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IN THE SUPREME COURT
OF THE STATE OF WASHINGTON

ON TRANSFER FROM
COURT OF APPEALS DIVISION I
NO. 65948-1-I

ESTATE OF JESSIE CAMPBELL MACBRIDE,

THOMAS H. MACBRIDE III AND PHILIP C. MACBRIDE, Personal Representatives of the Estate of Jesse Campbell Macbride,

Appellants,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

APPELLANTS' SUPPLEMENTAL REPLY BRIEF

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I. INTRODUCTION

The position of the Department of Revenue ("DOR") in this case is that the 2005 Legislature intended to enact – for the first time *ever* in a U.S. jurisdiction – a naked, stand-alone transfer tax on the death of a passive income beneficiary of a trust.

The Washington Supreme Court saw correctly, however, that under applicable law the deceased income beneficiary had nothing to transfer, because the trust in question had already received a complete transfer of the property from the trust settlor. *Clemency v. State (In re Estate of Bracken)*, 175 Wn.2d 549, 566, 290 P.3d 99 (2012) ("*Bracken*").

Not content to let the Supreme Court have the last word on statutory interpretation, the 2013 Legislature decided as a matter of fact that the Court had misconstrued the federal case law on the meaning of "transfer." The Legislature enacted Laws of 2013, 2d Spec. Sess. ch. 2 (Engrossed House Bill 2075) (the "2013 Amendments"), for the purpose of "clarifying" the 2005 enactment and to "reinstate" the supposedly intended 2005 meaning of "transfer." *Id.* § 1(6), (5). The definition of "transfer" now provides that it "includes any shifting upon death of the economic benefit in property or any power or legal privilege incidental to the ownership or enjoyment of property." *Id.* § 2.

The problem is that the federal opinion used by the Legislature and DOR as their talisman, *Fernandez v. Wiener*, 326 U.S. 340, 66 S. Ct. 178, 90 L. Ed. 116 (1945), *cited in, e.g.,* 2013 Amendments § 1(3), does not mean what they say it means. *Wiener* has *never* been used by Congress or any other State as the basis for a naked transfer tax on the termination of a lifetime income estate. To do so would be inconsistent with the actually relevant precedents regarding trust property. The result is that *Bracken* correctly interpreted the 2005 Estate Tax, even as "clarified" in 2013.

The DOR's brief also does not rebut the alternative arguments of the Estate of Jessie Macbride ("Jessie's Estate") that, if the 2013 Amendments did retroactively change the law, they are unconstitutional under the separation of powers doctrine, Due Process, the federal and state impairment clauses, and the uniformity requirement of the state Constitution, Article VII, § 1. The DOR's response to the estoppel claim of Jessie's Estate also fails.

II. ARGUMENT

A. The DOR and Legislature Urge the Court to Interpret Federal Estate Tax Law Based on False Premises.

For a correct understanding of the federal estate tax, the Court need only look to the opinion in *Bracken,* 175 Wn.2d at 558-60, 563-69. The Court is not better informed by the Second Supplemental Brief of

Respondent's discussion (pages 2 to 5) or the discussion of federal case law later in the brief. The DOR makes two repeated, misleading errors.

First, the DOR repeatedly relies on fundamentally misreading the *Wiener* opinion. Contrary to the DOR's position, the *Wiener* opinion did not define "transfer" – indeed it expressly disclaimed that purpose. Moreover, the contemporaneous but actually relevant federal cases hold that a taxable transfer occurs on the death of an income beneficiary *only if* the beneficiary also has a power to dispose of the trust corpus.

Second, the DOR repeatedly states that trust property "passes" under Internal Revenue Code § 2044. This is a mischaracterization. Section 2044 instead governs the value of a gross estate and provides that the referenced property is fictionally "treated as" being transferred.

1. *Wiener* Does NOT Mean that a Mere "Shift" in Economic Interests is a "Transfer" for Federal Estate Tax Purposes in the Trust Context.

Understood with due care and as applied to the facts at stake in the case, the *Wiener* opinion does not support the DOR's position.

