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NO. 89419-1

SUPREME COURT OF THE STATE OF WASHINGTON

In re the Matter of the:

ESTATE OF HELEN M. HAMBLETON, Deceased.

STEVEN HAMBLETON in his capacity as personal representative of the Estate of Helen M. Hambleton,

Respondent,

v.

THE DEPARTMENT OF REVENUE OF THE STATE OF WASHINGTON,

Appellant.

APPELLANT'S REPLY BRIEF

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ORIGINAL

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I. INTRODUCTION

After the Supreme Court held in *Clemency v. State (In re Estate of Bracken)*, 175 Wn.2d 549, 290 P.3d 99 (2012), that Washington's estate tax statutes were not intended to apply to qualified terminable interest property ("QTIP") passing under Internal Revenue Code § 2044, the Legislature responded rapidly. Because *Bracken* would have eliminated over $160 million in estate tax revenue dedicated to education funding in the 2013-15 biennium, and would have allowed many large estates to escape taxation, the Legislature amended the relevant statutes to expressly provide that QTIP passing under section 2044 is subject to the Washington tax as to all estates of decedents dying on or after May 17, 2005. These amendments resolve this case.

The Hambleton estate ("Estate") raises a litany of arguments in an effort to avoid paying any Washington estate tax on QTIP passing at Ms. Hambleton's death. All fail. As explained below and in the Department's opening brief, the Washington estate tax code as amended by the 2013 Act applies to the Estate, and the Estate has not met its burden of proving beyond a reasonable doubt that the Act violates any constitutional provision. The Court should therefore uphold the 2013 Act.

II. ARGUMENT

A. The 2013 Act Applies To The Hambleton Estate.

The Estate contends that the 2013 Act does not apply in this case because the Estate had a "final judgment" in its favor prior to the date the

Act was passed. Resp. Br. at 11-13. That is incorrect. The Act does apply and requires reversal of the trial court judgment.

1. The trial court judgment was not final and was properly appealed by the Department.

The Estate incorrectly asserts that the 2013 Act does not apply to it because the order granting its motion for summary judgment was supposedly "a final unappealable judgment." Resp. Br. at 11. A "final judgment," however, is a judgment that ends all litigation, including appellate review, leaving nothing for the court to do but to execute the judgment. *Anderson & Middleton Lumber Co. v. Quinault Indian Nation*, 79 Wn. App. 221, 225, 901 P.2d 1060 (1995) (citing *Catlin v. United States*, 324 U.S. 229, 233, 65 S. Ct. 631, 89 L. Ed. 911 (1945)). Here, the order granting summary judgment to the Estate was not a final judgment because it was subject to appellate review under RAP 2.2(a)(1).

The Estate also contends that the Department filed a frivolous appeal solely for the purpose of delay. Resp. Br. at 12. When considering whether an appeal is frivolous, the court is guided by the following considerations: (1) An appellant has a right to appeal; (2) all doubt as to whether the appeal is frivolous should be resolved in favor of the appellant; (3) the record should be considered as a whole; (4) an appeal that is affirmed simply because the appellant's arguments are rejected is not frivolous; and (5) an appeal is frivolous only if there are "no debatable issues upon which reasonable minds might differ, and it is so totally devoid of merit that there was no reasonable possibility of reversal." *Streater v. White*, 26 Wn. App. 430, 434-35, 613 P.2d 187 (1980).

The Department's appeal was nowhere near frivolous. The Department argued in good faith and with citations and explanation that *Bracken* was incorrect, and "a good faith argument for a change in existing law" that is supported by authority is "not frivolous." *Intermountain Elec., Inc. v. G-A-T Bros. Const., Inc.*, 115 Wn. App. 384, 394, 62 P.3d 548 (2003) (citing *Morehouse v. Goodnight Bros. Constr.*, 77 Wn. App. 568, 574, 892 P.2d 1112 (1995)). That *Bracken* had so recently been decided did not render the Department's argument frivolous, as this Court has previously reversed very recent decisions. *See, e.g.*, *State v. Berlin*, 133 Wn.2d 541, 547, 947 P.2d 700 (1997) (overruling *State v. Lucky*, 128 Wn.2d 727, 912 P.2d 483 (1996)).

2. The trial court judgment should be reversed.

The order granting summary judgment to the Estate should be reversed. Under the Washington estate tax code as amended by the 2013 Act, it is the Department that is entitled to summary judgment.

a. *Bracken* is not controlling in this appeal.

Prior to the 2013 amendment to the Washington estate tax statutes, this Court in *Bracken* held that the Legislature did not intend to include QTIP in the Washington estate tax computation when it amended the tax in 2005 to change from a pick-up tax to a stand-alone tax. *Bracken*, 175 Wn.2d at 570-71. As part of its analysis, the Court reasoned that the real transfer of QTIP occurs when the first spouse dies and his or her estate elects to claim the QTIP deduction under Internal Revenue Code § 2056(b)(7). *Bracken*, 175 Wn.2d at 572-74. The Court considered the transfer occurring at the death of the second spouse, when the spouse's life estate is extinguished and the property passes to the remainder beneficiaries under Internal Revenue Code § 2044, as merely a "deemed" or "fictional" transfer created by Congress. *Id.* The Court then held that the Legislature intended to tax only real transfers. *Id.* at 574.

