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SUPREME COURT OF THE STATE OF WASHINGTON

ESTATE OF SHARON M. BRACKEN,

CAROL B. CLEMENCY, LAURA B. CLOUGH, and JOHN L.
BRACKEN, Personal Representatives of the Estate of Sharon M. Bracken,

Appellants,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

**ANSWER TO STATEMENT OF GROUNDS FOR DIRECT
REVIEW**

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I. INTRODUCTION

At issue in this appeal is a relatively straightforward tax dispute that raises no “fundamental and urgent issue of broad public import” requiring the prompt attention of this Court. As a result, direct review is not warranted under RAP 4.2(a)(4).

II. NATURE OF THE CASE AND DECISION BELOW

A. Statement Of The Facts.

This appeal involves the Washington estate tax, chapter 83.100 RCW, and whether “qualified terminable interest property” (“QTIP”) included in the federal taxable estate of a surviving spouse may be deducted in computing the Washington estate tax owed when that surviving spouse dies. QTIP is a life estate designed to take advantage of the unlimited marital deduction allowed under federal estate tax law. When a spouse dies, his or her estate can elect to create a QTIP trust that provides income to the surviving spouse for life. Upon the surviving spouse’s death, the assets remaining in the QTIP trust are treated as passing from the surviving spouse to the remainder beneficiaries of the QTIP trust. In this way, the estate tax on the value of the QTIP assets is deferred until the second spouse dies.

The decedent in this case, Sharon M. Bracken died on September 24, 2006. Sharon was predeceased by her husband, Jim, who died in 1984. When Jim Bracken died, his estate made a QTIP election that established a QTIP trust. Sharon, as the surviving spouse, was the lifetime beneficiary of that QTIP trust.

After Sharon Bracken died in 2006, her estate (“the Estate”) filed an amended United States estate tax return. On that amended return the Estate reported a taxable estate of \$19,921,263.25, which included QTIP in the amount of \$13,761,274.06. The QTIP was included in the Estate’s federal taxable estate as required by 26 U.S.C. § 2044, and was “treated as property passing from the decedent” to the remainder beneficiaries of the QTIP trust. *See* 26 U.S.C. § 2044(c). The Estate paid the federal estate tax owed.

The Estate filed its amended Washington State estate tax return in November 2007. On the amended state return the Estate reported a “tentative taxable estate” of \$20,544,113.40 (which included the QTIP), but then claimed a deduction in the amount of \$13,761,274.06. The deduction was equal to the amount of QTIP included in the Estate’s federal taxable estate. In effect, the Estate determined that QTIP included in the federal taxable estate and subject to the federal tax should be deducted or excluded from the Washington taxable estate.

The amended Washington estate tax return was received and examined by the Department of Revenue’s Special Programs Division. Upon examination, the Special Programs Division denied the deduction and sent the Estate a notice of tax due. The Estate did not pay the amount due. In November 2008, the Department filed “Findings of the Department of Revenue Fixing Tax Due” with the Clerk of the King County Superior Court. *See* RCW 83.100.150 (authorizing the Department to file findings with the probate court regarding the amount of state estate tax due). The Estate timely objected to those findings under RCW 83.100.180. The matter

was eventually assigned to Judge John Erlick and consolidated for purposes of discovery and trial with two other estate tax cases, Estate of Nelson and Estate of Toland.

After discovery was completed, the Department moved for summary judgment, asserting that the estates were claiming a deduction that did not exist. The three “consolidated estates” filed a cross-motion, asserting that (1) the deduction was authorized by an administrative rule issued by the Department in 2006, (2) there was no taxable “transfer” when the surviving spouse died, and (3) including the QTIP in the Washington taxable estate of the surviving spouse was unconstitutional. On November 13, 2009, the trial court granted the Department’s motion for summary judgment and denied the cross-motion filed by the “consolidated estates.”

