

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.

APPELLANT'S REPLY BRIEF

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I. INTRODUCTION

The estate of Barbara Mesdag (“Estate”) raises a hodgepodge of statutory and constitutional arguments in an effort to obtain a refund of estate tax on the value of QTIP passing at Ms. Mesdag’s death. Each of the Estate’s arguments fall into two major themes: (1) *In re Estate of Bracken* is still controlling because, according to the Estate, the Legislature did not substantively amend the Washington estate tax code when it passed Engrossed House Bill 2075 during the 2013 legislative session; and (2) if the Legislature did substantively amend the estate tax code, those amendments are unconstitutional as applied to the Estate.

None of the Estate’s arguments has any merit. The Legislature enacted Engrossed House Bill 2075 to retroactively amend the Washington estate tax code so that QTIP passing under Internal Revenue Code § 2044 does not escape the Washington tax. That retroactive amendment (the “2013 Act”) was a valid exercise of legislative authority and applies to the QTIP passing at the death of Ms. Mesdag.

II. ARGUMENT

A. *In re Estate Of Bracken* Is Not Controlling.

The Estate argues that the holding in *Clemency v. State (In re Estate of Bracken)*, 175 Wn.2d 549, 290 P.3d 99 (2012), is controlling and that the amendments to the Washington estate tax code enacted during the

2013 legislative session do not alter the outcome of this case. *See* Resp. Br. at 8-15. The Estate is incorrect.

1. *Bracken* was decided on statutory grounds, not constitutional grounds.

In re Bracken was decided in October 2012. The Supreme Court held that the Legislature did not intend to tax QTIP passing under the Internal Revenue Code when the second spouse dies. *Bracken*, 175 Wn.2d at 570-71. The Legislature promptly amended the Washington estate tax code in June 2013 to close the significant loophole created by *Bracken*.

The Estate incorrectly contends that *Bracken* was “based upon constitutional requirements that may not be circumvented by legislative tinkering.” Resp. Br. at 10. The Estate miscomprehends the Court’s holding. The Supreme Court based its analysis on the plain language of the statute as amended in 2005. *Bracken*, 175 Wn.2d at 571 (the statute and regulation present no ambiguity and “can be plainly read to create a state estate tax scheme which, like its federal counterpart, has a QTIP election that is designed to operate prospectively”). The Court expressly declined to address constitutional arguments made by the estates. *Id.* at 563, 575. Thus, the *Bracken* decision did not establish a constitutional barrier that prohibits the Legislature from imposing the Washington tax on QTIP passing under Internal Revenue Code § 2044.

2. The 2013 Act's changes to the Washington estate tax treatment of QTIP are controlling.

Contrary to the Estate's argument, the 2013 Act substantively amended the Washington estate tax code and is controlling in this case. The Legislature made three significant amendments. First, the definition of "transfer" was amended to make it clear that Washington's tax was not limited to "real" transfers recognized under state property law. Laws of 2013, 2d Spec. Sess., ch. 2, § 2 (amending and renumbering former RCW 83.100.020(11)). Instead, a "transfer" "includes any shifting upon death of the economic benefit in property." *Id.* That definition—and the "shifting of economic benefit" concept incorporated into the definition—is consistent with the constitutional limits imposed on estate and inheritance taxes. *See In re McGrath's Estate*, 191 Wash. 496, 504, 71 P.2d 395 (1937) (state may tax as a transfer the "shifting of economic benefit" in property occurring at death).

Second, the Legislature amended the definition of "Washington taxable estate" to expressly include QTIP in the tax base. Laws of 2013, 2d Spec. Sess., ch. 2, § 2. Finally, the Legislature retroactively amended RCW 83.100.047 to repudiate administrative rules issued in 2006 that inadvertently permitted a deduction of QTIP passing under Internal Revenue Code § 2044 by the estate of the second spouse to die. *Id.* at §

5.¹ As amended, RCW 83.100.047 permits a deduction for QTIP passing under Internal Revenue Code § 2044 *only* when a separate Washington QTIP election was made by the estate of the first spouse to die. *See id.* (creating new subsection 83.100.047(3)(b) to permit the second spouse to die to deduct federal QTIP and add the amount of the Washington QTIP if a Washington QTIP election was made by the estate of the first spouse to die). Because Barbara Mesdag’s predeceased husband, Joseph Mesdag, did not make a separate Washington QTIP election, the deduction authorized by RCW 83.100.047(3)(b) does not apply.

The Legislature made sections 2 and 5 of the 2013 Act retroactive to “all estates of decedents dying on or after May 17, 2005.” *Id.* at § 9. These key amendments were enacted to close the QTIP loophole created by the *Bracken* decision by defining “transfer” and “Washington taxable estate” to expressly include QTIP passing under Internal Revenue Code § 2044 in the Washington taxable estate and to permit a deduction only when the estate of the first spouse to die makes a separate Washington QTIP election. *Id.* at § 1(4)-(5).

¹ The Department’s 2006 estate tax rules were poorly drafted and, according to the *Bracken* decision, allowed a deduction for QTIP passing under Internal Revenue Code § 2044 even when no separate Washington QTIP election was made. *Bracken*, 175 Wn.2d at 571 n.5 (discussing former WAC 458-57-105(3)(q) and -115(2)(d)). The rules were amended in 2009 to correct the error. Wash. St. Reg. 09-04-008 (effective February 22, 2009).

The 2013 Act's changes to the Washington estate tax code are controlling. See *Washington State Farm Bureau Fed'n v. Gregoire*, 162 Wn.2d 284, 304, 174 P.3d 1142 (2007) (the legislature may pass a law that directly impacts a case pending in Washington courts); *Haberman v. Wash. Pub. Power Supply Sys.*, 109 Wn.2d 107, 143-44, 744 P.2d 254, 750 P.2d 254 (1987) (same). Under the plain language of the amended estate tax code, the Estate cannot deduct QTIP from its taxable estate and is not entitled to a refund of the Washington estate tax it paid on the value of QTIP passing at Ms. Mesdag's death. Accordingly, the Estate's statutory arguments should be rejected.

B. The 2013 Act Is Constitutional As Applied To The Estate.

The Estate also contends that the 2013 Act is unconstitutional as applied. Resp. Br. at 15-16. Statutes enacted by the Legislature are presumed to be constitutional and a party seeking to invalidate a statute on constitutional grounds must establish that the provision is unconstitutional beyond a reasonable doubt. *Washington State Grange v. Locke*, 153 Wn.2d 475, 486, 105 P.3d 9 (2005). This presumption applies to retroactive laws. *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 15, 96 S. Ct. 2882, 49 L. Ed. 2d 752 (1976). Applying the 2013 Act to the QTIP passing at Ms. Mesdag's death is constitutional and should be upheld.

1. Taxing QTIP passing under Internal Revenue Code § 2044 is constitutional.

The Estate incorrectly asserts that, as a matter of constitutional law, “only *real* transfers” may be taxed. Resp. Br. at 16-19. To the contrary, controlling case law holds that Congress and the States have broad power to determine by statute when a transfer occurs.

As the Estate concedes, courts broadly construe the term “transfer” as used in the federal estate tax code as extending “to the creation, exercise, acquisition, or relinquishment of any power or legal privilege which is incident to the ownership of property.” *Fernandez v. Wiener*, 326 U.S. 340, 352, 66 S. Ct. 178, 90 L. Ed. 116 (1945); Resp. Br. at 11. Consequently, the parties agree that a “transfer” subject to the federal tax is not limited to a formal conveyance of property under state law or common law. Rather, “Congress has a wide latitude in the selection of objects of taxation” and may include within the federal estate tax base property that was not formally conveyed upon the death of the decedent. *Wiener*; 326 U.S. at 352; *see also Helvering v. Hallock*, 309 U.S. 106, 60 S. Ct. 444, 84 L. Ed. 604 (1940) (formal distinctions pertaining to the law of real property are “irrelevant criteria in this field of [estate] taxation”). Ownership of the property by the decedent is not constitutionally required so long as the decedent had some economic interest in the property that

passes at death. *Whitney v. State Tax Comm'n*, 309 U.S. 530, 538-39, 60 S. Ct. 635, 84 L. Ed. 909 (1940).

