NO. 92231-4

SUPREME COURT 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.

ANSWER TO PETITION FOR REVIEW

ROBERT W. FERGUSON
Attorney General

David M. Hankins, WSBA # 19194
Senior Counsel
Charles Zalesky, WSBA # 37777
Assistant Attorney General
Revenue Division, OID No. 91027
P.O. Box 40123
Olympia, WA 98504-0123
(360) 753-5528

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Rules

Treatises

I. INTRODUCTION

This Court's decision in *In re Estate of Hambleton*, 181 W.2d 802, 335 P.3d 398 (2014), resolved all but two of the issues raised before the Court of Appeals in this case. Those two issues were the Mesdag estate's claim that the trial court order granting the estate's motion for judgment on the pleadings was "final" at the time it was entered and not subject to appeal, and its claim that it was entitled to a refund of interest from the Department of Revenue—a claim that was raised for the first time in the estate's post-*Hambleton* supplemental brief. The Court of Appeals rejected the first claim, holding that the Department properly appealed the trial court's order. The Court declined to address the merits of the estate's "interest" claim, explaining that the Administrative Procedure Act required the issue to be remanded to the Department of Revenue for determination before the estate could seek judicial review.

The unpublished decision of the Court of Appeals does not merit review by this Court. That decision does not conflict with any decision of this Court or of any other court. It also raises no issue of significant constitutional law and addresses no issue of substantial public importance. Consequently, the Petition should be denied. *See* RAP 13.4(b).

II. IDENTITY OF RESPONDENT

Respondent to this motion is the State of Washington, Department of Revenue.

III. RESTATEMENT OF THE ISSUES

Should this Court grant discretionary review, the following issues would be presented:

1. Did the Court of Appeals correctly conclude that the trial court's order granting relief to the Mesdag estate was subject to appeal and that the Department's appeal was proper?

2. Should the Mesdag estate's argument that it is entitled to a refund of interest be remanded to the Department for determination as required by RCW 34.05.554(2) when the issue was not raised by the estate as part of its administrative refund claim filed with the Department?

IV. COUNTERSTATEMENT OF THE CASE

In 2010 the estate of Barbara Mesdag ("Estate") filed a complaint seeking review of a Department letter decision denying the Estate's claim for refund of estate tax. CP 4. The Estate asserted that it had overpaid the Washington tax on the value of qualified terminable interest property ("QTIP") included in the Estate's federal gross estate. The trial court proceedings were stayed pending final resolution of *In re Estate of Bracken*, which involved the same QTIP issue. CP 40. *Bracken* was

decided in October 2012. In that case, the Supreme Court held that the Legislature did not intend to impose estate tax on QTIP passing at the death of the second spouse. *In re Estate of Bracken*, 175 Wn.2d 549, 574, 290 P.3d 99 (2012), *superseded by statute as recognized in In re Estate of Hambleton*, 181 W.2d 802, 335 P.3d 398 (2014).

After *Bracken* was decided, the Estate moved for judgment on the pleadings, asserting that it was entitled as a matter of law to the estate tax refund it was seeking. CP 42. The trial court granted the Estate's motion, and the Department appealed. CP 96, 99. Soon thereafter, the Estate filed a motion with the Court of Appeals under RAP 18.9(c) seeking to have the Department's appeal dismissed. The Court Commissioner denied the motion. *See* May 29, 2013, Ruling. The Estate filed a timely motion to modify the Commissioner's order. The motion was denied on July 17, 2013, and the Estate did not seek discretionary review under RAP 13.5(a). Thus, the appeal proceeded.

In June 2013, while this appeal was pending, the Legislature amended the estate tax code in response to *Bracken*. Laws of 2013, 2d Spec. Sess., ch. 2. That 2013 legislation amended the definitions of "transfer" and "Washington taxable estate" to expressly include QTIP in the Washington taxable estate of a decedent. *Id.* at § 2. The amendments apply retroactively to "all estates of decedents dying on or after May 17,

2005." *Id.* at § 9. The amended law applies to the estate of Barbara Mesdag, who died in 2007. *See* CP 8.