The “consolidated estates” filed a motion for reconsideration, which was denied. Thereafter, the Estate of Nelson filed a notice of appeal to the Washington Court of Appeals which has been assigned case number 64613-3-I. The Estate of Bracken filed a notice of appeal seeking direct review by this Court. The Estate of Toland did not appeal.

B. Overview Of The Federal Estate Tax Treatment Of QTIP.

The federal estate tax is set out in 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.” *See*

¹ All references to the Internal Revenue Code, chapter 26 U.S.C., (hereinafter “IRC”) will be to the Internal Revenue Code of 1986 as amended or renumbered as of January 1, 2005.

IRC § 2001. The term “taxable estate” is defined in IRC § 2051 as the “gross estate” of the decedent less the deductions provided in IRC §§ 2053 through 2058. “Gross estate,” in turn, is defined as the value determined under IRC §§ 2031 through 2046 of all the decedent’s property wherever situated. IRC § 2031(a).

One of the deductions allowed in computing the “taxable estate” of a decedent is the marital deduction set out in IRC § 2056. That section provides in general that “the value of the taxable estate shall, except as limited by subsection (b), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse[.]” IRC § 2056(a). IRC § 2056(b) then sets out a limitation relating to life estates and other “terminable interests.” Thus, the transfer of terminable interest property to the surviving spouse of the decedent is normally not deductible in computing the taxable estate. However, in 1981 Congress created an “exception to the exception” for **qualified** terminable interest property, or QTIP. IRC § 2056(b)(7). *See also, Clayton v. Commissioner*, 976 F.2d 1486, 1490-93 (5th Cir. 1992) (discussing the history of the marital deduction and the policy behind expanding the deduction to include QTIP). Thus, QTIP—if properly elected—is deductible in computing the taxable estate of the first spouse to die. The QTIP election must be made by the executor of the estate on the federal estate tax return of the decedent. IRC § 2056(b)(7)(B)(v). Once made, the election is irrevocable. *Id.*

The trade-off for allowing the estate of the first spouse to die to deduct QTIP in computing its taxable estate is that the value of the property is treated as passing to the surviving spouse and is included in the surviving spouse's gross estate when he or she dies. IRC § 2056(b)(7)(A) (QTIP treated as passing to the surviving spouse); IRC § 2044(b)(A) (QTIP included in the gross estate of the surviving spouse). In this way, the value of the qualified terminable interest property does not escape taxation; the tax is only delayed until the surviving spouse dies. *See Clayton v. Commissioner, supra*, at 1492-93 n.26 (allowing the marital deduction for QTIP “satisfies each of the two objectives [of Congress]—postponing payment of tax and being able to control the disposition of the property.”) (quoting H. Rep. No. 97-201, 97th Cong., 1st Sess., at 159-60). To insure that the QTIP is taxed on the death of the surviving spouse, Congress specified that the property “shall be treated as property passing from the decedent.” IRC § 2044(c).

C. Overview of the Washington Estate Tax.

The Washington estate tax was enacted in 1981 as a result of Initiative No. 402. *See* Laws of 1981, 2d Ex. Sess., ch. 7.² The Washington estate tax, as initially enacted, imposed a tax equal to the state death tax credit allowed under IRC § 2011. The amount of the credit (and therefore

² Prior to 1981, Washington imposed an inheritance tax. The primary difference between an inheritance tax and an estate tax is how the tax is imposed. Inheritance taxes are “imposed on the right or privilege of receiving property Estate taxes, on the other hand, are taxes on the right or privilege of transferring property at death, measured by the value of the estate.” 2 Jerome R. Hellerstein & Walter Hellerstein, *State Taxation* ¶ 21.02[1] (3d ed. 1998) (footnotes omitted).

the amount of the Washington tax) was set out in the table provided at IRC § 2011(b)(1). State estate taxes of this nature are commonly referred to as “pick-up” or “sponge” taxes.