Since *Helvering v. Hallock* and *Whitney v. State Tax Commission* were decided in 1940, courts have consistently upheld the power of Congress to direct by statute what property will be included in the taxable estate of a decedent. See, e.g., *Fernandez v. Wiener, supra*; *Commissioner v. Church's Estate*, 335 U.S. 632, 69 S. Ct. 322, 93 L. Ed. 288 (1949); *United States v. Manufacturers National Bank of Detroit*, 363 U.S. 194, 198-200, 80 S. Ct. 1103, 4 L. Ed. 2d 1158 (1960). A “transfer” in the constitutional sense is a broad and flexible concept, and an estate tax will withstand constitutional scrutiny “if there was a transfer of economic benefit, use, enjoyment or control [of property] at death.” 1 Jacob Mertens, *The Law of Federal Gift and Estate Taxation*, § 1.04 at 9-10 (1959) (footnote omitted) (Appendix A). It is well settled that an estate tax is not restricted to the passing of particular items of property from the decedent to the transferee. Instead, Courts have narrowed the inquiry to two factors: did the decedent have an interest in property at death, and was the decedent’s death “the generating source of definite accessions to the survivor’s property rights.” *Id.* at 11. “No formal transfer of title from the decedent to the transferee is required; a mere shifting of the economic benefits of the property may be the real subject of the tax.” *Id.* at 10.

The passing of QTIP under Internal Revenue Code § 2044 undoubtedly qualifies as a “transfer” in the broad constitutional sense. A QTIP trust creates a life estate for the benefit of the surviving spouse and a future interest in the assets for the benefit of the remainder beneficiaries. When the second spouse dies, the life estate is extinguished and the remainder beneficiaries receive a present interest in the property. It is the death of the second spouse that causes the remainder beneficiaries’ interest in the QTIP to transform from a future interest to a present interest. Consistent with the U.S. Supreme Court’s holding in *Fernandez v. Wiener*, Congress is permitted to treat that shift in the economic benefit as a “transfer” subject to estate tax. *Cf. Commissioner v. Church’s Estate*, 335 U.S. 632, 644-45, 69 S. Ct. 322, 93 L. Ed. 288 (1949) (right to receive trust income is a valuable property interest that passes to the remainder beneficiaries at death of the income beneficiary). Congress has expressly exercised that power by enacting Internal Revenue Code § 2044.

There are several provisions in the federal estate tax code designed to ensure that QTIP is subject to estate tax when the second spouse dies. *See* I.R.C. § 2056(b)(7)(A)(i) (QTIP is treated as passing to the surviving spouse when the first spouse dies); I.R.C. § 2044(b)(1)(A) (QTIP passing to the surviving spouse is included in that spouse’s gross estate when he or she dies); I.R.C. § 2044(c) (QTIP is treated as passing from the surviving

spouse when he or she dies). Under these provisions, the entire value of the QTIP passes through the surviving spouse even though the surviving spouse only held an income interest in the property. *Estate of Morgens v. Commissioner*, 678 F.3d 769, 771 (9th Cir. 2012). Because QTIP is treated as passing through the surviving spouse, federal estate tax is deferred until the surviving spouse dies. As a result of the marital deduction, no estate tax is owed when the first spouse dies. I.R.C. § 2056(b)(7). However, estate tax is owed when the second spouse dies because Congress, by enacting Internal Revenue Code § 2044, has made that second transfer the subject of the tax.

The same treatment applies under the Washington estate tax code as amended by the 2013 Act. The federal definition of “taxable estate” is incorporated into the Washington tax. Laws of 2013, 2d Spec. Sess., ch. 2, § 2. The federal taxable estate of the second spouse to die includes the value of QTIP passing under Internal Revenue Code § 2044. Thus, the term “federal taxable estate” as defined in the Washington estate tax code includes QTIP passing when the second spouse dies. The QTIP is also included in the decedent’s Washington taxable estate. *See id.* (amending and renumbering former RCW 83.100.020(13)). And the Legislature has amended the statutory definition of “transfer” to expressly incorporate the

broad and flexible concept of that term that is employed under the federal tax code. *Id.* (amending and renumbering former RCW 83.100.020(11)).

“It is a fundamental principle of our system of government that the legislature has plenary power to enact laws, except as limited by our state and federal constitutions.” *Washington State Farm Bureau*, 162 Wn. 2d at 290. Accordingly, “[t]he legislature has broad plenary powers in its capacity to levy taxes.” *Japan Line, Ltd. v. McCaffree*, 88 Wn. 2d 93, 96, 558 P.2d 211 (1977). The Legislature may exercise its power to levy an estate tax by incorporating definitions and concepts included in the federal estate tax code. And that authority is not limited by artificial distinctions between “real” and “deemed” transfers. Instead, the shift in economic benefit of the QTIP resulting from the death of the second spouse satisfies the requirement of a “transfer” in the constitutional sense. *Wiener*, 326 U.S. at 352; *In re McGrath’s Estate*, 191 Wash. at 504. *See also Prestidge v. Dep’t of Revenue*, 2012 WL 4069231 at *6 (Or. T.C. Magistrate Div. 2012) (Oregon tax on QTIP was constitutional).

The Estate’s “real transfer” argument is contrary to law. The Constitution does not limit the Washington estate tax to “real” transfers.

2. The 2013 Act does not violate separation of powers.

The Estate also contends that the Legislature acted beyond its authority when it amended the Washington estate tax code to close the tax

loophole created by the *Bracken* decision. Resp. Br. at 20-27. The Estate relies on an incorrect understanding of the separation of powers doctrine and misstates the purpose and effect of the 2013 Act.

As explained in the Department's opening brief, the 2013 Act does not violate the separation of powers doctrine. See App. Br. at 24-28. The 2013 Act amended the Washington estate tax code to expressly include QTIP passing under Internal Revenue Code § 2044 in the Washington taxable estate of a decedent. The Legislature has the authority to determine the tax policy of this state and to enact and amend laws to achieve that policy. *Hale v. Wellpinit Sch. Dist.*, No. 49, 165 Wn.2d 494, 506, 198 P.3d 1021 (2009). Moreover, the Legislature did not reverse or annul the Supreme Court's decision in *Bracken*. Instead, the Legislature changed the statutory definitions of "transfer" and "Washington taxable estate" to ensure that QTIP does not escape the Washington tax. This was clearly within the "appropriate sphere of activity" of the legislative branch. *Hale*, 165 Wn.2d at 509; accord *Plaut v. Spendthrift Farms, Inc.*, 514 U.S. 211, 226-27, 115 S. Ct. 1447, 131 L. Ed. 2d 328 (1995).

The Estate also incorrectly contends that in amending the estate tax code, the Legislature made "judicial determinations." Resp. Br. at 21. It is true that the Legislature has made legislative findings to support the underlying purpose of the 2013 Act and to assist in construing the Act.

See Laws of 2013, 2d Spec. Sess., ch. 2, § 1. Those findings are entitled to substantial deference. *Washington Off Highway Vehicle Alliance v. State*, 176 Wn.2d 225, 236, 290 P.3d 954 (2012). But nothing in the 2013 Act can be regarded as a “judicial determination.” The Legislature has not declared that the 2013 Act is constitutional or limited the ability of the judicial branch to consider the constitutional arguments advanced by the Estate. Nor has the Legislature limited the ability of the judiciary to decide issues of fact or to apply the facts to the relevant law.² Instead, the Legislature declared that it is the tax policy of this state to fund education through an estate tax that fairly, and constitutionally, applies to any transfer occurring at death, not just “real” transfers recognized under state property law. Laws of 2013, 2d Spec. Sess., ch. 2, § 1(5).

Amending the estate tax code to achieve the legislative purpose of closing a tax loophole does not intrude on the power of the courts to make judicial determinations. See *Haberman*, 109 Wn.2d at 144 (“legislative enactment of a facially neutral law for the court to apply to the facts before it” did not invade the province of the judicial branch); see also *American Nat’l Can Corp. v. Dep’t of Revenue*, 114 Wn.2d 236, 252-53, 787 P.2d 545 (1990) (retroactive amendment to tax code that applied to pending litigation did not violate separation of powers). It is well established that

² The material facts in this case are undisputed. But if they were not, the 2013 Act in no way dictates the outcome of any factual dispute.

separation of powers is not violated when the Legislature affirmatively amends a previously construed statute. *Lummi Indian Nation v. State*, 170 Wn.2d 247, 262, 241 P.3d 1220 (2010); *Hale*, 165 Wn.2d at 509-10. The Legislature has not engaged in the judicial function of applying existing law to a particular set of facts but rather created “a rule of general application” that “falls squarely within the realm of legislation.” *State v. McCuiston*, 174 Wn.2d 369, 396, 275 P.3d 1092 (2012).

