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DIVISION II

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

In re the Matter of the:
ESTATE OF ARTHUR D. PHELPS,
Deceased.

APRIL PHELPS FORD, in her capacity as personal representative of the
Estate of Arthur D. Phelps,
Respondent,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,
Appellant.

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BRIEF OF RESPONDENT

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INTRODUCTION

The Estate of Arthur D. Phelps, by and through its Personal Representative, April Phelps Ford (the “Estate”), seeks a refund of Washington estate tax imposed on property in a “QTIP” (or “qualified terminable interest property”) trust set up by Arthur’s wife, Marguerite, who predeceased him. That QTIP trust was created and funded in 1996, nine years before Washington enacted a standalone estate tax. The Washington Supreme Court ruled unanimously in *Clemency v. State (In re Estate of Bracken)*, 175 Wn.2d 549, 290 P.3d 99 (2012), known as the “*Bracken*” decision, that the State could not assess estate tax on such property. But the Department of Revenue (“Department”) has resolutely refused to follow *Bracken*. One question in this case is whether it must.

The Department claims that it “did not err when it denied the Estate’s refund claim,” Brief of Appellant (“Br. of App.”) at 17-18, because even though that denial was at odds with the Department’s regulations and in total contravention of the holding in *Bracken*, the Department’s error has since been “corrected” by the Legislature’s very recent enactment of a bill (EHB 2075) that the Department believes reverses *Bracken* and negates the Department’s regulations. The Department also argues that *Bracken* was wrongly decided and should be overruled.

Contrary to the Department's position, *Bracken* governs the disposition of this case. The new legislation is unconstitutional as applied and therefore invalid. This Court should affirm the Stipulation and Agreed Order granting summary judgment in favor of the Estate and reject the Department's arguments on appeal.

ISSUES PRESENTED

1. Is *Bracken* binding on this Court, requiring the Department immediately to issue an estate tax refund to the Estate?
2. Is EHB 2075 unconstitutional as applied?
 - (a) Does EHB 2075 violate constitutional requirements for imposing an excise tax?
 - (b) Does EHB 2075 violate the Due Process Clause?
 - (c) Does EHB 2075 violate the Separation of Powers doctrine?
 - (d) Does EHB 2075 unconstitutionally impair contracts?
 - (e) Does EHB 2075 violate the Equal Protection Clause?
4. Does the doctrine of collateral estoppel require judgment in favor of the Estate?
5. Was *Bracken* correctly decided?

STATEMENT OF THE CASE

I. Background Facts

Arthur D. Phelps' wife, Marguerite K. Phelps, died on January 21, 1996, in Fullerton, California. Clerk's Papers ("CP") 48. Marguerite was never a resident of Washington, and she had no connection to this state. *Id.* At the time of her death, Marguerite's estate made a "QTIP" (or "qualified terminable interest property") election (26 U.S.C. § 2056) on her federal estate tax return for assets that were put into a trust for her surviving spouse, Arthur. CP 49. The QTIP trust became irrevocable and the transfer of the funds to the lifetime and remainder beneficiaries of the QTIP trust became fixed and effective upon Marguerite's death. Thus the beneficiaries' rights in Marguerite's QTIP trust vested at the time her QTIP trust was created and funded in 1996.

As allowed by federal law, by qualifying the QTIP trust for the marital deduction at Marguerite's death, any assets remaining in the QTIP trust at her husband's later death would then be subject to federal estate taxation. Taxation in the surviving spouse's estate is the *quid pro quo* of allowing a marital deduction at the first spouse's death. *Bracken*, 175 Wn.2d 549, 555-56, 290 P.3d 99 (2012). If no deduction is taken at the first spouse's death, the assets of the QTIP trust are not, and cannot be, taxed on the surviving spouse's death. *See id.* at 556, 566 .

Nine years later, Washington State enacted a state estate tax, effective May 17, 2005. Arthur died on August 3, 2009. CP 49. He was a resident of San Juan County, Washington at the time of his death. *Id.* The Personal Representative (“PR”) of Arthur’s estate, April Phelps Ford, timely filed the Estate’s Washington State Estate and Transfer Tax Return, which properly excluded the assets held in the QTIP trust in calculating the tax due and owing. *Id.*

In accordance with WAC 458-57-115 (2007), entitled “Valuation of property, property subject to estate tax, and how to calculate the tax,” Arthur’s estate determined the Washington taxable estate on which Washington estate tax is imposed by making prescribed adjustments to the federal taxable estate.¹ Appendix A. As the regulations directed, Arthur’s estate subtracted “any amount included in the federal taxable estate pursuant to IRC § 2044 (inclusion of amounts for which a federal QTIP election was previously made).” WAC 458-57-115(2)(d)(vi) (2007); *accord* WAC 458-57-105(3)(q)(vi) (2007);² Appendix A.

¹ “Federal taxable estate” and “Washington taxable estate” are defined in WAC 458-57-105(3)(g) and 3(q), respectively. Appendix A.

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

On December 27, 2010, the Department sent the Estate a letter asserting that the Estate had underreported the value of its Washington taxable estate on its state estate tax return. CP 49. The Estate objected to this assessment, but paid the additional tax and interest in the amount of \$904,499.33 under protest, and then immediately sent a written request for a refund to the Department. CP 49, 53. On February 17, 2011, the Department denied the Estate's application for a refund. CP 49, 104.

On March 3, 2011, the Estate filed a timely petition for judicial review of the Department's refund denial. CP 4. The Petition asked the Court to reverse the Department's denial of the Estate's refund request and to direct the Department to issue the refund to the Estate. CP-24-25.³ Because the same issue was pending before the Washington State Supreme Court in *Bracken*, the parties filed a joint motion on March 25, 2011, to stay the proceeding, pending final resolution of *Bracken*. CP 49,107-08.

The *Bracken* decision was issued on October 18, 2012. In *Bracken*, the Washington Supreme Court *unanimously* held that no state estate tax is due on amounts held in a QTIP trust at the time of a second spouse's death where (1) a first spouse dies before the enactment of the

³ The Petition also made several claims based on violation of the United States and Washington Constitutions.

state estate tax, May 17, 2005, (2) a QTIP election is made on the first spouse's federal estate tax return, and (3) the second spouse dies after May 17, 2005. The Court also noted that the Department's "2006 regulations were valid and were justifiably relied upon by the Estates." 175 Wn.2d at 570. Three justices concurred in the result on the basis that the regulations mean "that the state estate tax is computed wholly without regard to any federal QTIP election." *Id.* at 588 (Madsen, C.J., concurring/dissenting). The Department sought reconsideration of the *Bracken* decision, but the Supreme Court denied the Department's motion on January 10, 2013, and issued its mandate on January 14, 2013.

Bracken involved only those situations in which the first-to-die spouse died before May 17, 2005. Thus, if both spouses die after that date, *Bracken* has no impact, and the Department may assess and collect the rightfully due estate tax.

Calculating Arthur D. Phelps' state estate tax liability once the value of Marguerite's QTIP trust is excluded from his Estate demonstrates that the Estate overpaid the Department by \$904,499.33. CP 49.

To date, the Department has refused to abide by the parties' March 25, 2011, stay in which they agreed that the decision in *Bracken* would control the outcome of this case. The Department has also refused to issue

a refund to the Estate of the \$904,499.33 overpayment made under protest.
Id.

On April 12, 2013, the Estate moved for summary judgment. CP 33. On or about April 30, 2013, the Department and the Estate filed a Stipulation and Agreed Order granting the Estate's motion for summary judgment. CP 109. In the Stipulation and Agreed Order, the parties agreed that pursuant to RCW 34.05 and the holding in *Bracken*, the Department is "ordered to grant the Estate's January 27, 2011, estate tax refund claim" and to refund the tax to the Estate. CP 111.

II. Legislative Developments

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

House Bill 1920 was not adopted during the Legislature's regular session or first special session. Other bills seeking to reverse *Bracken* (HB 2064, SB 5872, and HB 5939) also failed. But on June 13, 2013, the Legislature passed EHB 2075, which was read for the first time on June 12, 2013.⁴ The Governor signed the bill on June 14, 2013. In accordance with its emergency clause, EHB 2075 became effective immediately.