In June 2001, Congress enacted the Economic Growth and Tax Relief Reconciliation Act of 2001.³ That act reduced the amount of the state death tax credit by 25% per year, resulting in the total elimination of the credit by 2005. This reduction and eventual elimination of the state death tax credit had a serious impact on states like Washington that employed a “pick-up” tax. *See Estate of Hemphill v. Dep’t of Revenue*, 153 Wn.2d 544, 548, 105 P.3d 391 (2005) (“The implementation of [the Economic Growth and Tax Relief Reconciliation Act of 2001] essentially ends the estate tax revenue sharing between the federal government and states.”). To keep the Washington tax viable, the Legislature needed to uncouple from the “pickup-tax” mechanism and establish a “stand alone” tax calculation. *Id.* at 551.

In 2005, the Washington Legislature made several significant amendments to the estate tax statute in reaction to the *Hemphill* decision. *See* Laws of 2005, ch. 516. These 2005 amendments became effective on May 17, 2005, and are at the heart of the current dispute.⁴

³ Pub. L. No. 107-16, 115 Stat. 73 (2001).

⁴ The Estate incorrectly refers to the 2005 amendments as creating a “new” estate tax. *See* Statement of Grounds, p.1. This is clearly incorrect. While the Legislature amended the manner in which the tax is computed (changing from a “pick-up” tax mechanism to a “stand-alone” tax calculation), that does not equate to the repeal and replacement of the tax with a “new” tax. *Compare* Laws of 1981, 2d Ex. Sess., ch. 7 (repealing and replacing the old Washington inheritance tax with the current estate tax) *with* Laws of 2005, ch. 516 (amending the Washington estate tax).

As amended, RCW 83.100.040 imposes a “stand-alone” estate tax on “every transfer of property located in Washington,” including intangible property of a Washington resident decedent. The term “property” means “property included in the gross estate.” RCW 83.100.020(8). “Gross estate,” in turn, is defined as “‘gross estate’ as defined and used in section 2031 of the Internal Revenue Code.” RCW 83.100.020(5). Thus, the Washington tax is imposed on every transfer of property included in the “gross estate” as defined in IRC § 2031 (2005) so long as the property is located in Washington or is intangible property of a Washington resident.

In computing the tax, the Legislature has authorized a separate Washington QTIP election. RCW 83.100.047(1). That section provides that “[i]f the federal taxable estate on the federal return is determined by making an election under section 2056 . . . of the Internal Revenue Code, 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.”

The separate Washington QTIP election is only available to an estate of a spouse 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 QTIP election is made, the Washington taxable estate is

adjusted as provided in WAC 458-57-115(2)(c)(iii)(B) and, more generally, in WAC 458-57-115(2)(c).⁵

III. REASONS WHY DIRECT REVIEW SHOULD BE DENIED

RAP 4.2(a) lists the limited types of cases in which a party may bypass the Court of Appeals and seek review directly from the Supreme Court. Direct review is discretionary and may be denied even when one of the circumstances listed in RAP 4.2(a) is present.

In this case, the Estate seeks direct review under RAP 4.2(a)(4). That subsection allows direct review in “[a] case involving a fundamental and urgent issue of broad public import which requires prompt and ultimate determination.” The Department respectfully asserts that direct review is not appropriate. The Estate’s dispute with the Department of Revenue over the Washington estate tax treatment of QTIP does not raise a fundamental and urgent issue of broad public importance, and this is not a case that requires prompt and ultimate determination by the Supreme Court. Rather, this case is a relatively straightforward tax dispute that can and should proceed through the normal appellate process.