The Legislature's entire rationale for the 2013 Amendments is based on a misadventure in quotation:

> (3) The legislature finds that it is *well established* that the term "transfer" as used in the federal estate tax code is construed broadly and extends to the "shifting from one to another of any power or privilege incidental to the ownership or enjoyment of

> property" that occurs at death. *Fernandez v. Wiener,* 326 U.S. 352 (1945).

2013 Amendments § 1(3) (emphasis added). This reading of the *Wiener* opinion is utterly wrong. The passage is not directly about the estate tax code *at all,* let alone "establish[ing]" how the term "transfer" is used in the estate tax. Rather, it is about the power to impose indirect taxes:

> Congress may tax real estate or chattels if the tax is apportioned, and without apportionment it may lay an excise upon a particular use or enjoyment of property or the shifting from one to another of any power or privilege incidental to the ownership or enjoyment of property. *Bromley v. McCaughn, supra; Burnet v. Wells,* 289 U.S. 670, 678; *cf. Nashville, C. & St. L.R. Co v. Wallace,* 288 U.S. 249, 267-8; *Henneford v. Silas Mason Co.,* 300 U.S. 577, 582.

Wiener, 326 U.S. at 352. The *Wiener* Court was talking about direct taxes versus excise taxes in the broadest way, with illustrations of types of excise taxes. Nothing here implies that the death of a passive income trust beneficiary entails the taxable "shifting" of privileges incidental to the ownership or enjoyment of property. As for the cited cases:

Bromley upheld a *gift tax* on inter vivos gifts as an excise tax "imposed upon a particular use of property or the exercise of a single power over property incidental to *ownership.*" *Bromley v. McCaughn,* 280 U.S. 124, 136, 50 S. Ct. 46, 74 L. Ed. 226 (1929) (emphasis added).

Burnet v. Wells, 289 U.S. 670, 53 S. Ct. 761, 77 L. Ed. 1439 (1933), was an *income tax* case that upheld taxing a trust settlor on the income of several trusts to the extent that the income was used to pay premiums on life insurance policies on *his own life* that he had taken out personally. *Id.* at 678. The case was not about ownership of trust property at all.

Nashville, C. & St. L.R. Co. v. Wallace, 288 U.S. 249, 267-68, 53 S. Ct. 345, 77 L. Ed. 730 (1933), involved a Tennessee *fuel tax.* *Henneford v. Silas Mason Co.,* 300 U.S. 577, 582, 57 S. Ct. 524, 81 L. Ed. 814 (1937), involved the Washington *use tax.*

Therefore, in light of the full text of this *Wiener* quotation and the cases cited, the conclusion is unavoidable that the Legislature was misled. Its justification in Section 1(3) of the 2013 Amendments for clarifying the 2005 Estate Tax *retroactively* is without basis and empty of any force.

The DOR's own misadventures in quoting *Wiener* start here:

> The term "transfer" is construed broadly and "extends to the creation, exercise, acquisition, or relinquishment of any power or legal privilege which is incident to the ownership of property."

Second Supp. Brief of Resp. at 2 (quoting *Wiener,* 326 U.S. at 352); *see also id.* at 8 (same). This citation forces a different meaning on the *Wiener* Court's statement, which was *again* about the taxing power of Congress, not the scope of the term "transfer:"

> [T]he power of Congress to impose *death taxes* is not limited to the taxation of *transfers* at death. It 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.

Wiener, 326 U.S. at 352 (emphasis added) (citing *Bromley,* 280 U.S. 124, 135 *et seq.* (the gift tax case discussed above)). This passage is, then, not about what specific transactions were subject to the federal *estate* tax. More important, the Court said death taxes are based on privileges incidental to *ownership* of property.

The DOR's final slice of the *Wiener* opinion is again removed from the proper context. Its brief quotes *Wiener* as affirming the imposition of the federal estate tax on any "shift in economic interest" in property. Second Supp. Brief of Resp. at 14 (quoting 326 U.S. at 354 (quoting *Whitney v. State Tax Comm'n,* 309 U.S. 530, 539, 60 S. Ct. 635, 84 L. Ed. 909 (1940))). From this snippet, the DOR concludes:

> So long as there is a transfer of some interest in property occasioned by death, Congress may impose an un-apportioned, indirect, estate tax on the full value of the property passing at death.