It is also beyond reasonable dispute that the Legislature did not violate separation of powers when it retroactively amended RCW 83.100.047 in order to supersede two poorly drafted estate tax rules that, when read literally, permitted an estate to deduct “section 2044 property” even when no separate Washington QTIP election had been made. *See* Laws of 2013, 2d Spec. Sess., ch. 2, § 5(3).³ A retroactive amendment that supersedes or invalidates an administrative rule does not violate separation of powers because the Legislature, not the administrative agency, has the ultimate responsibility for enacting and amending the laws of this state. Consequently, the Estate’s separation of powers argument with respect to section 5 of the 2013 Act fails.

³ Section 5 of the 2013 Act makes clear that “notwithstanding any department rule” the second spouse’s estate may deduct section 2044 property only if the first spouse’s estate made a separate Washington QTIP election pursuant to RCW 83.100.047.

3. The 2013 Act does not violate substantive due process.

The Estate next argues that the retroactive reach of the 2013 Act violates substantive due process under the rational basis standard applied by the courts when analyzing retroactive tax legislation, and deprives the Estate and the remainder beneficiaries of the QTIP trust of “vested rights.” Resp. Br. at 27-36. The Estate’s due process arguments are contrary to the law and should be rejected.

The United States Supreme Court’s most current decisions involving retroactive legislation refute any notion that the Due Process Clause imposes a fixed limit on the retroactive reach of tax statutes. *E.g., United States v. Carlton*, 512 U.S. 26, 114 S. Ct. 2018, 129 L. Ed. 2d 22 (1994). If a retroactive statute “is supported by a legitimate legislative purpose furthered by rational means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative and executive branches.” *Id.* at 30-31; *see also W.R. Grace & Co. v. Dep’t of Revenue*, 137 Wn.2d 580, 602-03, 973 P.2d 1011 (1999) (analyzing and applying *Carlton*).

The 2013 Act supported a legitimate legislative purpose furthered by rational means. The Legislature amended the estate tax code to fix the significant loophole created when the Supreme Court narrowly construed the term “transfer” to mean only “real” transfers. In addition, the Legislature amended the statute at its first opportunity after the Supreme Court decided

Bracken.⁴ Moreover, it was entirely rational for the Legislature to amend the Washington estate tax code retroactively to May 17, 2005, because that was the effective date of the stand-alone estate tax. *See* Laws of 2005, ch. 516, § 22 (emergency clause). By amending the estate tax retroactively to May 17, 2005, the Legislature ensured that the tax loophole would be closed for all estates.⁵ A shorter period of retroactivity would have been irrational because it would have permitted some estates, but not others, to benefit from the QTIP loophole created by the *Bracken* decision. *See Montana Rail Link, Inc. v. United States*, 76 F.3d 991, 994 (9th Cir. 1996) (seven-year retroactive period was rational and a shorter period “would have been arbitrary and irrational” under the circumstances).

In addition, the 2013 Act does not impermissibly tax the transfer of QTIP occurring before May 17, 2005. The Estate’s argument to the contrary is based on the false premise that the *taxable* transfer of QTIP occurs when the first spouse dies and the QTIP election is made. *See*

⁴ The Estate suggests that the Legislature could have amended the estate tax code in 2009 when the *Bracken* litigation began. Resp. Br. at 31. However, the Department prevailed before the superior court in *Bracken*. Legislation to close the QTIP loophole was not needed until the Supreme Court overturned the superior court decision.

⁵ There was no reason for the Legislature to be concerned with the tax treatment of QTIP under the former pickup tax because there was no QTIP loophole in the former tax regime. The pickup tax was computed on the “adjusted taxable estate” of the decedent. *See* former RCW 83.100.030 (2004) and I.R.C. § 2011. Therefore, QTIP *excluded from the taxable estate* under Internal Revenue Code § 2056(b)(7) was not subject to the Washington tax under the pickup tax computation, while QTIP *included in the taxable estate* under Internal Revenue Code § 2044 was subject to the Washington tax. This is not materially different from the treatment of QTIP under the stand-alone estate tax as amended by the 2013 Act.

Resp. Br. at 27-28. But the Washington estate tax as amended—like the federal estate tax—applies to the transfer of QTIP occurring at the death of the second spouse when that spouse’s life estate is extinguished and the property passes to the remainder beneficiaries. The transfer of assets *into* the QTIP trust is not subject to either the federal or Washington estate tax as a result of Internal Revenue Code § 2056(b)(7), which permits the value of QTIP to be deducted in computing the federal taxable estate of the first spouse to die. The Estate simply focuses on the wrong transfer when it argues that the 2013 Act should be invalidated on due process grounds.

Finally, the Legislature did not impermissibly target any estates when it retroactively amended the estate tax code. There is no question that the Legislature was concerned with the significant and unexpected fiscal impact of the *Bracken* decision and that it acted swiftly to close the unintended loophole. But closing a loophole that could have been exploited by the estate of Barbara Mesdag and by other estates is not the type of “targeting” that could raise due process concerns. Otherwise, the Legislature would be powerless to retroactively close any tax loophole since, in every case, some taxpayer would have been able to exploit the loophole but for the retroactive amendment.

The Estate also argues that the 2013 Act “deprives” the remainder beneficiaries of “their vested right” to the QTIP passing at Ms. Mesdag’s

death, and “deprives” the Estate of a “vested right” to a refund. Resp. Br. at 33-36. Both arguments are incorrect. First, the 2013 Act does not take any “vested right” from the remainder beneficiaries. The Estate argues that the beneficiaries had “the right to receive the corpus of the [QTIP] trust, a right that has been fully vested for over a decade.” Resp. Br. at 34. But the Estate makes no effort to explain how any “vested right” belonging to the remainder beneficiaries was impacted by the 2013 Act. Presumably the remainder beneficiaries received the QTIP that remained in the trust at the death of Barbara Mesdag. There is no evidence in the record suggesting otherwise. The Estate simply raises a constitutional claim on behalf of non-parties to this lawsuit that is not supported by any evidence.

Second, the Estate has no “vested right” to a refund. “Tax legislation is not a promise” and no taxpayer has a “vested right” in the continuation of a particular tax law. *Carlton*, 512 U.S. at 33; *see also General Motors Corp. v. Dep’t of Treasury*, 803 N.W.2d 698, 709 (Mich. Ct. App. 2010) (rejecting taxpayer’s claim that it had a vested right to a tax refund); *see generally* 16A C.J.S. *Constitutional Law*, § 394 (2013) (in general, a taxpayer has no vested rights in a tax statute or in the continuance of a particular tax law). The fact that the Estate filed its refund claim with the Department and sought judicial review under the APA before the retroactive amendment to the estate tax code does not create a vested right to the

claimed refund because the tax code as construed by the Supreme Court in *Bracken* was “not a promise.”

4. The 2013 Act does not violate the Impairment Clause.

The Estate’s claim that the Washington estate tax violates the Impairment Clause is also unfounded. *See* Resp. Br. at 36-38. Article I, section 10 of the United States Constitution provides in part that “No state shall . . . pass any . . . law impairing the obligation of contracts.” The Washington constitution contains a similar prohibition. Const. art. I, § 23. These constitutional provisions are coextensive. *Tyrpak v. Daniels*, 124 Wn.2d 146, 151, 874 P.2d 1374 (1994).

The Impairment Clause—sometimes referred to as the “Contracts Clause”—“is applicable only if the legislative act complained of impairs a contractual relationship.” *Haberman*, 109 Wn.2d at 145. In determining whether legislation impermissibly impairs a contractual relationship, the reviewing court must determine (1) whether a contractual relationship exists, (2) whether the legislation at issue substantially impairs that contractual relationship, and, if so, (3) whether the substantial impairment is reasonable and necessary to serve a legitimate public purpose. *Pierce County v. State*, 159 Wn.2d 16, 28, 148 P.3d 1002 (2006). The last prong is a balancing of interests and recognizes that substantial impairment may still be valid if the state has “a significant and legitimate public purpose

behind the regulation.” *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411, 103 S. Ct. 697, 74 L. Ed. 2d 569 (1983).

Applying the three-part Impairment Clause test to the facts in this case, there is no constitutional violation. As to the first element, the Washington Supreme Court has held that a “contract” for purposes of the Impairment Clause must be a contract “in the usual sense” of that word, i.e., “an agreement of two or more minds, upon sufficient consideration, to do or not to do certain acts.” *Caritas Servs., Inc. v. Dep’t of Soc. & Health Servs.*, 123 Wn.2d 391, 403, 896 P.2d 28 (1994) (internal quotations and citation omitted). In the present case, the QTIP trust created when Mr. Mesdag died was not part of any “agreement of two or more minds, upon sufficient consideration.” Instead, the trust was created to accomplish a testamentary gift.

