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IN THE SUPREME COURT OF THE STATE OF WASHINGTON

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In re the Matter of the:

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.

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BRIEF OF APPELLANTS

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## I. INTRODUCTION

The Washington State Department of Revenue (“DOR”) has sought to impose the new Washington State estate tax, which became effective on May 17, 2005, on a trust that was created by Jim Bracken more than twenty years before. Despite the Washington State Legislature’s express direction that the new law is to be applied prospectively only, and contrary to the regulations promulgated and adopted by DOR as the Legislature directed, DOR asserts that the trust’s assets are subject to the new state estate tax at the death of Jim’s wife, Sharon Bracken, who died in September 2006. The regulations that DOR adopted in 2006 specifically exclude the assets in Jim’s trust in determining Sharon’s Washington taxable estate for state estate tax purposes. Sharon’s estate was one of three similarly situated estates consolidated for discovery and trial that challenged DOR’s position on taxing these preenactment trusts. The trial court, however, granted summary judgment to DOR and denied summary judgment to the consolidated estates. Sharon’s estate seeks direct review in the Supreme Court of the trial court’s rulings because DOR’s attempt to tax those trust assets violates DOR’s own regulations and the express terms of the law, and is unconstitutional under both the United States and Washington State Constitutions.

## **II. ASSIGNMENTS OF ERROR**

### **A. Assignments of Error**

The trial court erred in its order of November 13, 2009, when it granted DOR's motion for summary judgment and denied the consolidated estates' motion for summary judgment on the estates' objections to DOR's findings that additional estate tax was due.

### **B. Issues Pertaining to Assignments of Error**

Does DOR's attempt to tax property held in an irrevocable trust created before the enactment of Washington's new stand-alone estate tax violate DOR's own regulations as adopted in 2006, chapter 485-57 WAC, as well as the provisions of the Washington Estate and Transfer Tax Act, chapter 83.100 RCW, and the United States and Washington State Constitutions?

## **III. STATEMENT OF THE CASE**

### **A. Enactment of the New Washington Estate and Transfer Tax Act**

In 1981, the voters abolished Washington's inheritance tax and created a state estate tax based exclusively on the credit allowed for estate taxes paid to a state on a decedent's federal estate tax return. Laws of 1981, 2nd Ex. Sess., ch. 7 (Initiative No. 402, approved Nov. 3, 1981). This was commonly called a "pickup tax," and was a mechanism for sharing estate tax revenues between the federal government and the state

government. See *Estate of Hemphill v. Dep't of Revenue*, 153 Wn.2d 544, 547, 105 P.3d 391 (2005). The pickup tax did not increase the total amount of estate taxes paid by an estate since the amount of estate tax paid to the state was credited against the federal estate tax. *Id.* at 547-48.

In 2001, under the Economic Growth and Tax Relief Reconciliation Act ("EGTRRA"), Congress phased out the federal credit for state estate taxes, eliminating it completely for estates of persons dying after December 31, 2004. P.L. 107-16, § 531. For Washington State, this meant that the estate tax revenue stream would be eliminated in 2005 unless the Legislature changed the state's estate tax scheme. *Hemphill*, 153 Wn.2d at 548-49. The Legislature did not change the state's estate tax scheme. DOR continued to impose the Washington estate tax, nevertheless, through its erroneous conclusion that it could ignore the changes to federal law and maintain a reference to the federal law that existed prior to EGTRRA. *Id.* at 549-52.

This Court rejected DOR's approach in *Hemphill*, stating that "[u]ntil or unless the legislature revises RCW 83.100.030 to specifically and expressly create a *stand alone* estate or inheritance tax," the state's estate tax would remain a pickup tax. *Id.* at 551-52 (emphasis added). This Court determined that under RCW 83.100.030 as it existed at that

time, without a federal credit for estate taxes paid to a state, there would be no tax paid to the State of Washington.

On May 17, 2005, the Legislature enacted a new stand-alone estate tax under the Washington Estate and Transfer Tax Act (the "Act"), Laws of 2005, ch. 516 (codified in RCW ch. 83.100).

**B. Qualified Terminable Interest Property Trusts and the Taxable Estate of the First Spouse to Die**

Unlike the pickup tax, the new Washington estate tax is imposed "on every transfer of property located in Washington," regardless of the federal estate tax. *Id.* The tax is imposed on the "Washington taxable estate," which in turn is based on the taxable estate determined for federal estate tax purposes ("federal taxable estate"). RCW 83.100.020(14).

In determining the federal taxable estate a deduction is allowed for property passing to a decedent's surviving spouse in a qualified manner (the "marital deduction"). I.R.C. § 2056(a). A gift to a trust for the benefit of a decedent's surviving spouse that meets certain statutory requirements is called a "qualified terminable interest property trust" ("QTIP trust").<sup>1</sup> If the personal representative of the estate of the first spouse to die makes an irrevocable election on the deceased spouse's federal estate tax return (a "QTIP election"), the trust property will qualify

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<sup>1</sup> For a comprehensive discussion of QTIP trusts and the associated provisions of the Internal Revenue Code, see JOHN R. PRICE AND SAMUEL A. DONALDSON, PRICE ON CONTEMPORARY ESTATE PLANNING, § 5.23 (2009 ed).

for the marital deduction. I.R.C. § 2056(b)(7)(B)(v). By qualifying a QTIP trust for the marital deduction, no tax is paid on the trust assets at the time of the first spouse's death. I.R.C. § 2056(a). However, because those assets would have been taxed at the first death but for the marital deduction, any assets remaining in the QTIP trust on the surviving spouse's death ("QTIP property") are subject to the federal estate tax at that time. I.R.C. § 2044(b)(1)(A).

The Act incorporates the unlimited marital deduction concept for Washington State estate tax purposes. It allows for an irrevocable election to be made to qualify a QTIP trust for a state marital deduction.

RCW 83.100.047. The election to qualify a QTIP trust for the Washington State estate tax marital deduction, however, is separate and distinct from an election to qualify the trust for the federal estate tax marital deduction. *Id.*

**C. The 2006 Regulations Excluded Federal QTIP Property from the Washington Taxable Estate of the Second Spouse to Die**

On April 9, 2006, DOR adopted regulations to provide guidance on the application and interpretation of the new Act ("2006 Regulations"). CP 969-1014; *see* chapter 458-57 WAC.<sup>2</sup> The Act provides that these

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<sup>2</sup> DOR later amended two of its regulations effective February 22, 2009 ("2009 amendments"). CP 618-636; *see* WAC 458-57-105(3)(q)(vi) (2009); WAC 458-57-115(2)(d)(vi) (2009). The Estate of Sharon Bracken filed its state estate tax return prior

regulations are to have the same force and effect as if they were specifically set out in chapter 83.100 RCW. RCW 83.100.200. Among other things, the 2006 Regulations set forth the manner in which the Washington taxable estate is to be calculated. WAC 458-57-105 (2006); WAC 458-57-115 (2006). The 2006 Regulations provide that a personal representative may make a larger or smaller QTIP election for Washington estate tax purposes than for federal estate tax purposes. WAC 458-57-115(2)(c)(iii)(A) (2006).

