] Speaker has locked the roll call machine. Clerk will take the record, please.

Clerk: Mr. Speaker, there are 53 yea, 33 nay, 11 excused or not voting.

Speaker: Having received a constitutional majority, Engrossed House Bill 2075 is declared passed. [*gavel*] With the consent of the House the bill that was just immediately, that was just worked on, will be immediately transferred to the Senate. Hearing no objection, so ordered. [*gavel*] The House is now at ease subject to the call of the speaker. The House is now at ease.

*** END of 6/13/2013 Washington State House Floor Debate on Engrossed House Bill 2075 ***

K:\2069007\00001\22658\22658O20F6

**Washington State Senate Floor Debate on Engrossed House Bill 2075
2013 Special Session on June 13, 2013**

[Transcribed from TVW PLAYER BEGINNING MINUTE 52:05]

Forum: Washington State Senate Floor Session on Pending Legislation (2nd day of 2013
Second Special Session)

<u>Members Speaking</u>	<u>District</u>
Sen. Andy Hill	45
Sen. Mike Padden	4
Sen. James Hargrove	24
Sen. Jim Honeyford	15
Sen. Joe Fain	47
Sen. Sharon Brown	8
Sen. Sharon Nelson	34
Sen. Michael Baumgartner	6
Sen. Rodney Tom	48
Sen. John Braun	20

Senate President: . . . and the bill be placed on final passage. Hearing no objection, so ordered. [*gavel*] Senator Hill.

Sen. Hill: Usually I work with my soccer teams. I wait when they quiet down. Mr. President, this bill clarifies some language in our Washington estate tax. It truly does close a loophole that was determined by Supreme Court order. In short order, it basically requires that marital trust property be included in the estate for the purposes of the estate tax. We also make some tweaks to the estate tax code. We provide a deduction for family-owned businesses and we adjust the – we now allow the \$2 million exemption to grow indexed at inflation on an annual basis. And it also increases the top four rates in the estate tax to make the entire change revenue-neutral. So I think what you have here is, we close a loophole, we give some needed relief to our family businesses, and in doing all of this we free up \$160 million. Now, according to my calculations we've got about \$1.9 billion of taxes coming in this year more than we did last year – I mean last biennium. When you add in our hospital safety net, our cost-shift to Medicaid expansion, and now this \$160 million, we now have roughly \$2.7 billion more than we had last biennium – 2.7 billion. And yet we have a budget that was pushed over here from the other side that could only get 700 dol- -- 700 million into basic education. And we have a Governor saying that we need to raise more taxes to get a billion into basic education. I hope that now with \$2.7 billion we can finally get a budget that both houses and the Governor can agree on that'll get us a billion dollars. Now this body has passed out two budgets that got a billion

into *McCleary*. And we have threats of shutting down the government because we need more taxes because we can't get that billion dollars. So I fully expect every dollar of this \$160 million to go to basic education, and I ask you for your vote. Thank you.

President: Senator Padden.

Sen. Padden: Tim. Evening's late but I did want to point out a few concerns I have, and certainly have tremendous respect for the gentleman from the 45th District in trying to put together a budget, certainly not an easy thing. But I have questions specifically about this. Frankly, I don't think we'll ever see this money. I think the Supreme Court will rule that this legislation, as far as the retroactivity, is unconstitutional. Certainly that was the opinion of the estate section of the Washington State Bar Association, and it wasn't just an opinion by a majority of those members, it was the unanimous opinion of each and every member of that estate tax division. I mean, the whole idea of retroactivity generally is considered unfair. And I mean I think you go back to Roman law or common law or whatever and the idea is, I mean, you ought to know what the rules are at the time that you take action, and here we're changing the rules after the fact. So certainly those estates that were involved before 2005, I just don't see the court's upholding this. I know that this new bill is an effort to have some policy changes that I support but, again, to do that they are raising the rates even more. And we have the highest estate tax rates in the country already. So I just have a lot of concerns with this. This bill did not have a hearing in the Ways and Means Committee and the last bill on this subject that had a hearing in the Ways and Means Committee didn't have enough votes to get out of the committee. So I mean, I think there's a lot of problems with this legislation and I would urge a no vote.