Id. at 15. Neither *Wiener* nor *Whitney* support this statement.

Wiener was part of a subcategory of federal estate tax litigation concerning jointly owned property. [1] In all those cases, the first spouse to

[1] *Wiener,* 326 U.S. at 354, cited *Tyler v. United States,* 281 U.S. 497, 50 S. Ct. 356, 74 L. Ed. 991 (1930) (tenancy by the entirety); and *United States v. Jacobs,* 306 U.S. 363, 59 S. Ct. 551, 78 L. Ed. 142 (1939) (joint tenancy). *See also id.* at 357 (citing *Moffitt v. Kelly,* 218 U.S. 400, 31 S. Ct. 79, 54 L. Ed. 1086 (1910) (community property)).

die had held an undivided ownership in *100% of the joint property* at issue. Affirming estate tax on 100% of the value of property in which the spouse had a full, undivided legal and beneficial interest says nothing about taxing trust property upon the death of a passive income beneficiary.

2. Trust Property and Life Insurance Cases Require Termination of Some Power to Dispose of Property by the Decedent to Make the Property Taxable in the Decedent's Estate.

Wiener's citation to *Whitney* points the way to the body of case law that does resolve the scope of taxable "transfers" applicable to Jessie's Estate – in the Estate's favor. *Whitney*, and the subsequent *Rogers* case discussed below, show that imposing an estate tax upon the death of an income beneficiary requires (*in the absence of a deferral of the tax* ***in question*** *upon the creation of the trust*) that the income beneficiary have a power of appointment to determine the remainder beneficiaries. Unless the trust property is also "appointive property" in this sense, there is no taxable transfer upon the death of the income beneficiary. [2]

Whitney involved a trust created by Cornelius Vanderbilt for the lifetime benefit of his wife with a power to alter the shares of remainder

[2] The Supreme Court in *Wiener* explicitly distinguished between trust-property cases and those involving the taxation of joint or community interests and said that the reasoning in *Coolidge v. Long*, 282 U.S. 582, 51 S. Ct. 306, 75 L. Ed. 567 (1931) (holding that succession to trust remainder interests occurred when the trusts were created), would not apply to the taxation of joint or community interests. *Wiener*, 326 U.S. at 357. That the Court did not overrule *Coolidge v. Long* and quoted from *Whitney*, also a trust case, with approval shows that the converse is also true: the result of *Wiener* does not bear on the taxation of trust property.

interests upon her death. She exercised that power. 309 U.S. at 534-35. New York's inheritance tax provided that property subject to a power of appointment, if exercised, was included in the taxable amounts. *Id.* at 536.

The Court upheld imposing the tax on the trust appointive property. As quoted in *Wiener* and emphasized by the DOR, the *Whitney* Court cited the shift in economic interest occasioned by the power of appointment. More important, the Court also stated plainly that *power to dispose* of the trust property was the *sine qua non* of the tax.

> [W]hen the end comes, the power that property gives, no matter how absolutely it may have been held, also comes to an end – except in so far as *the power to determine its succession and enjoyment* may be projected beyond the grave. But *the exercise of this power* is precisely the privilege which the state confers and upon which it seizes for the imposition of a tax. It is *not* the decedent's enjoyment of the property – the "beneficial interest" – which is the occasion for the tax, *nor even the acquisition of such enjoyment by the individual beneficiaries.*

Id. at 538 (emphasis added). Further (at page 540 (emphasis added)),

> [I]f death may be made the occasion for taxing property in which the decedent has no "beneficial interest," then the measurement of that tax by *the decedent's total wealth-disposing power* is merely an exercise of legislative discretion in determining what the state shall take in return for *allowing* the transfer.

Thus, the power to dispose of property was the key to New York's power to tax the particular "shift in economic interest" in question.

The DOR's citation to *Whitney* as support for the proposition that States have authority "to tax as a 'transfer' the passing of *any* economic interest in property" is therefore a bold exaggeration. *See* Second Supp. Brief of Resp. at 16 (emphasis added).[3]

The rationale in *Whitney* was followed identically in *Estate of Rogers v. Comm'r,* 320 U.S. 410, 64 S. Ct. 172, 88 L. Ed. 134 (1943). In *Rogers,* the Court upheld federal estate tax measured by trust property subject to a general testamentary power of appointment, which was exercised by the income beneficiary's will.