Under the Act and the 2006 Regulations, the calculation of the Washington taxable estate begins with the “federal taxable estate.” RCW 83.100.020(13); WAC 458-57-105(3)(q) (2006).<sup>3</sup> The 2006 Regulations also direct that any federal QTIP property that was included in the federal taxable estate of the second spouse to die is to be excluded from that spouse’s Washington taxable estate. WAC 458-57-105(3)(q)(vi) (2006); WAC 458-57-115(2)(d)(vi) (2006). The 2006 Regulations further provide that only the assets remaining in a Washington QTIP trust for which a Washington QTIP election was made are to be included in the

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to DOR’s adoption of the 2009 amendments. CP 425-26. The trial court determined that the 2009 amendments would not apply to Sharon’s estate in this case. RP 75.

<sup>3</sup> The federal taxable estate is defined as the taxable estate determined under Chapter 11 of the Internal Revenue Code without regard to the termination of the federal estate tax under EGTRRA or the deduction for state estate taxes under I.R.C. § 2058. RCW 83.100.020(14); WAC 458-47-105(3)(g); WAC 458-57-115(2)(e).

surviving spouse's Washington taxable estate. WAC 458-57-105(3)(q)(v) (2006); WAC 458-57-115(2)(d)(v) (2006).

**D. Sharon Bracken's Estate Complied with the 2006 Regulations**

Sharon M. Bracken's husband, Jim Bracken, predeceased her on November 23, 1984, more than 20 years before the effective date of the new Act. CP 405. Pursuant to Jim's estate plan, the personal representatives of Jim's estate transferred property to an irrevocable trust for the benefit of Sharon, his surviving spouse. CP 405-09. Jim's estate made an election to qualify the trust as a QTIP trust for the federal estate tax marital deduction under I.R.C. § 2056(b)(7). CP 407-09. At Jim's death no election was made to qualify the trust for a Washington marital deduction. No such election was even possible under the law in effect at that time.

Sharon, a Washington resident, died on September 24, 2006, after the effective date of the Act. CP 419. As required by I.R.C. § 2044, Sharon's federal taxable estate included the property that remained in Jim's QTIP trust. CP 419-23. As required by the 2006 Regulations, however, those assets were not included as a part of Sharon's Washington taxable estate. CP 425-26; *see* WAC 458-57-105(3)(q)(vi) (2006); WAC 458-57-115(2)(d)(vi) (2006). Sharon's estate did, however, pay

Washington estate tax on all of the property that she owned and controlled at the time of her death. CP 425-26.

DOR issued a deficiency notice to Sharon's estate stating, contrary to its own regulations, that the estate needed to include in her Washington taxable estate the property remaining in Jim's QTIP trust. CP 165-70.

Sharon's estate declined to pay the amount cited in the deficiency notice and DOR made findings under RCW 83.100.150. CP 171-74. Sharon's estate timely filed objections to DOR's findings. CP 2-14.

**E. The Trial Court Ruled that the 2006 Regulations Do Not Apply to Sharon's Estate**

The proceeding involving Sharon's estate was consolidated with proceedings for two other similarly situated estates for purposes of discovery and trial on the objections. CP 58-66. On cross motions for summary judgment, the trial court, the Honorable John P. Erlick, granted DOR's motion and denied the motion of the three consolidated estates. CP 24-26.

Without ever articulating any ambiguity in the Act or the 2006 Regulations, the trial court deferred to DOR's interpretation that its own 2006 Regulations do not apply to Sharon's estate because Jim's estate had never made a Washington QTIP election. RP 78. Moreover, finding that the exclusion of Jim's pre-enactment QTIP trust as required by the 2006

Regulations was a “deduction,” the trial court construed the regulations against Sharon’s estate and concluded that her estate was not entitled to that “deduction.” *Id.* The trial court also ruled that the estate tax enacted on May 17, 2005, is not a new tax, and that therefore it’s application to Jim’s QTIP trust was not an unconstitutional retroactive application of the tax. RP 79.

The trial court subsequently denied the three estates’ motion for reconsideration and entered judgment against Sharon’s estate in favor of DOR. CP 27-28; 39-41. The estate has satisfied that judgment. CP 54. Sharon’s estate now seeks review of the trial court’s decisions and an order that the amount paid on the judgment be refunded to the estate.

#### **IV. SUMMARY OF ARGUMENT**

DOR’s 2006 Regulations are clear on their face. By their plain language, the 2006 Regulations apply to Sharon’s estate and to all estates of decedents dying after May 17, 2005. When properly applied, the 2006 Regulations require that property remaining in Jim’s QTIP trust and included in Sharon’s federal taxable estate pursuant to I.R.C. § 2044 must be excluded in computing Sharon’s Washington taxable estate. Even without the 2006 Regulations, however, DOR’s attempt to include Jim’s QTIP property as part of Sharon’s Washington taxable estate is contrary to the express provisions of the Act, violates the premise on which QTIP

property is taxed in a surviving spouse's estate, and constitutes an unconstitutional retroactive application of the tax.

## V. ARGUMENT

### A. The Applicable Standard of Review is *De Novo*

The interpretation of a statute and its implementing regulations is a question of law, which the Court reviews *de novo*. *In re Impoundment of Chevrolet Truck*, 148 Wn.2d 145, 154, 60 P.3d 53 (2002). The Court reviews an agency's interpretation of statutes and the application of the law *de novo* under the error of law standard, which allows the Court to substitute its own interpretation of the statute or regulation for the agency's interpretation. *Postema v. Pollution Control Hearings Bd.*, 142 Wn.2d 68, 77, 11 P.3d 726 (2000). Finally, the Court reviews summary judgment rulings *de novo*. *York v. Wahkiakum Sch. Dist. No. 200*, 163 Wn.2d 297, 302, 178 P.3d 995 (2008). In reviewing a summary judgment ruling, the Court's inquiry is the same as the trial court. *Lybbert v. Grant County*, 141 Wn.2d 29, 34, 1 P.3d 1124 (2000).