A gift is not a contract in the usual sense. *Oman v. Yates*, 70 Wn.2d 181, 185-86, 422 P.2d 489 (1967) (“owing to the absence of consideration, a gift inter vivos does not come within the legal definition of a contract”) (quoting 24 Am. Jur., *Gifts* § 11 (1939)). It follows that a trust created to complete a testamentary gift is not a “contract in the usual sense.” At a minimum, the Estate cannot dispute that the *beneficiaries* of the trust were not parties to any “contract” since the beneficiaries made no promise supported by consideration. Because the Impairment Clause

applies to contracts, not gifts, the Estate fails the first element.

The Estate has also not established that the 2013 Act imposes a substantial impairment to a contractual relationship. An “impairment is substantial if the complaining party relied on the supplanted part of the contract.” *Margola Assoc. v. Seattle*, 121 Wn.2d 625, 653, 854 P.2d 23 (1993). Moreover, “[a] contract is not considered impaired by a statute in force when the contract was made, as parties are presumed to enter into contracts in contemplation of existing law.” *Shoreline Cmty. Coll. Dist. No. 7 v. Emp’t Sec. Dep’t*, 120 Wn.2d 394, 410, 842 P.2d 938 (1992). In this case, the estate tax treatment of QTIP under the stand-alone tax as amended by the 2013 Act is not materially different from the treatment under the former pickup tax.⁶ Thus, it is reasonable to conclude that Joseph Mesdag was aware that Washington estate tax would likely be owed on the QTIP when Barbara died. As a result, there is no substantial impairment even if a contract existed. *Margola*, 121 Wn.2d at 653 (“a party who enters into a contract regarding an activity already regulated in the particular to which he now objects is deemed to have contracted subject to further legislation upon the same topic”).

Finally, in applying the third prong, the balancing of interests weighs most heavily in favor of the 2013 Act and against its invalidation.

⁶ See footnote 5, *supra*.

Washington has had an estate or inheritance tax since 1901. The current estate tax was enacted by the voters in 1981. Laws of 1981, 2d Ex. Sess., ch. 7. It cannot come as a surprise that Washington estate tax will be owed by estates with sufficient assets to qualify for the tax. Moreover, the estate of Joseph Mesdag elected to enjoy the benefit of the QTIP deduction when it filed its federal and state estate tax returns. Thus, even if application of the Washington tax to QTIP passing at the death of Barbara Mesdag qualifies as “impairment,” it is a minimal impairment under *Margola Associates* and *Shoreline Community College*.

By contrast, the State’s sovereign authority and responsibility to provide for the general welfare of its citizens through its taxing power is vitally important. The purpose of Washington’s estate tax is to fund education. RCW 83.100.220, .230. Providing dependable tax sources to fund education is one of the most important functions of government. *See* Const. art. IX, § 1. When the justification for the tax — funding education — is balanced against the “impairment” the Estate is claiming, it is evident that the Estate also fails the third prong of the three-part test.

5. The 2013 Act does not violate equal protection.

The Estate also asserts that the 2013 Act violates “equal protection principles” as applied to the Estate. Resp. Br. at 39. The Estate’s equal protection challenge has no merit.

Under the Fourteenth Amendment of the United States Constitution “[n]o state shall . . . deny to any person within its jurisdiction the equal protection of the laws.” Article I, § 12 of the Washington Constitution similarly state that “[n]o law shall be passed granting to any citizen, class of citizens, or corporation other than municipal, privileges or immunities which upon the same terms shall not equally belong to all citizens, or corporations.” Courts apply the same constitutional analysis to the state Privileges and Immunities Clause that applies to the federal Equal Protection Clause, unless the challenged law favors a minority class. *Andersen v. King County*, 158 Wn.2d 1, 18, 138 P.3d 963 (2006) (plurality opinion) (independent analysis applies “only where the challenged law grants a privilege or immunity to a minority class”). The Estate has not asserted that the 2013 Act favors a minority class. Therefore, separate analysis under the state constitution is not required.

Legislation is subject to rational basis review under the Equal Protection Clause unless the challenger is a member of a suspect class or a fundamental right is at stake. *F.C.C. v. Beach Commc’ns, Inc.*, 508 U.S. 307, 313, 113 S. Ct. 2096, 124 L. Ed. 2d 211 (1993). Because neither circumstance is present here, the Estate’s equal protection challenge is analyzed under the rational basis standard. The Estate must prove that the classification drawn by the law is not rationally related to any legitimate

state interest. *Beach Commc 'ns*, 508 U.S. at 314-15; *DeYoung v. Providence Med. Ctr.*, 136 Wn.2d 136, 144, 960 P.2d 919 (1998). A classification will be upheld unless “the varying treatment of different groups or persons is so unrelated to the achievement of any combination of legitimate purposes” that the Court “can only conclude that the [legislature’s] actions were irrational.” *Gregory v. Ashcroft*, 501 U.S. 452, 472, 111 S. Ct. 2395, 115 L. Ed. 2d 410 (1991). The 2013 Act easily survives minimal scrutiny under the equal protection clause.

The Estate complains that the 2013 Act amended the Washington estate tax with respect to the treatment of QTIP, but not with respect to property passing through a “credit shelter trust.” Resp. Br. at 39.⁷ The simple answer to the Estate’s complaint is that the Washington estate tax code incorporates the federal definition of “taxable estate” as the starting point for computing the decedent’s Washington taxable estate. By using the federal taxable estate as the starting point, the Legislature “avoided having to duplicate congressional effort involved in explaining all the possible inclusions, exemptions, and deductions necessary to reach the taxable estate, and also helped to avoid the complication and confusion that a different set of state rules might create.” *Bracken*, 175 Wn.2d at

⁷ A credit shelter trust allows married couples to take advantage of the unified credit against estate taxes provided in Internal Revenue Code § 2010. *See generally*, Steven D. Nofziger, Comment, *EGTRRA and the Past, Present, and Future of Oregon’s Inheritance Tax System*, 84 Or. L. Rev. 317, 338-39 (2005).

583 (Madsen, C.J., concurring/dissenting). Under the federal estate tax code, QTIP is included in the taxable estate of the second spouse to die, but property passing through a credit shelter trust is not. Instead, property placed into a credit shelter trust is subject to federal estate tax when the first spouse dies; however, the tax is offset by a tax credit provided in Internal Revenue Code § 2010.

The Legislature amended the Washington estate tax in 2013 to make the tax as applied to QTIP consistent with the federal tax. There was no need to amend the Washington tax as applied to property passing through a credit shelter trust since the Washington tax code was already consistent with the federal tax code. The Legislature acted rationally when it chose to incorporate the federal definition of taxable estate as the starting place of determining the Washington taxable estate. The Estate's claim to the contrary is incorrect as a matter of law.

C. The Estate Is Not Entitled To Attorneys' Fees.

The Estate requests an award of attorneys' fees under RCW 4.84.185 and RAP 18.9(a). Resp. Br. at 49. RCW 4.84.185 permits an award of fees when the action or defense "is one that cannot be supported by any rational argument on the law or facts." *Goldmark v. McKenna*, 172 Wn.2d 568, 582, 259 P.3d 1095 (2011). RAP 18.9(a) permits an award of fees if, considering the entire record, "the court is convinced that the

appeal presents no debatable issues upon which reasonable minds might differ, and that the appeal is so devoid of merit that there is no possibility of reversal.” *Advocates for Responsible Dev. v. W. Wash. Growth Mgmt. Hearings Bd.*, 170 Wn.2d 577, 580, 245 P.3d 764 (2010). All doubts as to whether an appeal is frivolous are resolved in favor of the appellant. *Id.*

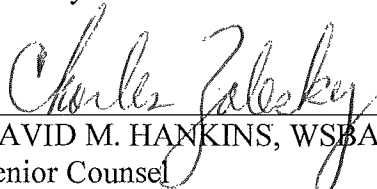
In this case, the Department’s appeal is not devoid of merit, and the arguments presented are rational and supported by the law and by the undisputed facts. Consequently, the Estate is not entitled to an award of attorneys’ fees under either RCW 4.84.185 or RAP 18.9(a).

III. CONCLUSION

This Court should reverse the order granting the Estate’s motion for judgment on the pleadings and remand the case with instructions to enter judgment in favor of the Department.

RESPECTFULLY SUBMITTED this 16th day of October, 2013.

