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SUPREME COURT OF THE STATE OF WASHINGTON

IN RE THE ESTATE OF SHARON M. BRACKEN, et al.

Appellants,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

Consolidated with

IN RE THE ESTATE OF BARBARA J. NELSON, et al.

Appellants,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

DEPARTMENT OF REVENUE'S ANSWER TO AMICUS BRIEF OF THE ESTATE OF BARBARA HAGYARD MESDAG

ROBERT M. MCKENNA
Attorney General

Charles Zalesky, WSBA # 37777
Assistant Attorney General
David M. Hankins, WSBA # 19194
Senior Counsel
Donald F. Cofer, WSBA # 10896
Senior Counsel
Revenue Division
P.O. Box 40123
Olympia, WA 98504-0123
(360) 753-5528

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I. INTRODUCTION

In order for the issues addressed by amicus to have any bearing in this appeal, the Court must first accept the premise that no transfer of QTIP occurred when Ms. Bracken and Ms. Nelson died and that, instead, the "taxable transfer" occurred years earlier when the QTIP trusts were created. This is the linchpin to understanding the Mesdag estate's amicus brief. If the "taxable transfer" occurred when the trusts were formed, imposing the "new" Washington estate tax on those prior transfers would be inconsistent with the prospective nature of the 2005 amendments to the tax. If, on the other hand, the taxable transfers occurred when Ms. Bracken and Ms. Nelson died, the QTIP was properly included in their Washington taxable estates. Thus, determining when the "taxable transfer" occurred is essential.

The Mesdag estate's "taxable transfer" premise is incorrect. QTIP included in the federal taxable estate of a decedent under I.R.C. § 2044 is treated as passing when the decedent dies. This is expressly stated in I.R.C. § 2044(c). Moreover, it is beyond any reasonable dispute that QTIP passing under I.R.C. § 2044 qualifies as a taxable transfer of that property under both the federal estate tax code and the Washington estate tax code. It therefore follows that the "taxable transfer" of QTIP passing under I.R.C. § 2044 occurs when the decedent dies, not when the QTIP trust is created. Consequently, including the QTIP in the Washington taxable estate of a decedent dying on or after May 17, 2005, is consistent with the prospective nature of the 2005 amendments to the Washington estate tax.

II. ARGUMENT

A. The Taxable Transfer Of QTIP Occurred On The Deaths Of Ms. Bracken And Ms. Nelson, Not When The QTIP Trusts Were Formed

1. Under I.R.C. § 2044, the transfer occurs on the death of the second spouse.

The federal estate tax is set out in subtitle B, chapter 11, of the Internal Revenue Code.[1] The tax is "imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States." I.R.C. § 2001(a). It is well-established that the term "transfer" as used in the federal estate tax code is construed broadly and "extends to the creation, exercise, acquisition, or relinquishment of any power or legal privilege which is incident to the ownership of property." *Fernandez v. Wiener*, 326 U.S. 340, 352, 66 S. Ct. 178, 90 L. Ed. 116 (1945). Thus, a "transfer" for estate tax purposes is not limited to a formal transfer of property under state property law. Rather, Congress may include within the estate tax base property that was not actually owned in the property law sense by the decedent at the time of his or her death. Congress has exercised this power with respect to several types of property interests. Examples include I.R.C. § 2035(a) (property transferred by gift made within 3 years prior to the decedent's death is included in the gross estate), § 2040(a) (property held as joint tenants with right of survivorship is included in the gross estate), § 2041(a)(2) (property over which the

[1] All references to the Internal Revenue Code will be to the Internal Revenue Code of 1986 as amended or renumbered as of January 1, 2005. Relevant portions of the Estate Tax chapter of the I.R.C. are attached to the respondent briefs filed by the Department in both the Estate of Bracken and Estate of Nelson appeals.

decedent had a general power of appointment is included in the gross estate), and § 2044 (QTIP passing to the surviving spouse when the first spouse dies is included in the gross estate of the surviving spouse when he or she dies). *See generally* I.R.C. §§ 2031–2045 (specifying property interests included in the gross estate of a decedent).

The federal estate tax, in simplified terms, is computed on the "taxable estate" of the decedent. I.R.C. § 2001(b). The term "taxable estate" is defined as the gross estate of the decedent less authorized deductions. I.R.C. § 2051. One of the deductions allowed in computing the taxable estate of a decedent is the marital deduction. I.R.C. § 2056(a).

The marital deduction was added to the federal estate tax code in 1948 to equalize the disparate estate tax treatment of spouses residing in community property states and those residing in common law property states. *United States v. Stapf*, 375 U.S. 118, 128, 84 S. Ct. 248, 11 L. Ed. 2d 195 (1963). As originally enacted, the marital deduction was limited to fifty percent of the decedent's separate property passing outright to the surviving spouse. Transfers of "terminable interest" property, such as a life estate, did not qualify.

In 1981 Congress made a significant change to the marital deduction by exempting all transfers between husband and wife. In addition to making the marital deduction unlimited in amount, Congress also liberalized the "terminable interest" rule by creating a special category of terminable interest property—so called "qualified terminable interest property" or "QTIP"—that would qualify for the deduction.

I.R.C. § 2056(b)(7). To qualify, terminable interest property must pass from the decedent to the surviving spouse, the surviving spouse must have the right to receive the income from the property for life, and the executor of the decedent's estate must make an election to have the property treated as QTIP. I.R.C. § 2056(b)(7)(B)(i).

The trade-off for allowing the estate of the first spouse to die to deduct QTIP is that the property is treated as passing to the surviving spouse, and any QTIP remaining when the surviving spouse dies is included in his or her gross estate. In this way, QTIP does not escape taxation. Instead, the estate tax applies to the remaining QTIP when the surviving spouse dies. To insure that the remaining QTIP is taxed on the death of the surviving spouse, Congress specified that the property "shall be treated as property passing from the decedent." I.R.C. § 2044(c).