### B. The 2006 Regulations Are Clear on their Face and Apply to All Estates of Decedents Dying After May 17, 2005

The Legislature recognized that the new Act was only the general framework for the operation and application of the new estate tax and that the specific details would be set forth in the regulations. Accordingly, the Legislature gave DOR a directive and broad authority to adopt all

regulations necessary to carry out the provisions of the new stand-alone estate tax act. RCW 83.100.200; *see also* RCW 83.100.047(1). Under this authority DOR promulgated and adopted the 2006 Regulations. CP 891, 929, 969.

Under the 2006 Regulations promulgated by DOR, the Washington taxable estate is determined by making adjustments to the federal taxable estate. WAC 458-57-105(3)(q) (2006); WAC 458-57-115(2)(d) (2006). One of the required adjustments is that any amount included in the federal taxable estate pursuant to I.R.C. § 2044 (inclusion of amounts for which a federal QTIP election was previously made) is to be removed in computing the Washington taxable estate. WAC 458-57-105(3)(q)(vi) (2006); WAC 458-57-115(2)(d)(vi) (2006).

The trial court ruled that these regulations do not apply to Sharon's estate because Jim's estate never made a Washington QTIP election. RP 77. The trial court looked solely at the statutory definition of "federal taxable estate," which provides no exclusion for I.R.C. § 2044 property. *See* RCW 83.100.020(14). The trial court simply ignored the plain language of the 2006 Regulations that DOR adopted at the Legislature's direction.

1. The Plain Meaning Rule Applies to the 2006 Regulations

The rules of statutory interpretation apply to agency regulations. *Tesoro Ref. & Mktg. Co. v. Dep't of Revenue*, 164 Wn.2d 310, 322, 190 P.3d 28 (2008). "If an administrative rule or regulation is clear on its face, its meaning is to be derived from the plain language of the provision alone." *Cannon v. Dep't of Licensing*, 147 Wn.2d 41, 56, 50 P.3d 627 (2002). "The language of an unambiguous regulation is given its plain and ordinary meaning unless the legislative intent indicates to the contrary." *Tesoro*, 164 Wn.2d at 322. Where a rule is unambiguous, a court does not speculate as to its intent, nor question the wisdom of a particular regulation, it merely determines what the regulation requires. *Multicare Med. Ctr. v. Dep't of Soc. & Health Servs.*, 114 Wn.2d 572, 591, 790 P.2d 124 (1990). "[R]egulations are interpreted as a whole, giving effect to all the language and harmonizing all provisions." *Cannon*, 147 Wn.2d at 57. A court must assess the plain meaning of a statute or regulation by viewing the words of the particular provisions in context, together with related provisions and the statutory or regulatory scheme as a whole. *Tesoro*, 164 Wn.2d at 319. A court also must consider the subject, nature and purpose of the statute or regulation as well as the consequences of adopting one interpretation over another. *Id.*

Without ever finding any ambiguity in the 2006 Regulations, the trial court erroneously resorted to various other rules of construction in reaching its decision that Sharon's Washington taxable estate must include the property remaining in Jim's QTIP trust.<sup>4</sup> This Court has consistently ruled, however, that a trial court may only apply rules of construction to a statute or regulation that it finds to be ambiguous. *Tesoro*, 164 Wn.2d at 317 n.3 (only after court determines that statute is ambiguous may it resort to tools of statutory construction); *Nelson v. Appleway Chevrolet, Inc.*, 160 Wn.2d 173, 179, 157 P.3d 847 (2007) (only ambiguous statutes are to be construed). The trial court did not find, and DOR did not argue, that the 2006 Regulations are ambiguous.

Applying the plain meaning rule, DOR's 2006 Regulations clearly apply to Sharon's estate and direct that Jim's QTIP property is to be excluded in determining Sharon's Washington taxable estate. Both the Act and the 2006 Regulations plainly state that they apply to estates of all

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<sup>4</sup> DOR argued, among other things, that the exclusion of the federal QTIP property in determining the Washington taxable estate was a "deduction." RP 55-57. The trial court ruled that as a deduction any ambiguity would be construed against the taxpayer (although the trial court found no such ambiguity). RP 78. In DOR's state estate tax return form used by Sharon's estate, DOR did not consider the exclusion of the federal QTIP property to be a "deduction," but rather recognized it as an "adjustment" from Sharon's federal taxable estate to determine her Washington taxable estate. CP 425-26 (*compare* line 2 with line 4).

decedents dying after May 17, 2005, which includes Sharon's estate.<sup>5</sup> Laws of 2005, ch. 516, § 20; WAC 458-57-105(1) (2006); WAC 458-57-115(1) (2006). Under the plain reading of the 2006 Regulations, property that is included in the decedent's federal taxable estate under I.R.C. § 2044 is excluded in determining the decedent's Washington taxable estate. WAC 458-57-105(3)(q)(vi) (2006); WAC 458-57-115(3)(d)(vi) (2006). The trial court's ruling and DOR's interpretation are contrary to the plain language of the regulations.

2. The Trial Court Erred in Deferring to DOR's Interpretation

The trial court gave deference to DOR's interpretation that the 2006 Regulations simply do not apply to Sharon's estate. This Court has directed that trial courts should not defer to an agency's interpretation of legislative intent or its own regulations unless the statute or regulations are ambiguous in the first place. *Waste Mgmt. of Seattle, Inc. v. Utils. & Transp. Comm'n*, 123 Wn.2d 621, 627-28, 869 P.2d 1034 (1994). This Court also has instructed that trial courts should not defer to an agency's interpretation of regulations that are not plausible or that are contrary to the legislative intent. *Bostain v. Food Express Inc.*, 159 Wn.2d 700, 153 P.3d 846 (no deference due agency interpretation regardless of

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<sup>5</sup> By contrast, WAC 458-57-005 and WAC 458-57-015 are the regulations that apply to estate's of decedent's dying prior to May 17, 2005. See WAC 458-57-005; WAC 458-57-015.

whether it is stated in an agency rule when agency interpretation conflicts with statute), *cert. denied*, 552 U.S. 1040 (2007); *Flanigan v. Dep't of Labor & Indus.*, 123 Wn.2d 418, 426, 869 P.2d 14 (1994) (statutory interpretation must not reach an absurd result). The Court will uphold an agency's interpretation of a regulation only if "it reflects a plausible construction of the language of the statute and is not contrary to the legislative intent." *Seatoma Convalescent Ctr. v. Dep't of Soc. & Health Servs.*, 82 Wn. App. 495, 518, 919 P.2d 602 (1996).