Although constitutional considerations informed the Court's analysis, it rested its holding solely on statutory construction grounds, *see, e.g., id.* at 571, expressly declining to address the estates' constitutional arguments, *id.* at 563, 575. Thus, *Bracken* did not establish a constitutional barrier prohibiting the Legislature from imposing estate tax on QTIP passing under Internal Revenue Code § 2044. Instead, the Court ruled as a matter of statutory interpretation that the federal definition of "taxable estate," which includes the value of QTIP passing when the second spouse dies, "cannot be used without a modification necessary to conform to the [2005] Act: the definition must be read to exclude items that are not transfers." *Id.*

The *Bracken* decision caused great concern in the Legislature because of its impact on education funding and its creation of a means for married couples with large estates to avoid Washington estate tax. Taxes collected from the Washington estate tax are deposited into the Education Legacy Trust Account and are used to support K-12 public schools and institutions of higher education. *See* RCW 83.100.220, .230. The fiscal impact of *Bracken* was estimated to be a loss of approximately $160.3 million in the 2013-2015 biennium alone. *See* Fiscal Note for EHB 2075.

On June 13, 2013, the Legislature addressed the fiscal and tax policy issues *Bracken* raised by amending the Washington estate tax to make clear that the tax *does* apply to QTIP passing at the death of the second spouse. Laws of 2013, 2d Spec. Sess., ch. 2. The Legislature made three significant amendments relevant to this appeal.

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

Second, the Legislature amended the definition of "Washington taxable estate" to expressly include QTIP in the tax base. Laws of 2013, 2d Spec. Sess., ch. 2, § 2. Thus, the Washington taxable estate of a resident decedent includes "the value of any property included in the gross estate under section 2044 of the internal revenue code." *Id.* at § 2(14).

Finally, the Legislature amended RCW 83.100.047 to repudiate administrative rules issued in 2006 that inadvertently permitted a deduction of QTIP passing under Internal Revenue Code § 2044 by the estate of the second spouse to die. *Id.* at § 5.[1] As amended, RCW 83.100.047 permits a deduction for QTIP passing at the death of the second spouse under Internal Revenue Code § 2044 *only* when the estate of the first spouse to die made a separate Washington QTIP election. *See id.* (creating new subsection 83.100.047(3)(b) to permit the second spouse to die to deduct federal QTIP and add the amount of the Washington QTIP if the estate of the first spouse to die made a Washington QTIP election). Because Helen Hambleton's predeceased husband did not make a separate Washington QTIP election, the deduction authorized by RCW 83.100.047(3)(b) does not apply here.

The Legislature made these provisions of the 2013 Act retroactive to "all estates of decedents dying on or after May 17, 2005." *Id.* at § 9. These key amendments closed the QTIP loophole by defining "transfer" and "Washington taxable estate" to expressly include QTIP passing under Internal Revenue Code § 2044 in the Washington taxable estate and to permit a deduction only when the estate of the first spouse to die makes a separate Washington QTIP election.

As explained more fully below, the 2013 Act's changes to the Washington estate tax code are constitutional and controlling. *See*

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[1] The Department's 2006 estate tax rules were not artfully drafted and, as interpreted in *Bracken*, allowed a deduction for QTIP passing under Internal Revenue Code § 2044 even when no separate Washington QTIP election was made. *Bracken*, 175 Wn.2d at 571 n.5 (discussing former WAC 458-57-105(3)(q) and -115(2)(d)). The Department amended the rules in 2009 to correct the error. Wash. St. Reg. 09-04-008 (effective February 22, 2009).

Washington State Farm Bureau Fed'n v. Gregoire, 162 Wn.2d 284, 304, 174 P.3d 1142 (2007) (the legislature may pass a law that directly impacts a case pending in Washington courts); *Haberman v. Wash. Pub. Power Supply Sys.*, 109 Wn.2d 107, 143-44, 744 P.2d 1032, 750 P.2d 254 (1987) (same). Under the plain language of the amended estate tax code, the Estate cannot exclude QTIP from its taxable estate and owes Washington tax on the value of QTIP passing at Ms. Hambleton's death.

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

In *Bracken* this Court expressly declined to address the estates' constitutional arguments. However, part of the Court's reasoning was clearly based on constitutional limits that apply to "direct taxes" but not estate or excise taxes. *Bracken*, 175 Wn.2d at 564-66 (discussing limits imposed on the taxing authority of Congress under U.S. Const. art. I, § 9, cl. 4 and concluding that "[i]f estate taxation cannot be tied to a transfer, it fails as an un-apportioned (and therefore unconstitutional) direct tax").[2] Before proceeding to the other issues raised by the Estate, the Court may want to satisfy itself that taxing QTIP passing under Internal Revenue Code § 2044 does not violate any constitutional limitations. For the reasons discussed below, this inquiry need not distract the Court for long.

[2] Article I, section 9, of the United States Constitution imposes specific limits on the power of Congress and provides in relevant part that Congress may not impose a "capitation, or other direct, tax . . . unless in proportion to the census or enumeration hereinbefore directed to be taken." It has long been held that the federal estate tax is not a "direct tax" within the meaning of Article I, section 9, because the tax applies to the transfer of property at death, not to the property itself. *Knowlton v. Moore*, 178 U.S. 41, 20 S. Ct. 747, 44 L. Ed. 969 (1900).

Congress and the States have broad power to determine by statute when a transfer subject to an un-apportioned estate tax occurs. Taxing QTIP passing under Internal Revenue Code § 2044 does not exceed this broad constitutional authority.

It is well-established that Congress has "wide latitude in the selection of objects of taxation" and may include within the federal estate tax base property that was not formally conveyed upon the death of the decedent. *Fernandez v. Wiener*, 326 U.S. 340, 352, 66 S. Ct. 178, 90 L. Ed. 116 (1945). Formal distinctions based on the law of real property are "irrelevant criteria in this field of [estate] taxation." *Helvering v. Hallock*, 309 U.S. 106, 111, 60 S. Ct. 444, 84 L. Ed. 604 (1940). Ownership of the property by the decedent is not constitutionally required so long as the decedent had some economic interest in the property that passes at death.