ARGUMENT

I. Standard Of Review

The Department is appealing from the parties' Stipulation and Agreed Order granting summary judgment in favor of the Estate. The Estate agrees with the Department that even though this case arose from a petition for review filed under the Administrative Procedures Act, RCW 34.05 *et seq.*, this Court should review the trial court decision because the trial court considered additional evidence. *Residents Opposed to Kittitas Turbines v. State Energy Facility Site Evaluation Council*, 165 Wn.2d 275, 300-01, 197 P.3d 1153 (2008):

The standard of review for an order granting summary judgment is *de novo*. *Heath v. Uruga*, 106 Wn. App. 506, 512, 24 P.3d 413 (2001) (citing *Enterprise Leasing Inc. v. City of Tacoma*, 139 Wn.2d 546, 551–

⁴ The legislative floor debate on EHB 2075 is included at Appendix C.

52, 988 P.2d 961 (1999)). When reviewing an order of summary judgment, appellate courts engage in the same inquiry as the trial court. *Id.* Summary judgment is appropriate only if the pleadings, affidavits, depositions, and admissions on file demonstrate the absence of any genuine issues of material fact and that the moving party is entitled to judgment as a matter of law. *Id.* (citing CR 56(c)). The court must consider all facts and all reasonable inferences from them in the light most favorable to the nonmoving party. *Id.* at 513. The court should grant the motion only if, from all the evidence, reasonable minds could reach but one conclusion. *Id.* In addition, an appellate court may sustain a trial court on any correct ground, even though that ground was not considered by the trial court. *Id.*

II. *Bracken* Governs This Case

The Department concedes, as it must, that there is no material difference between the facts of this case and those considered in *Bracken*. Here, as in *Bracken*, a taxpayer (Marguerite) created a QTIP marital deduction trust nine years before the standalone Washington estate tax was enacted.⁵ The QTIP trust provided a life estate for her surviving spouse (Arthur) and qualified for the marital deduction, which meant federal

⁵ The QTIP provisions have been a part of *federal* estate tax law since 1981. See *Eisenbach v. Schneider*, 140 Wn. App. 641, 652-53, 166 P.3d 858 (2007).

estate tax was deferred. When Arthur died, the assets in Marguerite's QTIP trust went to the remainder beneficiaries, exactly as she had directed.

The question presented is whether the fact that the QTIP trust qualified for a federal tax deferral and the surviving spouse died after May 17, 2005, means that the QTIP trust assets—unlike the assets of other trusts established before May 17, 2005—are subject to Washington estate tax. The answer is no.

Bracken rests on two straightforward propositions. First, that the Washington estate tax is a tax on transfers by the deceased. Second, that the standalone estate tax applies prospectively—*i.e.*, to persons dying on or after May 17, 2005. From these two propositions the Court's holding follows directly: Washington estate tax does not apply to the assets in QTIP trusts created before May 17, 2005, because the transfer of those assets occurred before the Washington estate tax was established.

The Supreme Court in *Bracken* held, in a section entitled "*Transfer Taxation Requires a Transfer*," that only "a transfer—a real transfer—is the sanction for the [estate] tax." 175 Wn.2d at 566. "The requirement for a transfer is constitutionally grounded and long standing." *Id.* at 564. Its source is the fundamental distinction between an excise tax and a property tax. An excise tax "is levied upon the use or transfer of property . . .,"

whereas a tax “levied upon the property itself” or the income derived from property is a direct tax. *Id.* “If estate taxation cannot be tied to a transfer, it fails as an unapportioned (and therefore unconstitutional) direct tax.” *Id.* at 565 (citing *Levy v. Wardell*, 258 U.S. 542, 42 S. Ct. 395, 66 L. Ed. 758 (1922)).

The Supreme Court in *Bracken* correctly held further that the QTIP trust assets are transferred by the first spouse to die, not the surviving spouse. *Id.* at 566. The court stated:

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

Id. (citations omitted).

Arthur Phelps is in precisely the same position as Barbara Nelson and Sharon Bracken. He did not transfer, in any manner, the QTIP in the marital deduction trust set up by Marguerite. That transfer occurred in 1996. The assets of Marguerite’s QTIP trust are not taxable in Arthur’s Washington taxable estate. These assets pass through his estate, outside of his control, on their way to the ultimate beneficiaries of the QTIP trust.

III. EHB 2075 Is Unconstitutional As Applied

EHB 2075, as applied in this case, violates both the state and federal constitutions. An as-applied challenge “occurs where a plaintiff

contends that a statute's application in the context of the plaintiff's actions or proposed actions is unconstitutional.'" *Lummi Indian Nation v. State*, 170 Wn.2d 247, 258, 241 P.3d 1220 (2010) (quoting *Wash. State Republican Party v. Pub. Disclosure Comm'n*, 141 Wn.2d 245, 282 n.14, 4 P.3d 808 (2000)). A statute held unconstitutional as applied in a particular case "cannot be applied in the future in a similar context, but it is not rendered completely inoperative.'" *Id.* (quoting *Wash. State Republican Party*, 141 Wn.2d at 282 n.14).⁶

As read by the Department, EHB 2075 cannot constitutionally be applied to Arthur's estate because it violates (i) the limits on imposition of an excise tax, (ii) the Due Process Clause, (iii) the Separation of Powers doctrine, (iv) the impairment clauses, and (v) the Equal Protection Clause.

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

The Department, through EHB 2075, seemingly attempted to amend the Washington estate tax in a manner that would tax a fictional transfer of QTIP assets as if the transfer were real. If EHB 2075 actually brings the assets of Marguerite's QTIP trust into Arthur's Washington taxable estate, it does so by (a) untethering the statutory definition of

⁶ A facial challenge would require a holding (not necessary here) that the challenged provision cannot be constitutionally applied in any circumstance. See *Lummi Indian Nation*, 170 Wn.2d at 258. Here, EHB 2075 can be applied when *both* spouses die *after* the enactment of the standalone Washington estate tax on May 17, 2005.

“transfer” from the constitutionally required meaning of that term,

(b) imposing the estate tax on property without any transfer, or (c) both.

The Department fails to heed one of the most critical points made by the Supreme Court in *Bracken*:

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

175 Wn.2d at 566.

The Court in *Bracken* added that without “a real transfer,” there is no constitutional authority for the tax. *Id.* No legislative alchemy can turn fiction into reality. And this was clear long before *Bracken* was decided.

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

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

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

What was true in *In re McGrath's Estate* was no less true in *Bracken*, and is no less true in this case. Here, the rights of the beneficiaries vested at the time that Marguerite's QTIP trust was created in 1996, and those rights were complete and indefeasible. Arthur had no power to alter the beneficiaries' rights. On the contrary, "[t]he assets in

the QTIP trust could have been left to any recipient of [Marguerite's] choosing, and neither [Arthur] nor the estate had any control over their ultimate disposition." *Estate of Bonner v. U.S.*, 84 F.3d 196, 198 (5th Cir. 1996) (per curiam).

Bracken and *In re McGrath's Estate* demonstrate that, if "transfer" is interpreted as the Department urges, the estate tax is an unconstitutional direct tax on property rather than a constitutionally permissible excise tax. The same flaw is apparent if the change in the definition of "Washington taxable estate" is read as the Department urges—namely, as adding (and not allowing the deduction under RCW 83.100.047(3) of "the value of any property included . . . under section 2044 of the internal revenue code, regardless of whether the decedent's interest in such property was acquired before May 17, 2005." RCW 83.100.020(14). Absent a taxable transfer, which Arthur did not make, this definition represents the direct taxation of property, and, as such, it violates the *sine qua non* of a permissible excise tax.

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

If EHB 2075 applies to the assets in Marguerite's QTIP trust, the statute violates state and federal constitutional Due Process protections⁷ by imposing tax on transfers, namely the transfer of assets into Marguerite's QTIP trust at her death, which occurred long before the effective date of the standalone Washington estate tax. Legislative tax decisions may be entitled to deferential review, but this deference does not permit a tax to apply retroactively as EHB 2075 does, nor does it permit retroactive taxation that divests vested rights.

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

⁷ U.S. Const., amend. XIV; Wash. Const. art. I, § 3.

assets in 1996. In purporting to capture and to tax the transfer of the QTIP trust assets, EHB 2075 violates Due Process.