The 2006 Regulations that DOR adopted provide general guidance concerning the Washington estate tax. WAC 458-57-115 in particular covers a variety of topics relevant to estates that may not make a Washington QTIP election: how to value property in the estate; the ability to use alternate values and special use values; how to treat various deductions, such as funeral expenses and mortgages; how to obtain a deduction for property passing to a non-US citizen spouse. WAC 458-57-115. Under DOR's argument and the trial court's ruling, unless the decedent's predeceased spouse's estate had made a Washington QTIP election, none of DOR's estate tax regulations would apply.

Taxpayers have the right to rely on tax regulations adopted by DOR. *Cf.* RCW 82.32A.020(2). Indeed, an agency must follow its own rules and regulations. *Ritter v. Bd. of Comm'rs*, 96 Wn.2d 503, 507,

637 P.2d 940 (1981). Nowhere does WAC 458-57-105 or WAC 458-57-115 indicate that the 2006 Regulations do not apply to an estate in which the decedent's predeceased spouse died before May 17, 2005. Nothing in WAC 458-57-105 or WAC 458-57-115 indicates that the 2006 Regulations do not apply to estates with a federal QTIP trust but no Washington QTIP trust. Moreover, nothing in WAC 458-57-105 or WAC 458-57-115 indicates how taxpayers would know which parts of the 2006 Regulations to apply and which parts not to apply. Under the trial court's ruling and DOR's argument, taxpayers would be left without any guidance about how to determine their Washington estate tax obligation, even though the Legislature directed that DOR adopt regulations to provide such guidance. This is illogical and is not supported by the plain language of the 2006 Regulations or the Act. It is simply implausible to argue that the 2006 Regulations have no application to Sharon's estate.

3. The 2006 Regulations Are Consistent with the Act

DOR argued that the 2006 Regulations only apply to decedents who satisfy certain "conditions precedent" which DOR claims are required for RCW 83.100.047(1) to apply. CP 524-25; RP 49. This argument was based on a premise that DOR adopted the 2006 Regulations solely to address issues associated with different state and federal QTIP elections under RCW 83.100.047. CP 524-25. Nothing in the regulations or the

statutes supports this concept of a “condition precedent” or the contention that these regulations are so limited.

In RCW 83.100.047, the Legislature established a framework for making a QTIP election for Washington estate tax purposes that is different from any QTIP election that might be made for federal estate tax purposes. The Legislature directed DOR to adopt regulations that would provide the details for its application that are consistent with the rules governing federal QTIP elections. RCW 83.100.047(1). Although RCW 83.100.047(1) references rules that DOR might enact to address a situation where different QTIP elections are made for state and federal purposes, that rule making authority is ancillary to the provisions of RCW 83.100.200 and does not purport in any way to limit the authority or impact of the 2006 Regulations DOR adopted pursuant to RCW 83.100.200.

Under RCW 83.100.200 the Legislature gave DOR a directive to adopt regulations necessary to implement all provisions of the new stand-alone estate tax. RCW 83.100.200. In compliance with this directive DOR promulgated and adopted the 2006 Regulations. CP 891, 929, 969. Because DOR adopted the 2006 Regulations at the express direction of the Legislature, those regulations have the force of law. RCW 83.100.200.

As such, these regulations are binding. *Ass'n of Wash. Bus. v. Dep't of Revenue*, 155 Wn.2d 430, 446, 120 P.3d 46 (2005).

4. The 2009 Amendments Demonstrate that the 2006 Regulations Apply to Sharon's Estate

DOR's 2009 amendments to WAC 458-57-105(3)(q)(vi) and WAC 458-57-115(2)(d)(vi) undermine its argument that the 2006 Regulations do not apply to Sharon's estate. DOR amended those sections to add the following underlined language: "(vi) Less any amount included in the federal taxable estate pursuant to IRC § 2044 (inclusion of amount for which a federal QTIP election was previously made), from a predeceased spouse that died on or after May 17, 2005." CP 618-36.

Although the 2009 amendments completely change the law regarding the inclusion of QTIP property, DOR claimed these amendments are simply a "clarification." See CP 618, 632, 635. When a material change is made in the wording of a statute, a change in legislative purpose must be presumed. *WR Enters., Inc. v. Dep't of Labor & Indus.*, 147 Wn.2d 213, 221, 53 P.3d 504 (2002). Likewise, when such a substantive change in the wording of regulations is made nearly three years after the adoption of the original regulations, a change in the agency's purpose may be presumed. If DOR needed to "clarify" the regulations specifically for estates in which

the first spouse died before enactment of the Act, then DOR must have intended the 2006 Regulations to apply to estates like Sharon's.

5. Summary

The trial court erred in ruling that the 2006 Regulations do not apply to Sharon's estate when by their plain language they do. When properly applied, the 2006 Regulations lead to the conclusion that I.R.C. § 2044 property is to be excluded from the Washington taxable estate. WAC 458-57-105(3)(q)(vi) (2006); WAC 458-57-115(2)(d)(vi) (2006). Those regulations have the force of law. Sharon's estate followed the direction of the 2006 Regulations and properly excluded the remaining property in Jim's irrevocable federal QTIP trust from her Washington taxable estate. The Court should reverse the trial court's rulings.

**C. The Trial Court's Rulings Tax Property Sharon Bracken Never Owned, Never Controlled, and Had No Ability to Transfer**

The new Act applies specifically to *transfers of property* by a decedent. RCW 83.100.040(1) (emphasis added). Barring another applicable statutory provision, without a transfer of property there can be no tax. *See Helvering v. Safe Deposit & Trust Co. of Baltimore*, 316 U.S. 56, 62 S. Ct. 925, 86 L. Ed. 1266 (1942). Under both the federal and state estate tax schemes property is taxed when it is transferred.

RCW 83.100.040(1); I.R.C. § 2001(a). The new Washington estate tax

gives the term “transfer” the same meaning it is given under federal estate tax law. RCW 83.100.020(11). The term is given specific meaning in the context of transfers in trust for which a QTIP election is made. In particular, the operative “transfer” for tax purposes occurs when the estate of the first spouse establishes the trust. I.R.C. § 2044(b)(1), (c). To give effect to the tax deferral, the property is *treated* as having *passed* from the surviving spouse, but the *transfer* occurs, under federal estate tax law and, thus, for purposes of Washington estate tax when the trust was established and the income interest was transferred to the surviving spouse.