Several estates challenged the 2013 amendments on constitutional grounds. Two of those appeals were transferred to this Court and consolidated for argument. *In re Estate of Hambleton*, 181 Wn.2d 802, 815-16, 335 P.3d 398 (2014). The Court unanimously rejected all of the estates' arguments and held that the 2013 amendments were constitutional.

After *Hambleton* was decided, the Estate filed a supplemental brief with the Court of Appeals arguing that *Hambleton* did not fully resolve this appeal, that it was entitled to the estate tax refund it was seeking because "the Estate's judgment was final" at the time it was entered by the trial court and not subject to appeal, and that even if it owed the underlying estate tax in dispute it was entitled to a refund of interest. Estate's Supp. Br. at 1, 9. The Court of Appeals rejected the Estate's claim that the trial court's order was final at the time it was entered, holding that the Department filed a proper appeal of that order and observing that the Estate cited no persuasive authority supporting its claim. *Osborne v. Dep't of Revenue (In re Estate of Mesdag)*, Ct. App. No. 44766-5-II, slip. op. at 7-8 (Aug. 11, 2015). By contrast, the Court of Appeals did not reject the Estate's "interest" argument on the merits. Instead, it ordered that the issue be remanded to the Department for

determination pursuant to RCW 34.05.554(2). Slip op. at 10. The Estate seeks discretionary review of the Court of Appeals unpublished opinion.

V. REASONS WHY THE COURT SHOULD DENY REVIEW

The outcome in this appeal was largely dictated by this Court's decision in *Hambleton*. Under *Hambleton*, the Estate is not entitled to the estate tax refund it is seeking. Moreover, the Court of Appeals correctly applied the controlling law in rejecting the Estate's contention that the Department was precluded from appealing the trial court's order granting the Estate's refund claim. The Court of Appeals also correctly applied relevant provisions of the Administrative Procedure Act when it remanded the Estate's "interest" argument to the Department for determination. The Estate has not presented a legitimate reason for this Court to grant review of either issue.

A. Speculation That The United States Supreme Court May Grant A Pending Petition For Writ Of Certiorari Does Not Support A Petition For Discretionary Review.

The Estate first suggests that discretionary review is "merited here because the United States Supreme Court is considering a petition for writ of certiorari in *Hambleton*." Pet. at 8. In *Hambleton*, this Court held that the 2013 retroactive amendments to the Washington estate tax code were rationally related to a legitimate legislative purpose and, therefore, did not offend substantive due process. *See Hambleton*, 181 Wn.2d at 826-27. In

reaching its decision, the Court applied the rational basis standard set out in *United States v. Carlton*, 512 U.S. 26, 114 S. Ct. 2018, 129 L. Ed. 2d 22 (1994). The litigants in *Hambleton* are attempting to persuade the U.S. Supreme Court to modify the due process standard by imposing a one-year limit on the period of any retroactive amendment to a tax law. *See* Pet. for Writ of Cert., U.S. Sup. Ct. No. 14-1436, 2015 WL 3542743 at i (filed June 5, 2015) ("The question presented is whether . . . imposing additional tax beyond the year preceding the legislative session in which the law was enacted violates due process.").

The chance that the United States Supreme Court might accept the *Hambleton* litigants' petition for writ of certiorari and change the due process standard that applies to retroactive civil legislation is not a sound reason for granting discretionary review. This Court has already spoken, upholding the 2013 amendments under the current due process standard. The possibility that the U.S. Supreme Court might someday change the substantive due process standard does not present a significant question of constitutional law requiring the attention of this Court in this case.