The constitutional authority to impose an estate tax on the transfer of property that the decedent did not own was expressly recognized in *Wiener*. That case involved a 1942 amendment to the federal estate tax whereby the value of community property, including the surviving spouse's community interest, was included in the gross estate of the first spouse to die. *Wiener*, 326 U.S. at 342. The heirs of a Louisiana resident decedent challenged the 1942 amendment, arguing that inclusion of the surviving wife's community property interest in the gross estate of the deceased husband imposed an unconstitutional "direct tax" and also violated due process. *Id.* at 342-43. According to the heirs, the 1942 amendment that taxed the entire value of the community property on the death of either spouse was "a denial of due process because the death of neither operates to transfer, relinquish or enlarge any legal or economic interest in the property of the other spouse." *Id.* at 346.

In rejecting the heirs' constitutional claims, the Court held that Congress has broad authority to define the taxable event upon which the estate tax is imposed and to determine by statute what property interests shall be included in the taxable estate of a decedent. *Id.* at 352-54. Relying on earlier precedent, the Court explained that an indirect estate tax may be imposed on the "shift in economic interest" in property that is brought about by death. *Id.* at 354 (citing *Whitney v. State Tax Comm'n*, 309 U.S. 530, 60 S. Ct. 635, 84 L. Ed. 909 (1940)). So long as there is a transfer of some interest in property occasioned by death, Congress may impose an un-apportioned estate tax on the full value of the property passing at death. Accordingly, Congress had the authority to include in the tax base of the first spouse to die the value of the surviving spouse's community property because the death of the first spouse, by ending the marital community, brings into being new powers and control over the surviving spouse's community property. *Id.* at 355-56.

The Court also rejected the heirs' due process arguments, explaining that the "cessation" of the deceased husband's powers over property "which he never 'owned', and the establishment in the wife of new powers of control over her share [of the community property], though it was always hers, furnish appropriate occasions for the imposition of an excise tax." *Id.* at 355. In addition, the fact that the surviving wife's community property interest was created and vested prior to the enactment of the 1942 amendment did not offend due process. *Id.* In short, including the full value of the surviving spouse's share of community property in the gross estate of the first spouse to die infringed upon no constitutional provision. *Id.* at 362.

The authority to tax as a "transfer" the passing of any economic interest in property extends to the States. As explained in *Whitney v. State Tax Comm'n*, 309 U.S. 530, 60 S. Ct. 635, 84 L. Ed. 909 (1940), state estate taxes are "not confined" to the passing of property "'owned' by a decedent before death, nor even to that over which he had an unrestricted power of testamentary disposition." *Id.* at 538. Rather, "[i]t is enough that one person acquires economic interest in property through the death of another person, even though such acquisition is in part the automatic consequence of death . . . ." *Id.* The Court in *Whitney* also explained that "[a] person may by his death bring into being greater interests in property than he himself has ever enjoyed," and the state having power to impose an estate or inheritance tax may include the full value of the property in the measure of the tax. *Whitney*, 309 U.S. at 539-40.

Over the past seventy years the U.S. Supreme Court has consistently upheld the power of Congress and state legislatures to direct by statute what property will be included in the taxable estate of a decedent. *See, e.g.*, *West v. Oklahoma Tax Comm'n*, 334 U.S. 717, 68 S. Ct. 1223, 92 L. Ed. 1676 (1948); *Commissioner v. Church's Estate*, 335 U.S. 632, 69 S. Ct. 322, 93 L. Ed. 288 (1949); *United States v. Mfrs. Nat'l*

Bank of Detroit, 363 U.S. 194, 198-200, 80 S. Ct. 1103, 4 L. Ed. 2d 1158 (1960). These cases all recognize that a "transfer" in the constitutional sense is a broad and flexible concept, and an estate tax will withstand constitutional scrutiny "if there was a transfer of economic benefit, use, enjoyment or control [of property] at death." 1 Jacob Mertens, *The Law of Federal Gift and Estate Taxation*, § 1.04 at 9-10 (1959) (footnote omitted).[3] It is thus well settled that an estate tax is not constitutionally restricted to the passing of property from the decedent to the transferee. Instead, Courts have narrowed the inquiry to two factors: Whether the decedent had an interest in property at death, and whether the decedent's death was "the generating source of definite accessions to the survivor's property rights." *Id.* at 11. "No formal transfer of title from the decedent to the transferee is required; a mere shifting of the economic benefits of the property may be the real subject of the tax." *Id.* at 10; *see also* 42 Am. Jur. 2d *Inheritance, Estate, and Gift Taxes* § 1 (2013) (the taxable incident of "death taxes" is the "shifting of the enjoyment of property, the economic benefits thereof or economic interests therein").

The passing of QTIP under Internal Revenue Code § 2044 is a "transfer" in the constitutional sense. A QTIP trust creates a life estate for the benefit of the surviving spouse and a future interest in the assets for the remainder beneficiaries. The right to receive trust income is a valuable property interest that passes to the remainder beneficiaries at death of the

[3] Relevant portions of the Mertens treatise are attached as Appendix A.

income beneficiary. *Church's Estate*, 335 U.S. at 644-45. In the context of QTIP, when the second spouse dies and the life estate is extinguished, the remainder beneficiaries receive a present interest in the QTIP, including all the income generated by the property. Consistent with the U.S. Supreme Court cases cited above, Congress and the States are permitted to treat the shift in the economic benefit of QTIP occurring at the death of the second spouse as a "transfer" subject to estate tax. The Legislature has expressly exercised that power by passing the 2013 Act.