Like the federal estate tax, the Washington estate tax is imposed on the *transfer* of property. *Compare* I.R.C. § 2001(a) ("A tax is hereby imposed on the transfer of the taxable estate of every decedent . . . .") *with* RCW 83.100.040(1) ("A tax . . . is imposed on every transfer of property located in Washington."). Under the Washington estate tax code, "transfer" means a "'transfer' as used in section 2001 of the Internal Revenue Code." RCW 83.100.020(11). Thus, by referencing I.R.C. § 2001, the Legislature has clearly established that a "transfer" subject to the federal estate tax is also a "transfer" subject to the Washington tax. Moreover, because "transfer" has an identical meaning under both the federal and Washington estate tax codes, the Washington tax is not limited to property interests owned (in a property

law sense) by the decedent at the time of death. Rather, the Washington tax– like its federal counterpart– applies to all property interests included in the gross estate of the decedent, including QTIP passing under I.R.C. § 2044.

2. A transfer of QTIP occurred when Sharon Bracken died and when Barbara Nelson died.

Sharon Bracken died on September 24, 2006. Barbara Nelson died on October 15, 2006. Both deaths occurred after the Legislature amended the Washington estate tax in 2005.

The supposition underlying the arguments advanced by amicus is that no taxable transfer of the QTIP occurred when Ms. Bracken and Ms. Nelson died. Rather, the Mesdag estate contends that the "taxable transfer" occurred years earlier when the QTIP trusts were created. Amicus Br. at 15. The Mesdag estate is incorrect. Under the modern understanding of "transfer" for estate tax purposes, a formal transfer of property owned by the decedent is not required. Instead, Congress has the power to direct by statute what property will be included in the taxable estate of a decedent so long as "that decedent had an interest in property at death, and that death became the generating source of definite accessions to the survivor's property rights." 1 Jacob Mertens, *The Law of Federal Gift and Estate Taxation*, § 1.04 (1959).[2]

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[2] The Mertens treatise is available at the Supreme Court law library at KF6572 M47. A copy of sections 1.02 through 1.04 of the Mertens treatise is attached hereto as Appendix A.

The passing of QTIP under I.R.C. § 2044 undoubtedly qualifies as a "transfer." A QTIP trust creates a life estate for the benefit of the surviving spouse and creates a future interest in the assets of the QTIP trust for the benefit of the remainder beneficiaries. When the second spouse dies, the life estate is extinguished and the remainder beneficiaries receive a present interest in the property. It is the death of the second spouse that causes the remainder beneficiaries' interest in the QTIP to transform from a future interest to a present interest. Congress may treat that shift in economic benefit as a "transfer" subject to estate tax. Congress has expressly exercised that power in I.R.C. § 2044.

Several provisions in the federal estate tax code confirm that QTIP is treated for estate tax purposes as passing from the surviving spouse to the remainder beneficiaries when the surviving spouse dies. First, I.R.C. § 2056(b)(7)(A)(ii) and (ii) provide that property for which a QTIP deduction was elected by the estate of the first spouse to die "shall be treated as passing to the surviving spouse" and "no part of such property shall be treated as passing to any person other than the surviving spouse." In addition, I.R.C. § 2044(b)(1)(A) provides that QTIP passing to the surviving spouse is included in that spouse's gross estate when he or she dies. Finally, I.R.C. § 2044(c) provides that QTIP "shall be treated as property passing from the decedent" when he or she dies.

It is precisely because QTIP is treated as passing through the surviving spouse under I.R.C. §§ 2056(b)(7)(A) and 2044(c) that the federal estate tax is delayed until the surviving spouse dies. As a result of

the marital deduction, no estate tax is owed on the QTIP when the first spouse dies. I.R.C. § 2056(b)(7). However, estate tax is owed when the second spouse dies. I.R.C. § 2044.

The same treatment applies under the Washington tax. The Legislature has incorporated the federal definition of "taxable estate" into the Washington tax. *See* RCW 83.100.020(14) (defining "federal taxable estate" as "the taxable estate as determined under chapter 11 of the Internal Revenue Code."). The federal taxable estate as determined under the Internal Revenue Code includes the value of QTIP passing under I.R.C. § 2044. Thus, the term "federal taxable estate" as defined in RCW 83.100.020(14) includes QTIP passing when the second spouse dies. Because the QTIP is included in the federal taxable estate of the second spouse to die, it is also included in the Washington taxable estate. *See* RCW 83.100.020(13) (defining "Washington taxable estate" as "the federal taxable estate" less certain deductions not related to QTIP).

3. Congress and the Washington Legislature have the authority to decide when a taxable transfer occurs for estate tax purposes.

Congress has broad authority to determine when a transfer of property occurs under the federal estate tax code. *Fernandez v. Wiener*, 326 U.S. 340, 66 S. Ct. 178, 90 L. Ed. 116 (1945). This authority is not constrained by common law concepts of property ownership or transfer. Instead, in determining when a transfer occurs for tax purposes "'the emphasis . . . [is] on the practical effect of death in bringing about a shift in economic interest, and the power of the legislature to fasten on that shift

as the occasion for a tax.'" *Id.* at 354 (quoting *Whitney v. State Tax Commission*, 309 U.S. 530, 539, 60 S. Ct. 635, 84 L. Ed. 909 (1940)). Consistent with this broad authority, Congress clearly may "fasten on" the shifting of economic interest in QTIP when the second spouse dies as "the occasion for a tax."

This Court's decision in *In re McGrath's Estate*, 191 Wash. 496, 71 P.2d 395 (1937), is consistent with the approach the United States Supreme Court adopted in *Fernandez*. The pertinent facts in *McGrath's Estate* involved William A. McGrath, president of McGrath Candy Company, who died in May 1935. *In re McGrath*'s *Estate*, 191 Wash. at 497. When Mr. McGrath died, there were three insurance policies on his life that named McGrath Candy Company as the beneficiary. *Id.* One of the insurance policies (the "Union Central Life" policy) was purchased by Mr. McGrath, and he reserved the right to change the beneficiary of that policy. *Id.* at 501. The other two policies (the "Northwestern Mutual" policies) were purchased by the candy company, and Mr. McGrath had no right to "do anything with relation to them." *Id.* at 502.