> [W]hat is decisive is what values were included in *dispositions made by a decedent*, values which but for such dispositions could not have existed. That other values, whether worth more or less as to some of the beneficiaries, would have ripened into enjoyment if a testator had not exercised his *privilege of transmitting property* does not alter the fact that he and no one else *did transmit property* which it was his to do with as he willed. And that is precisely what the federal estate tax hits – an exercise of *the privilege of directing the course of property* after a man's death.

Id. at 413 (emphasis added). Thus, contemporaneous with its *Wiener* decision, the Supreme Court held twice that the power to dispose of trust

[3] The DOR cites other cases in the brief (pages 16 and 20) as general support for unlimited taxation of any change in economic benefits. These citations are similarly cut loose from their facts. They are not instructive for the following reasons: *West v. Oklahoma Tax Comm'n,* 334 U.S. 717, 68 S. Ct. 1223, 92 L. Ed. 1676 (1948), involved a state inheritance tax expressly imposed on the receipt of trust property. *Commissioner v. Estate of Church,* 335 U.S. 632, 69 S. Ct. 322, 93 L. Ed. 288 (1949), involved a trust that the decedent created for his own benefit during life with the property passing to others at his death. *United States v. Manufacturers Nat'l Bank of Detroit,* 363 U.S. 194, 80 S. Ct. 1103, 4 L. Ed. 2d 1158 (1960), upheld taxing life insurance proceeds in the decedent's estate when the decedent had paid the premiums throughout his life, which the Court took to be the equivalent of setting up a fund over time to pass to his wife. *Prestidge v. Dep't of Revenue,* 2012 WL 4069231 (Or. T.C. Magistrate Div. 2012), was another state inheritance tax case where heirs were taxed on the value of property received, including remainder interests in QTIP trust property.

property was essential and necessary to the taxation of trust property in an income beneficiary's estate.

In 1942, Congress changed the law to include all appointive property for which there was a general power of appointment in taxable estates, whether that power was exercised or not. *See Estate of Bagley v. United States,* 443 F.2d 1266, 1270 (5^{th} Cir. 1971) (Ainsworth, J., dissenting).

> The rationale for including in the gross estate of a decedent property subject to unexercised powers of appointment vested in him is apparent: one who has a power of appointment and has a reasonable opportunity to exercise it, *controls the disposition* of the property whether he exercises the power or not.

Id. (citing congressional report) (emphasis added). This rationale was directly analogous to the Court's treatment of life insurance proceeds – they are includable in the decedent's estate if the decedent retained the right to change beneficiary. *Id.* at 1271 (citing *Chase Nat'l Bank v. United States,* 278 U.S. 327, 334-35, 49 S. Ct. 126, 73 L. Ed. 405 (1929)).

Washington's estate tax laws follow precisely this line. In *In re McGrath's Estate,* 191 Wash. 496, 503-04, 71 P.2d 395 (1937), the Court adopted the rationale of *Chase National Bank* that a taxable "shift of economic benefit" occurs when a decedent has reserved the power to change the beneficiary and the power is terminated by death, but does not occur when such a power is lacking. *See id.* at 504 (where McGrath lacked an appointive power, "[t]he death of McGrath added nothing to the company's right to the proceeds of the policies, for the right was from the beginning complete and indefeasible").

To sum up, for a trust income beneficiary or a named insured on life insurance paid by and payable to another person, a taxable transfer occurs only where the decedent (at death) has a power to dispose of that property. *See United States v. Merchants Nat'l Bank of Mobile,* 261 F.2d 570, 573 (5th Cir. 1958) (emphasis added): "If [the power of appointment is] exercisable at the time of death, there is that *essential control over the property,* [fn4] and shifting of the economic benefits [fn5] to make the appointive property taxable as a part of the decedent's estate."[4]

Because Jessie Macbride had no power or authority to determine the disposition of the trust of which she was the passive income beneficiary, *see* CP 201-13, she had no present interest that was independently taxable under any U.S. Supreme Court or other precedent.[5]