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

B. The 2013 Act Is Constitutional.

Just as taxing QTIP passing at the death of a second spouse to remainder beneficiaries is constitutional, it is also constitutional to apply the 2013 Act to the Estate. Statutes enacted by the Legislature are presumed constitutional, and a party seeking to invalidate a statute on constitutional grounds must establish that the provision is unconstitutional beyond a reasonable doubt. *Washington State Grange v. Locke*, 153 Wn.2d 475, 486, 105 P.3d 9 (2005). This presumption applies with equal force to both prospective and retroactive laws. *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 15, 96 S. Ct. 2882, 49 L. Ed. 2d 752 (1976).

1. The 2013 Act complies with substantive due process.

The Estate argues that the 2013 Act creates a "wholly new tax" on QTIP that may not be applied retroactively. Resp. Br. at 17-22. The Estate's argument fails because the Legislature did not create a wholly new estate tax and the Act satisfies the rational basis standard applied to retroactive tax legislation under the Due Process Clause.

a. The 2013 Act did not create a wholly new tax.

The Estate bases its "wholly new tax" theory on the false premise that the 2013 Act "seeks to impose a tax where no tax previously existed." Resp. Br. at 18. Contrary to this assertion, Washington has imposed an inheritance tax or estate tax since 1901. *See* Laws of 1901, ch. 55 § 1. In 1981 the Voters repealed and replaced the former inheritance tax with an estate tax. *See* Laws of 1981, 2d Ex. Sess., ch. 7. In 2005, the Legislature amended the manner in which the estate tax is computed, changing from a "pick-up" tax mechanism to a "stand-alone" tax calculation. *See* Laws of 2005, ch. 516. The tax was amended again in 2013 to close the QTIP loophole. But the change in the manner in which the estate tax is computed, and the creation or elimination of deductions or exemptions, does not equate to a "wholly new tax." *See, e.g., United States v. Carlton,* 512 U.S. 26, 34, 114 S. Ct. 2018, 129 L. Ed. 2d 22 (1994) (amendment to federal estate tax to close unintended loophole did not amount to a "wholly new tax"); *Quarty v. United States,* 170 F.3d 961, 966-67 (9th Cir. 1999) (amendment to federal gift tax did not amount to the creation of a wholly new tax, rejecting *Lochner*-era due process precedent).

The Estate's "wholly new tax" argument is reminiscent of the argument made and rejected in *Japan Line, Ltd. v. McCaffree*, 88 Wn.2d 93, 558 P.2d 211 (1977). In that case, lessors of public port space argued that retroactive application of a newly enacted leasehold excise tax violated due process because it was a "novel" tax that had never been imposed before. The statute at issue imposed an excise tax on the privilege of occupying or using publicly owned property, and applied in lieu of property tax. *Id.* at 95. This Court explained that retroactive application of the tax was permissible so long as the tax had a legitimate government purpose and was not "novel in character." *Id.* at 97.[4] The Court had no trouble concluding that the excise tax was constitutional and

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[4] *Japan Line* was decided prior to *Carlton* and *W.R. Grace & Co. v. Dep't of Revenue*, 137 Wn.2d 580, 602-03, 973 P.2d 1011 (1999), and applied the due process analysis set out in *Bates v. McLeod,* 11 Wn.2d 648, 120 P.2d 472 (1941). *Id.* at 96. But even though the due process analysis in *Japan Line* has been superseded by *Carlton* and *W.R. Grace*, the Court's holding still undercuts the Estate's "wholly new tax" argument.

could be applied retroactively. While the form of the tax was new, "the subject matter had previously been taxed. Therefore, petitioners' contention that the tax is 'novel' is not supported by the facts." *Id.* at 98.

Like the leasehold excise tax in *Japan Line*, the Washington estate tax as applied to QTIP is not novel. QTIP was subject to the Washington pick-up tax from 1981, when Congress enacted the federal QTIP provisions and the voters enacted the pick-up tax, until 2005, when the pick-up tax was completely phased out as a result of the Economic Growth and Tax Relief Reconciliation Act of 2001. This was so because the pick-up tax was equal to the federal death tax credit allowed under Internal Revenue Code § 2011. *See* former RCW 83.100.030(1) (2004) ("A tax in an amount equal to the federal credit is imposed on every transfer of property of a resident."). The amount of the credit was based on the "adjusted taxable estate of the decedent," which was equal to the decedent's "taxable estate" less $60,000. *See* I.R.C. § 2011(b)(1) (defining adjusted taxable estate). The decedent's "taxable estate" included QTIP passing under Internal Revenue Code § 2044. *See* I.R.C. § 2051.. Consequently, QTIP passing under section 2044 made up part of the tax base upon which the pick-up tax was computed.

The treatment of QTIP under the former pick-up tax is no different from the treatment under the stand-alone estate tax as amended by the 2013 Act. QTIP deducted by the estate of the first spouse to die under Internal Revenue Code § 2056(b)(7) was (and is) excluded from the tax base used to compute the Washington tax, while QTIP passing under

Internal Revenue Code § 2044 was (and is) included in the tax base used to compute the Washington tax. As in *Japan Line*, "the subject matter had previously been taxed. Therefore, [the] contention that the tax is 'novel' is not supported by the facts." *Japan Line*, 88 Wn.2d at 98.