President: Senator Hargrove?

Sen. Hargrove: Well, thank you, Mr. President. Thank you very much. Just to make a few comments here. First of all, I'm very glad we're finally getting this particular piece done. This was \$160 million bogey that got handed to us by the court after we came here. We didn't get this news on this case until after we came to session and, if you remember, we were about 900 million in the hole on our current law budget when we came to session and then of course we knew we were going to have to make an investment in *McCleary* of, you know, whether it's a billion or a little less or a little more. Some people think more. Some people think a little less will do this year. The point is that our current law budget was upside-down by over a billion after this *McCleary* – after this estate tax decision came to us early in session. So, no matter how you look at the numbers and the math, you have to make real cuts. Things happen in our budget that are caseloads that grow, there's inflation, there's other things that are in current law that you have to make

decisions on. And we went through a long and a difficult decision-making process in our Senate budget even to end up coming up with a number of cuts that were very painful for some people that we've talked about in order to try to make these things balance. So I'm, you know – I appreciate the, the comments here. I'm very glad we're getting this particular piece done. I think it's going to be part of our go-home budget at some point in time, and I – believe me – I am very much looking forward to *going home*. Thank you very much. Encourage your support.

President: Senator Honeyford?

Sen. Honeyford: Thank you, Mr. President. A point of inquiry.

President: What is your point of inquiry?

Sen. Honeyford: Thank you, Mr. President. I notice tonight that several people have addressed the President of the Senate as President Pro Tem and I noticed that I know in the past the tradition of the Senate has been we address the President Pro Tem as President. And when we had the Vice-President Pro Tem we addressed him as President. Would you give us some direction, please?

President: Well, thank you for asking, Senator Honeyford. I believe the correct address to the presiding officer is 'Mr. President.' The President Pro Tem is elected by all the members of the Senate and, in the absence of the Lieutenant-Governor, serves in the role as President. So I believe the correct address to the presiding office is 'Mr. President.' Thank you for inquiring, Senator Honeyford. Senator Fain?

Sen. Fain: Thank you, Mr. President. I belatedly move that we suspend Rule 15 so that the chamber may be past 10:00 p.m.

[*Laughter*]

President: Senator Fain has moved that we suspend Rule 15 so we may belatedly be in session past 10:00 p.m. Hearing no objection [*clamor*] – so retroactively. Hearing no objection, so order. [*gavel*] Senator Brown.

Sen. Brown: Mr. President, thank you. I stand in opposition of the bill, particularly because it's retroactive and, as an attorney, I just cannot support retroactivity. The bill allows the Department of Revenue to tax a transaction with a tax that was not enacted until *thirty years* after the transfer was completed. This bill is an unconstitutional attempt to change the terms of the contract entered into prior to the enactment of Washington's estate tax and for that reason I stand in opposition of this. Thank you, Mr. President.

President: Senator Nelson?

Sen. Nelson: Thank you, Mr. President. And I stand in strong support of this legislation. The people of this state were very, very clear. They wanted an estate tax. They supported taxing the wealthiest estates for our children's education and their future. And when the Supreme Court threw a loop into the estate tax in January of this year we began our discussions and it became very clear that, if we are going to have a strong financial foundation to fund *McCleary*, we needed to take this action. We need to preserve not only the 160 million that go into refunds immediately but funding for the next biennium and the next for our kids. And ladies and gentlemen, in eight hours and fifteen minutes without this legislation we begin to refund to the wealthiest estates in Washington. We begin to mail out checks for funds that could be used for our kindergartners, for our third-graders, for everything that we believe in for our kids' futures. We need this action now. It is on the brink of being too late and in eight and a half hours, eight and a half hours, these checks go in the mail. We need this action tonight. Thank you.

President: Senator Baumgartner.