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[4] The court's footnote 4 cited to *Corliss v. Bowers,* 281 U.S. 376, 50 S. Ct. 336, 74 L. Ed. 916 (1930), and *Tyler v. United States,* 281 U.S. 497, 50 S. Ct. 356, 74 L. Ed. 991 (1930) [*cited in Wiener,* 326 U.S. at 354, and *Whitney,* 309 U.S. at 539]. The court's footnote 5 cited to *Burnet v. Guggenheim,* 288 U.S. 280, 53 S. Ct. 369, 77 L. Ed. 748 (1933), and *Estate of Sanford v. Comm'r,* 308 U.S. 39, 43, 60 S. Ct. 51, 84 L. Ed. 20 (1939).

[5] The IRS continues to apply these "first principles" of federal estate taxation developed in the 1920s through 1940s before the marital deduction was adopted. "Life estates given to the decedent by others in which the decedent has no further control or power at the date of death are not included" in the decedent's gross estate. IRS, "What is excluded from the Estate?", in Frequently Asked Questions on Estate Taxes at 1, *available at* http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Frequently-Asked-Questions-on-Estate-Taxes (reproduced in the Appendix, at A-2).

3. The Legislature's "Clarification" of the Meaning of "Transfer" Did Not Expand the Scope of Taxable Transfers as Determined in *Bracken.*

The 2013 Amendments sought to "clarify" the 2005 Estate Tax in part by amending the definition of "transfer" in RCW 83.100.020(11) (renumbered as (12)). The new, clarified definition is as follows:

> "Transfer" means "transfer" as used in section 2001 of the internal revenue code <u>and includes any shifting upon death of [A] the economic benefit in property or [B] any power or legal privilege incidental to the ownership or enjoyment of property</u>.

2013 Amendments § 2 (underscoring language added).

Clause [A], referring to the shifting of "economic benefit," apparently is drawn from the life insurance cases – *McGrath* and *Chase National Bank. See* Second Supp. Brief of Resp. at 10 (citing *McGrath* for proposition that this phrase "is consistent with the constitutional limits imposed on estate and inheritance taxes"). But those cases clearly require that the decedent have a power, at the time of death, to change the beneficiary. The Legislature is presumed to have used this phrase in light of existing case law. *See Price v. Kitsap Transit,* 125 Wn.2d 456, 463, 886 P.2d 556 (1994) (citing cases). Clause [A] therefore does not bring the QTIP in this case into Jessie's Washington gross estate.

Clause [B] is a quote from *Wiener* just like Section 1(3) of the 2013 Amendments. This phrase, too, fails to bring the QTIP into Jessie's

Washington gross estate, because the *Wiener* quotation was not about "transfers" at all and *Wiener's* general rationale does not provide the result for trust property. In the latter case (and in *this* case), having a power to dispose of the property is essential to taxability under such decisions as *Rogers, Whitney, Coolidge v. Long,* and *Merchants National Bank.*

The Legislature specifically intended to address the *Bracken* decision "by reaffirming its intent that the term 'transfer' as used in the Washington estate and transfer tax is to be given its broadest possible meaning *consistent with established United States supreme court precedents.*" 2013 Amendments § 1(5) (emphasis added). The Legislature had already achieved this goal in the 2005 Act, and the Supreme Court in *Bracken* gave the Legislature credit for doing so.[6]

Jessie Macbride had no power to affect the disposition of the trust property. Therefore, no naked, stand-alone transfer tax could constitutionally reach that property on her death – *in the absence of a deferral of tax under the* ***same*** *tax upon the real transfer previously made by her husband to the QTIP trust.* The *Bracken* decision stands unblemished: "For purposes of imposing a state estate tax, [Jessie] has not received or transferred the property at all." *Bracken,* 175 Wn.2d at 573.

[6] It should be noted that the DOR makes no attempt to explain how the anomalies in the DOR's position as identified in *Bracken,* 175 Wn.2d at 571-72, are avoided by the 2013 Amendments, such as imposition of tax on trusts created when the State had no estate tax, on gifts, and on QTIP trusts created by settlors who were not Washington residents.