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I certify under penalty of perjury under the laws of the State of
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DATED this 16th day of October, 2013, at Tumwater, WA.


Carrie A. Parker, Legal Assistant

THE LAW
OF FEDERAL GIFT
AND ESTATE TAXATION

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IN SIX VOLUMES

VOLUME ONE

LOFIT PUBLICATIONS, INC.
SAUGERTIES, N. Y.

APPENDIX A

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II. Limitations on the Exercise by Congress of the Taxing Power

A. ESTATE AND GIFT TAXES AS INDIRECT TAXES

§ 1.02. ESTATE AND GIFT TAXES ARE IMPOSED ON THE PRIVILEGE OF TRANSFER. The modern estate and gift tax laws have been upheld as an excise tax on the privilege of transfer of property,⁶

life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation."

⁶ It is well settled that the federal estate tax is an excise tax requiring no apportionment, as is required where the statute imposes a direct tax on property. See *Chase Nat'l Bank of City of N.Y., Ex'rs v. U.S.*, 278 U.S. 327, 49 S.Ct. 126, 73 L.Ed. 405 (1929), 7AFTR38844; *Greiner, Exec. v. Lewellyn*, 253 U.S. 384, 42 S.Ct. 824, 68 L.Ed. 676 (1922), 3AFTR3136; *New York Trust Co., Ex'rs v. Eisner*, 266 U.S. 345, 41 S.Ct. 506, 65 L.Ed. 963 (1921), 3AFTR3110. See also *Mertens, LOFTT*, § 4.03.

The Supreme Court first sustained the constitutionality of a federal estate tax in 1874 when the succession tax of 1864 was upheld against an attack on the ground that it was invalid as an unapportioned direct tax. *Scholey v. Rew*, 90 U.S. (23 Wall.) 331, 23 L.Ed. 99 (1874), 2AFTR2345. The 1864 tax had already been repealed at the time of this decision and the issue remained moot thereafter until 1894. In that year Congress passed an income tax act which contained a provision including as income property acquired by gift or inheritance. The Supreme Court declared this act unconstitutional as it applied to income from real estate. *Pollock v. Farmers Loan & Trust Co.*, 157 U.S. 429, 15 S.Ct. 673, 39 L.Ed. 759 (1895), 3AFTR2557, on rehearing 158 U.S. 601, 15 S.Ct. 912, 39 L.Ed. 1108 (1895), 3AFTR2602 (i.t.).

However, when, in 1898, another succession tax was passed, its constitutionality was upheld in the leading case of *Knowlton, Ex'rs v. Moore*, 178 U.S. 41, 20 S.Ct. 747, 44 L.Ed. 969 (1900), 3AFTR2684. In a lengthy and exhaustive opinion, the Court found that the arguments under which the 1894 Act had been declared unconstitutional applied only to the income tax features of the act, that the succession tax was not a direct tax, that it was uniform and that it did adhere to due process.

The reasoning of the Court in the *Knowlton* case was so definitive that when the modern estate tax was passed in 1916, its constitutionality was upheld practically without discussion. *New York Trust Co., Ex'rs v. Eisner*, supra. The fact that the 1916 Act was an estate tax whereas the prior acts had imposed succession taxes made no difference.

The answer to the question of the validity of the gift tax was simplified by the fact that the Supreme Court did not have to face the issue until the estate tax cases, referred to above, had been decided. When the case did

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thus avoiding the prohibition against direct taxes on property without apportionment. The distinction between a direct tax on property and an excise on the transfer of property is neither illusory nor inconsequential. It is so fundamental that it has been made the basis for sustaining a tax of the latter character even though the subject of the transfer itself was tax-exempt. Thus the Federal Government may impose an estate tax on a gross estate which consists wholly of tax-exempt state or municipal bonds.¹⁰ Such transfer concept supports a tax, without apportionment, on the shifting from one to another of any power or legal privilege incidental to the ownership or enjoyment of property. The Supreme Court in holding that the gift tax did not constitute a direct tax has rejected the proposition that taxes on the exercise of all rights and powers incident to ownership amounted to a direct tax on the property itself; hence, a tax on the exercise of individual rights and powers is clearly distinguishable from a tax which falls upon the owner merely because he is owner, regardless of the use or disposition made of his prop-

come up, the Court upheld the gift tax against the usual objections after finding that there was no "intelligible distinction", for constitutional purposes, between the estate and gift taxes. *Bromley v. McCaughrin*, 280 U.S. 124, 50 S.Ct. 46, 74 L.Ed. 226 (1929), 8AFTR10251 (g.t.).

¹⁰ *Greiner v. Lewellyn*, 253 U.S. 384, 42 S.Ct. 324, 66 L.Ed. 676 (1922), 3AFTR3136; *U.S. Trust Co. of N.Y., Exec. v. Helvering*, 307 U.S. 57, 59 S.Ct. 692, 83 L.Ed. 1104 (1939), 22AFTR327. See § 14.17.

In *Landman v. Comm.*, 123 F(2d) 787 (10th Cir.1941), 28AFTR417, aff'g 42 BTA 958, cert.den. 315 U.S. 810, 62 S.Ct. 799, 86 L.Ed. 1209 (1942), the estate of a member of an Indian tribe granted certain tax exemptions was held subject to estate tax, since the latter fell "upon the transfer or shifting of the economic benefits and not upon the property of which the estate [was] composed." Consequently, there was not available in this instance "any constitutional immunity growing out of [agreements] between the United States and Creek Indian".

The statement in the text is in part from the opinion in 42 BTA 958, supra, in which it is also said:

"Likewise it was held in *United States Trust Co. v. Helvering*, 307 U.S. 57, that the proceeds of a War Risk Insurance policy payable to a deceased veteran's widow was subject to Federal estate tax. In that case the executor of the estate contended that the proceeds of such policy should not be included in the estate because of the provisions of the World War Veterans Act, 43 Stat. 607, which provided that insurance . . . shall be exempt from all taxation."¹¹

But compare *Landman v. U.S.*, 71 F.Supp. 640 (Ct.Cl.1947), 35AFTR1331,

erty.¹¹ The Supreme Court has said¹² that the power to impose estate taxes:

"extends to the creation, exercise, acquisition, or relinquishment of any power or legal privilege which is incident to the ownership of property, and when any of these is occasioned by death, it may as readily be the subject of the federal tax as the transfer of the property at death",¹³

and that:

"The power to tax the whole necessarily embraces the power to tax any of its incidents or the use or enjoyment of them. If the property itself may constitutionally be taxed, obviously it is competent to tax the use of it . . . or the gift of

cert.den. 332 U.S. 815, 68 S.Ct. 153, 92 L.Ed. 392 (1947), and *Landman v. U.S.*, (Ct.Cl.1945), 34AFTR1682, superseding 58 F.Supp. 836 (Ct.Cl.1945), 33AFTR 811.

¹¹In *Bromley v. McCaughn*, 280 U.S. 124, 50 S.Ct. 46, 74 L.Ed. 226 (1929), 34AFTR10251 (g.t.), the Supreme Court stated: "Even if we assume that a tax levied upon all the uses to which property may be put, or upon the exercise of a single power indispensable to the enjoyment of all others over it, would be in effect a tax upon property, . . . and hence a direct tax requiring apportionment, that is not the case before us."

The same contention was made 10 years later in *Dupont v. Deputy*, 26 F. Supp. 773 (D.Del.1939), 22AFTR788 (g.t.), the taxpayer emphasizing what he felt to be the netlike incidences of taxes in connection with the ownership of stock: income taxes imposed on dividends and on capital gains following its sale, estate taxes on its devolution at death, and gift taxes on its transfer without consideration during life. The court summarily rejected this argument, citing *Bromley v. McCaughn*, supra, and added that the "controlling authority of that case" was not affected by a provision in the 1932 Act rendering the gift tax a lien upon the property given and the donee personally liable for payment to the extent of its value.

¹²*Fernandez v. Wiener*, 326 U.S. 340, 66 S.Ct. 178, 90 L.Ed. 116 (1945), 34AFTR276, reh.den. 327 U.S. 814, 66 S.Ct. 525, 90 L.Ed. 1038 (1946).

¹³A broader view was expressed in *Chickering, Adm. v. Comm.*, 118 F(2d) 254 (1st Cir.1941), 26AFTR663, cert.den. 314 U.S. 636, 62 S.Ct. 70, 86 L.Ed. 511 (1941), to the effect that:

" . . . the estate tax is not a direct tax upon the property; nor is it in a strict sense a tax upon a 'transfer' of the property by the death of the decedent. It is an excise tax upon the happening of an event, namely, death, where the death brings about certain described changes in legal relationships affecting property. The value of the property so affected is merely used as a factor in the measurement of the excise tax."