Sen. Baumgartner: Well, thank you, Mr. President. You know, I rise with some concerns and ask for a no vote. You know, I agree that the spirit of what was passed back in 2006 intended for folks to make these payments but the fact of the matter was the rule of law says that they shouldn't have. And I really think this is a trust issue with governance that if the law says that you shouldn't pay it, and you deserve to get it back, it's a fundamental trust in government to have the government reach back and take that money. You know, I think there's a lot of things going on in society right now that are eroding trust in government and I just think it's a wrong precedent for us to set here. This is a very potential slippery slope towards other times that we – you know, this is, is necessary money because we decided to greatly increase the size of government and government spending and this is a necessary accounting measure, I guess, to do that. To some extent I look at this as a short-term loan with a very high interest payment because I do expect the State is going to lose this lawsuit and these folks will get that money and will get at - be costing our future funds. But, you know, I just ask everybody to think about this basic trust in government. Does government do what it says it's going to do? And I don't think we're doing that here today. So spirit of 2006, yes. But this, this basic sense that these folks, under the rule of law, shouldn't have paid this money, and we should respect that. So I ask for a no, Mr. President.

President: Senator Tom?

Sen. Tom: Thank you, Mr. President. I would ask members to vote yes on this. I was here back when we passed this out of the Legislature. I'll be honest, I did vote no on this, and back in 2005. And the reason why I voted no is because

I don't think the estate tax is great on a state-by-state basis. I am a firm believe that an estate tax is a good tax on a national basis. I think, you know, one of the things as a country that probably we should do is have a stronger estate tax at the national and then that to fund maybe some of our higher-ed institutions, higher-ed research, and that. I don't think on an individual state basis it's a great idea. But I do think it was very clear when we passed that that the intent wasn't to have couples and singles taxed differently. I think everybody – one, that's not a logical means of having taxation policy and it surely wasn't the intent of the Legislature. So think that this is a good bill. But, more importantly, we need to make sure that if we have now \$160 million more than we did in the original Senate budget, if we were able to put a billion dollars for *McCleary* and we continue to hear off this Senate floor that education is our paramount duty and we need more money for education to make sure that our kids are prepared for a 21st Century economy, we need to make sure that this 160 goes to education, goes to *McCleary*, so that we can fund our constitutional and moral obligation. Thank you, Mr. President.

President: Senator Braun?

Sen. Braun: Thank you, Mr. President. I rise in somewhat conflicted support of this bill. You know, this bill attempts to fix the result of *Bracken* by expanding the definition of a transfer, a move that raises serious constitutional challenges under the contract clause of both the U.S. and the Washington State Constitution. It also attempts to apply a death tax enacted in 2005 to trusts created prior to 2005, again raising serious constitutional concerns. These are serious issues that deserve our careful consideration. Unfortunately, the dominant narrative has been one that pits millionaires against our children and it's created a political atmosphere that limited discussion on the issues of constitutionality. As a result, I believe we're abdicating our responsibilities to the courts. However – this is why I'm conflict –, this has offered the opportunity to do something I believe of great benefit to our state's small family businesses that are disproportionately affected by the death tax. This bill creates a small family business deduction for our smallest employers that I believe are critical to our economic future, and our greatest risk to failure during intergenerational transfer. It does this in a revenue-neutral fashion and has high sideboards to prevent the gaming of the system. It's an important reform that was reached by finding common philosophical ground and then working in good faith to craft a compromise that met that shared vision. So, although I have great concerns about the constitutionality of this *Bracken* fix, I do trust our court system to address the issue. And I'm very proud of the good work this bill does for our smallest employers. Thank you, Mr. President.

President: The question before the Senate is final passage of Engrossed House Bill 2075. The Secretary will call the roll.

Secretary: [*calls roll*] Mr. President, 30 ayes, 19 nay.

President: Having received the constitutional majority, Engrossed House Bill 2075 is declared passed. The title of the bill will be the title of the Act.

[*gavel*]

[*procedural matters*]

*** END of 6/13/2013 Washington State Senate Floor Debate on Engrossed House Bill 2075 ***

K:\2069007\00001\22658\22658O20F5