This Court held that the proceeds of the Union Central Life policy were properly subject to the Washington inheritance tax upon Mr. McGrath's death, while the proceeds of the Northwestern Mutual policies were not. *Id.* at 502-03. In distinguishing the Union Central policy from the Northwestern Mutual policies, the Court did not hold that the common law of property transfers controlled. Rather, with respect to the Union Central Policy, Mr. McGrath's death extinguished his right to change the

beneficiary, thereby causing "a shifting of economic benefit." *Id.* at 504. The two Northwest Mutual policies, by contrast, involved no identifiable shift in economic benefit. *Id.*

This Court's analysis in *McGrath's Estate* is consistent with the concept of a "transfer" for estate tax purposes. Because there was a "shifting of economic benefit" in the Union Central insurance policy brought about by Mr. McGrath's death, the Washington Legislature had authority to include the value of the property in the decedent's inheritance tax base. *In accord, West v. Oklahoma Tax Commission*, 334 U.S. 717, 727, 68 S. Ct. 1223, 92 L. Ed. 1676 (1948) (Oklahoma had authority to include value of property that was not owned by decedent in a property law sense in decedent's inheritance tax base where there was a "shifting of economic benefit" brought about by the decedent's death).

A "shifting of economic benefit" occurred with respect to QTIP passing under I.R.C. § 2044 when Sharon Bracken and Barbara Nelson died. Not only were the life estates held by Ms. Bracken and Ms. Nelson extinguished at their deaths, but the interests held by the remainder beneficiaries in the QTIP trusts changed from future interests to present interests. This shifting in economic benefit is a transfer for estate tax purposes. Moreover, the value of the QTIP is subject to tax under both the federal estate tax code and the Washington estate tax code at the point in time when Ms. Bracken and Ms. Nelson died. That the QTIP trusts were created prior to this taxable transfer is of no consequence.

4. Including QTIP passing under I.R.C. § 2044 in the Washington taxable estate of the second spouse to die, as required under the plain language of the Washington estate tax code, does not require a prior Washington QTIP election.

In computing the Washington estate tax, the Legislature has authorized a separate Washington QTIP election. RCW 83.100.047(1). That section provides in part:

> If the federal taxable estate on the federal return is determined by making an election under section 2056 . . . of the Internal Revenue Code [i.e., the federal QTIP election], or if no federal return is required to be filed, the department may provide by rule for a separate election on the Washington return, consistent with section 2056 . . . of the Internal Revenue Code, for the purpose of determining the amount of tax due under this chapter.

The separate Washington QTIP election is available only to an estate of a married person dying on or after May 17, 2005 (the effective date of RCW 83.100.047), that makes a federal QTIP election under IRC § 2056 or that is not required to file a federal estate tax return.

If a separate Washington election is made, the Washington taxable estate is adjusted as provided by administrative rules set out in WAC 458-57. Under these rules, the estate of a first spouse to die that makes a federal QTIP election and a separate Washington QTIP election must replace the federal QTIP amount with the Washington QTIP amount. WAC 458-57-105(3)(q). Likewise, the estate of the second spouse to die must replace the QTIP included in its federal taxable estate under I.R.C. § 2044 with the Washington QTIP amount. *Id.*[3]

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[3] The adjustment required by the estate of the second spouse to die when the predeceased spouse has made a separate Washington QTIP election under RCW 83.100.047(1) is further explained in WAC 458-57-115(2)(c)(iii)(B). That rule provides

The Mesdag estate argues that a separate Washington QTIP election is required before any QTIP can be included in the Washington taxable estate of the second spouse to die. Amicus Br. at 16. This is incorrect. The separate Washington QTIP election, if applicable, may change the amount of the Washington taxable estate of a decedent, but that election is not a condition precedent for including QTIP in the Washington tax base. Instead, QTIP is included in the Washington taxable estate of the second spouse to die as a result of the statutory definitions set out in RCW 83.100.020. More specifically, RCW 83.100.020(13) provides that the Washington taxable estate for a decedent dying on or after January 1, 2006, is made up of his or her federal taxable estate less $2,000,000 and less the farm property deduction set out in RCW 83.100.046. The statute does not include a deduction or exclusion for QTIP included in the federal taxable estate of the decedent.

It is telling that the Legislature, in defining "Washington taxable estate," clearly and explicitly excluded qualifying farm property that is deductible under RCW 83.100.046. *See* RCW 83.100.020(13) ("'Washington taxable estate' means the federal taxable estate, less . . . (c) the amount of any deduction allowed under RCW 83.100.046[.]"); RCW 83.100.046 (deduction for certain property used in farming). The Legislature knows how to exclude certain property from the Washington

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that if the value of federal QTIP is different than the value of the Washington QTIP, the federal QTIP is subtracted and the Washington QTIP is added. By making this adjustment, the estate of the second spouse is taxable on the value of the Washington QTIP amount.

taxable estate base if it chooses to do so. If the Legislature had intended to exclude QTIP from the definition of Washington taxable estate, it would have done so in clear and explicit language.

Moreover, the Mesdag estate misunderstands the purpose of the separate Washington QTIP election. RCW 83.100.047(1) was enacted to alleviate tax planning complications created by the 2001 Economic Growth and Tax Relief Reconciliation Act (EGTRRA) and the Washington Legislature's subsequent decision to impose a stand-alone estate tax. The ability for the estate of a decedent to make a separate Washington QTIP election allows the estate to obtain full advantage of a credit shelter trust and a QTIP trust for both federal estate tax planning purposes and Washington estate tax planning purposes. *See* Steven D. Nofziger, Comment, *EGTRRA and the Past, Present, and Future of Oregon's Inheritance Tax System*, 84 Or. L. Rev. 317, 344-45 (2005) (explaining how the separate Oregon QTIP election allows estates to take full advantage of both a credit shelter trust and a QTIP trust as estate tax planning tools). In effect, the Legislature has granted estates subject to the Washington estate tax the option to uncouple from the federal QTIP election and to make a separate Washington QTIP election. This option provides added flexibility by allowing "[a] personal representative [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." WAC 458-57-115(2)(c)(iii)(A).