The Estate's reliance on *Lochner*-era cases to support its due process argument is also misguided. *See* Resp. Br. at 18-19. Under *Carlton*, retroactive tax legislation satisfies due process when it is "supported by a legitimate legislative purpose furthered by rational means." *Carlton,* 512 U.S. at 30-31 (quoting *Pension Benefit Guaranty Corporation v. R.A. Gray & Co.*, 467 U.S. 717, 729-30, 104 S. Ct. 2709, 81 L. Ed. 2d 601 (1984)). The Court expressly rejected the cases the Estate relies on, explaining that those cases "were decided during an era characterized by exacting review of economic legislation" under an approach that "has long since been discarded." *Id.* at 34 (discussing *Nichols v. Coolidge*, 274 U.S. 531, 47 S. Ct. 710, 71 L. Ed. 1184 (1927); *Blodgett v. Holden*, 275 U.S. 142, 48 S. Ct. 105, 72 L. Ed. 206 (1927); and *Untermyer v. Anderson*, 276 U.S. 440, 48 S. Ct. 353, 72 L. Ed. 645 (1928)). To the extent their authority survives, it is not applicable in circumstances where, as here, an existing tax statute is amended to close an unintended loophole.

b. The 2013 Act meets the due process standard applied in *Carlton* and *W.R. Grace.*

As explained in the Department's opening brief, the 2013 Act complies with substantive due process because the Act had a legitimate purpose furthered by rational means. App. Br. at 19-24. The Legislature amended the estate tax code at its first opportunity in order to fix the significant loophole recognized by *Bracken*. Furthermore, it was rational for the Legislature to amend the estate tax code retroactively to May 17, 2005, because that was the effective date of the stand-alone estate tax. By amending the estate tax retroactively to May 17, 2005, the Legislature ensured that the tax loophole would be closed for all estates. A shorter period of retroactivity would have been irrational because it would have permitted some estates, but not others, to benefit from the QTIP loophole. *See Montana Rail Link, Inc. v. United States*, 76 F.3d 991, 994 (9th Cir. 1996) (seven-year retroactive period was rational and a shorter period "would have been arbitrary and irrational" under the circumstances).

In addition, the Legislature did not impermissibly target any estates when it passed the 2013 Act. There is no question that the Legislature was concerned with the unexpected fiscal impact of the *Bracken* decision and that it acted swiftly to close the unintended loophole. But closing a loophole that could have been exploited by the estate of Helen Hambleton and by other estates is not the type of "targeting" that could raise due process concerns. Otherwise, the Legislature would be powerless to retroactively close any tax loophole because, in every case, some taxpayer would have been able to exploit the loophole but for the retroactive amendment.

Finally, the U.S. Supreme Court's decision in *Carlton* refutes the notion that the constitutionality of retroactive tax legislation is impacted by a taxpayer's detrimental reliance on the former law, or his lack of notice that the law might change. *Carlton*, 512 U.S. at 33-34. As a result, the Estate's claim that "[t]he Hambletons had no . . . constructive notice that the value of property transferred to the Marital Trust" would be subject to Washington estate tax when Ms. Hambleton died, is of no constitutional significance. *See* Resp. Br. at 21. "Tax legislation is not a promise," and the Estate is not immune from paying Washington estate tax merely because no tax would have applied under the prior law. *Carlton*, 512 U.S. at 33.

2. The 2013 Act complies with separation of powers.

In addition to being a rational means of achieving a legitimate purpose, the 2013 Act satisfies separation of powers principles. The separation of powers doctrine is grounded in the notion that "each branch of government has its own appropriate sphere of activity," and seeks to ensure that "the fundamental functions of each branch remain inviolate." *Hale v. Wellpinit Sch. Dist. No. 49*, 165 Wn.2d 494, 504, 198 P.3d 1021 (2009). The 2013 Act is consistent with this doctrine. Section 10 of the Act provides that it "does not affect *any final judgments, no longer subject to appeal*, entered by a court of competent jurisdiction before the effective date of this section." Laws of 2013, 2d Spec. Sess., ch. 2, § 10 (emphasis added). Thus, the amended law preserved the final judgments entered in *Bracken*, and any other final judgment entered prior to June 14, 2013.

Applying the amended law to the transfer of QTIP occurring at the death of Helen Hambleton does not threaten the independence or integrity of the judicial branch by dictating how a court should determine an issue of fact. Instead, the Legislature "acted wholly within its sphere of authority to make policy, to pass laws, and to amend laws already in effect" when it passed the retroactive fix to the Washington estate tax. *Hale*, 165 Wn.2d at 509. The Legislature did not "reverse" or "annul" the Supreme Court's decision in *Bracken*. Instead, it changed the statutory definitions of "transfer" and "Washington taxable estate" to ensure that QTIP passing under Internal Revenue Code § 2044 will not escape the Washington tax. Enacting laws and determining tax policy clearly are within the "appropriate sphere of activity" of the legislative branch, and the 2013 Act was a valid exercise of legislative power.