But this view has never been adopted by the Supreme Court.

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it It may tax the exercise, non-exercise, or relinquishment of a power of disposition of property, where other important indicia of ownership are lacking."

In line therewith taxation of the proceeds of life insurance payable to third persons was upheld where decedent retained the power to change the beneficiary and to surrender or pledge the policy, since these incidents of ownership were, in effect, transferred on death.¹⁴

§ 1.03. DEVELOPMENT OF THE MODERN CONCEPT OF A TRANSFER. The courts in applying the indirect tax theory to particular provisions of the estate tax law have evidenced considerable ingenuity in expanding the term "transfer" to meet the necessities of each new challenge.¹⁵ The earlier cases rested on the fact that there was a "passing" of property from decedent at death.¹⁶ Such passing concept did not require, however, that the term "transfer" be limited to those situations where there was a transfer in the technical, local law sense of the term, since Congress can completely disregard the refinements of state property law and rely on more realistic classifications.¹⁷ Thus local characteristics of dower,¹⁸ joint tenancies and tenancies by the entirety,¹⁹ community property,²⁰ and life insurance proceeds²¹

¹⁴ Chase Nat'l Bank of City of N.Y., Ex'rs v. U.S., 278 U.S. 327, 49 S.Ct. 126, 73 L.Ed. 405 (1929), 7AFTR8844.

¹⁵ Since taxes are based on the "fundamental and imperious necessity of all government", it is obvious that the Supreme Court will reach for theories, definitions, and apologia to avoid a successful constitutional attack. This task has been ably performed.

¹⁶ See §§ 19.26, 23.17 discussing the "passing" requirement.

¹⁷ Fernandez v. Wiener, supra, n.12. See especially the concurring opinion of Mr. Justice Douglas.

¹⁸ See Mayer, Trustees v. Reinecke, 130 F(2d) 350 (7th Cir.1942), 29AFTR 1156, cert.den. 317 U.S. 684, 63 S.Ct. 257, 87 L.Ed. 548 (1942); Allen v. Henggeler, Adm., 32 F(2d) 69 (8th Cir.1929), 7AFTR8630, cert.den. 280 U.S. 594, 50 S.Ct. 40, 74 L.Ed. 642 (1929); Nyberg, Adm. v. U.S., 66 Ct.Cl. 153 (1923), 6AFTR7845, cert.den. 278 U.S. 646, 49 S.Ct. 82, 73 L.Ed. 559 (1928).

¹⁹ See U.S. v. Jacobs, Exec., 306 U.S. 363, 59 S.Ct. 551, 83 L.Ed. 763 (1939), 22AFTR282, motion to set aside judgment denied 306 U.S. 620, 59 S.Ct. 640, 83 L.Ed. 1026 (1939); Dimock, Exec. v. Corwin, 306 U.S. 363, 59 S.Ct. 551, 83 L.Ed. 763 (1939), 22AFTR282 (companion cases); Gwinn v. Comm., 287 U.S. 224, 53 S.Ct. 157, 77 L.Ed. 270 (1932), 11AFTR1092; Phillips v. Dine

have been disregarded. The constitutionality of a federal taxing act is not dependent upon conformity with state law. If such were the case, then an admittedly constitutional federal act could be rendered unconstitutional by a subsequent state enactment.²² None of the successful constitutional attacks on the federal estate and gift tax provisions cases affected the established freedom of Congress to ignore the local law of property in the absence of arbitrariness or capriciousness.²³ On the con-

Trust & Safe Deposit Co., Exec., 284 U.S. 160, 52 S.Ct. 48, 76 L.Ed. 220 (1931), 10AFTR459; Tyler, Jr., Adm'rs v. U.S., 281 U.S. 497, 50 S.Ct. 356, 74 L.Ed. 991 (1930), 8AFTR10912.

²⁰ See *Fernandez v. Wiener*, 326 U.S. 340, 66 S.Ct. 173, 90 L.Ed. 116 (1945), 34AFTR276, reh.den. 327 U.S. 814, 66 S.Ct. 525, 90 L.Ed. 1038 (1946); *U.S. v. Rompel, Jr., Adm.*, 326 U.S. 367, 66 S.Ct. 191, 90 L.Ed. 137 (1946), 34AFTR 289, reh.den. 327 U.S. 814, 66 S.Ct. 526, 90 L.Ed. 1038 (1946); *Beavers v. Comm.*, 165 F(2d) 208 (5th Cir.1947), 36AFTR514, cert.den. 334 U.S. 811, 68 S.Ct. 1017, 92 L.Ed. 1743 (1948) (g.t.); *Charles L. Francis*, 8 TC 822 (g.t.).

²¹ See *Chase Nat'l Bank of City of N.Y., Ex'rs v. U.S.*, 278 U.S. 327, 49 S.Ct. 126, 73 L.Ed. 405 (1929), 7AFTR3844; *Lewellyn v. Friek, Ex'rs*, 268 U.S. 233, 45 S.Ct. 437, 69 L.Ed. 934 (1925), 5AFTR5383, had earlier held contra, at least by inference; but see *Kohl, Ex'rs v. U.S.*, 226 F(2d) 381 (7th Cir.1955), 47 AFTR2022, which involved the "payment of premiums" test which was then applied in determining what insurances should be included in the gross estate, and in which the tax in effect was held unconstitutional as imposing an unapportioned direct tax.

²² *Continental Ill. Bank & Trust Co., Exec. v. U.S.*, 65 F(2d) 506 (7th Cir. 1933), 12AFTR313, cert.den. 290 U.S. 653, 54 S.Ct. 77, 73 L.Ed. 573 (1933), rejecting the contention that a provision, requiring the inclusion of property in the gross estate only if subject to payment of administration expenses, violated the uniformity requirement because state laws vary as to whether real estate was subject to payment of administration expenses. See discussion in § 1.06 of the due process requirement.

²³ See (1) *Nichols v. Coolidge, Ex'rs*, 274 U.S. 531, 47 S.Ct. 710, 71 L.Ed. 1184 (1927), 6AFTR6758, holding Sec.402(c) of the 1919 Act unconstitutional as confiscatory and in violation of the Fifth Amendment insofar as it applied the possession and enjoyment section to transfers made prior to the act, where the transfers were not in fact testamentary or designed for tax evasion; (2) *Untermeyer v. Anderson*, 276 U.S. 440, 48 S.Ct. 353, 72 L.Ed. 645 (1928), 6AFTR 7739, rev'g 18 F(2d) 1923 (2d Cir.1927), which had aff'd an unreported district court opinion (g.t.), holding retroactive application of the gift tax provisions of the 1924 Act invalid under the Fifth Amendment; and (3) *Heiner v. Donnan, Ex'rs*, 285 U.S. 312, 52 S.Ct. 353, 76 L.Ed. 772 (1932), 10AFTR1609, holding unconstitutional, under the due process provisions of the Fifth Amendment, that part of Sec.302(a) of the 1926 Act which called for a conclusive pre-

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trary, it has been held that the Tenth Amendment constituted no limitation on congressional power to tax even though there might be some incidental regulatory effect of such taxation on local community property systems.²⁴ The Fifth Amendment, which invalidates a tax which is so arbitrary and capricious as to constitute confiscation of property and hence a deprivation of property without due process of law, has similarly failed to restrain congressional power to disregard local characterizations in designating the objects to be taxed under the federal estate and gift tax law where the provision prevents avoidance.²⁵

In accord with the view above expressed that congressional power is not limited to an imposition upon the "passing" of property, it is equally well settled with respect to the imposition of estate taxes that the power to tax is not limited to "substitutes for testamentary disposition", although the phrase may be relevant in interpreting the purpose and scope of a statutory provision. Applying this principle to property jointly held and tenancies by the entirety the Supreme Court has clearly indicated that the basis for the estate tax thereon was not that the creation of the tenancy was a substitute for a testamentary transfer, nor a taxable event which antedated the death of one of the joint owners, but rather the practical effect of death in bringing about a shift in economic interests permitting the legislature to fasten on that shift as the occasion for a tax.²⁶

§ 1.04. — TRANSFER AS PRESENTLY DEFINED. The modern concept of a transfer, in the constitutional sense, is premised on the recognition that taxation is "eminently practical".²⁷ In the

sumption that gifts made within 2 years of decedent's death were made in contemplation of death.