A. **Review Under RAP 4.2(a)(4) Is Inappropriate Because This Case Does Not Present A “Fundamental And Urgent Issue Of Broad Public Import Which Requires Prompt And Ultimate Determination.”**

In its statement of grounds, the Estate contends that “[t]he case presents an issue of **sufficient importance** to the citizens of this state and

⁵ The separate Washington QTIP election is not relevant in this case because the Estate of Sharon Bracken did not make a federal QTIP election under IRC § 2056, and was required to file a federal estate tax return. As a result, the condition precedent in RCW 83.100.047(1) was not met.

to the Department to require resolution by this Court.” Statement at 12. (Emphasis added). The Estate offers very little argument supporting its claim that direct review is warranted. In fact, the Estate spends most of its statement of grounds arguing the merits of its appeal, not explaining why direct review should be accepted.

The Estate offers only two arguments supporting its request for direct review. First, the Estate notes that roughly a dozen other cases currently in the superior court could benefit from this Court’s prompt determination of this case. Statement at 13. Second, the Estate notes that this Court has granted direct review in other tax cases. Statement at 14-15. These reasons do not rise to the level required by RAP 4.2(a)(4). Rather, the rule clearly provides that the party seeking direct review must show that the case involves a “fundamental and urgent” issue that “requires prompt and ultimate determination.”

The Estate never grapples with the requirements of the RAP 4.2. Instead, it merely suggests that “[u]ltimately, this Court will be required to resolve this [case]. It is better to do so now.” Statement at 13-14. The Estate’s plea for this Court to decide the case “now” falls far short of the requirements for direct review under RAP 4.2(a)(4). Under the Estate’s reading of the rule, almost any tax case, especially one involving a new or novel claim for deduction or exemption, would qualify for direct review. Nothing in the plain language of RAP 4.2 suggests such a broad and unprincipled reading.

The existence of other pending superior court cases involving similar legal issues does not, by itself, warrant direct review. Thus far, none of those other cases has resulted in a determination inconsistent with the judgment of the King County court in this case. In addition, the Estate has not argued, much less established, that intermediate review by the Court of Appeals will adversely impact any of the pending superior court cases. In short, having a relatively small number of estate tax cases at the superior court level involving QTIP issues does not create a “fundamental and urgent” need for “prompt and ultimate determination” by this Court.

Moreover, the fact that the Court has accepted direct review in some other tax cases does not support the Estate’s request for direct review in this case. The Department readily acknowledges that many tax cases have implications beyond the particular taxpayer or tax years at issue. However, that does not mean the issues in every taxpayer’s case justify direct review under RAP 4.2(a)(4). Compared to other tax cases in which this Court has accepted direct review, this case simply does not present a fundamental issue of broad public import. For instance, in *Estate of Hemphill v. Dep’t of Revenue*, 153 Wn.2d 544, 105 P.3d 391 (2005), the Court resolved a fundamental issue concerning the validity of Washington’s estate tax in light of the Economic Growth and Tax Relief Reconciliation Act of 2001. In *Hemphill*, the Department agreed direct review was appropriate because the central issue affected hundreds of Washington estates. In addition, the amount of tax revenue at issue in that case was quite large, with potential revenue loss to the general fund

estimated at approximately \$400 million for 2001 through 2010. Thus, the Legislature also needed a prompt and definitive answer to the legal issue presented in *Hemphill*. In terms of the number of estates affected and the potential impact on the state, this case pales in comparison to *Hemphill*.

While it is true that this case does present some issues of first impression, it does not present an issue of “fundamental” or “broad” public import. Depending upon how the Court of Appeals decides the issues, this case may qualify for discretionary review at a later time under RAP 13.4(b). However, in its present posture this case does not warrant direct review under RAP 4.2(a)(4).

B. The Estate’s Arguments On The Merits Do Not Provide A Basis For Direct Review.

The Estate’s statement of grounds for direct review relies primarily on briefing and argument on the merits of the legal issues in the case. *See* Statement at 2-12. In effect, the Estate argues that the Court should accept direct review because, in the Estate’s view, the trial court erred in granting the Department’s motion for summary judgment.