It is of no constitutional significance that the Legislature amended a statute that had been previously construed in *Bracken*. It is well settled that the Legislature does not violate the separation of powers doctrine when it amends a previously construed statute. *Lummi Indian Nation v. State*, 170 Wn.2d 247, 262, 241 P.3d 1220 (2010); *Hale*, 165 Wn.2d at 509-10. If the Legislature is careful not to attempt to "overrule" a final judgment, there is no reason why it cannot retroactively amend a statute to affirmatively change the law. To conclude otherwise would likely violate separation of powers because the judicial branch would be invading the sphere of authority of the legislative branch to make policy, pass laws, and to amend laws already in effect. *Lummi*, 170 Wn.2d at 262.[5]

[5] A few Court of Appeals decisions have suggested that while the Legislature may "amend" the meaning of a statute that has been previously construed by the courts it cannot "clarify" such a statute. *See, e.g.*, *State v. Mann*, 146 Wn. App. 349, 358, 189 P.3d 843 (2008) (citing *Marine Power & Equip. Co. v. Human Rights Comm'n Hearing Tribunal*, 39 Wn. App. 609, 615 n.2, 694 P.2d 697 (1985)). However, this Court in *Hale* strongly suggested that this analysis is incorrect. *See Hale*, 165 Wn.2d at 508 ("The legislature has expressed its intent unequivocally" and the nature of the legislation,

Finally, the Estate's claim that the 2013 Act interferes with a judicial function by making "judicial determinations" is without merit. *See* Resp. Br. at 31-32. Separation of powers does not prohibit the legislative branch from defining terms or from incorporating terminology developed by the federal courts. More importantly, nothing in the 2013 Act interferes with the ability of the judicial branch to make judicial decisions as to the meaning of the term "transfer" under the federal estate tax code. What the 2013 Act does is to define the term "transfer" broadly to encompass more than just "real" transfers recognized under state property law or common law. The Washington estate tax as amended also applies to "deemed" or "fictional" transfers so long as there is a "transfer" of property in the constitutional sense. The Department believes that the weight of authority supports its assertion that Congress and the Legislature can constitutionally tax QTIP passing at the death of the second spouse. *See* discussion *supra* at pages 7-12. But the judiciary retains the ultimate responsibility to determine whether QTIP passing under Internal Revenue Code § 2044 is a "transfer" that may constitutionally be taxed, and nothing in the 2013 Act interferes with that judicial function.

The 2013 Act amended the Washington estate tax code by changing the statutory definitions of "transfer" and "Washington taxable

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whether it was clarifying, restorative, curative, or remedial, is "unhelpful in analyzing the separation of powers issue"). In any event, the 2013 Act amended the Washington estate tax code to expressly provide that QTIP passing under section 2044 is subject to the Washington tax as to all estates of decedents dying on or after May 17, 2005. This was not a clarification of existing law, and the 2013 Act would be consistent with separation of powers principles even under those Court of Appeals cases decided before *Hale*.

estate." In making these changes, the Legislature did not invade the province of the judiciary by overruling any final judgment or by making judicial determinations about the meaning or constitutionality of the amended law. Under the analysis in *Lummi* and *Hale*, the 2013 Act does not violate separation of powers principles.

3. The 2013 Act does not violate the Contracts Clause.

The Estate's claim that the 2013 Act violates the Contracts Clause is also unfounded. Resp. Br. at 33. Article I, section 10 of the United States Constitution provides in part that "No state shall . . . pass any . . . law impairing the obligation of contracts." The Washington constitution contains a similar, coextensive prohibition. Const. art. I, § 23; *Tyrpak v. Daniels*, 124 Wn.2d 146, 151, 874 P.2d 1374 (1994).

The Contracts Clause "is applicable only if the legislative act complained of impairs a contractual relationship." *Haberman*, 109 Wn.2d at 145. Moreover, the Contracts Clause "does not prohibit the states from repealing or amending statutes generally, or from enacting legislation with retroactive effects." *Id.* (citing *United States Trust Co. v. New Jersey*, 431 U.S. 1, 17, 97 S. Ct. 1505, 52 L. Ed. 2d 92 (1977)). As to "private contracts," the Contracts Clause requires only that the legislation under attack was "reasonably necessary" to achieve a legitimate public purpose. *Carlstrom v. State*, 103 Wn.2d 391, 394, 694 P.2d 1 (1985). Accordingly, the 2013 Act passes scrutiny under the Contracts Clause unless the Estate can prove that a private contractual relationship existed and that any impairment to that contract served no rational public purpose. *Ketcham v.*

King County Medical Serv. Corp., 81 Wn.2d 565, 570, 502 P.2d 1197 (1972).

Applying this test here, there is no constitutional violation. This Court has held that the Contracts Clause applies only to a contract "in the usual sense" of that word, i.e., "an agreement of two or more minds, upon sufficient consideration, to do or not to do certain acts." *Caritas Servs., Inc. v. Dep't of Soc. & Health Servs.*, 123 Wn.2d 391, 403, 896 P.2d 28 (1994) (internal quotations and citation omitted). Here, the QTIP trust created under Mr. Hambleton's will was not an "agreement of two or more minds, upon sufficient consideration." Instead, the trust was created to accomplish a testamentary gift. And the beneficiaries of the trust were certainly not parties to any "contract" because the beneficiaries made no promise supported by consideration. Moreover, tax legislation is not a promise, and the beneficiaries of the QTIP trust had no contractual right to the continuation of the Washington estate tax laws as they existed in 2005 when Floyd Hambleton died. The Estate fails the first element.

Even if the Estate could show a contractual relationship existed, it has shown no impairment. The Estate's sole complaint is that it is no longer permitted to avoid Washington estate tax on the value of QTIP passing to the remainder beneficiaries. Resp. Br. at 34. However, applying a tax to a transaction that previously might have escaped taxation is insufficient to establish impairment of a private contract. *Cf.*, *Exxon Corp. v. Eagerton*, 462 U.S. 176, 192-93, 103 S. Ct. 2296, 76 L. Ed. 2d

(1983) (state law prohibiting oil and gas producers from passing a tax increase on to their purchasers did not substantially impair contract rights).