The separate Washington QTIP election is an important tax planning tool for estates of decedents dying on or after May 17, 2005. However, the Mesdag estate's argument that the election must be made before any QTIP can be included in the Washington taxable estate of the second spouse to die is incorrect. Because the argument is not supported by the plain language of the statute, and misapplies the true purpose for the separate Washington QTIP election, it should be rejected.[4]

B. The 2005 Amendments To The Washington Estate Tax Code Did Not Create A "New" Estate Tax

The Mesdag estate characterizes the 2005 amendments to the Washington estate tax code as creating an "entirely new" estate tax. Amicus Br. at 10, 11. This characterization is both misleading and irrelevant. While the Legislature amended the manner in which the tax is measured—changing from a pickup tax calculation to a stand-alone calculation—it did not repeal the former estate tax and replace it with an "entirely new" estate tax. Moreover, whether the tax is characterized as "new" has no real bearing in these appeals since both Ms. Bracken and Ms. Nelson died after the effective date of the 2005 legislation.

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[4] The Mesdag estate's argument that the separate Washington QTIP election must be made before any QTIP can be included in the Washington taxable estate of a decedent is inconsistent with the explanation of RCW 83.100.047 that the Bracken estate provided to the trial court. See VRP at page 22, line 18 to page 23, line 21, where counsel for the Bracken estate explained that the purpose of the separate Washington QTIP election was to benefit married persons subject to the Washington estate tax that had no need for a federal QTIP because of the larger federal exclusion amount. A copy of pages 22 and 23 of the Verbatim Report of Proceedings is attached hereto as Appendix B.

There is no question that the 2005 amendments made significant changes to several key provisions in the Washington estate tax code. For instance, RCW 83.100.040 was amended to change from the former pickup tax calculation to the current, stand alone estate tax calculation. Laws of 2005, ch. 516, § 3. In addition, RCW 83.100.020 was amended to add, modify, or delete various definitions used in the estate tax code. *Id.*, § 2. Several other sections were added or amended. But many other provisions in the estate tax code remained unchanged, and the fact that Washington imposes an estate tax remained unchanged.[5]

As the Department explained in the respondent's briefs it filed in both the Bracken and Nelson appeals, the treatment of QTIP under the Washington estate tax code was not materially changed by the 2005 amendments. Under the former pickup tax calculation, QTIP deducted under I.R.C. § 2056(b)(7) was not part of the tax base used to compute the Washington tax, while QTIP included in the taxable estate under I.R.C. § 2044 was part of the tax based used to compute the tax. This was so because the pickup tax calculation was based on the "adjusted taxable estate" of the decedent. *See* I.R.C. § 2011(b)(3) (defining "adjusted taxable estate" as "the taxable estate reduced by $60,000."). *See generally Estate of Turner v. Dep't of Revenue*, 106 Wn.2d 649, 652, 724 P.2d 1013

[5] The Washington estate tax has existed since 1981. Laws of 1981, 2d Ex. Sess., ch. 7. Before that, Washington imposed an inheritance tax going back to 1901. Laws of 1901, ch. 55. Clearly, "the subject matter [has] . . . been taxed" both before and after the 2005 amendments. *Japan Line, Ltd. v. McCaffree*, 88 Wn.2d 93, 98, 558 P.2d 211 (1977). Thus, the Washington estate tax as amended in 2005 is "new" only in the sense that the manner in which the tax is computed has changed.

(1986) (describing the pickup tax computation). Therefore, QTIP excluded from the tax base under I.R.C. § 2056(b)(7) was not subject to the Washington tax, while QTIP included in the base under I.R.C. § 2044 was subject to the Washington tax. This is not materially different from the treatment of QTIP under the current stand-alone tax calculation under RCW 83.100.040(1). All that has changed is the method and rates used to calculate the Washington tax.

Finally, whether the tax as amended is characterized as a "new" tax should have no bearing on the Bracken or Nelson appeals. Both Ms. Bracken and Ms. Nelson died after the effective date of the 2005 amendments. Thus, even if the tax is characterized as a "new" estate tax, the estates of Ms. Bracken and Ms. Nelson are subject to that "new" tax. The "new" estate tax argument only matters if the Court accepts the initial premise advanced by amicus that the "taxable transfer" of QTIP occurred when the QTIP trust were created, not when Ms. Bracken and Ms. Nelson died. Since that initial premise is incorrect, the "new" tax argument advanced by amicus is purely academic.

C. Including QTIP Passing Under I.R.C. § 2044 As Part Of The Washington Taxable Estate Is Consistent With The Prospective Application Of The 2005 Amendments To The Washington Estate Tax

There is no dispute that the Washington estate tax as amended in 2005 was intended to apply prospectively only. The prospective nature of the tax was expressly set out by the Legislature in section 20 of the 2005 act: "This act applies prospectively only and not retroactively. Sections 2

through 17 of this act apply only to estates of decedents dying on or after the effective date of this section." But the prospective nature of the tax does not relieve the estates of Sharon Bracken or Barbara Nelson from the Washington tax on QTIP passing under I.R.C. § 2044. Simply put, the stand-alone estate tax is imposed on the Washington taxable estate computed upon the death of the decedent. This includes QTIP passing under I.R.C. § 2044 when Ms. Bracken and Ms. Nelson died.

The fact that the QTIP trusts were created before the 2005 amendments to the Washington estate tax does not make the tax retroactive. It is well-established that an estate tax "does not operate retroactively merely because some of the facts or conditions upon which its application depends came into being prior to the enactment of the tax." *United States v. Mfrs. Nat'l Bank of Detroit*, 363 U.S. 194, 200, 80 S. Ct. 1103, 4 L. Ed. 2d 1158 (1960) (quoting *United States v. Jacobs*, 306 U.S. 363, 367, 59 S. Ct. 551, 83 L. Ed. 763 (1939)). This is consistent with the Supreme Court's due process analysis in *Fernandez v. Wiener*, where the Court explained: "'Under the statute the death of decedent is the event in respect of which the tax is laid. It is the existence of the joint tenancy at that time, and not its creation at the earlier date, which furnishes the basis for the tax.'" 326 U.S. at 354-55 (quoting *Griswold v. Helvering*, 290 U.S. 56, 58, 54 S. Ct. 5, 78 L. Ed. 166 (1933)). Likewise, it is the existence of QTIP passing under I.R.C. § 2044 at the time of death, not the creation of the QTIP trusts at some earlier date, that "furnishes the basis of the tax."