The United States Supreme Court has held that property is transferred when the trust is created, not when an income interest in the trust expires. *Coolidge v. Long*, 282 U.S. 582, 51 S. Ct. 306, 75 L. Ed. 562 (1931). At issue there was a trust the Coolidges created in 1907 that gave each of them a life estate in the income of the trust. On the death of the survivor of Mr. and Mrs. Coolidge, the trust principal was to be distributed to the Coolidges’ five sons. *Id.* at 593-94. Mrs. Coolidge died in 1921 and Mr. Coolidge died in 1925. *Id.*

In 1920, Massachusetts enacted an excise tax on property that passed by deed, grant or gift, which was made or intended to take effect in possession or enjoyment after the grantor’s death. *Id.* at 594-95. The statute applied only to transfers occurring on or after May 4, 1920. *Id.* at

595. The issue was whether the taxable transfer occurred when the trust was formed in 1907 or at Mr. Coolidge's death in 1925 when the trust assets were distributed to the remainder beneficiaries. The Massachusetts Supreme Judicial Court held that the taxable transfer occurred when the remainder beneficiaries became entitled to receive the trust property on their father's death in 1925. *Id.*

The United States Supreme Court reversed on constitutional grounds. It held that the remainder interest in the trust came "into effect in possession or enjoyment" when the trust was irrevocably formed in 1907, not when Mr. Coolidge died in 1925. *Id.* at 597.

Upon the happening of the event specified without more, the trustees were bound to hand over the property to the beneficiaries. Neither the death of Mrs. Coolidge nor her husband was a generating source of any right in the remaindermen. Nothing moved from her or him or from the estates of either when she or he died. There was no transmission then. The rights of the remaindermen, including possession and enjoyment upon termination of the trusts, were derived solely from the deeds.

*Id.* at 597-98 (citation omitted). The Court further concluded that "[n]o act of Congress has been held by this court to impose a tax upon possession and enjoyment, the right to which had fully vested prior to the enactment." *Id.* at 599. Because the transfer was completed prior to the

enactment of the law, the Court held the transfer was outside the reach of the tax. *Id.*

Federal estate tax laws confirm that no “transfer” of assets in a QTIP trust occurs upon the death of the surviving spouse. Under the federal laws, QTIP elections that are made pursuant to I.R.C. § 2056(b)(7) “relate back” to the date of death of the first spouse to die. *Estate of Clayton v. Comm’r*, 976 F.2d 1486, 1495 (5th Cir. 1992), Treas. Reg. § 20.2056(b)(7)(d)(3). The first spouse’s date of death is determinative because any QTIP election made for property passing to the surviving spouse will be deemed to have been transferred at the first spouse’s death, regardless of the date on which the QTIP election was made. *Id.* The Act and its regulations look to, and incorporate by reference, the federal estate tax laws to determine if a state QTIP election is properly made.

RCW 83.100.047(1).

DOR erroneously asserted below that property “treated as passing from” a surviving spouse by virtue of a provision of the federal tax code is the same as property being “transferred by” the decedent for Washington estate tax purposes. CP 530-36. It is not. Courts have confirmed that property in a QTIP trust “does not actually pass to or from” the surviving spouse, it is merely treated as though it does for federal estate tax purposes. *See Estate of Bonner v. U.S.*, 84 F.3d 196, 198 (5th Cir. 1996);

*Estate of Mellinger v. Comm'r*, 112 T.C. 26 (1999). Analyzing I.R.C.

§ 2044(c) the court in *Mellinger* held:

This [QTIP] property is “treated as property passing from the” surviving spouse, § 2044(c), and is taxed as part of the surviving spouse’s estate at death, *but QTIP property does not actually pass to or from the surviving spouse. . . .*

Neither § 2044(c) nor the legislative history indicates that the decedent should be treated as the owner of QTIP property for this purpose.

112 T.C. at 35-36 (emphasis added).

In the case at hand, the only “transfer” of QTIP property occurred as of the date of Jim’s death when the personal representative of Jim’s estate fulfilled the terms of Jim’s will and funded the QTIP trust established under the terms of that will. The taxable “transfer” occurred when the rights of the remainder beneficiaries of Jim’s QTIP trust were vested at the time of Jim’s death. Sharon did not own the property in Jim’s QTIP trust nor did she control the disposition of that property at the time of her death. *See Estate of Bonner*, 84 F.3d 196; *Estate of Mellinger*, 112 T.C. 26. All Sharon had was the right to receive specified benefits from the trust during her lifetime. The assets of QTIP trusts are in fact controlled at every step by the first spouse to die. *Bonner*, 84 F.3d at 198. “The estate of each decedent should be required to pay taxes on those

assets whose disposition that decedent directs and controls, in spite of the labyrinth of federal tax fictions.” *Id.* at 199. Sharon did not transfer that property. On her death, the trust property passed automatically to the remainder beneficiaries of the trust, the terms of which were created and determined by her predeceased spouse, Jim Bracken, who died before May 17, 2005. *Coolidge*, 282 U.S. at 597.

DOR agreed that the QTIP property belongs to Jim’s trust, not to Sharon. CP 313-14. Consistent with *Coolidge*, DOR agreed that for a QTIP trust the transfer takes place when the first spouse dies and the QTIP trust is created. CP 313-14. When it drafted the 2006 Regulations DOR understood it could not include QTIP property in the surviving spouse’s Washington taxable estate because the requisite transfer by the surviving spouse is absent. DOR’s 2006 Regulations were promulgated to implement the new Washington stand-alone estate tax and are consistent with that understanding.

Absent a statute that makes the surviving spouse the transferor of the trust assets for Washington state estate tax purposes, those assets cannot be taxed as part of the Washington taxable estate. *See Helvering*, 316 U.S. 56. Because there was no transfer of the trust property by or from Sharon, the assets of Jim’s QTIP trust were not subject to the

Washington stand-alone estate tax as part of Sharon's Washington taxable estate. The Court should reverse the trial court's rulings.

**D. The Federal Estate Tax Applies at the Time of the Second Spouse to Die Only Because Congress Allows the Estate of the First Spouse to Defer the Tax**

QTIP property can be taxed in a surviving spouse's estate only if it was subject to the applicable tax at the first spouse's death and a marital deduction was taken for the QTIP trust property at that time. Under federal law, when a QTIP election is made, I.R.C. § 2056(a) gives the estate an estate tax deduction equal to the amount of the property placed in the QTIP trust. I.R.C. § 2056(b)(7)(A). Absent a federal QTIP election, a federal estate tax would be paid on the assets transferred to the trust at the first spouse's death. I.R.C. § 2056(b)(1)(A). The trade off is that when the surviving spouse dies, the property remaining in the trust for which an irrevocable QTIP election has been made will be subject to the federal estate tax as part of the surviving spouse's federal taxable estate.