Finally, even if the 2013 Act did impair a contract right, the Estate's claim would still fail because that Act served a rational public purpose—to close an unintended tax loophole that would have resulted in a significant drain on education funding. *See* Laws of 2013, 2d Spec. Sess., ch. 2, § 1. Providing dependable tax sources to fund education is one of the most important functions of government. *See* Const. art. IX, § 1. Because the 2013 Act served a rational public purpose, it does not violate the Contracts Clause. *Ketcham*, 81 Wn.2d at 570.

C. The Department Timely Assessed The Estate.

The Estate argues that the 2013 Act creates a wholly new tax that cannot be applied here as a result of the four-year statute of limitation for assessing unpaid estate taxes. Resp. Br. at 13-15 (citing RCW 83.100.095). The Estate is incorrect. As previously discussed, the 2013 Act did not create a wholly new tax. In addition, the Department is not required to issue another assessment to the Estate merely because the legislature amended the statute.

RCW 83.100.095(3) provides that the Department may not assess an estate for additional estate tax after four years from the end of the calendar year in which the estate tax return was due. The Department assessed the Estate for additional estate tax well within that four-year period. *See* CP 17, ¶ 7 (Estate filed its Washington estate tax return on

January 11, 2008); CP 12 (assessment issued to the Estate on December 12, 2008). The Estate was timely assessed.

The 2013 amendment to the Washington estate tax code does not require the Department to issue a new assessment. In the context of a contract dispute or a negligence case, a change in the underlying substantive law would not restart the statute of limitations or require a new claim to be brought. There is no legal or logical reason to apply a different rule here. The Department's claim that the Estate underpaid its Washington estate tax has not changed; it is just the substantive law that has changed. Similarly, if a taxpayer had timely filed a refund claim, the taxpayer would not have to file a new refund claim if the Legislature changed the substantive law. In short, a change to the substantive law does not require a new claim to be brought.

Because the Department issued the assessment asserting its claim against the Estate before the four-year statute of limitation had lapsed, the claim is timely. The Estate's argument to the contrary should be rejected.

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

The Estate requests an award of attorneys' fees under Civil Rule 11, RAP 18.9(a), and RCW 4.84.185. Resp. Br. at 38. This Court should deny the request. Civil Rule 11 does not apply in the appellate court. *See* CR 1. The appellate equivalent of CR 11 is RAP 18.9(a), which permits an award of attorneys' fees if, considering the entire record, "the court is convinced that the appeal presents no debatable issues upon which reasonable minds might differ" and "is so devoid of merit that there is no possibility of reversal." *Advocates for Responsible Dev. v. W. Wash. Growth Mgmt. Hearings Bd.*, 170 Wn.2d 577, 580, 245 P.3d 764 (2010). Similarly, RCW 4.84.185 permits an award of fees when the action "is one that cannot be supported by any rational argument on the law or facts." *Goldmark v. McKenna*, 172 Wn.2d 568, 582, 259 P.3d 1095 (2011).

In this case, the Department's appeal at the very least presents debatable issues, and the arguments presented are rational and supported by the law and the facts. Consequently, the Estate is not entitled to an award of attorneys' fees under CR 11, RAP 18.9(a), or RCW 4.84.185.

III. CONCLUSION

After considering this Court's decision in *Bracken* and the policy challenges it presented, the Legislature amended Washington's estate tax statutes to clearly impose the tax on QTIP passing under Internal Revenue Code § 2044. The Estate has failed to prove that any aspect of the Act is unconstitutional. This Court should therefore reverse the order granting the Estate's motion for summary judgment and remand the case with instructions to enter judgment for the Department.

Dated this 13th day of November, 2013.

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I certify under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 13th day of November, 2013, at Tumwater, WA.

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APPENDIX A

THE LAW OF FEDERAL GIFT AND ESTATE TAXATION

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IN SIX VOLUMES

VOLUME ONE

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

A. ESTATE AND GIFT TAXES AS INDIRECT TAXES

§ 1.02. ESTATE AND GIFT TAXES ARE IMPOSED ON THE PRIVILEGE OF TRANSFER. The modern estate and gift tax laws have been upheld as an excise tax on the privilege of transfer of property,[8]

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

[8] It is well settled that the federal estate tax is an excise tax requiring no apportionment, as is required where the statute imposes a direct tax on property. See Chase Nat'l Bank of City of N.Y., Ex'rs v. U.S., 278 U.S. 327, 49 S.Ct. 126, 73 L.Ed. 405 (1929), 7AFTR8844; Greiner, Exec. v. Lewellyn, 258 U.S. 384, 42 S.Ct. 324, 66 L.Ed. 676 (1922), 3AFTR3186; New York Trust Co., Ex'rs v. Eisner, 256 U.S. 345, 41 S.Ct. 506, 65 L.Ed. 963 (1921), 3AFTR3110. See also Mertens, LOFIT, § 4.08.

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

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

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

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

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

[10] Greiner v. Lewellyn, 258 U.S. 384, 42 S.Ct. 324, 66 L.Ed. 676 (1922), 3AFTR3186; U.S. Trust Co. of N.Y., Exec. v. Helvering, 307 U.S. 57, 59 S.Ct. 692, 83 L.Ed. 1104 (1939), 22AFTR327. See § 14.17.

In Landman v. Comm., 123 F(2d) 767 (10th Cir.1941), 28AFTR417, aff'g 42 BTA 958, cert.den. 315 U.S. 810, 62 S.Ct. 799, 86 L.Ed. 1209 (1942), the estate of a member of an Indian tribe granted certain tax exemptions was held subject to estate tax, since the latter fell "upon the transfer or shifting of the economic benefits and not upon the property of which the estate [was] composed." Consequently, there was not available in this instance "any constitutional immunity growing out of [agreements] between the United States and Creek Indian".