Washington law also holds that a statute is not retroactive "merely because it relates to prior facts or transactions where it does not change their legal effect." *State v. Scheffel*, 82 Wn.2d 872, 879, 514 P.2d 1052 (1973). *See also State v. Varga*, 151 Wn.2d 179, 196-98, 86 P.3d 139 (2004) (explaining why amendments to the Sentencing Reform Act of 1981 did not operate retroactively even though convictions occurring prior to the amendments were considered in determining the sentence imposed for crimes occurring after the amendments). The 2005 amendments to the Washington estate tax did not change the legal effect of facts or transactions occurring before its passage. Rather, the 2005 amendments merely changed the manner in which the Washington estate tax is computed for persons dying on or after May 17, 2005.

The life estates Sharon Bracken and Barbara Nelson held in the QTIP were extinguished upon their deaths in 2006, and the interests the remainder beneficiaries held in the QTIP trusts were converted from future interests to present interests. Ms. Bracken's and Ms. Nelson's deaths were the "crucial last step in what Congress can reasonably treat as a testamentary disposition" under I.R.C. § 2044. *Mfrs. Nat'l Bank*, 363 U.S. at 198. Those "crucial last steps" occurred after the 2005 legislation became effective. Thus, the tax was not retroactive.

When properly analyzed, the Washington estate tax code as amended in 2005 does not operate retroactively and the Washington tax imposed on the estates of Sharon Bracken and Barbara Nelson is consistent with the prospective application of the 2005 amendments. The

arguments presented by amicus to the contrary are incorrect and built on the false premise that the "taxable transfer" occurred when the QTIP trusts were created. Because the initial premise is incorrect, the conclusion that the Washington tax is retroactive is also incorrect.

D. Correct Application Of The Washington Estate Tax Code To QTIP Passing Under I.R.C. § 2044 Does Not Lead To Absurd Results

The final argument advanced by amicus suggests that including QTIP passing under I.R.C. § 2044 in the Washington taxable estate of a resident decedent will lead to "absurd results." Amicus Br. at 16-17. In support of this argument, amicus presents a hypothetical circumstance where the first spouse to die was a California resident with no Washington estate tax obligation, while the second spouse to die was a Washington resident subject to the Washington estate tax. Amicus then contends that including QTIP in the Washington taxable estate of the second spouse to die under the hypothetical is "absurd" and requires an "expansive" reading of the Washington estate tax code.

Correct application of the Washington estate tax under the hypothetical described by amicus does not require an expansive interpretation of the law. Rather, the controlling statutes are clear and unambiguous. The Washington tax is calculated on the "Washington taxable estate" of the decedent, RCW 83.100.040(2)(a), which is defined as "the federal taxable estate" less certain deductions. RCW 83.100.020(13). QTIP passing under I.R.C. § 2044 is included in the federal taxable estate of the second spouse to die. Moreover, none of the deductions set out in RCW

83.100.020(13) apply to QTIP. Thus, it is beyond dispute that QTIP passing under I.R.C. § 2044 is included as part of the Washington taxable estate subject to the Washington tax. This is so even if the first spouse to die was not a Washington resident when she died.[6]

Based on the plain and unambiguous language of the Washington estate tax code, there is no QTIP deduction or exemption that applies in the hypothetical circumstance described by amicus. Amicus is essentially asking the Court to engraft an implied exemption into the Washington estate tax code. "However, 'taxation is the rule and exemption is the exception, and where there is an exception, the intention to make one should be expressed in unambiguous terms.'" *TracFone Wireless, Inc. v. Dep't of Revenue*, 170 Wn.2d 273, 296-97, 242 P.3d 810 (2010) (quoting *Columbia Irrig. Dist. v. Benton County*, 149 Wash. 234, 240, 270 P. 813 (1928)).

Whether it is appropriate as a matter of fiscal or tax policy to include QTIP in the estate tax base of the second spouse to die under these hypothetical facts is a decision for the Washington Legislature. *See Rousso v. State*, 170 Wn.2d 70, 75, 239 P.3d 1084 (2010). The Legislature has not created a deduction or exemption that would apply where the first spouse to die was not a Washington resident. This does not lead to an "absurd" result. It simply means that the estate of a Washington

[6] By moving from California to Washington, the second spouse in the hypothetical becomes a Washington resident and would be subject to the Washington estate tax on "every transfer of property located in Washington." RCW 83.100.040(1). Imposing the Washington estate tax in this circumstance is not absurd or even surprising. If the facts were reversed, and the second spouse moved from Washington to California before dying, Washington would not tax the QTIP passing on his death.

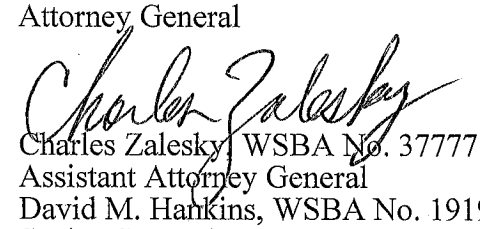
resident decedent is taxed on the value of its Washington taxable estate without regard to the residency status of the prior deceased spouse.

III. CONCLUSION

The arguments presented in the Mesdag estate's amicus brief provide no basis for permitting the estates of Sharon Bracken and Barbara Nelson to deduct or exclude QTIP passing under I.R.C. § 2044. Consequently, the Court should affirm the trial court's order granting the Department's summary judgment motion and denying the summary judgment motion filed by the "Consolidated Estates" on behalf of the estates of Sharon Bracken and Barbara Nelson.

RESPECTFULLY SUBMITTED this 6th day of May, 2011.