The Department provides a string of citations referencing various periods of retroactivity⁸ to justify the eight-year retroactive period—that is from June 14, 2013 to May 17, 2005. Br. of App. at 23. However, even the most extreme example that the Department provides does not come close to EHB 2075’s 32-year reach. The Legislature’s attempt to tax transfers occurring long before the effective date of the statute violates the Due Process requirements of the state and federal constitutions. *See McGrath*, 191 Wn.2d at 510.

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

⁸ Other Washington cases, not cited by the Department, conclude that shorter retroactive periods fail to withstand constitutional scrutiny: *Bates v. McLeod*, 11 Wn.2d 648, 657, 120 P.2d 472 (1941) (imposition of three-month retroactive tax on privilege of employing others, “the exercise of which had formerly been freely enjoyed,” violated Due Process Clause); *cf. State v. Pac. Tel. & Tel. Co.*, 9 Wn.2d 11, 17, 113 P.2d 542 (1941) (in case involving use tax, holding that approximately four-year retroactive period could not be sustained; retroactive tax could only apply to “prior but recent transactions”).

The Department relies on *United States v. Carlton*, 512 U.S. 26, 114 S. Ct. 2018, 129 L. Ed. 2d 22 (1994), which involved a retroactive amendment clarifying a federal estate tax deduction for the sale of employer securities to an employee stock ownership plan. In *Carlton*, the Court applied various factors in evaluating whether retroactivity was permitted under the Due Process Clause. The Court upheld retroactivity because (a) Congress's purpose was not illegitimate or arbitrary and (b) Congress "acted promptly and established only a modest period of retroactivity," in accordance with the traditional practice of confining retroactive tax legislation "to short and limited periods required by the practicalities of producing national legislation." *Id.* at 32-33 (citations omitted). In *Carlton*, and in stark contrast to the 32-year effective reach of EHB 2075, the "modest period of retroactivity" was slightly greater than a year. *See id.* at 33.⁹

No doubt raising revenue for education is an appropriate legislative purpose, but it cannot justify arbitrary action. And regardless of whatever

⁹ *Carlton* distinguished one prior case that held for the taxpayer as inapposite because it "involved a novel development in the estate tax which embraced a transfer that occurred 12 years earlier." 512 U.S. at 34 (citing *Nichols v. Coolidge*, 274 U.S. 531, 543, 47 S. Ct. 710, 71 L. Ed. 1184, 52 A.L.R.1081 (1927)). Save one year, that is precisely the effect of EHB 2075 as applied to the transfer of Marguerite's property in 1996.

else might be said of EHB 2075, it does not represent prompt action, nor does it establish only a modest level of retroactivity.

In 2006, the Department enacted regulations that clearly exempted Marguerite's 1996 QTIP trust from taxation. The Department knew as early as 2007 with the commencement of the *Bracken* litigation that taxpayers applied those regulations and the statute to exclude pre-2005 QTIP trust assets from the Washington taxable estate of the surviving spouse. The Department knew from the tax return filed by the Estate that it asserted the 1996 QTIP trust assets were excluded from taxation. In fact, the Department changed its regulations in 2009, tacitly acknowledging the correctness of the Estate's deduction of Marguerite's pre-2005 QTIP trust assets. The Department knew the Estate would claim a refund in 2010 when the Department forced payment of the disputed taxes under the threat of imposition of penalties and interest. Nevertheless, the Department continued to illegally collect taxes on pre-2005 QTIP trusts without seeking any "corrective" legislation to address a potential "leak in the public treasury." It was only in 2013 – *seventeen* years after Marguerite's 1996 QTIP trust was established, seven years after the Department adopted regulations exempting pre-2005 QTIP trusts, six years after the *Bracken* refund suit was filed, and three years after the Estate was forced to pay the disputed taxes under the Department's threat

of additional penalties and interest – that the Department sought a change in the law. The bottom line is that EHB 2075 is not a prompt remedial measure. Its period of retroactivity (32 years) is not modest, and the potential cost of the refund due to Arthur’s estate cannot be considered unanticipated.

The circumstances surrounding the enactment of EHB 2075 also undermine its validity. EHB 2075 was passed with the specific purpose of avoiding the payment of refunds that the Legislature knew were imminent.¹⁰ This case is very similar to the situation in *Tesoro Refining and Marketing Co. v. Department of Revenue*, 159 Wn. App. 104, 110, 246 P.3d 211 (2010), *rev’d on other grounds*, 173 Wn.2d 551, 559 n.3, 269 P.3d 1013 (2012),¹¹ where this Court held that the retroactive effect of a B&O tax amendment violated constitutional Due Process:

And, unlike in *Carlton*, here the legislative history of the 2009 act shows the recent amendment was in direct

¹⁰ Appendix C, page 9 (Senate Floor Debate, June 13, 2013 (Statement of Sen. Nelson) (“[I]n eight hours and fifteen minutes without this legislation we begin to refund to the wealthiest estates in Washington. We begin to mail out checks for funds that could be used for our kindergartners, for our third-graders, for everything that we believe in for our kids’ futures.”).

¹¹ Although this Court’s decision was reversed on other grounds, the Due Process analysis in *Tesoro* remains a valid constitutional interpretation. *See Order, Nw. Env. Defense Ctr. v. Brown*, No. 07-35266 (9th Cir. 2013) (citing *Misic v. Bldg. Serv. Emps. Health & Welfare Trust*, 789 F.2d 1374, 1379 (9th Cir. 1986) (when the U.S. Supreme Court reverses the federal court of appeals on other grounds, it leaves unchanged the law of this circuit on issues not reached by the Court)).

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

Id. at 118-119.

In addition, EHB 2075 violates Due Process requirements by depriving the beneficiaries of their vested rights to the remainder of Marguerite’s QTIP trust. “Due process is violated if the retroactive application of a statute deprives an individual of a vested right.” *Caritas Servs. Inc. v. Dep’t of Social & Health Servs.*, 123 Wn.2d 391, 413, 869 P.2d 28 (1994) (quoting *In re Marriage of MacDonald*, 104 Wn.2d 745, 750, 709 P.2d 1196 (1985)). A vested right “must be something more than a mere expectation based upon an anticipated continuance of the existing law; it must have become a title, legal or equitable, to the present or future enjoyment of property, a demand, or a legal exemption from a demand by another.” *Id.* (quoting *MacDonald*, 104 Wn.2d at 750) (emphases in original).

In this case, the rights of the beneficiaries to inherit the remainder of Marguerite’s QTIP trust vested immediately upon creation of that trust in 1996. See *Empire Props. v. County of Los Angeles*, 44 Cal. App. 4th

781, 787, 52 Cal. Rptr. 2d 69 (1996). These rights, therefore, were a “title, legal or equitable, to the . . . future enjoyment of property,” *Caritas*, 123 Wn.2d at 413, and as such are protected by the Due Process clause from divestment by retroactive legislation. *See McGrath’s Estate*, 191 Wash. at 508-09 (noting that Northwest Mutual policies had fully vested before inheritance tax was enacted, and tax on right to receive proceeds of policies “would conflict with the due process clause of the Fourteenth Amendment”) (citing *Coolidge v. Long*, 282 U.S. 582, 605, 51 S. Ct. 306, 75 L. Ed. 562 (1931) (enforcement of tax on fully vested trusts created before Massachusetts inheritance tax “would be repugnant to . . . the due process clause of the Fourteenth Amendment.”)).

The Department points out that a taxpayer does not have a vested right in the tax code (see *Carlton*, 512 U.S. at 33), but the beneficiaries of Marguerite’s QTIP trust have an entirely distinct vested right—namely, the right to receive the corpus of Marguerite’s QTIP trust. This right has been fully vested for more than a decade, and Due Process principles prohibit the Legislature from impairing this vested right.

The Department’s refund obligation to Arthur’s estate had also moved far beyond a mere expectancy by the time that the Legislature acted. As the Department stipulated, the Estate timely filed a refund request. CP 109. Under RCW 83.100.130, the Department had the

mandatory statutory duty to pay the refund, plus interest, when it received the Estate's request and determined that it had overpaid taxes.