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

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

But compare Landman v. U.S., 71 F.Supp. 640 (Ct.Cl.1947), 35AFTR1331, erty.[11] The Supreme Court has said[12] that the power to impose estate taxes:

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

and that:

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

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

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

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

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

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

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

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

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

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

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

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

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

[16] See §§ 19.26, 28.17 discussing the "passing" requirement.

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

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

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

have been disregarded. The constitutionality of a federal taxing act is not dependent upon conformity with state law. If such were the case, then an admittedly constitutional federal act could be rendered unconstitutional by a subsequent state enactment.[21] None of the successful constitutional attacks on the federal estate and gift tax provisions cases affected the established freedom of Congress to ignore the local law of property in the absence of arbitrariness or capriciousness.[23] On the con-

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

[29] Tyler, Jr., Adm'rs v. U.S., supra. See also Foster, Exec. v. Comm., 90 F(2d) 486 (9th Cir.1937), 19AFTR864, aff'd 303 U.S. 618, 58 S.Ct. 525, 82 L.Ed. 1083 (1938), 19AFTR1266, per curiam, reh.den. 303 U.S. 667, 58 S.Ct. 748, 82 L.Ed. 1124 (1938); O'Shaughnessy, Exec. v. Comm., 60 F(2d) 235 (6th Cir.1932), 11AFTR788, cert.den. 288 U.S. 605, 53 S.Ct. 397, 77 L.Ed. 980 (1933); Comm. v. Emery, Exec., 62 F(2d) 591 (7th Cir.1932), 11AFTR1340, rev'g and remanding 21 BTA 1038.

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

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

The fact that, under state law, a power of appointment is not part of the probate estate, and that its transmission is not technically a "transfer" under local concepts, does not limit the federal power to tax such property. The use, enjoyment or control at death,[31] and it is now accepted that a passing or transfer of economic benefit is not required, though it may, of itself, justify the imposition of the tax.

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

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

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

See also U.S. v. Waite, Ex'rs, 33 F(2d) 567 (8th Cir.1929), 7AFTR9134, rev'g and remanding 29 F(2d) 149 (W.D.Mo.1927), 7AFTR8288, cert.den. 280 U.S. 608, 50 S.Ct. 157, 74 L.Ed. 651 (1930); Estate of Laura Nelson Kirkwood, 23 BTA 955; Mercantile-Commerce Nat'l Bank in St. Louis, Ex'rs, 21 BTA 1347; Mary S. Garrison, Ex'rs, 21 BTA 904; Mattie McMullin, Exec., 20 BTA 527. See also Kurz, Ex'rs v. U.S., 156 F.Supp. 99 (S.D.N.Y.1957), aff'd — F(2d) — (2d Cir.1958), per curiam.

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

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

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

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

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

[35] See discussion in § 28.17 of cases of Comm. v. Estate of Church, 335 U.S. 632, 69 S.Ct. 322, 93 L.Ed. 288 (1949), 37AFTR480, and Estate of Spiegel v. Comm., 335 U.S. 701, 69 S.Ct. 301, 93 L.Ed. 330 (1949), 37AFTR459.

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

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

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

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

As to the effect of a required consent of a person having an adverse interest of assurance to the beneficiaries that their rights are secure.[37] Both of these standards fall within the general principle that the underlying justification for imposing the estate tax on an inter vivos transfer is that it remains "incomplete" at death. The question is, not whether there has been, in the strict sense of that word, a "transfer" of the property by the death of the decedent, or a receipt of it by right of succession, but whether the death has brought into being or ripened for the survivor, property rights of such character as to make appropriate the imposition of a tax upon that result to be measured, in whole or in part, by the value of such rights.[39] The essential difference between the old and new rationalization of such justification is that incompleteness can be demonstrated either by ascertaining whether interests remained in the grantor or by determining whether the interests of the beneficiaries were enlarged, improved, or "ripened" at the time of the grantor's death. In demonstrating such incompleteness, substance rather than form or any particular device, is controlling.[40] Both factors had been previously expressed in several early constitutional cases,[41] although their influence was submerged by the fact that a number of the important decisions were rendered in cases which employed the "incomplete" test to determine whether a provision was arbitrarily retroactive under the Fifth Amendment.[42]

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

"If it were proposed to impose a tax on a transfer of property which came about by a mere refusal to accept a gratuitous proffer of that property, which the profferor was under no obligation to deliver even if his proffer were accepted, an argument might be made against the constitutionality of such a tax, since the taxpayer never received the property or any attribute of ownership over it. The proffer never became a gift and there would be no tax on the intended donor. It would be incongruous to tax the intended donee in this situation, and here we need not even consider the constitutional aspects of this mentary power the necessary property interest is clearly present and the renunciation would qualify as a "transfer" for the purpose of determining whether the tax is indirect; there is nothing "arbitrary" in the due process sense of that term, particularly since renunciation is a voluntary act. That the imposition of a tax would not violate the necessity of "uniformity" is obviously not any longer a debatable question.

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

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

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

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Importance: High

Attached is the Appellant's Reply Brief for filing. Please use this brief instead of the brief previously filed via email at 2:46 pm today. We noticed two errors on our Table of Authorities and have corrected those errors in both the table and the corresponding pages in the brief. The corrections were made to the following citations:

Haberman v. Wash. Pub. Power Supply Sys., 109 Wn.2d 107, 744 P.2d 1032, 750 P.2d 254 (1987) (page 7 of brief)

and

Prestidge v. Dep't of Revenue, 2012 WL 4069231 at *6 (Or. Tax 2012) (page 12 of brief)

Opposing counsel has been served a copy of the updated brief via this email as well. I apologize for the error.

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