4. The DOR's Mantra that Property "Passes" Under I.R.C. § 2044 Is Misleading.

Section 2044 of the Internal Revenue Code provides as follows:

> (a) General Rule.—*The **value** of the gross estate shall include the **value** of any property to which this section applies* in which the decedent had a qualifying income interest for life.
>
> (b) Property to Which This Section Applies.—This section applies to any property if—
>
> (1) a deduction was allowed with respect to the transfer of such property to the decedent—
>
> (A) Under section 2056 by reason of subsection (b)(7) thereof, or
>
> (B) Under section 2523 by reason of subsection (f) thereof, and
>
> (2) section 2519 (relating to dispositions of certain life estates) did not apply with respect to a disposition by the decedent of part or all of such property.
>
> (c) Property Treated as Having Passed From Decedent.—For purposes of this chapter and chapter 13, property includible in the gross estate of the decedent under subsection (a) *shall be treated as* property passing from the decedent.

26 U.S.C. § 2044 (emphasis added). This section provides an adjustment of the value of the decedent's gross estate, which would not otherwise include QTIP or other property described here because the decedent does *not* have an "interest therein" under I.R.C. § 2033. Given the settled law that the decedent has no interest in the trust property at the time of death, this section creates the fiction that such property "shall be treated as . . . passing from the decedent." *Id.* § 2044(c). *See Bracken,* 175 Wn.2d at 568.

This statutory text is clear. It is hard to understand the intention of DOR's misstatement, repeated from the first to the last page of its brief, that there is "property . . . *passing* under Internal Revenue Code § 2044." Second Supp. Brief of Resp. at 1 (emphasis added).[7] No property "passes" at all pursuant to Section 2044. "QTIP property does not actually pass to or from the surviving spouse." *Estate of Mellinger v. Comm'r,* 112 T.C. 26, 35 (1999), *quoted in Bracken,* 175 Wn.2d at 568.

B. The 2013 Amendments Impose an Unconstitutional Tax Under Separation of Powers, Due Process, and Impairment-Clause Principles.

The DOR's statutory defense relies almost entirely on the baseless argument that *Bracken* misunderstood the Legislature's original 2005 intention to apply the tax to the fullest extent permitted by U.S. Supreme Court precedents. The DOR hardly mentions the amendment of the definition of "Washington taxable estate" in Section 2 of the 2013 Amendments to include "the value of any property included in the gross estate under section 2044 of the internal revenue code, regardless of whether the decedent's interest in such property was acquired before May 17, 2005." *See, e.g.,* Second Supp. Brief of Resp. at 10, 11. The question is implicitly raised whether the Legislature intended that this amendment of the definition of "Washington taxable estate" stand alone as an

[7] *See id.* at 8 ("property passes to the remainder beneficiaries under" § 2044); 9, 10 (twice), 11 (three times), 12, 13 (twice), 17, 18, 19, 31, 35 (twice), 37, 40, 42, 45, 46.

intentional, retroactive extension of the 2005 Estate Tax *beyond* transfers that are recognized at federal law.

The DOR's discussion of the separation of powers issue appears to concede that the Legislature did *not* intend the definition of "Washington taxable estate" to operate independently of the definition of "transfer."

> 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.* . . . [T]he judiciary retains the ultimate responsibility to determine whether the passing of QTIP under Internal Revenue Code § 2044 is a "transfer" within established constitutional constraints . . . .

Second Supp. Brief of Resp. at 36-37 (emphasis added). Given that the Legislature's clarification of "transfer," based on a mistaken reading of the *Wiener* opinion, has no effect in this case, this concession would resolve the case in favor of Jessie's Estate.

However, should the Court disagree that the *Bracken* analysis still controls the meaning of "transfer," or if it should find that the amendment of "Washington taxable estate" does operate independently of the meaning of "transfer," then the 2013 Amendments are unconstitutional as set forth in the Appellant's (Second) Supplemental Brief and supplemented here.

1. The 2013 Amendments Violate the Separation of Powers Doctrine.

If the 2013 Amendments are read to overrule *Bracken* and impose a tax on Jessie's Estate, then they violate "the bedrock principle that the legislature cannot contravene an existing judicial construction of a statute." *State v. Maples*, 171 Wn. App. 44, 50, 286 P.3d 386 (2012).