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

No principled distinction exists between the vested rights recognized by Washington courts, such as reimbursement under an existing statutory formula or L&I payments under the existing statutory scheme, and the vested right to recover overpaid taxes under the refund directive of RCW 83.100.130. Because EHB 2075 divests the vested right of the Estate to receive a refund under RCW 83.100.130 *and* the vested

right of the beneficiaries to receive the full QTIP trust remainder, it violates the Due Process Clause.

C. EHB 2075 violates the Separation of Powers Doctrine

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

When the Legislature retroactively amends a statute that the Washington Supreme Court has construed, that action must be carefully evaluated to determine whether the Legislature’s action “threatens the independence or integrity or invades the prerogatives of” the Court. *Id.* at 507 (internal citations omitted).¹² One principle guiding this evaluation is

¹² “[S]eparation of powers problems are raised when a subsequent legislative enactment is viewed as a clarification and applied retroactively, if the subsequent enactment contravenes the construction placed on the original statute by this court.” *Wash. State Farm Bureau Fed’n v. Gregoire*, 162 Wn.2d 284, 304, 174 P.3d 1142 (2007) (quoting *Overton v. Econ. Assistance Auth.*, 96 Wn.2d 552, 558, 637 P.2d 652 (1981)); *see also Port of Seattle v. Pollution Control Hearings Bd.*, 151 Wn.2d 568, 627, 90 P.3d 659 (2004) (“Although the legislature may not retroactively overrule a decision of the State’s

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

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

- When a QTIP trust is established, it is the trustor who transfers the QTIP trust assets.¹³
- The transfer occurs when the QTIP trust is established.¹⁴
- The holder of a life estate who has no power to dispose of QTIP trust assets does not transfer them by dying.¹⁵

highest court, the legislature may clarify a law in response to an administrative adjudication or trial court decision.”).

¹³ “Property is transferred from a trustor when a trust is created, not when an income interest in the trust expires.” *Bracken*, 175 Wn.2d at 566.

¹⁴ The “transfers [were] completed by William Nelson and Jim Bracken years ago” *Bracken*. 175 Wn.2d at 554.

¹⁵ The surviving spouses and their estates “never transferred, in any manner, the QTIP” assets that passed to the beneficiaries of the QTIP trust. . . . QTIP assets “do[] not actually pass to or from the surviving spouse.” *Bracken*. 175 Wn.2d at 566.

- The estate of someone dying after May 17, 2005, prepares the estate's Washington return and pays state estate tax in light of the Department's then-applicable regulations.¹⁶

Each of these is an adjudication of fact. Indeed, the *Bracken* decision emphasizes the difference between what actually happens when a QTIP trust is created and administered—as reflected in the first three bullets above—and the provisions in federal tax law that permit deferral of federal estate tax on QTIP trusts.¹⁷ On the Department's reading, however, EHB 2075 requires this Court (1) to defer to the Legislature's finding that the Washington Supreme Court has too narrowly construed the term “transfer” and (2) to treat the assets in the QTIP trust that Marguerite created in 1996 as having been transferred by Arthur when he died, regardless of whether he in fact transferred anything. In the words of *O'Brien*, “[T]he legislature has no power to make such a judicial determination.” 85 Wn.2d at 270.

¹⁶ “[The Department's] 2006 regulations were valid and were justifiably relied on by the Estates.” *Bracken*, 175 Wn.2d at 570.

¹⁷ It is a mistake, the *Bracken* majority states, to rely on “Ms. Bracken's **fictional** receipt and transfer of property for federal tax purposes to ignore **the fact** that for purposes of imposing a state estate tax, she has not received or transferred the property at all.” *Bracken*, 175 Wn.2d at 573 (emphasis added).

Furthermore, the Department's reading of EHB 2075 violates "the bedrock principle that the legislature cannot contravene an existing judicial construction of a statute." *State v. Maples*, 171 Wn. App. 44, 50, 286 P.3d 386 (2012). As the Court observed in *State v. Dunaway*, 109 Wn.2d 207, 216 note 6, 743 P.2d 1237, 749 P.2d 160 (1987), "even a clarifying enactment cannot be applied retrospectively when it contravenes a construction placed on the original statute by the judiciary. . . . Any other result would make the legislature a court of last resort." (Internal quotations and citations omitted).

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

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

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

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

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

The Department’s reason for seeking this extraordinary provision is plain: Every justice hearing the *Bracken* case found that the Department’s position was contradicted by its own rules (i.e., the 2006 regulations). Directing courts to treat those rules as if they never existed is revisionist and unconstitutional.

In *O’Brien*, the Court pointed out the crucial temporal dimension of judicial vs. legislative determinations:

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

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

The Department argues that EHB 2075 does not violate the Separation of Powers doctrine because it does not affect any final judgment or dictate how a court should decide any factual issue. The Department’s view of this constitutional doctrine is too narrow: “Retroactive changes in the law may violate separation of powers by disturbing judgments, interfering with judicial functions, or cause manifest injustice.” *Lummi Indian Nation v. State*, 170 Wn.2d 247, 261, 241 P.3d 1220 (2010). The Department does not address interference with judicial functions or manifest injustice, even though both are present here. Regardless, EHB 2075 fails even the narrow tests posited by the Department.

The conflict between EHB 2075 and the Separation of Powers principles is manifest when one considers that EHB 2075 purports to

overrule *Bracken* on the very judicial determinations that lie at its heart: the Court's adjudications of (1) who makes a transfer when a trust with a life estate is established, (2) when that transfer takes place, (3) the difference between transferring assets and simply dying, and (4) the regulatory context in which state tax returns were prepared between 2006 and 2009.

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

D. EHB 2075 violates the prohibition against impairing contracts in the state and federal constitutions by substantially interfering with private contractual rights

In addition to violating Due Process, EHB 2075 violates the impairment of contracts clauses of the state and federal constitutions. Wash. Const. art. I, § 23 (no "law impairing the obligations of contracts shall ever be passed"); U.S. Const. art. I, § 1, cl. 1 ("No State shall . . . pass any . . . Law impairing the Obligation of Contracts."). The impairment clauses are implicated when (1) a contractual relationship exists and (2) legislation substantially impairs the contractual relationship. *Caritas*, 123 Wn.2d at 402-03.

EHB 2075 applies to a contractual relationship because interests in trusts have long been treated as contractual rights for impairment clause purposes. See *Coolidge v. Long*, 282 U.S. at 594-95 (“The trust deeds are contracts within the meaning of the contract clause of the Federal Constitution. They were fully executed before the taking effect of the state law under which the excise is claimed. The commonwealth was without authority by subsequent legislation, whether enacted under the guise of its power to tax or otherwise, to alter their effect or to impair or destroy rights which had vested under them.”); *McGrath’s Estate*, 191 Wash. at 507-08 (quoting *Coolidge’s* analysis of impairment of trusts with approval, and concluding that taxation of indefeasible insurance policies purchased before the state death taxes applied would violate the contracts clauses of the state and federal constitution); see also *In re Estate of Bodger*, 130 Cal. App. 2d 416, 424, 279 P.2d 61 (1955) (declaration of trust is “a contract between the trustor and the trustee for the benefit of a third party”).

EHB 2075 also impairs the contractual rights of the beneficiaries with respect to the QTIP trust by “alter[ing] its terms, impos[ing] new conditions, or lessen[ing] its value.” *Caritas*, 123 Wn.2d at 404 (emphasis added). The value of the beneficiaries’ rights to the QTIP trust has been substantially devalued by retroactive imposition of the

Washington estate tax. See *McGrath's Estate*, 191 Wash. at 496 (“[A]ny subsequent statute passed during the existence of the contracts providing for taxation of that right would, if enforced, impair the obligation of these contracts, for the McGrath Candy Company would then receive less than it was entitled to receive according to the terms thereof.”).

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

“Financial necessity, though superficially compelling, has never been sufficient of itself to permit states to abrogate contracts.” *Carlstrom v. State*, 103 Wn.2d 391, 396, 694 P.2d 1 (1985). The Department’s attempt to extract revenue by altering contracts created years before any

standalone estate tax existed in Washington is not legitimate under any standard. EHB 2075 violates the state and federal impairment clauses.