I.R.C. § 2044(b)(1)(A).

The remaining property in Jim's irrevocable trust was taxed as part of Sharon's federal taxable estate only because the assets of that trust were subject to the federal estate tax at the time of his death, and his estate elected to take a federal estate tax marital deduction for those assets on his federal estate tax return. I.R.C. § 2044(b)(1)(A). If Jim's estate had not

made the federal QTIP election for the trust assets, those trust assets would not have been included in Sharon's federal taxable estate. This is because there would have been no deferral of the federal tax.<sup>6</sup> The requisite "transfer" of those assets would not have occurred on her death. *Coolidge* 282 U.S. at 597; *In re McGrath's Estate*, 191 Wn. 496, 504-05, 71 P.2d 395 (1937). The federal QTIP election simply has no bearing on when the "transfer" occurs.

The Act and DOR's 2006 Regulations are entirely consistent with this. The new Washington estate tax may not be applied to the property remaining in Jim's QTIP trust at the time of Sharon's death unless the property was first subject to the new Washington estate tax at the time of Jim's death, and a Washington marital deduction was claimed for those assets. Since the new Washington estate tax did not even exist at the time of Jim's death, the QTIP trust assets were not subject to that tax, and no Washington marital deduction could even have been taken. There was no deferral of the state's stand-alone estate tax at the time of Jim's death, and

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<sup>6</sup> Washington taxes the assets in a federal QTIP trust when the assets are transferred into the trust at the first spouse's death. For decedents dying after May 17, 2005, the regulations require that the assets of a trust for which the estate made a federal QTIP election and took a marital deduction under I.R.C. 2056(b)(7) on the federal taxable estate nevertheless are to be included in determining the Washington taxable estate of the first spouse to die. See WAC 458-57-105(3)(q)(iv) (2006) and WAC 458-57-115(2)(d)(iv) (2006). For purposes of the Washington taxable estate the regulations do not recognize the federal marital deduction for assets transferred to a federal QTIP trust. Washington chooses to tax those assets at the time of transfer rather than defer the tax as permitted for the federal taxable estate.

no transfer of those assets occurred on Sharon's death within the meaning of RCW 83.100.040(1). Because the QTIP property was not transferred by Sharon at her death and there was no deferral of the new Washington estate tax, the QTIP property is not includable in Sharon's estate.

**E. The Court's Rulings Apply the New Estate Tax Retroactively Contrary to the Legislature's Express Direction**

1. The Act Is to be Applied Prospectively Only

The 2006 Regulations that DOR adopted are entirely consistent with the legislative direction and the statutory requirement that it is only to be applied to transfers by the decedent whose estate is being taxed. The new Act applies specifically to transfers of property by a decedent. RCW 83.100.040(1). The plain language of the Act provides that the new tax "applies prospectively only and not retroactively" to estates of decedents dying on or after May 17, 2005. Laws of 2005, ch. 516, § 20. But the trial court in this case ruled that Jim Bracken, who died on November 23, 1984, is a "decedent" for purposes of the new Washington estate tax enacted May 17, 2005, and therefore his QTIP trust is subject to the new tax. RP 77. The trial court's determination that Jim's QTIP trust must be included as part of Sharon's Washington taxable estate permits DOR to tax property that Jim transferred to an irrevocable trust more than 20 years before enactment of the new estate tax.

Not only is this contrary to the express language of the Act, such retroactive application of statutes is disfavored. *Am. Discount Corp. v. Shepherd*, 160 Wn.2d 93, 99, 156 P.3d 858 (2007). The key to determining if a statute operates retroactively is whether the event triggering its application occurred before or after the statute was enacted. *State v. Belgarde*, 119 Wn.2d 711, 722, 837 P.2d 599 (1992). A statute operates prospectively when the precipitating event for its application occurs after the effective date of the statute. *Heidgerken v. Dep't of Natural Res.*, 99 Wn. App. 380, 387-88, 993 P.2d 934 (2000).

The triggering event in this case is the transfer of property to Jim's QTIP trust. To apply the new Washington estate tax to Jim's QTIP trust applies the tax to a transfer made long before the new Washington estate tax was enacted in violation of the express terms of the law. By removing Jim's QTIP trust from Sharon's taxable estate, as the 2006 Regulations require, DOR would be applying the tax prospectively only as required by the express terms of the Act. In contrast, by including Jim's QTIP trust in Sharon's estate, the DOR is applying the tax retroactively to a transfer Jim made to his QTIP trust more than 20 years before the Act was enacted.

## 2. The Act Establishes a New Estate Tax

The trial court found that the Act was simply a reformulation of the old estate tax, and therefore including Jim's QTIP trust as part of Sharon's

Washington taxable estate was not a retroactive application of the state estate tax. RP 79. This finding is incorrect. The estate tax enacted in 2005 is a wholly new estate tax and is substantially and substantively different from the prior Washington estate tax.

The prior state estate tax was a pickup tax equal to a credit on the federal estate tax return, the amount of which the federal government determined. *Hemphill*, 153 Wn.2d at 550-51. The prior estate tax provided for Washington to receive revenue only when a tax was payable to the federal government, and the amount of the tax paid to the state was determined by a formula established by the Internal Revenue Code. In applying the prior state estate tax, no consideration of how the federal estate tax was determined or what assets were subject to that tax was necessary. The prior estate tax was simply a revenue sharing arrangement between the federal government and the states. *Id.* Washington state imposed no additional tax burden on Washington residents, it merely shifted a portion of the federal estate tax revenue to the state. *Id.* (citing *Estate of Turner v. Dep't of Revenue*, 106 Wn.2d 649, 655, 724 P.2d 1013 (1986)). The old estate tax scheme had to be administered complementary to federal law to guarantee that a separate state estate tax did not burden estates. *Id.* (citing *Turner*, 106 Wn.2d at 653-54). Under EGTRRA that

estate tax was completely eliminated as of December 31, 2004. P.L. 107-16, § 531.