ROBERT M. MCKENNA
Attorney General



Charles Zalesky, WSBA No. 37777
Assistant Attorney General
David M. Hankins, WSBA No. 19194
Senior Counsel
Attorneys for Respondent

APPENDIX A

THE LAW OF FEDERAL GIFT AND ESTATE TAXATION

BY

JACOB MERTENS
of the New York Bar

ASSISTANT EDITOR
ALVIN E. MOSCOWITZ
of the New York Bar

IN SIX VOLUMES

VOLUME ONE

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

A. ESTATE AND GIFT TAXES AS INDIRECT TAXES

§ 1.02. ESTATE AND GIFT TAXES ARE IMPOSED ON THE PRIVILEGE OF TRANSFER. The modern estate and gift tax laws have been upheld as an excise tax on the privilege of transfer of property,[9]

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

[9] It is well settled that the federal estate tax is an excise tax requiring no apportionment, as is required where the statute imposes a direct tax on property. See Chase Nat'l Bank of City of N.Y., Ex'rs v. U.S., 278 U.S. 327, 49 S.Ct. 126, 73 L.Ed. 405 (1929), 7AFTR8844; Greiner, Exec. v. Lewellyn, 258 U.S. 384, 42 S.Ct. 324, 66 L.Ed. 676 (1922), 3AFTR3136; New York Trust Co., Ex'rs v. Eisner, 256 U.S. 345, 41 S.Ct. 506, 65 L.Ed. 963 (1921), 3AFTR3110. See also Mertens, LOFIT, § 4.08.

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

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

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

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

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

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

[10] Greiner v. Lewellyn, 258 U.S. 384, 42 S.Ct. 324, 66 L.Ed. 676 (1922), 3AFTR3136; U.S. Trust Co. of N.Y., Exec. v. Helvering, 307 U.S. 57, 59 S.Ct. 692, 83 L.Ed. 1104 (1939), 22AFTR327. See § 14.17.

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

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

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

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

erty.[11] The Supreme Court has said[12] that the power to impose estate taxes:

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

and that:

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

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cert.den. 332 U.S. 815, 68 S.Ct. 153, 92 L.Ed. 392 (1947), and Landman v. U.S., (Ct.Cl.1945), 34AFTR1662, superseding 58 F.Supp. 836 (Ct.Cl.1945), 33AFTR 811.

[11] In Bromley v. McCaughn, 280 U.S. 124, 50 S.Ct. 46, 74 L.Ed. 226 (1929), 8AFTR10251 (g.t.), the Supreme Court stated: "Even if we assume that a tax levied upon all the uses to which property may be put, or upon the exercise of a single power indispensable to the enjoyment of all others over it, would be in effect a tax upon property, . . . and hence a direct tax requiring apportionment, that is not the case before us."

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

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

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

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

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

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

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

§ 1.03. DEVELOPMENT OF THE MODERN CONCEPT OF A TRANSFER. The courts in applying the indirect tax theory to particular provisions of the estate tax law have evidenced considerable ingenuity in expanding the term "transfer" to meet the necessities of each new challenge.[15] The earlier cases rested on the fact that there was a "passing" of property from decedent at death.[16] Such passing concept did not require, however, that the term "transfer" be limited to those situations where there was a transfer in the technical, local law sense of the term, since Congress can completely disregard the refinements of state property law and rely on more realistic classifications.[17] Thus local characteristics of dower,[18] joint tenancies and tenancies by the entirety,[19] community property,[20] and life insurance proceeds[21]

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

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

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

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

[18] See Mayer, Trustees v. Reinecke, 130 F(2d) 350 (7th Cir.1942), 29AFTR 1156, cert.den. 317 U.S. 684, 63 S.Ct. 257, 87 L.Ed. 548 (1942); Allen v. Henggeler, Adm., 32 F(2d) 69 (8th Cir.1929), 7AFTR8680, cert.den. 280 U.S. 594, 50 S.Ct. 40, 74 L.Ed. 642 (1929); Nyberg, Adm. v. U.S., 66 Ct.Cl. 153 (1928), 6AFTR7845, cert.den. 278 U.S. 646, 49 S.Ct. 82, 73 L.Ed. 559 (1928).

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

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

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Trust & Safe Deposit Co., Exec., 284 U.S. 160, 52 S.Ct. 46, 76 L.Ed. 220 (1931), 10AFTR459; Tyler, Jr., Adm'rs v. U.S., 281 U.S. 497, 50 S.Ct. 356, 74 L.Ed. 991 (1930), 8AFTR10912.

[20] See Fernandez v. Wiener, 326 U.S. 340, 66 S.Ct. 178, 90 L.Ed. 116 (1945), 34AFTR276, reh.den. 327 U.S. 814, 66 S.Ct. 525, 90 L.Ed. 1038 (1946); U.S. v. Rompel, Jr., Adm., 326 U.S. 367, 66 S.Ct. 191, 90 L.Ed. 137 (1946), 34AFTR 289, reh.den. 327 U.S. 814, 66 S.Ct. 526, 90 L.Ed. 1038 (1946); Beavers v. Comm., 165 F(2d) 208 (5th Cir.1947), 36AFTR514, cert.den. 334 U.S. 811, 68 S.Ct. 1017, 92 L.Ed. 1743 (1948) (g.t.); Charles I. Francis, 8 TC 822 (g.t.).

[21] See Chase Nat'l Bank of City of N.Y., Ex'rs v. U.S., 278 U.S. 327, 49 S.Ct. 126, 73 L.Ed. 405 (1929), 7AFTR8844; Lewellyn v. Frick, Ex'rs, 268 U.S. 238, 45 S.Ct. 487, 69 L.Ed. 934 (1925), 5AFTR5383, had earlier held contra, at least by inference; but see Kohl, Ex'rs v. U.S., 226 F(2d) 381 (7th Cir.1955), 47 AFTR2022, which involved the "payment of premiums" test which was then applied in determining what insurance should be included in the gross estate, and in which the tax in effect was held unconstitutional as imposing an unapportioned direct tax.