E. Drawing a distinction between the assets of QTIP trusts and all other trusts violates Equal Protection principles

One peculiarity of EHB 2075 as applied here is that it distinguishes between the life estate established under the terms of Marguerite's QTIP trust and all other types of trusts. According to the Department, the assets of the QTIP trust are subject to Washington estate tax upon the death of Arthur, but the assets of other types of trusts, such as a credit shelter trust, are not—this despite the fact that the terms of the two trusts may be virtually identical, their beneficiaries may be the same, and the life estate that the second spouse enjoyed in the trusts would terminate in exactly the same way: by his or her death.

There is no revenue-enhancing rationale for sparing all trusts established before May 17, 2005, except QTIP trusts, from taxation on the death of the second spouse. There is no distinction that can be drawn between the tax consequences to a QTIP trust and any other trust type. In fact, the only distinction that exists is that a QTIP trust qualifies for the federal marital deduction, and federal law provides a mechanism for collection of deferred federal estate tax. Neither that federal law mechanism nor hostility to the federal marital deduction can provide a

legitimate basis for subjecting the assets in QTIP trusts, alone, among those created before 2005, to state estate tax after 2005.

Our state's Equal Protection Clause (Const. art. I, § 12) and the Fourteenth Amendment to the United States Constitution require that "persons similarly situated with respect to the legitimate purpose of the law must receive like treatment." *State v. Marintorres*, 93 Wn. App. 442, 450, 969 P.2d 501 (1999) (quoting *State v. Coria*, 120 Wn.2d 156, 169, 839 P.2d 890 (1992)). Economic legislation that neither sets up a suspect class nor affects a fundamental right is subject to the rational basis test. *Schuchman v. Hoehn*, 119 Wn. App. 61, 68, 79 P.3d 6 (2003). The test under rational basis "is not whether the *law* being challenged has a rational basis; it is whether there is a rational basis for the *classification* embodied by the legislative scheme." *Marintorres*, 93 Wn. App. at 451 (citations omitted, emphasis in original).

To pass muster as rational, a classification must (1) apply alike to all members within the designated class, (2) be based on reasonable distinctions between those within and those outside the class, and (3) bear a rational relationship to the purpose of the legislation. *Id.* (statute requiring interpreter reimbursement for hearing-impaired convicts, but not non-English speaking convicts, was irrational and violated Equal Protection as applied). Tax statutes are analyzed the same way. *See*

Snow's Mobile Homes, Inc. v. Morgan, 80 Wn.2d 283, 287, 494 P.2d 216 (1972) (distinction between similarly situated taxpayers, based only upon timing of assessment for taxation, would constitute denial of Equal Protection; “[i]t is fundamental that all persons within the same class must be treated equally”). For this reason, too, EHB 2075 is unconstitutional.

IV. Collateral Estoppel Requires Judgment In Favor Of The Estate

The doctrine of collateral estoppel or issue preclusion should prevent the Department from re-litigating the issue decided in *Bracken*. *Hanson v. City of Snohomish*, 121 Wn.2d 552, 561, 852 P.2d 295 (1993); *Rains v. State*, 100 Wn.2d 660, 665, 674 P.2d 165 (1983). The elements of collateral estoppel require that: (1) the issue decided in the prior adjudication is identical with the one presented in the second action, (2) the final adjudication ended in a final judgment on the merits, (3) the party against whom the plea is asserted was a party or was in privity with a party to the prior adjudication, and (4) the application of the doctrine does not work an injustice. *Hanson*, 121 Wn.2d at 561. The party asserting collateral estoppel need not be a party in the earlier action. *Lucas v. Velikanje*, 2 Wn. App. 888, 894, 471 P.2d 103 (1970).

Here, each element of collateral estoppel is present. First, the issue in this case—that a pre-May 17, 2005 QTIP trust was not taxable in

the estate of the second spouse to die—is the very same issue litigated by the Department and decided by the Washington Supreme Court in *Bracken*. 175 Wn.2d at 575-76. The Department concedes this point in the parties' Stipulation and Agreed Order. CP at 110-11. Second, the party against whom the plea is asserted, the Department, was a party in the prior adjudication. *Id.* Third, the Department had every opportunity to litigate this case in the trial and appellate courts, including its unsuccessful filing of a motion for reconsideration of the Supreme Court's decision in *Bracken*. Finally, application of the doctrine of collateral estoppel does not work an injustice.

Indeed, the failure to apply the doctrine would work an injustice against the Estate, not only because *Bracken* decided the issue, and Washington courts are bound to follow it under the principle of *stare decisis*,¹⁸ but also because Arthur's estate and the Department agreed to stay its refund litigation while *Bracken* was pending. CP at 27. The terms of that stay provided that *Bracken* would control the outcome of the instant refund litigation. *Id.* However, after the Supreme Court rejected

¹⁸ A decision by the State Supreme Court is binding precedent on the lower courts in other cases in the state. *See Satterlee v. Snohomish County*, 115 Wn. App. 229, 233, 62 P.3d 896 (2002). The doctrine of *stare decisis* "means that the rule laid down in any particular case is applicable to another case involving identical or substantially similar facts." *Greene v. Rothschild*, 68 Wn.2d 1, 8, 414 P.2d 1013 (1966).

the Department's motion for reconsideration of *Bracken*, the Department refused to abide by the terms of the stay by failing to issue the refund. The Estate was then forced into the position of having to recommence litigation to obtain the refund that the Department had tacitly agreed to provide if *Bracken* was decided in the taxpayer's favor, which it was *unanimously*. By refusing to issue the refund after *Bracken* was decided and reconsideration was denied, the Department blatantly violated the terms of the stay. Accordingly, the doctrine of collateral estoppel provides yet another basis on which this Court should affirm the Stipulation and Agreed Order granting summary judgment in favor of the Estate and reject the Department's arguments on appeal.

In addition, the doctrine of equitable estoppel against the government should prevent the Department from attempting to impose a new tax on the Estate. The elements of government estoppel require that: (1) the party to be estopped must know the facts, (2) the party estopped must intend that its conduct shall be acted on or must act in such a way that the party asserting the estoppel has a right to believe it was so intended, (3) the party asserting the estoppel must be ignorant of the true facts, and (4) the party asserting the estoppel must rely on the former's conduct to his injury. *Morgan v. Gonzales*, 495 F.3d 1084, 1092 (9th Cir. 2007) (citing *Watkins v. U.S. Army*, 875 F.2d 699, 709 (9th Cir. 1989) (en

banc)). A party asserting equitable estoppel against the government must also establish that (1) the government engaged in affirmative misconduct that goes beyond mere negligence, (2) the government's wrongful acts will cause a serious injustice, and (3) the public's interest will not suffer undue damage by imposition of estoppel. *Morgan v. Heckler*, 779 F.2d 544, 545 (9th Cir. 1985); *see also Watkins*, 875 F.2d at 708; *Baccei v. United States*, 632 F.3d 1140, 1147 (9th Cir. 2011). All of these elements are present here.

First and foremost, there is a clear indication in the legislative floor debates that estates with pending refund applications were, in fact, being targeted. *See Appendix C*. For instance, during the Senate floor debate, Senator Sharon Nelson stated, “[I]n eight hours and fifteen minutes without this legislation we begin to refund to the wealthiest estates in Washington. We begin to mail out checks for funds that could be used for our kindergartners, for our third-graders, for everything that we believe in for our kids’ futures.” *Id.*, page 9 (Senate Floor Debate, June 13, 2013). In addition, during the House of Representative’s floor debate on EHB 2075, Representative Maureen Walsh called out her fellow Representatives by noting that while yes, it would cost the state approximately \$160 million to refund the families that would be entitled to an estate tax refund, that amount was taken unlawfully from these families

by the Department, and these families should be paid back the \$160 million instead of using those funds for the unrelated purpose of mitigating budget shortfalls in education. Appendix C, page 3-4 (House Floor Debate, June 13, 2013).