On May 17, 2005, the Washington Legislature created a new stand-alone estate tax. Laws of 2005, ch. 516. The new estate tax is not a pick-up tax but rather is an independently operating estate tax. The Act expressly states that, unlike the prior estate tax that it effectively repealed and replaced, the “tax imposed under this chapter is independent of any federal estate tax obligation and is not affected by the termination of the federal estate tax.” Laws of 2005, ch. 516, § 3 (codified at RCW 83.100.040(3)). The Act imposes a new and additional tax burden on estates above and beyond what the federal estate tax imposes. The amount of the new stand-alone estate tax is determined by the Legislature, not by Congress. It is no longer a revenue sharing device based on an artificial formula. It is independently calculated based on assets actually included in the Washington taxable estate and independently applied. The Act is not a mere amendment of the prior state estate tax nor a mere change in the manner in which the estate tax is calculated. The entire nature of the tax was changed.

DOR has acknowledged that the stand-alone estate tax that was adopted on May 17, 2005, is a new tax scheme. In explaining the purpose for proposing rules in December 2005, DOR wrote “[n]ew estate tax rules

are needed to implement *the new Washington estate tax* that became effective May 17, 2005. . . . *The new rules clarify the nature of the new tax*, property subject to the tax, the Washington qualified terminable interest property election, the new method of estate tax apportionment, filing dates, refunds, the new farm deduction, and escheat estates and absentee distributee property.” CP 929.

Even if, however, the new state estate tax act is merely an amendment of the prior state estate tax, it still may not be applied retroactively. Statutory amendments are presumed to be prospective in application. *In re Martin*, 129 Wn. App. 135, 144, 118 P.3d 387 (2005). This presumption can be overcome only by showing that (1) the Legislature intended the amendment to apply retroactively; (2) the amendment is curative; or (3) the amendment is remedial. *Id.* at 144. A remedial amendment relates to practice, procedure or remedies and does not affect a substantive or vested right. *Miebach v. Colasurdo*, 102 Wn.2d 170, 181, 685 P.2d 1074 (1984). A curative amendment clarifies or technically corrects ambiguous statutes. *State Farm Bureau Fed'n v. Gregoire*, 162 Wn.2d 284, 303, 174 P.3d 1142 (2007).

Here, the Act states expressly that it is to be applied prospectively only, and not retroactively. Laws of 2005, ch. 516, § 20. The new Washington estate tax does not relate to practice, procedure or remedies.

It does not clarify or correct an ambiguous statute. It is neither remedial nor curative. In fact, it is a substantive change to Washington's taxation of property upon death. DOR's attempt to impose the new estate tax on Jim's trust affects the vested rights of the remainder beneficiaries.

Accordingly, the trial court erred in finding that the Act did not establish a new state estate tax and upholding DOR's retroactive application of the new estate tax to the property held in Jim's QTIP trust.

**F. Retroactive Application of the New State Estate Tax is Unconstitutional**

Application of the Washington estate tax to property (1) held in an irrevocable QTIP trust created prior to May 17, 2005, and (2) that was never previously subject to the stand-alone Washington estate tax is not only contrary to the Legislature's express intent, but constitutes a retroactive application of the tax in violation of both the Impairment Clauses<sup>7</sup> and Due Process Clauses<sup>8</sup> of the United States and Washington State Constitutions. A retroactive statute is unconstitutional when it takes away or impairs vested rights acquired under existing laws. *Martin*, 129 Wn. App. at 145 (quoting *I.N.S. v. St. Cyr*, 533 U.S. 289, 321,

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<sup>7</sup> Article I, Section 10 of the United States Constitution provides that "[n]o state shall . . . pass any bill of attainder, ex post facto law, or law impairing the obligation of contracts." Article I, Section 23 of the Washington State Constitution provides that "[n]o bill of attainder, ex post facto law, or law impairing the obligations of contracts shall ever be passed."

<sup>8</sup> The 14th Amendment to the United States Constitution and Article I, Section 3 of the Washington State Constitution provide in essential part that "[n]o person shall be deprived of life, liberty or property without due process of law."

121 S. Ct. 2271, 150 L. Ed. 347 (2001)); *Gregoire*, 162 Wn.2d at 304-05 (Legislature may not give an amendment retroactive effect where the effect would be to interfere with vested rights). Vested rights are entitled to due process protections from subsequently enacted legislation. *Id.* at 305. A vested right entitled to protection from legislation must be something more than a mere expectation based upon an anticipated continuance of the existing law; it must have become a title, legal or equitable to the present or future enjoyment of property. *Id.* (quoting *Lawson v. State*, 107 Wn.2d 444, 455, 730 P.2d 1038 (1986)).

The Legislature may not interfere with or divest estates which have already become vested through the death of the testator. *Strand v. Stewart*, 51 Wn. 685, 687-88, 99 P. 1027 (1909). An interest in an estate vests in the heir or devisee entitled thereto immediately upon the death of the ancestor, subject only to the right of creditors. *In re Verchot's Estate*, 4 Wn.2d 574, 582, 104 P.2d 490 (1940); *see also In re Estate of Burns*, 131 Wn.2d 104, 118 n.4, 928 P.2d 1094 (1997) (recognizing that heirs' rights vest upon testator's death). The rights of the remainder beneficiaries of the QTIP trust vested at the time of Jim's death, some 20 years before Sharon died.

1. Retroactive Taxation Violates the Impairment Clauses

Applying the Act to Jim's irrevocable QTIP trust violates the Impairment Clauses of both the United States and Washington State Constitutions. The Impairment Clause treats trusts like any other contract in its application. In *Coolidge v. Long*, 282 U.S. 582, 605, 51 S. Ct. 306, 75 L. Ed. 562 (1931), the United States Supreme Court stated that:

We conclude that the succession was complete when the trust deeds of Mr. and Mrs. Coolidge took effect, and the enforcement of the statute imposing the excise tax in question would be repugnant to the contract clause of the Constitution and the due process clause of the Fourteenth Amendment.

This Court followed *Coolidge* in *In re McGrath's Estate*, 191 Wn. 496. There, McGrath Candy Company purchased two life insurance policies before the Legislature enacted a law subjecting life insurance proceeds to Washington's then existing inheritance tax. *Id.* at 497-98. This Court held that taxing the insurance proceeds was an unconstitutional impairment of the insurance contracts under both the federal and state constitutions.

In formulating its holding, this Court noted that in *Coolidge* the remainder beneficiaries' right to take the trust property upon their parents' deaths arose and vested in them when the Coolidges created the trust. *Id.*

at 508. By analogy the Court found that McGrath Candy Company's right to take the proceeds of the life insurance arose and vested in the company when it executed the insurance contracts. *Id.* Any subsequent statute that attempted to tax the insurance proceeds would, if enforced, impair the company's contractual rights because the company would receive less than it was entitled to receive under the terms of the contract. *Id.* at 508-09; see also *Blodgett v. Holden*, 275 U.S. 142, 147, 276 U.S. 594, 48 S. Ct. 105, 72 L. Ed. 206 (1927) (assessing a tax upon gifts completed before effective date of gift tax was unconstitutional and wholly unreasonable).