The DOR argues that the Legislature has met the minimum required respect for the integrity of the judiciary by preserving the final judgment in *Bracken*. *See* Second Supp. Brief of Resp. at 33-34 (citing 2013 Amendments § 10). Having preserved the final judgment in *Bracken*, the DOR argues, the Legislature was free to "retroactively amend a statute to *affirmatively change* the law." Second Supp. Brief of Resp. at 36 (emphasis added).

This analysis is wrong. The Legislature acted to "clarify" the original 2005 Act on its own construction, not to change it.

> (5) . . . [T]he legislature finds it necessary to *reinstate* the legislature's intended meaning when it enacted the estate tax, . . . , and prevent the adverse fiscal impacts of the *Bracken* decision by *reaffirming its intent* that the term "transfer" as used in the Washington estate and transfer tax is to be given its broadest possible meaning consistent with established United States supreme court precedents, ...
>
> (6) As curative, *clarifying*, and remedial, the legislature intends for this act to apply both prospectively and retroactively to estates of decedents dying on or after May 17, 2005.

2013 Amendments § 1 (emphasis added).

The Court of Appeals, in all Divisions, has repeatedly relied on a series of this Court's opinions to hold that "legislative clarifications construing or interpreting existing statutes are unconstitutional when they contravene prior judicial interpretations of a statute." *State v. Elmore*, 154 Wn. App. 885, 905, 228 P.3d 760 (2010) (citing *Marine Power & Equip. Co. v. Human Rights Comm'n Hearing Tribunal*, 39 Wn. App. 609, 615 n.2, 694 P.2d 697 (1985)). *See also State v. Maples*, 171 Wn. App. at 49 (citations omitted); *State v. Mann*, 146 Wn. App. 349, 358, 189 P.3d 843 (2008) (citing *Marine Power*, 39 Wn. App. at 615 (citing *Johnson v. Morris*, 87 Wn.2d 922, 926, 557 P.2d 1299 (1976))). The Court in *In re Pers. Restraint of Stewart*, 115 Wn. App. 319, 75 P.3d 521 (2003), said:

> When an amendment clarifies existing law and where that amendment does not contravene *previous constructions of the law*, the amendment may be deemed curative, remedial and retroactive.

Id. at 331 (quoting *Tomlinson v. Clarke*, 118 Wn.2d 498, 510-11, 825 P.2d 706 (1992), and adding emphasis).

The DOR relies primarily on two decisions, *Hale v. Wellpinit Sch. Dist. No. 49*, 165 Wn.2d 494, 198 P.3d 1021 (2009), and *Lummi Indian Nation v. State*, 170 Wn.2d 247, 241 P.3d 1220 (2010), but the factual contexts and statutory changes involved in *Lummi* and *Hale* are far afield from the simple, retroactive tax increase at issue here. *See* Appellant's (Second) Supp. Brief at 17-18 and 22-24.[8]

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[8] Justice Scalia's dictum in *Plaut v. Spendthrift Farms, Inc.*, 514 U.S. 211, 226-27, 115 S. Ct. 1447, 131 L. Ed. 2d 328 (1995), cited by the DOR to the effect that a retroactive law does not violate separation of powers limits when applied to a case not yet finally decided, *see* Second Supp. Brief of Resp. at 34, does not undermine Washington's many subsequent state-law decisions that prohibit retroactive "clarifying" statutes in

In short, the 2013 Amendments "reversed" the decision in *Bracken* in just the way that violates separation of powers – as a clarifying interpretation that contravenes a prior, final judicial interpretation.

2. The 2013 Amendments Violate the Due Process Clause.

Appellants reply to the DOR's Due Process arguments as follows:

First, if the 2013 Amendments survive scrutiny under separation of powers doctrine because they represent an "affirmative change in law," then the 2013 Amendments violate Due Process by imposing a retroactive "novel" tax on fictional transfers by income beneficiaries. *See Bates v. McLeod,* 11 Wn.2d 648, 656-57, 120 P.2d 472 (1941) (citing cases). *See also* Second Supp. Brief of Resp. at 23 (conceding that the cases cited by *Bates v. McLeod* apply to retroactive enactment of new taxes).