While RAP 4.2(a) and 4.2(c) do not expressly forbid an appellant from presenting arguments on the merits of the appeal as part of its statement of grounds for seeking direct review, it is also true that argument on the merits is not listed as a relevant consideration in the rule. Consequently, little attention should be paid to the Estate’s arguments suggesting that the trial court erred.

Moreover, even if arguments on the merits was proper under RAP 4.2(a)(4), the Estate's arguments suggesting that the trial court erred are easily refuted. The Estate ignores key provisions in the Washington and federal estate tax statutes, and misstates the Department's position below.

Under federal law, the QTIP passing to the remainder beneficiaries when Ms. Bracken died was properly included in the Estate's federal taxable estate. *See* IRC § 2044 (requiring inclusion of QTIP in the gross estate of the second spouse to die). Because the QTIP was included in the Estate's federal taxable estate, it also was part of the Estate's Washington taxable estate. *See* RCW 83.100.020(13) (defining "Washington taxable estate" to mean "federal taxable estate" less specific amounts unrelated to QTIP). There is no deduction or exclusion in the Washington estate tax statutes for QTIP included in a decedent's federal and Washington taxable estate. Moreover, the Department did not (and could not) create such a deduction by administrative rule. *See Coast Pacific Trading, Inc. v. Department of Rev.*, 105 Wn.2d 912, 917, 719 P.2d 541 (1986) (Department of Revenue cannot use its administrative rules to expand tax immunity beyond the exemptions or deductions provided by statute). In short, there is no statutory basis for the QTIP deduction claimed by the Estate. Thus, the superior court correctly held that the Estate improperly deducted the QTIP when it filed its Washington estate tax return.

There is nothing unconstitutional or "retroactive" about the application of the Washington estate tax statutes to the facts of this case. The Estate's novel arguments to the contrary are unpersuasive and should

ultimately be rejected on appeal. At a minimum, the superior court's rejection of the Estate's legal arguments is not so surprising or exceptional as to raise a "fundamental and urgent issue of broad public importance" requiring prompt resolution by the Supreme Court on direct review.

C. Intermediate Review By The Court Of Appeals Would Benefit The Parties And The Court.

Beyond the requirements of RAP 4.2(a)(4), which are not met here, practical considerations suggest that the Estate's request for direct review should be denied. The Estate of Sharon Bracken was one of three cases consolidated for purposes of discovery and trial in the superior court. The superior court granted the Department's motion for summary judgment and denied the three estates' cross-motion. Of the three "consolidated estates," only the Estate of Sharon Bracken is seeking direct review. The Estate of Nelson has appealed to the Court of Appeals, and the Estate of Toland has decided not to appeal.

In light of the fact that an appeal of the superior court's decision granting the Department's motion for summary judgment is already proceeding in the Court of Appeals, it makes practical sense to transfer this case to the Court of Appeals to be considered with that other appeal. If the case is transferred to the Court of Appeals, the two appeals could be consolidated for review under RAP 3.3. Not only would this save time and expense, it would also help conserve limited judicial resources and promote the orderly administration of justice.

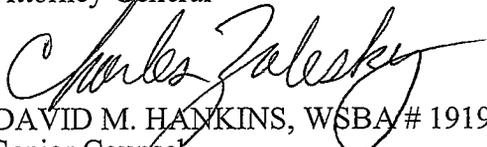
But even if this case is not consolidated for review with Estate of Nelson, this Court would still benefit from the Court of Appeals' analysis of all the issues raised in this case and the Estate of Nelson case. Ultimately, an appellate process that includes intermediate review by the Court of Appeals will promote justice and facilitate the decision of this case on the merits. *See* RAP 1.2(a).

IV. CONCLUSION

For all of the foregoing reasons, this Court should deny direct review and allow the Court of Appeals to determine in the first instance whether the trial court properly granted summary judgment to the Department.

RESPECTFULLY SUBMITTED this 3rd day of February, 2010.

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