DOR's imposition of the Washington estate tax on Jim's irrevocable QTIP trust is an unconstitutional impairment of the rights arising from that trust. The trust arose, and the property subject to the trust vested in the remainder beneficiaries prior to the enactment of the new stand-alone Washington estate tax. From the date the trusts were created they were irrevocable contracts within the meaning of the state and federal constitutions. To apply the later-enacted Washington estate tax to these trusts would impair the rights of the trusts' beneficiaries in contravention of the Impairment Clauses of the federal and state constitutions.

2. Retroactive Taxation Violates the Due Process Clauses

Not only does the imposition of the Washington estate tax on Jim's QTIP trust violate the Impairment Clauses, it violates the Due Process Clauses of the United States and Washington State Constitutions. In *Coolidge*, the Supreme Court held that the retroactive application of a taxing statute violates the Due Process Clause because the remainder beneficiaries are deprived of their property without due process of law. 282 U.S. at 605. Likewise, under Washington law, "[a] retroactive law violates due process when it deprives an individual of a vested right." *State v. Varga*, 151 Wn.2d 179, 195, 86 P.3d 139 (2004) (internal quotation marks and citation omitted). Retroactive laws allow the legislature "to sweep away settled expectations suddenly and without individualized consideration." *Landgraf v. USI Film Prods.*, 511 U.S. 244, 266, 114 S. Ct. 1483, 128 L. Ed. 2d 229 (1994). Applying the new Washington estate tax to Jim's QTIP trust, which was irrevocable before the enactment of the Act, deprives the beneficiaries of the trust their property rights without due process, which is prohibited by both the federal and state constitutions.

The United States Supreme Court declines "to give retroactive effect to statutes burdening private rights unless Congress had made clear its intent." *Id.* at 270. Where a statute "expressly prescribe[s] the statute's

proper reach,” however, “there is no need to resort to judicial default rules.” *Id.* at 280. In a recent case dealing with a state B&O tax exemption, a majority of this Court found persuasive the argument that a state cannot impose tax on someone based upon the actions of another person whose actions are beyond the taxpayer’s control. *Dot Foods, Inc. v. Dep’t of Revenue*, 166 Wn.2d 912, 923, 215 P.3d 185 (2009). The Court agreed that such a holding is required by the Due Process Clauses of both the United States and Washington State Constitutions. *Id.* Here DOR seeks to tax Sharon’s estate based on the transfer of property by Jim’s estate which was beyond Sharon’s control.

The sole constitutional case on which DOR has relied, *United States v. Carlton*, 512 U.S. 26, 31-32, 114 S. Ct. 2018, 129 L. Ed. 2d 22 (1994), relates only to the federal due process standard and is irrelevant to the Impairment Clauses of the United States or Washington State Constitutions. The due process standard set forth in *Carlton* applies only where a legislature specifically has provided for retroactive application of a statute. *Id.* at 30-32 (“Provided that the retroactive application of a statute is supported by a legitimate legislative purpose furthered by rational means, *judgments about the wisdom of such legislation remain within the exclusive province of the legislative and executive branches.*”) (emphasis added) (internal citations and quotation marks omitted); *see*

*also Landgraf*, 511 U.S. at 280 (courts do not determine whether statute applies retroactively where the legislature “has expressly prescribed the statute’s proper reach”).

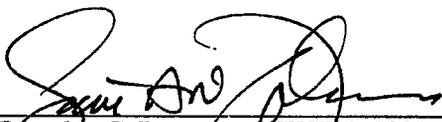
Nowhere in the Act did the Legislature include a provision that any aspect of the new stand-alone estate tax could be applied retroactively, nor did the Legislature articulate any statement of purpose that would support such retroactive application. Here, the Legislature did exactly the opposite: it expressly provided that the new Act is to be applied prospectively only. Laws of 2005, ch. 516, § 20. Thus, *Carlton* is inapplicable. Without question the retroactive application of the Washington estate tax violates the Due Process Clauses.

## VI. CONCLUSION

The 2006 Regulations plainly require Sharon’s estate to exclude Jim’s QTIP trust from Sharon’s Washington taxable estate. Those regulations apply to all estates of decedents dying after May 17, 2005, including Sharon’s estate. The 2006 Regulations are consistent with the new Act which applies to transfers by decedents and is to be applied prospectively only. They also are entirely consistent with the tax concepts associated with the marital deduction and QTIP trusts. Finally, if the new Act and the 2006 Regulations do not exclude Jim’s QTIP trust from Sharon’s taxable estate, they are unconstitutional.

Sharon Bracken's estate requests that this Court reverse the trial court's order granting summary judgment in favor of DOR and denying summary judgment in favor of Sharon's estate. Sharon's estate also requests that this Court enter summary judgment in it's favor and order DOR to refund the amount of estate tax Sharon's estate has paid attributable to Jim's QTIP trust, with interest. Costs on appeal should be awarded to the Estate.

Respectfully submitted this 30<sup>th</sup> day of April 2010.

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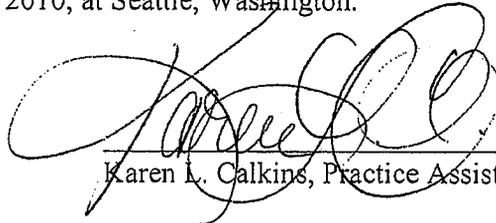
I hereby certify under penalty of perjury under the laws of the State of Washington that on the 30th day of April, 2010, I caused a true and correct copy of the foregoing document, "Brief of Appellants," to be delivered via email to the following counsel of record:

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Dated this 30th day of April, 2010, at Seattle, Washington.



Karen L. Calkins, Practice Assistant

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ORIGINAL

APPENDIX

WAC 458-57-105 (2006)

WAC 458-57-115 (2006)

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

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

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

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

(b) "Decedent" means a deceased individual;

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

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

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

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

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

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

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

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

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

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

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

**WAC 458-57-105 Nature of estate tax, definitions. (1)**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(i) **Funeral expenses.**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**Table W**

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

**(b) Examples.**

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

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

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

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

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

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

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

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Attached hereto please find the *Brief of Appellants*. Please let us know if you have any difficulty opening the attached document.

### **Karen Calkins**

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