In any event, the petition for writ of certiorari in *Hambleton* will likely be decided by the time this Court rules on the Estate's petition for

discretionary review.[1] If the *Hambleton* petition is denied, the Estate's argument for review in this appeal will be moot. If, on the other hand, the *Hambleton* petition is granted, this Court can defer its ruling on the Estate's petition for review until after *Hambleton* is decided. This appeal will present a significant issue warranting review only in the unlikely event that *Hambleton* is reversed based on a newly announced due process limit on retroactive tax legislation.

B. The Court Of Appeals Opinion Does Not Conflict With *Hambleton*, And Does Not Conflict With Any Other Decision Of This Court Or The Court Of Appeals.

The Estate argues that the Court of Appeals decision conflicts with *Hambleton* and with cases addressing the standard for imposing sanctions under RAP 18.9(c). Pet. at 8. There is no conflict.

In *Hambleton*, this Court explained that a litigant has a right to appeal under RAP 2.2, but may not appeal for an improper purpose. "A party may appeal final trial court judgments. RAP 2.2(a)(1). However, parties may not frivolously appeal or appeal simply for purposes of delay. RAP 18.9(c). Appellate courts will, on motion from the opposing party, dismiss frivolous appeals and appeals brought for purposes of delay. RAP 18.9(c)." *Hambleton*, 181 Wn.2d at 836. The Court of Appeals quoted

[1] The *Hambleton* litigant's petition for writ of certiorari has been fully briefed and is scheduled for consideration by the U.S. Supreme Court on October 9, 2015. *See* http://www.supremecourt.gov/search.aspx?filename=/docketfiles/14-1436.htm.

and followed *Hambleton* on this point. Slip op. at 6-7. Based on the facts in the record, the Court concluded that the Department's appeal was not improper. *Id.* at 7. Instead, the Department made a good-faith argument for overruling *Bracken*, and had a well-founded belief that the law as construed in *Bracken* would be amended by the Legislature. "Under these circumstances, we conclude that the Department's appeal was not frivolous or filed solely for the purposes of delay." *Id.*

RAP 18.9(c) does not preclude a litigant from filing an appeal to advocate for the modification or reversal of existing law or to take advantage of a pending change in the law. The Estate's claim to the contrary is supported by no authority. *Hambleton* certainly does not support the Estate's contention, as the Court of Appeals expressly noted in its decision. Slip op. at 8, n.3.

When considering whether an appeal is frivolous or brought solely for delay, appellate courts are guided by the following considerations: (1) an appellant has the right to appeal under RAP 2.2; (2) all doubt as to whether the appeal is frivolous are resolved in favor of the appellant; (3) the record should be considered as a whole; (4) an appeal that is affirmed simply because the appellant's arguments are rejected is not frivolous; and (5) an appeal is frivolous only if there are "no debatable issues upon which reasonable minds might differ, and it is so totally devoid of merit that

there was no reasonable possibility of reversal." *Millers Cas. Ins. v. Briggs*, 100 Wn.2d 9, 15, 665 P.2d 887 (1983) (quoting *Streater v. White*, 26 Wn. App. 430, 434-35, 613 P.2d 187, *review denied,* 94 Wn.2d 1014 (1980)). Nothing in the Court of Appeals decision is contrary to these established principles, and the Estate cites no case suggesting any conflict. *See* Pet. at 13. Consequently, review under RAP 13.4(b)(1) or (2) is not warranted.

C. The Estate's "Interest" Argument Was Correctly Remanded To The Department For Determination And Does Not Require This Court's Immediate Attention.

The Estate also argues that this Court should grant discretionary review to decide in the first instance whether the Estate is entitled to a refund of interest. Pet. at 13-16. Review of this issue is not appropriate under RAP 13.4(b).

1. New issues raised during judicial review of agency action, when allowed, must be remanded to the agency.

The Estate's claim that it is entitled to a refund of interest was first raised in its post-*Hambleton* supplemental brief. *See* Estate's Supp. Br. at 16-19. The Estate did not make the claim as part of its application for refund filed with the Department or in its motion for judgment on the pleadings. *See* AR 78; CP 42-53.