In *United States v. Carlton*, the United States Supreme Court discussed when equitable estoppel against the government applies. 512 U.S. 26, 114 S. Ct. 2018, 129 L. Ed. 2d 22 (1994). The Supreme Court concluded that estoppel did not apply in that case because no argument was made that Congress acted with an improper purpose in enacting the challenged estate tax regulation. The Court said, “There is no plausible contention that Congress acted with an improper motive, as by targeting estate representatives such as Carlton after deliberately inducing them to engage in ESOP transactions.” *Carlton*, 512 U.S. at 27.

Here, in contrast to the facts in *Carlton*, there is ample evidence that two government entities—the Washington State Legislature and the Department committed misconduct. The Legislature acted with an improper purpose in targeting the estates with pending refund applications. The Department committed misconduct by agreeing by stipulation with the Estate not to pursue an earlier action, and by implicitly representing that it would be bound by the decision in *Bracken*, but then ultimately

ignoring both the holding in *Bracken* and the agreement to stay the litigation. CP 110-11. These facts establish governmental misconduct.

The other elements of equitable estoppel are also present. The Department was aware of the facts; it proposed and agreed to the stay. CP at 27. The Department knew Arthur's estate would act in reliance on the stay, and there was no reason for Arthur's estate to anticipate that the Department would not to honor the stay. Arthur's estate relied on the stay to its detriment by agreeing not to pursue the refund in court until *Bracken* was decided. The parties understood that *Bracken*, as Washington Supreme Court authority, would control the issue in dispute. Nevertheless, the Department has prolonged this litigation in violation of the stay, forcing the Estate to incur additional costs and legal fees, and forestalling the PR's ability to complete the state estate tax accounting and to close the Estate.

Taken together, the facts show that the governmental action goes beyond mere negligence. The Department acted intentionally. Its misconduct caused a "serious injustice" for Arthur's estate, which has been waiting since 2011 for its requested refund to be issued. Last, the facts show that the public's interest will not suffer undue damage by imposition of estoppel because the public has a strong interest in the very things the Estate is trying to accomplish in this litigation—to hold the

Department to the promises that it made and to ensure that the new legislation is deemed invalid if this Court finds that it violates the state or federal constitutions.

V. *Bracken* Was Correctly Decided

The Department devotes a third of its brief, and nearly half of its argument, to attacking the *Bracken* decision and asking the Washington Supreme Court to overturn it—this in spite of the fact that no justice accepted the Department’s position in *Bracken*,¹⁹ and that the Court denied the Department’s motion for reconsideration just a few months ago. The Department’s refusal to admit error and to accept the Court’s judgment does not justify forcing the Estate to move for relief that should have been provided pursuant to the parties’ agreed stay pending the outcome of *Bracken*. Nor does it justify the Department’s filing an appeal solely for the purpose of delay. Regardless, the Department’s argument implicitly concedes the futility of its legislative gambit. If EHB 2075 were effective to change the outcome in this case, the decision in *Bracken* would be of historical interest only. But it is far from that.

¹⁹ The concurrence/dissent is no less emphatic than the majority: “[I]t is absurd to conclude that the federal QTIP property should be included in the surviving spouse’s estate to enable imposition of a state tax where there was no deferral of state estate taxation on any QTIP property.” *Bracken*, 175 Wn.2d at 594 (Madsen, C.J., concurring and dissenting).

The Department's argument ignores the important principle of *stare decisis*:

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

Lunsford v. Saberhagen Holdings, Inc., 166 Wn.2d 264, 278, 208 P.3d 1292 (2009) (internal quotations and citations omitted).

The Department does not and cannot make the “clear showing” that *Bracken* is “incorrect and harmful,” as required for the Washington Supreme Court to overrule its decision in that case. Although the Department claims that the Supreme Court in *Bracken* construed “transfer” too narrowly, this claim ignores both the Court’s acceptance of the Department’s primary authority on the scope of “transfer,” *Fernandez v. Wiener* (see 175 Wn.2d at 565), and the Court’s view that the analysis should focus not on *what* constitutes a transfer but on *who* makes it and *when*. If there is no transfer by the decedent, there is no constitutional sanction for an estate tax. 175 Wn.2d at 566-68.

The cases discussed by the Department do not support a different conclusion. At issue in *Fernandez v. Wiener* was whether community property could be subjected to federal estate taxation when the marital community was terminated by the death of Mr. Wiener. So long as he was alive, Mr. Wiener had both the ability and the authority to direct how that property would be used. Both were extinguished when he died. The court concluded that “the death of the insured, since it ended his control over the disposition of the proceeds, and gave his wife the present enjoyment of them, may be constitutionally made the occasion for the imposition of an indirect tax measured by the proceeds themselves.” 326 U.S. at 363. This suggests that the federal government could constitutionally tax Marguerite’s property when she died, and indeed this is the basis for the deferred tax that is imposed under I.R.C. § 2044. *Fernandez v. Wiener* does not suggest any basis for Washington to tax Arthur’s estate for the assets in Marguerite’s trust.

The central issue in *West v. Okla. Tax Comm’n*, 334 U.S. 717, 68 S. Ct. 1223, 92 L. Ed. 1676 (1948), was whether the property of an Osage Indian was immune from state taxation because legal title was held by the federal government. The Court said no. Federal law authorized the decedent to dispose of his estate, including trust funds from which

restrictions on alienation had not been removed, in accordance with Oklahoma law. *Id.* at 722.

The Court observed:

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

Id. at 727 (citations omitted; emphasis added).

This case offers no authority for Washington to tax Arthur's estate for the value of the assets in the irrevocable QTIP trust that Marguerite created when she died.

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

at 198. The Department omits from its description of this case the critical fact that the insured paid the insurance premiums. The Department also fails to complete the Court's quotation from *Chase Nat'l Bank v. United States*, 278 U.S. 327, 337, 49 S. Ct. 126, 73 L. Ed. 405, 63 A.L.R. 388 (1929), about the nature of a "transfer"—namely, that it must "include the transfer of property procured through expenditures by the decedent with the purpose, effected at his death, of having it pass to another." *Mfrs. Nat'l Bank*, 363 U.S. at 199. This describes Marguerite, not Arthur.

The Department argues that *In re McGrath's Estate* supports its analysis. Br. of App. at 34-36. The Department notes that it was the shifting of economic benefit in one insurance policy over which Mr. McGrath retained the power to change the beneficiary that was the basis for taxation. *Id.* It is precisely because Mr. McGrath did *not* have that power over the other policies that the Court held their proceeds to be beyond the power of the State to impose a tax. *Id.* As the Court held in *Bracken*, a life estate held by a surviving spouse who lacks *any* power to change the remainder beneficiaries designated by the first spouse to die—here, Marguerite—is just like those non-taxable insurance policies. *In re McGrath's Estate* fully supports *Bracken* and, as shown above, requires the same result in this case.

The Department next attacks the Court's analysis of federal QTIP principles, arguing that property in a QTIP trust transfers twice. This position is entirely unsupported.²⁰ There is only one transfer, and it occurs when the trust is created and funded. Federal law treats the trust property as if it had passed (*in toto*) to the surviving spouse and then from the surviving spouse to the remainder beneficiaries. These fictions permit the value of the property to be treated as qualifying for the marital deduction at the first death, while ensuring that the deferred federal estate tax is paid when the second spouse dies. But neither fiction should be confused with the reality of what happens when a trust is created and a true transfer occurs. Nor can they obscure the absence of any parallel deferral of Washington estate tax for a trust that, in this case, was established in 1996.

As the Court noted in *Bracken*, inclusion of QTIP in the federal taxable estate of the surviving spouse is the *quid pro quo* for excluding it from the federal taxable estate of the first to die. *Bracken*, 175 Wn.2d at 568-69. The duty of consistency supports this treatment, just as the Court states. Contrary to the Department's argument, that duty does not apply only to omissions or misrepresentations. *See, e.g., Beltzer v. United*

²⁰ The Department elsewhere mischaracterizes I.R.C. § 2056(b)(7)(B)(i) as requiring that property "pass from the decedent to the surviving spouse." Br. of App. at 11. The statute actually requires only that the QTIP property "pass from the decedent." I.R.C. § 2056(b)(7)(B)(i)(I).

States, 495 F.2d 211 (8th Cir. 1974) (taxpayer disagreed with older brother over values shown in earlier estate tax return).