²⁴ *Fernandez v. Wiener*, supra, n.20.

²⁵ See discussion of due process in § 1.06.

²⁶ *Fernandez v. Wiener*, supra, n.20.

²⁷ In *Tyler, Jr., Adm'r's v. U.S.*, 281 U.S. 497, 60 S.Ct. 356, 74 L.Ed. 991 (1930), 8AFTR10912, the Court made the following statement:

"Taxation, as it many times has been said, is eminently practical, and a practical mind, considering results, would have some difficulty in accepting the conclusion that the death of one of the tenants in each of these cases did not have the effect of passing to the survivor substantial rights, in respect of the property, theretofore never enjoyed by such survivor."

process of ruling out the "shadowy and intricate distinctions of common law property concepts"²⁸ and artificial rules which delimit the title, rights, and powers of tenants by the entirety (or joint tenancies) at common law,²⁹ the courts have striven to develop a concept of the term "transfer" which was both broad and flexible. The courts have said³⁰ that the estate tax provision was constitutional if there was a transfer of economic benefit,

²⁸ See *U.S. v. Jacobs, Exec.*, supra, n.19. This description as applied to the extent of congressional power to impose the tax is quite different from recourse to such common law precepts to determine the characteristics of such tenancies.

In this case it is also said: "By virtue of this feudal fiction of complete ownership in each of two persons, the surviving tenant by the entirety is conceived to be the recipient of all the property upon the death of the cotenant, and therefore—it is said—all the property can be taxed." As to this suggestion the Court says: "The constitutionality of an exercise of the taxing power of Congress is not to be determined by such shadowy and intricate distinctions of common law property concepts and ancient fictions."

The provisions with respect to dower are essentially aimed at those state decisions and local laws providing that dower interests are not includible in decedent's estate since they passed by operation of law and not by virtue of death. The dower provision was, therefore, inserted into the Code and the prior statutes to assure that the gross estate of a decedent would not be diminished by the value of dower or curtesy interests or statutory interests in lieu of dower or curtesy. See *Estate of Harry B. Byram*, 9 TC 1.

²⁹ *Tyler, Jr., Adm'rs v. U.S.*, supra. See also *Postar, Exec. v. Comm.*, 90 F(2d) 486 (9th Cir.1937), 19AFTR864, aff'd 303 U.S. 618, 58 S.Ct. 525, 82 L.Ed. 1083 (1938), 19AFTR1268, per curiam, reh.den. 303 U.S. 667, 58 S.Ct. 748, 82 L.Ed. 1124 (1938); *O'Shaughnessy, Exec. v. Comm.*, 60 F(2d) 235 (6th Cir.1932), 11AFTR738, cert.den. 238 U.S. 605, 58 S.Ct. 397, 77 L.Ed. 980 (1933); *Comm. v. Emery, Exec.*, 62 F(2d) 591 (7th Cir.1932), 11AFTR1340, rev'g and remanding 21 BTA 1038.

³⁰ The Supreme Court in *Saltonstall v. Saltonstall*, 276 U.S. 260, 48 S.Ct. 225, 72 L.Ed. 565 (1928), 7AFTR3303, in holding that a state inheritance tax could be levied on the value of an inter vivos trust set up by the decedent under which he retained the power to alter and revoke, said:

"So long as the privilege of succession has not been fully exercised it may be reached by the tax. [Citing cases.] And in determining whether it has been so exercised technical distinctions between vested remainders and other interests are of little avail, for the shifting of the economic benefits and burdens of property, which is the subject of a succession tax, may even in the case of a vested remainder be restricted or suspended by other legal devices."

The fact that, under state law, a power of appointment is not part of the probate estate, and that its transmission is not technically a "transfer" under local concepts, does not limit the federal power to tax such property. The

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use, enjoyment or control at death,³¹ and it is now accepted that a passing or transfer of economic benefit is not required, though it may, of itself, justify the imposition of the tax.

It is well settled that, as used in the section imposing a tax "on the transfer of the taxable estate",³² the word "transfer", or the privilege which constitutionally may be taxed, cannot be taken in such a restricted sense as to refer only to the passing of particular items of property directly from the decedent to the transferee. It includes the "transfer of property procured through expenditures by the decedent with the purpose, effected at his death, of having it pass to another."³³ No formal transfer of title from the decedent to the transferee is required; a mere shifting of the economic benefits of property may be the real subject of the tax.³⁴ It also now seems settled that nothing need "pass" at death, in the testamentary sense. The Supreme Court, in upholding the taxation of the full value of property held by the decedent and his wife as tenants by the entirety, has suggested that when applied to a taxing act the amiable fiction of the common law that husband and wife are but one person and that accordingly by the death of one party to this unit no interest in

constitutional limitations as to due process and direct taxation are satisfied since there is under local law a shifting of economic benefits at the time of death even though there is no technical transfer under local law.

³¹ U.S. v. Jacobs, Exec., supra, n.19.

See also U.S. v. Waite, Ex'rs, 33 F(2d) 567 (8th Cir.1929), 7AFTR9184, rev'g and remanding 29 F(2d) 149 (W.D.Mo.1927), 7AFTR8288, cert.den. 280 U.S. 608, 50 S.Ct. 157, 74 L.Ed. 651 (1930); Estate of Laura Nelson Kirkwood, 23 BTA 955; Mercantile-Commerce Nat'l Bank in St. Louis, Ex'rs, 21 BTA 1347; Mary S. Garrison, Ex'rs, 21 BTA 904; Mattie McMullin, Exec., 20 BTA 527. See also Kurz, Ex'rs v. U.S., 156 F.Supp. 99 (S.D.N.Y.1957), aff'd -- F(2d) -- (2d Cir.1958), per curiam.

³² I.R.C.1954, Sec.2001.

³³ Chase Nat'l Bank of City of N.Y., Ex'rs v. U.S., supra, n.14. This principle has been applied in numerous cases involving annuities. See, e.g., Hanner v. Glenn, 111 F.Supp. 52 (W.D.Ky.1953), 43AFTR748, aff'd 219 F(2d) 483 (6th Cir.1954), 45AFTR1444; Estate of Eugene F. Saxton, 12 TC 569; Estate of Isidor M. Stettenheim, 24 TC 1169 (1955-158); Estate of Paul G. Leoni, 11 TC 1140 (Memo.). See § 20.24.

³⁴ Chase Nat'l Bank of City of N.Y., Ex'rs v. U.S., supra, n.14; Tyler, Jr., Adm'rs v. U.S., supra, n.27 (tenancy by entirety); Fernandez v. Wiesner, supra, n.20 (community property).

property held by them as tenants by the entirety passes to the other to be quite unsubstantial and that the power of taxation being, as it is, a fundamental and imperious necessity of all government was not to be restricted by such legal fictions. Whether such power so construed has been properly exercised as to any specific statutory enactment is to be determined by the actual results brought about by the death rather than by a consideration of the artificial rules which limit the title, rights, and powers of tenants by the entirety at common law.³⁵

The modern explanations have been narrowed down to two factors: that decedent had an interest in property at death,³⁶ and that death became the generating source of definite accessions to the survivor's property rights.³⁷ His death is the source

³⁵ See discussion in § 28.17 of cases of *Comm. v. Estate of Church*, 335 U.S. 632, 69 S.Ct. 822, 93 L.Ed. 288 (1949), 37AFTR480, and *Estate of Spiegel v. Comm.*, 335 U.S. 701, 69 S.Ct. 301, 93 L.Ed. 330 (1949), 37AFTR459.

As to the application of the principle to a tenancy by the entirety see *Tyler, Jr., Adm'r v. U.S.*, supra, n.27.

³⁶ The dower provisions, it has been pointed out, are in no way a departure from the fundamental excoise character of the federal estate tax: ". . . the statute does not tax the widow's dower, it merely uses it as a measure of that part of the deceased husband's interest in his realty which was beyond his testamentary control and which ceased at his death." *Mayer, Trustees v. Reinecke*, 130 F(2d) 350 (7th Cir.1942), 29AFTR1156, cert.den. 317 U.S. 684, 63 S.Ct. 257, 87 L.Ed. 548 (1942) (1921 Act, Sec.402(b)).