Under the Administrative Procedure Act, a person seeking review of agency action is generally prohibited from raising new issues. RCW

34.05.554(1). "This rule is more than simply a technical rule of appellate procedure." *King County v. Boundary Review Bd.*, 122 Wn.2d 648, 668, 860 P.2d 1024 (1993). Rather, it serves important policy goals such as "(1) discouraging the frequent and deliberate flouting of administrative processes; (2) protecting agency autonomy by allowing an agency the first opportunity [to decide the matter]; (3) aiding judicial review by promoting the development of facts during the administrative proceeding; and (4) promoting judicial economy by reducing duplication, and perhaps even obviating judicial involvement." *Id.* at 669 (quoting *Fertilizer Inst. v. United States Envtl. Protection Agency*, 935 F.2d 1303, 1312-13 (D.C. Cir. 1991)).

The general rule prohibiting new issues from being raised on judicial review of agency action is subject to four exceptions. *See* RCW 34.05.554(1)(a)-(d). The Court of Appeals found that one of the statutory exceptions applied here. Specifically, the Court held that "[t]he interest [sic] of justice would be served by resolution of an issue arising from . . . [a] change in controlling law occurring after the agency action." Slip. op. at 9-10 (quoting RCW 34.05.554(1)(d)(i)). As required under the APA, the Court ordered a remand to the Department for determination of the new issue. *Id.* at 10; *see also* RCW 34.05.554(2) (when an exception

applies under RCW 34.05.554(1)(a)-(d), the court "shall remand to the agency for determination").

The Estate wishes to bypass the requirements of the APA and have this Court address its "interest" argument in the first instance. The Court should decline. Not only did the Court of Appeals correctly apply the relevant APA provision requiring remand, but the Estate's argument involves no significant issue of constitutional law requiring this Court's immediate attention.

2. Whether interest is, in fact, a civil penalty is a question of legislative intent that the Department can decide in the first instance.

The Estate contends that interest imposed under the Washington estate tax is a civil penalty that may not be assessed retroactively. Pet. at 15. Whether interest imposed under a statute is, in fact, a "penalty" is primarily a question of legislative intent. *United States v. Childs*, 266 U.S. 304, 309, 45 S. Ct. 110, 69 L. Ed. 299 (1924). In addressing the question, courts start from the position that interest does not equate to a penalty. "A penalty is a means of punishment; interest a means of compensation." *Childs*, 266 U.S. at 307; *see generally* 36 Am. Jur. 2d *Forfeitures and Penalties* § 6 (Feb. 2015) ("A penalty is distinguishable from a charge of interest, inasmuch as a penalty is a means of punishment, whereas interest is a means of compensation."). To overcome this general presumption, the

Estate must show that interest imposed under the Washington estate tax code is designed to *punish* estates that fail to timely pay their estate taxes.[2]

The weight of authority cuts against the Estate's claim that interest equates to a penalty. *See Childs*, 266 U.S. at 309-10 (interest imposed under a federal statute on late payment of taxes was not a penalty); *Unemployment Reserves Com'n of California v. Meilink*, 116 F.2d 330, 335 (9th Cir. 1940) (interest imposed under a California statute on late payment of taxes was not a penalty). This is so even when interest arises from a retroactive change to the law. *Brown & Williamson, Ltd. v. United States*, 688 F.2d 747, 750 (Ct. Cl. 1982); *Morton-Norwich Products, Inc. v. United States*, 602 F.2d 270, 276 (Ct. Cl. 1979); *Priess v. United States*, 42 F. Supp. 89, 91 (E.D. Wash. 1941).