[22] Continental Ill. Bank & Trust Co., Exec. v. U.S., 65 F(2d) 506 (7th Cir. 1933), 12AFTR816, cert.den. 290 U.S. 663, 54 S.Ct. 77, 78 L.Ed. 573 (1933), rejecting the contention that a provision, requiring the inclusion of property in the gross estate only if subject to payment of administration expenses, violated the uniformity requirement because state laws vary as to whether real estate was subject to payment of administration expenses. See discussion in § 1.06 of the due process requirement.

[23] See (1) Nichols v. Coolidge, Ex'rs, 274 U.S. 531, 47 S.Ct. 710, 71 L.Ed. 1184 (1927), 6AFTR6758, holding Sec.402(c) of the 1919 Act unconstitutional as confiscatory and in violation of the Fifth Amendment insofar as it applied the possession and enjoyment section to transfers made prior to the act, where the transfers were not in fact testamentary or designed for tax evasion; (2) Untermyer v. Anderson, 276 U.S. 440, 48 S.Ct. 353, 72 L.Ed. 645 (1928), 6AFTR 7789, rev'g 18 F(2d) 1023 (2d Cir.1927), which had aff'd an unreported district court opinion (g.t.), holding retroactive application of the gift tax provisions of the 1924 Act invalid under the Fifth Amendment; and (3) Heiner v. Donnan, Ex'rs, 285 U.S. 312, 52 S.Ct. 358, 76 L.Ed. 772 (1932), 10AFTR1609, holding unconstitutional, under the due process provisions of the Fifth Amendment, that part of Sec.302(a) of the 1926 Act which called for a conclusive pre-

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

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

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

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

[24] Fernandez v. Wiener, supra, n.20.

[25] See discussion of due process in § 1.06.

[26] Fernandez v. Wiener, supra, n.20.

[27] In Tyler, Jr., Adm'rs v. U.S., 281 U.S. 497, 50 S.Ct. 356, 74 L.Ed. 991 (1930), 8AFTR10912, the Court made the following statement:

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

process of ruling out the "shadowy and intricate distinctions of common law property concepts"[28] and artificial rules which delimit the title, rights, and powers of tenants by the entirety (or joint tenancies) at common law,[29] the courts have striven to develop a concept of the term "transfer" which was both broad and flexible. The courts have said[30] that the estate tax provision was constitutional if there was a transfer of economic benefit,

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

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

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

[29] Tyler, Jr., Adm'rs v. U.S., supra. See also Foster, Exec. v. Comm., 90 F(2d) 486 (9th Cir.1937), 19AFTR864, aff'd 303 U.S. 618, 58 S.Ct. 525, 82 L.Ed. 1083 (1938), 19AFTR1266, per curiam, reh.den. 303 U.S. 667, 58 S.Ct. 748, 82 L.Ed. 1124 (1938); O'Shaughnessy, Exec. v. Comm., 60 F(2d) 235 (6th Cir.1932), 11AFTR738, cert.den. 288 U.S. 605, 53 S.Ct. 397, 77 L.Ed. 980 (1933); Comm. v. Emery, Exec., 62 F(2d) 591 (7th Cir.1932), 11AFTR1340, rev'g and remanding 21 BTA 1038.

[30] The Supreme Court in Saltonstall v. Saltonstall, 276 U.S. 260, 48 S.Ct. 225, 72 L.Ed. 565 (1928), 7AFTR9303, in holding that a state inheritance tax could be levied on the value of an inter vivos trust set up by the decedent under which he retained the power to alter and revoke, said:

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

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

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

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

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

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

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

[32] I.R.C.1954, Sec.2001.

[33] Chase Nat'l Bank of City of N.Y., Ex'rs v. U.S., supra, n.14. This principle has been applied in numerous cases involving annuities. See, e.g., Hanner v. Glenn, 111 F.Supp. 52 (W.D.Ky.1953), 43AFTR748, aff'd 212 F(2d) 483 (6th Cir.1954), 45AFTR1444; Estate of Eugene F. Saxton, 12 TC 569; Estate of Isidor M. Stettenheim, 24 TC 1169 (1955–158); Estate of Paul G. Leoni, 11 TC 1140 (Memo.). See § 20.24.

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

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

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

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[35] See discussion in § 23.17 of cases of Comm. v. Estate of Church, 335 U.S. 632, 69 S.Ct. 322, 93 L.Ed. 288 (1949), 37AFTR480, and Estate of Spiegel v. Comm., 335 U.S. 701, 69 S.Ct. 301, 93 L.Ed. 330 (1949), 37AFTR459.

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

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

The courts in upholding the constitutionality of the dower provisions have pointed to the extensive rights (incidents of ownership) in such property determined under state law which ceased at the decedent's death and hence constituted a proper occasion for the levying of an estate tax. See, e.g., Allen v. Henggeler, Adm., 32 F(2d) 69 (8th Cir.1929), 7AFTR8680, cert.den. 280 U.S. 594, 50 S.Ct. 40, 74 L.Ed. 642 (1929), upholding the constitutionality of the 1924 Act, Sec.302(b). See also Nyberg, Adm. v. U.S., 66 Ct.Cl. 153 (1928), 6AFTR7345, cert.den. 278 U.S. 646, 49 S.Ct. 82, 73 L.Ed. 559 (1928), involving the 1921 Act, Sec.402(b).

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

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

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

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

[38] Porter, Ex'rs v. Comm., 288 U.S. 436, 53 S.Ct. 451, 77 L.Ed. 880 (1933), 12AFTR25.

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

[40] Comm. v. Estate of Church, supra, n.35.

[41] Phillips v. Dime Trust & Safe Deposit Co., Exec., 284 U.S. 160, 52 S.Ct. 46, 76 L.Ed. 220 (1931), 10AFTR459; Third Nat'l Bank & Trust Co. of Springfield, Ex'rs v. White, 287 U.S. 577, 53 S.Ct. 290, 77 L.Ed. 505 (1932), 11AFTR 1128, per curiam, involving property held by the decedent and spouse as tenants by the entirety. See also § 1.07, and Gwinn v. Comm., 287 U.S. 224, 53 S.Ct. 157, 77 L.Ed. 270 (1932), 11AFTR1092, involving property held by decedent and her son as joint tenants.