According to the Department, the death of the surviving spouse “is the generating event causing a shift of interests in the property.” Br. at 36. The penultimate paragraph in *McGrath's Estate* provides a decisive rejoinder to this argument:

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

191 Wash. at 510. Like Mr. McGrath, Arthur did not generate the funds at issue, and he had no vestige of control over Marguerite's QTIP trust. The trust was created by Marguerite and funded by her, for the benefit of persons that she chose. All of this happened nine years before the adoption of the standalone Washington estate tax. Given that statute's clear directive that it applies only to the estates of persons dying after May 17, 2005, there was no basis for imposing the tax on marital trust assets in *Bracken*, and there is none here.

Finally, the Department's argument for overturning *Bracken* nowhere mentions the rules and regulations that were in force when the decedents there died. Those regulations, which “have the same force and

effect as if specifically set forth in [ch. 83.100 RCW] . . .” (RCW 83.100.200), supported the estates’ position in *Bracken* and were flatly inconsistent with the Department’s argument. *See* 175 Wn.2d at 560-61; *id.* at 588 (Madsen, C.J., concurring and dissenting) (“The rule provides for removal of the effect of any federal QTIP elections, whether currently made by this decedent or made by a predeceased spouse. . . . This means that the state estate tax is computed wholly without regard to any federal QTIP election.”). The same regulations were in force when Arthur died and the Estate filed his Washington estate tax return. Just as those regulations belied the Department’s contentions in *Bracken*, they do so here. They may not be ignored.

Pursuant to RAP 18.1 and RAP 18.9 and RCW 4.84.185, the Court should award attorney fees and costs to the Estate for the expense it has been forced to incur in defending its rights on appeal.

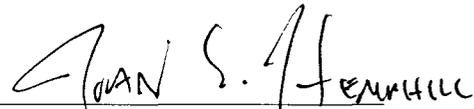
CONCLUSION

The Supreme Court’s decision in *Bracken* is correct as well as binding on this Court, and it is determinative of the issues presented in this case. The statute that the Department requested and the Legislature enacted to reverse *Bracken* is unconstitutional as applied: it violates the constitutional underpinnings of an excise tax by taxing property rather than a transfer, it violates the Due Process Clause, it violates the

Separation of Powers doctrine, it violates the constitutional prohibition against the impairment of contracts, and it violates the Equal Protection Clause.

The Stipulation and Agreed Order granting summary judgment for the Estate should be affirmed, and the Department's appeal dismissed in its entirety. Pursuant to that order, the Department is required to issue a refund to the estate in the amount \$904,499.33. In addition, the Court should award attorney fees and costs to the Estate.

By:



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CERTIFICATE OF SERVICE

I hereby certify under penalty of perjury under the laws of the State of Washington that on the 18th day of September, 2013, I caused a true and correct copy of the foregoing document, "Brief of Respondent," to be delivered by messenger to the following counsel of record:

Dated this 18th day of September, 2013, at Seattle, Washington.


Sarah Armon, Practice Assistant

File: 49614-001

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DIVISION II

Appendix A

HOUSE BILL 1920

State of Washington

63rd Legislature

2013 Regular Session

By Representatives Ormsby, Carlyle, Hunter, and Pollet; by request of Department of Revenue

Read first time 02/18/13. Referred to Committee on Finance.

1 AN ACT Relating to preserving funding deposited into the education
2 legacy trust account used to support common schools and access to
3 higher education by restoring the application of the Washington estate
4 and transfer tax to certain property transfers; amending RCW
5 83.100.020, 83.100.047, and 83.100.047; creating new sections;
6 providing an effective date; and providing an expiration date.

7 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

8 NEW SECTION. **Sec. 1.** (1) In 2005, to address an unexpected
9 significant loss of tax revenue resulting from the *Estate of Hemphill*
10 decision and to provide additional funding for public education, the
11 legislature enacted a stand-alone estate and transfer tax, effective
12 May 17, 2005. The stand-alone estate and transfer tax applies to the
13 transfer of property at death. By defining the term "transfer" to mean
14 a "transfer as used in section 2001 of the internal revenue code," the
15 legislature clearly expressed its intent that a "transfer" for purposes
16 of determining the federal taxable estate is also a "transfer" for
17 purposes of determining the Washington taxable estate.

18 (2) In *In re Estate of Bracken*, Docket No. 84114-4, the Washington

1 supreme court narrowly construed the term "transfer" as defined in the
2 Washington estate tax code.

3 (3) The legislature finds that it is well established that the term
4 "transfer" as used in the federal estate tax code is construed broadly
5 and extends to the "shifting from one to another of any power or
6 privilege incidental to the ownership or enjoyment of property" that
7 occurs at death. *Fernandez v. Wiener*, 326 U.S. 340, 352 (1945).

8 (4) The legislature further finds that it is necessary to prevent
9 the adverse fiscal impacts of the *Bracken* decision by reaffirming its
10 intent that the term "transfer" as used in the Washington estate and
11 transfer tax is to be given its broadest possible meaning consistent
12 with established United States supreme court precedents, subject only
13 to the limits and exceptions expressly provided by the legislature.

14 (5) As curative, clarifying, and remedial, the legislature intends
15 for this act to apply both prospectively and retroactively to estates
16 of decedents dying on or after May 17, 2005.

17 **Sec. 2.** RCW 83.100.020 and 2005 c 516 s 2 are each amended to read
18 as follows:

19 ~~((As used in this chapter:))~~ The following definitions in this
20 section apply throughout this chapter unless the context clearly
21 requires otherwise.

22 (1) "Decedent" means a deceased individual((+)).

23 (2) "Department" means the department of revenue, the director of
24 that department, or any employee of the department exercising authority
25 lawfully delegated to him by the director((+)).

26 (3) "Federal return" means any tax return required by chapter 11 of
27 the internal revenue code((+)).

28 (4) "Federal tax" means a tax under chapter 11 of the internal
29 revenue code((+)).

30 (5) "Gross estate" means "gross estate" as defined and used in
31 section 2031 of the internal revenue code((+)).

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

1 (7) "Person required to file the federal return" means any person
2 required to file a return required by chapter 11 of the internal
3 revenue code, such as the personal representative of an estate((+)).

4 (8) "Property" means property included in the gross estate((+)).

5 (9) "Resident" means a decedent who was domiciled in Washington at
6 time of death((+)).

7 (10) "Taxpayer" means a person upon whom tax is imposed under this
8 chapter, including an estate or a person liable for tax under RCW
9 83.100.120((+)).

10 (11) "Transfer" means "transfer" as used in section 2001 of the
11 internal revenue code and includes any shifting upon death of the
12 economic benefit in property or any power or legal privilege incidental
13 to the ownership or enjoyment of property. However, "transfer" does
14 not include a qualified heir disposing of an interest in property
15 qualifying for a deduction under RCW 83.100.046 or ceasing to use the
16 property for farming purposes((+)).

17 (12) "Internal revenue code" means(~~(, for the purposes of this~~
18 ~~chapter and RCW 83.110.010,)~~ the United States internal revenue code
19 of 1986, as amended or renumbered as of January 1, 2005((+)).

20 (13) "Washington taxable estate" means the federal taxable estate
21 and includes, but is not limited to, the value of any property included
22 in the gross estate under section 2044 of the internal revenue code,
23 regardless of whether the decedent's interest in such property was
24 acquired before May 17, 2005, (a) plus amounts required to be added to
25 the Washington taxable estate under RCW 83.100.047, (b) less:
26 ~~((+))~~ (i) One million five hundred thousand dollars for decedents
27 dying before January 1, 2006; and ~~((+))~~ (ii) two million dollars for
28 decedents dying on or after January 1, 2006; and ~~((+))~~ (iii) the
29 amount of any deduction allowed under RCW 83.100.046; and (iv) amounts
30 allowed to be deducted from the Washington taxable estate under RCW
31 83.100.047.

32 (14) "Federal taxable estate" means the taxable estate as
33 determined under chapter 11 of the internal revenue code without regard
34 to: (a) The termination of the federal estate tax under section 2210
35 of the internal revenue code or any other provision of law, and (b) the
36 deduction for state estate, inheritance, legacy, or succession taxes
37 allowable under section 2058 of the internal revenue code.