The Department is authorized by statute to review and decide estate tax refund claims. RCW 83.100.130(1). It is capable of considering the facts and arguments supporting the Estate's refund claim and taking agency action on the claim. If the Estate disagrees with the Department's decision, it may seek review under the APA. RCW 34.05.570(4). Under these circumstances, there is no reason for this Court to grant discretionary

---

[2] Interest is imposed on an estate tax deficiency under RCW 83.100.070(2). Interest imposed under that section is computed at the same rate as interest imposed on an excise tax deficiency. *See* RCW 83.100.070(2) (incorporating by reference RCW 82.32.050(2)). The interest rate is determined on an annual basis based on "an average of the federal short-term interest rate as defined in 26 U.S.C. Sec. 1274(d) plus two percentage points." RCW 82.32.050(2).

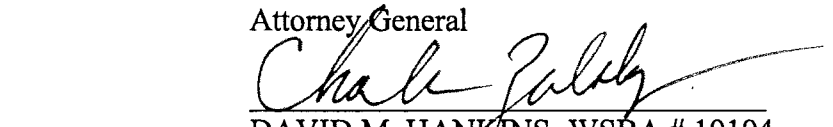
review and decide in the first instance whether interest imposed under the estate tax code is actually a civil penalty. Thus, beyond the express requirements of RCW 34.05.554(2), which require new issues to be remanded to the agency for determination, an appellate process that includes initial review by the agency tasked with granting refund claims will promote the interests justice and facilitate a rational resolution of this issue. *King County v. Boundary Review Bd.*, 122 Wn.2d at 669-71.

VI. CONCLUSION

For the reasons stated, the petition for discretionary review should be denied.

RESPECTFULLY SUBMITTED this 5th day of October, 2015.

ROBERT W. FERGUSON
Attorney General



DAVID M. HANKINS, WSBA # 19194
Senior Counsel
CHARLES ZALESKY, WSBA # 37777
Assistant Attorney General
OID No. 91027
Assistant Attorney General

PROOF OF SERVICE

I certify that I served a copy of this document, via electronic email on the following:

Mark W. Roberts
Robert B. Mitchell
Peter A. Talevich
K&L Gates LLP
925 Fourth Ave., Suite 2900
Seattle, WA 98104-1158
Rob.mitchell@klgates.com
Mark.roberts@klgates.com
Peter.talevich@klgates.com
Dawnelle.patterson@klgates.com
Joyce.hamack@klgates.com
Suzanne.petersen@klgates.com

Philip A. Talmadge
Talmadge/Fitzpatrick
2775 Harbor Ave. SW
Seattle, WA 98126-2138
phil@tal-fitzlaw.com

I certify under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 5th day of October, 2015, at Tumwater, WA.

Candy Zilinskas, Legal Assistant

OFFICE RECEPTIONIST, CLERK

To: Zilinskas, Candy (ATG)
Cc: Zalesky, Chuck (ATG); Hankins, David (ATG); Johnson, Julie (ATG)
Subject: RE: Scott B. Osborne, Personal Representative of the Estate of Barbara Hagyard Mesdag. v. The Department of Revenue, No. 92231-4

Received on 10-05-2015

Supreme Court Clerk's Office

Please note that any pleading filed as an attachment to e-mail will be treated as the original. Therefore, if a filing is by e-mail attachment, it is not necessary to mail to the court the original of the document.

From: Zilinskas, Candy (ATG) [mailto:CandyZ@ATG.WA.GOV]
Sent: Monday, October 05, 2015 2:34 PM
To: OFFICE RECEPTIONIST, CLERK <SUPREME@COURTS.WA.GOV>
Cc: Zalesky, Chuck (ATG) <ChuckZ@ATG.WA.GOV>; Hankins, David (ATG) <DavidH1@ATG.WA.GOV>; Johnson, Julie (ATG) <JulieJ@ATG.WA.GOV>
Subject: Scott B. Osborne, Personal Representative of the Estate of Barbara Hagyard Mesdag. v. The Department of Revenue, No. 92231-4

Please file the attached Answer to Petition for Review. Thank you.