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

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

In applying both the estate and gift tax provisions, a basic element is that decedent have an interest in property which is capable of transfer, otherwise there could be no transfer, and any asserted tax would fail to satisfy the constitutional requirements that the tax involve the privilege of transfer and be not arbitrary and capricious. It has been held[45] that a taxable gift results when an inheritance is renounced. It has been argued,[46] however, that such a tax is so arbitrary and capricious as to violate the Fifth Amendment. Setting aside the merits of imposing such a tax,[47] it would appear that the tax can withstand a constitutional attack.[48] In a renunciation of a valid testa-

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

[43] The nature of a transfer under the gift tax provisions is discussed in §§ 34.29, 34.51 and 34.56.

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

[45] Hardenbergh v. Comm., 198 F(2d) 63 (8th Cir.1952), 42AFTR314, cert.den. 344 U.S. 836, 73 S.Ct. 45, 97 L.Ed. 650 (1952) (g.t.); William L. Maxwell, 17 TC 1589 (g.t.).

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

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

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

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

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

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

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

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

APPENDIX B

1 THE SUPERIOR COURT FOR THE STATE OF WASHINGTON
2 IN AND FOR THE COUNTY OF KING
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4 In re the Matter of:)
5 CONSOLIDATED ESTATES') Cause No. 06-4-05865-5 SEA
6 OBJECTIONS TO DEPARTMENT OF)
7 REVENUE'S FINDINGS.)
8 ---
9 HEARING ON CROSS MOTIONS FOR SUMMARY JUDGMENT
10 The Honorable John P. Erlick Presiding
11 ---
12
13 November 13, 2009
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22 DATE TRANSCRIBED: November 20, 2009
23 TRANSCRIBED BY: Marjorie Jackson, CETD
24 Court-Certified Transcriptionist
25 Notary Public

1 A P P E A R A N C E S

2

3

4 For the Estate of Sharon M. Bracken:

5 SCOTT A.W. JOHNSON

6 DOUGLAS C. LAWRENCE

7 ROSEMARY REED

8 Stokes Lawrence, P.S.

9 800 Fifth Avenue, Suite 4000

10 Seattle, Washington 98104

11

12 For the Estate of John T. Toland:

13 MARK W. ROBERTS

14 LUKE E. THOMAS

15 JESSICA A. SKELTON

16 K & L Gates

17 925 Fourth Avenue, Suite 2900

18 Seattle, Washington 98104

19

20 For the Estate of Barbara J. Nelson

21 RHYS FARREN

22 Davis Wright Tremaine, LLP

23 777 - 108th Avenue NE, Suite 2300

24 Bellevue, Washington 98004

25

1 A P P E A R A N C E S (continued)

2

3

4 For the Washington State Department of Revenue:

5 CHARLES E. ZALESKY

6 DAVID M. HANKINS

7 Attorney General of Washington

8 Revenue Division

9 7141 Clearwater Drive Southwest

10 P.O. Box 40123

11 Olympia, Washington 98504

12

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1 adopted on May 17, 2005.
2 Now, under the old system, as you have
3 indicated earlier, it was simply a pick-up system.
4 Whatever the federal credit was provided -- and the
5 federal credit could change as the federal government
6 decided -- that was the tax, the state estate tax that
7 we got.
8 The new system in the state of Washington is a
9 stand-alone estate tax. And the legislature was clear
10 that it is prospective only. It allowed, under .047, it
11 allows for a marital deduction scheme much like the
12 federal government does.
13 THE COURT: Mm-hmm.
14 MR. JOHNSON: There may be different amounts,
15 but conceptually it was intended to be the same thing.
16 And the statute only provides, Your Honor, the general
17 framework. The real details are provided in the
18 regulations. So 83.100.047 generally authorizes for a
19 Washington-only QTIP that can be separate and distinct,
20 and I think was intended to be separate and distinct
21 from the federal QTIP.
22 THE COURT: Mm-hmm. Because you could have
23 different amounts. You could put --
24 MR. JOHNSON: Absolutely.
25 THE COURT: -- X amount in a federal QTIP and

1 Y amount in a Washington QTIP.
2 MR. JOHNSON: That's correct. And this year,
3 2009, is the reason why you could do that. The federal
4 exemption today is 3 -- exemption from taxation, is
5 $3.5 million on the federal side.
6 THE COURT: Mm-hmm.
7 MR. JOHNSON: It's $2 million on the state
8 side. So for a married couple living in Washington that
9 has a three-and-a-half million dollar -- the decedent
10 dies with a three-and-a-half million dollar estate and
11 the decedent is the first of the spouses to die, there
12 is no need for a federal QTIP.
13 THE COURT: Right.
14 MR. JOHNSON: But there would be a basis for a
15 state QTIP of one-and-a-half million dollars.
16 THE COURT: Right.
17 MR. JOHNSON: So that's why the legislature set
18 it up the way that it did. In 2005 they knew that in
19 2009, the differential between the federal exemption and
20 the state exemption would exist. Prior to that, it did
21 not. But .047, the statute that enables this, it only
22 talks about making the election. It doesn't provide any
23 of the details of how to do that.
24 Again, it's prospective only. It talk s about
25 enabling the first estate to make the deduction. It

1 C E R T I F I C A T E

2 STATE OF WASHINGTON)

3)

4 COUNTY OF SNOHOMISH)

5 I, the undersigned, under my commission as

6 a Notary Public in and for the State of Washington, do

7 hereby certify that the foregoing recorded statements,

8 hearings and/or interviews were transcribed under my

9 direction as a transcriptionist; and that the transcript

10 is true and accurate to the best of my knowledge and

11 ability; that I am not a relative or employee of any

12 attorney or counsel employed by the parties hereto, nor

13 financially interested in its outcome.

14

15 IN WITNESS WHEREOF, I have hereunto set my

16 hand and seal this day of

17 2009.

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19

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21 NOTARY PUBLIC in and for

22 the State of Washington,

23 residing at Lynnwood.

24 My commission expires 4-27-10.

25