The courts in upholding the constitutionality of the dower provisions have pointed to the extensive rights (incidents of ownership) in such property determined under state law which ceased at the decedent's death and hence constituted a proper occasion for the levying of an estate tax. See, e.g., *Allen v. Henggeler, Adm.*, 32 F(2d) 69 (8th Cir.1929), 7AFTR8680, cert.den. 280 U.S. 594, 50 S.Ct. 40, 74 L.Ed. 642 (1929), upholding the constitutionality of the 1924 Act, Sec.302(b). See also *Nyberg, Adm. v. U.S.*, 66 Ct.Cl. 153 (1928), 6AFTR7845, cert.den. 278 U.S. 646, 49 S.Ct. 82, 73 L.Ed. 559 (1928), involving the 1921 Act, Sec.402(b).

³⁷ In *Estate of Levy v. Comm.*, 65 F(2d) 412 (2d Cir.1933), 12AFTR791, involving certain insurance policies in which the insured retained no rights, the circuit court, in response to an argument of unconstitutionality as to their inclusion, cited other cases, stating: "By these cases, we think it is authoritatively established that the death of a tenant by the entirety results in the enjoyment of property rights in the survivor and furnishes the occasion for the imposition of the tax, if that event takes place after the passage of the taxing statute, regardless of when the tenancy was created."

As to the effect of a required consent of a person having an adverse interest

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of assurance to the beneficiaries that their rights are secure.³⁸ Both of these standards fall within the general principle that the underlying justification for imposing the estate tax on an inter vivos transfer is that it remains "incomplete" at death. The question is, not whether there has been, in the strict sense of that word, a "transfer" of the property by the death of the decedent, or a receipt of it by right of succession, but whether the death has brought into being or ripened for the survivor, property rights of such character as to make appropriate the imposition of a tax upon that result to be measured, in whole or in part, by the value of such rights.³⁹ The essential difference between the old and new rationalization of such justification is that incompleteness can be demonstrated either by ascertaining whether interests remained in the grantor or by determining whether the interests of the beneficiaries were enlarged, improved, or "ripened" at the time of the grantor's death. In demonstrating such incompleteness, substance rather than form or any particular device, is controlling.⁴⁰ Both factors had been previously expressed in several early constitutional cases,⁴¹ although their influence was submerged by the fact that a number of the important decisions were rendered in cases which employed the "incomplete" test to determine whether a provision was arbitrarily retroactive under the Fifth Amendment.⁴²

to an exercise of a power of revocation by decedent where there was a transfer prior to 1924, see §§ 25.42, 25.43.

³⁸ Porter, *Ex'rs v. Comm.*, 288 U.S. 436, 53 S.Ct. 451, 77 L.Ed. 860 (1933), 12AFTR25.

³⁹ The position of the Supreme Court in the Church and Spiegel cases was anticipated in *Tyler, Jr., Adm'rs v. U.S.*, 281 U.S. 497, 50 S.Ct. 356, 74 L.Ed. 991 (1930), 8AFTR10912, which uses the language stated in the text. See §§ 23.17, 23.20 discussing I.R.C.1954, Sec.2037, covering the reversionary interest test under the transfer to take effect at death section.

⁴⁰ *Comm. v. Estate of Church*, supra, n.35.

⁴¹ *Phillips v. Dime Trust & Safe Deposit Co., Exec.*, 284 U.S. 160, 52 S.Ct. 48, 76 L.Ed. 220 (1931), 10AFTR459; *Third Nat'l Bank & Trust Co. of Springfield, Ex'rs v. White*, 287 U.S. 577, 53 S.Ct. 290, 77 L.Ed. 505 (1932), 11AFTR 1128, per curiam, involving property held by the decedent and spouse as tenants by the entirety. See also § 1.07, and *Gwinn v. Comm.*, 287 U.S. 224, 53 S.Ct. 157, 77 L.Ed. 270 (1932), 11AFTR1092, involving property held by decedent and her son as joint tenants.

⁴² Whether the transfer is complete, or something remains to be gained by

An "incomplete" transfer concept is also applicable to the gift tax,⁴³ although such concept has been formulated almost entirely on the basis of statutory interpretation rather than constitutional power.⁴⁴

In applying both the estate and gift tax provisions, a basic element is that decedent have an interest in property which is capable of transfer, otherwise there could be no transfer, and any asserted tax would fail to satisfy the constitutional requirements that the tax involve the privilege of transfer and be not arbitrary and capricious. It has been held⁴⁵ that a taxable gift results when an inheritance is renounced. It has been argued,⁴⁶ however, that such a tax is so arbitrary and capricious as to violate the Fifth Amendment. Setting aside the merits of imposing such a tax,⁴⁷ it would appear that the tax can withstand a constitutional attack.⁴⁸ In a renunciation of a valid testa-

the survivors or lost by the decedent, so that decedent's death may be taken as the event which justifies at that time the imposition of an estate tax, has also been a material issue in determining whether particular provisions are arbitrarily retroactive or capricious and prohibited by the Fifth Amendment. See § 1.07.

⁴³ The nature of a transfer under the gift tax provisions is discussed in §§ 34.28, 34.51 and 34.56.

⁴⁴ As in the case of the estate tax, state law concepts do not furnish the standards for the definition of a completed transfer.

⁴⁵ *Hardenbergh v. Comm.*, 198 F(2d) 68 (8th Cir.1952), 42 AFTR314, cert.den. 344 U.S. 836, 73 S.Ct. 45, 97 L.Ed. 660 (1952) (g.t.); *William L. Maxwell*, 17 TC 1589 (g.t.).

⁴⁶ *Roehner and Roehner*, "Renunciation as Taxable Gift—An Unconstitutional Federal Tax Decision", 8 Tax L.Rev. 289 (1953). Contra, *Lauritzen*, "Only God Can Make An Heir", 48 Northwestern U.L.Rev. 568 (1953).

⁴⁷ A.L.I. Tent.Draft No.11, Sec.X1007(h), specifically excludes the renunciation from the gift tax. See discussion therein, pp.31-40.

⁴⁸ In A.L.I. Tent.Draft No.11, at p.39, there is a good statement in support of this view and the distinctions that must be drawn:

"If it were proposed to impose a tax on a transfer of property which came about by a mere refusal to accept a gratuitous proffer of that property, which the profferor was under no obligation to deliver even if his proffer were accepted, an argument might be made against the constitutionality of such a tax, since the taxpayer never received the property or any attribute of ownership over it. The proffer never became a gift and there would be no tax on the intended donor. It would be incongruous to tax the intended donee in this situation, and here we need not even consider the constitutional aspects of this

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mentary power the necessary property interest is clearly present and the renunciation would qualify as a "transfer" for the purpose of determining whether the tax is indirect; there is nothing "arbitrary" in the due process sense of that term, particularly since renunciation is a voluntary act. That the imposition of a tax would not violate the necessity of "uniformity" is obviously not any longer a debatable question.

§ 1.05. — SITUATIONS akin to TRANSFERS AT DEATH. Although the estate tax "contemplation of death" statutory provision involves a complete and full transfer by decedent of all incidents

situation. But where there is a renunciation in the case of a gift which is complete as far as the donor is concerned, as in the case of a trust or testamentary situation, as contrasted with a situation where the donor still had the power to make the gift incomplete regardless of whether it was accepted or not, different considerations arise. Here, the tax would be imposed on the only affirmative act which could result in an effective gratuitous transfer to someone other than the person intended by the decedent or donor to be the first taker—and a strong argument in favor of the validity of this proposal can be made. There would be no immediate hardships involved if the intended first taker knew he would be subject to the tax, since he could then not renounce, pay the tax, and then give away the balance. However, there would be an effect on his subsequent tax bracket. Since the federal laws are not governed by local property law concepts of when title passes but with the realities of the exercise of control over a bundle of rights, all in all this proposal should be able to withstand a challenge as to its constitutionality. It would not seem unconstitutional to tax the exercise of control of the property here possessed by the intended first taker, even though he got into this position of control involuntarily.

"If the argument of unconstitutionality were to prevail where the person who renounced the property never received under local law any attribute of ownership over it other than the ability to renounce, then this result would preclude a rule which operated with reasonable uniformity throughout the United States. For the tax would then be able to withstand a challenge to its constitutionality only where, under the applicable state law, some attribute of ownership other than the power to renounce vested in the person, such as vesting of title or ability of his judgment creditors to reach the property despite his desire to reject it. But the consequent limitation of the tax to situations where the renouncing taxpayer had some such attribute of ownership over the renounced property under the applicable local law would hardly be a satisfactory result. It may well be that this result of non-uniformity in operation of the tax would have some supporting effect on the argument of constitutionality in the situation where no local law attributes of ownership were received. At any event, it is a consideration in favor of the rule adopted in the Draft."

WASHINGTON STATE ATTORNEY GENERAL

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