1 **Sec. 3.** RCW 83.100.047 and 2005 c 516 s 13 are each amended to
2 read as follows:

3 (1) If the federal taxable estate on the federal return is
4 determined by making an election under section 2056 or 2056A of the
5 internal revenue code, or if no federal return is required to be filed,
6 the department may provide by rule for a separate election on the
7 Washington return, consistent with section 2056 or 2056A of the
8 internal revenue code, for the purpose of determining the amount of tax
9 due under this chapter. The election (~~shall be~~) is binding on the
10 estate and the beneficiaries, consistent with the internal revenue
11 code. All other elections or valuations on the Washington return
12 (~~shall~~) must be made in a manner consistent with the federal return,
13 if a federal return is required, and such rules as the department may
14 provide.

15 (2) Amounts deducted for federal income tax purposes under section
16 642(g) of the internal revenue code of 1986 (~~shall~~) are not (~~be~~)
17 allowed as deductions in computing the amount of tax due under this
18 chapter.

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

24 (a) For the taxpayer that made the election, any amount deducted by
25 reason of section 2056(b)(7) of the internal revenue code is added to,
26 and the value of property for which a Washington election under this
27 section was made is deducted from, the Washington taxable estate.

28 (b) For the estate of the surviving spouse, the amount included in
29 the estate's gross estate pursuant to section 2014 (a) and (b)(1)(A) of
30 the internal revenue code is deducted from, and the value of any
31 property for which an election under this section was previously made
32 is added to, the Washington taxable estate.

33 **Sec. 4.** RCW 83.100.047 and 2005 c 521 s 192 are each amended to
34 read as follows:

35 (1)(a) If the federal taxable estate on the federal return is
36 determined by making an election under section 2056 or 2056A of the
37 internal revenue code, or if no federal return is required to be filed,

1 the department may provide by rule for a separate election on the
2 Washington return, consistent with section 2056 or 2056A of the
3 internal revenue code and (b) of this subsection, for the purpose of
4 determining the amount of tax due under this chapter. The election
5 (~~shall be~~) is binding on the estate and the beneficiaries, consistent
6 with the internal revenue code and (b) of this subsection. All other
7 elections or valuations on the Washington return (~~shall~~) must be made
8 in a manner consistent with the federal return, if a federal return is
9 required, and such rules as the department may provide.

10 (b) The department (~~shall~~) must provide by rule that a state
11 registered domestic partner is deemed to be a surviving spouse and
12 entitled to a deduction from the Washington taxable estate for any
13 interest passing from the decedent to his or her domestic partner,
14 consistent with section 2056 or 2056A of the internal revenue code but
15 regardless of whether such interest would be deductible from the
16 federal gross estate under section 2056 or 2056A of the internal
17 revenue code.

18 (2) Amounts deducted for federal income tax purposes under section
19 642(g) of the internal revenue code of 1986 (~~shall~~) are not (~~be~~)
20 allowed as deductions in computing the amount of tax due under this
21 chapter.

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

27 (a) For the taxpayer that made the election, any amount deducted by
28 reason of section 2056(b)(7) of the internal revenue code is added to,
29 and the value of property for which a Washington election under this
30 section was made is deducted from, the Washington taxable estate.

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

36 NEW SECTION. Sec. 5. Sections 2 and 3 of this act apply both

1 prospectively and retroactively to all estates of decedents dying on or
2 after May 17, 2005.

3 NEW SECTION. **Sec. 6.** This act does not affect any final judgment,
4 no longer subject to appeal, entered by a court of competent
5 jurisdiction before the effective date of this section.

6 NEW SECTION. **Sec. 7.** If any provision of this act or its
7 application to any person or circumstance is held invalid, the
8 remainder of the act or the application of the provision to other
9 persons or circumstances is not affected.

10 NEW SECTION. **Sec. 8.** Section 3 of this act expires January 1,
11 2014.

12 NEW SECTION. **Sec. 9.** Section 4 of this act takes effect January
13 1, 2014.

--- END ---

Appendix B

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

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

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

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

(b) "Decedent" means a deceased individual;

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

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

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

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

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

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

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

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

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

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

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

WAC 458-57-105 Nature of estate tax, definitions. (1) Introduction. This rule applies to deaths occurring on or after May 17, 2005, and describes the nature of Washington state's estate tax as it is imposed by chapter 83.100 RCW (Estate and Transfer Tax Act). It also defines terms that will be used throughout chapter 458-57 WAC (Washington Estate and Transfer Tax Reform Act rules). The estate tax rule on the nature of estate tax and definitions for deaths occurring on or before May 16, 2005, can be found in WAC 458-57-005.

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

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

[Title 458 WAC—p. 552]

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(i) **Funeral expenses.**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Table W

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

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(b) Examples.

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

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

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

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

Gross estate	\$3,000,000
Less unlimited marital deduction	- \$1,500,000
Less \$1,500,000 statutory deduction	- \$1,500,000
Washington taxable estate	\$0

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

[Statutory Authority: RCW 83.100.047 and 83.100.200, 06-07-051, § 458-57-115, filed 3/9/06, effective 4/9/06.]

Appendix C

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

[Transcribed from TVW PLAYER BEGINNING MINUTE 5:15]

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

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

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

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

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

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

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

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

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

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

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

- Speaker: Members are excused. The gentleman from the 35th District, Representative MacEwen.
- MacEwen: Thank you, Mr. Speaker. Please excuse Representatives Condotta, Crouse, Harris, Holy, Overstreet, Parker, Pike and Rodne.
- Speaker: Members are excused. The gentleman from the 2nd District, Representative Alexander.
- Alexander: Thank you, Mr. Speaker. Mr. Speaker, I share the concerns about the retroactivity probably as much as anybody about – I don't like to see decisions made retroactive that basically change the laws and the rules that are being governing our decisions. Now, Mr. Speaker, I am going to support this legislation today for one reason and one reason only. I believe we're going to have to reach some amount of give-and-take to get a budget resolved and out of this body and out of the Senate body. And I've been working with both sides and I believe that a number of the concerns of the Senate regarding this bill have been addressed in this particular striker and I think if this bill goes forward, not just the question of saving, the fact that tomorrow we pay off some paychecks – or some checks, not paychecks but checks, big checks by the way – but, more importantly, if this helps get to a resolved consensus without requiring new tax obligations on our, on our citizens that affect their daily lives then I think it's a move that out to be supported, so thank you, Mr. Speaker.
- Speaker: Thank you. Any further remarks? Lady from the 16th District, Representative Walsh.
- Walsh: Thank you, Mr. Speaker. And I certainly appreciate the sentiments from the previous speaker and have tremendous respect for him and all the work that he's done trying to get us out of here this year. But I also think there's a tremendous inherent unfairness with this bill. I just read an article about a family who had \$700,000 taken from – after their mother passed away in 2008. Now they have a son who's recently lost his wife to cancer and he's disabled and they really need the money. We did not take this money lawfully from these people. This money came because somebody boo-bood. I don't care – it was somebody's fault in government, Department of Revenue, but the reality is this money was not obtained lawfully from these families. This money – and my understanding, simplistic as it is, is that it was somewhere hovering around 160 million bucks to take care of this, to nip this in the bud, to be done with this. You know what? Maybe it's rainin'. Maybe it's a rainy day. Maybe we ought to just take 160 million dollars, pay back these families who we took this money from and be done with this. Because guess what? Constitutional issues and everything else aside, reality is this money belongs to those families because it was not lawfully taken from them in the first place. And guess what? We have seen lawsuits increased exponentially in

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

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

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

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

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

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

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

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

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

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

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

(Transcribed from TVW PLAYER BEGINNING MINUTE 52 05)

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

<u>Members Speaking</u>	<u>District</u>
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Senate President: . . . and the bill be placed on final passage. Hearing no objection, so ordered. [*gavel*] Senator Hill.

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

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

President: Senator Padden.

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

President: Senator Hargrove?

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

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

President: Senator Honeyford?

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

President: What is your point of inquiry?

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

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

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

[*Laughter*]

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

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

President: Senator Nelson?

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

President: Senator Baumgartner.

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

President: Senator Tom?

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

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

President: Senator Braun?

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

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

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

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

[*gavel*]

[*procedural matters*]

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

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