Second, the 2013 Amendments do not stand up under either prong of the Due Process test applicable to retroactive increases in *existing* taxes under *United States v. Carlton*, 512 U.S. 26, 114 S. Ct. 2018, 129 L. Ed. 2d 22 (1994).

With regard to legislative purpose, the DOR attempts to clothe the 2013 Amendments with a legislative purpose like that endorsed in *Carlton* – to correct a "mistake" that had produced "a significant and *unanticipated*

contravention of a judicial construction. The *Plaut* case was squarely about congressional action that explicitly re-opened fully adjudicated cases, which the Supreme Court held to be unconstitutional.

revenue loss." *Carlton*, 512 U.S. at 32 (emphasis added), *cited in* Second Supp. Brief of Resp. at 24. The 2013 Amendments were motivated, says the DOR, by concern for "an *unexpected* loss of revenue to public school funding brought about by *Bracken*." *Id.* (emphasis added).

In fact, the Legislature did *not* describe the revenue impact of *Bracken* as "unexpected," "unanticipated," or even "significant." Instead, it merely stated that the *Bracken* decision would have "adverse fiscal impacts." 2013 Amendments § 1(5). This is true of every case where a taxpayer wins a refund. "Adverse fiscal impacts" do not by themselves provide a legitimate purpose for adopting a retroactive tax increase.

It could not be rational in this case to claim that the "adverse fiscal impacts" of *Bracken* were "unanticipated." For virtually the entire period after enactment of the Estate Tax, the DOR was in conflict with taxpayers and the Bar Association about the meaning of the 2005 Act.[9] The Legislature made no change to the statute to protect the DOR's position. *Compare Tesoro Ref. & Mktg. Co. v. Dep't of Revenue,* 159 Wn. App. 104, 109-10, 246 P.3d 211 (2010), *rev'd on other grounds,* 173 Wn.2d 551, 269 P.3d 1013 (2012) (*during same period as estate tax litigation,* DOR informed Legislature of Tesoro's refund suit seeking $6.5 million in 2009 and Legislature promptly amended statute on eve of trial).

[9] *See* CP 558, 611-15 (CP 613 cites "controversy" with WSBA), 620-23, 699-710 (DOR staff's testimony on disagreement with WSBA following 2006 rule-making).

In the most recent Due Process retroactivity decision nationwide, the New York Court of Appeals (the state's highest court) held that a retroactive tax increase for a period as short as 16 months violated Due Process, because merely maintaining or increasing revenues is not a legitimate purpose for retroactive tax changes. *See James Square Assocs. LP v. Mullen,* 21 N.Y.3d 233, 248-50, 993 N.E.2d 374 (2013).

With regard to the rational means test, the Supreme Court in *Carlton* said that a "modest period of retroactivity" may be a reasonable response to unintended consequences of a tax enactment. *See* 512 U.S. at 32. The eight-year period on the face of the 2013 Amendments exceeds the *Carlton* threshold because the issue had already come to the State's notice shortly after the DOR's initial regulations were published in 2006. *See* CP 699-710. Yet the Legislature took no action to remedy its now-claimed oversight.[10] The delay in the Legislature's response until after final action by the Supreme Court in *Bracken* does not meet the standard in *Carlton*, which emphasized the prompt action by Congress after the ***IRS*** became aware of Congress's mistake. *See* 512 U.S. at 31-33.

Third, the DOR's single Due Process precedent from Washington, *W.R. Grace & Co. v. Dep't of Revenue*, 137 Wn.2d 580, 973 P.2d 1011 (1999), arose out of an irrelevant context – the correction of a violation of

[10] That the Legislature acted promptly after *Bracken*, as claimed at page 25 of the DOR's brief, is a red herring that masks the Legislature's actual response time in this dispute.

the Commerce Clause nondiscrimination principle by *expanding* taxpayer remedies. *See id.* at 602 (new credit "designed to benefit taxpayers"). Further, the DOR does not rely on the *facts* of any of the cases from other jurisdictions listed on pages 25-26 of its brief, and *none* of them upheld, against taxpayers who already had disputed their liability, a retroactive tax increase that reversed a contrary judicial construction.

Fourth, the DOR's response to the vested-rights dimension of the Due Process issue relies incorrectly on *Carlton's* observation that there is no "vested right" in the continuation of a particular tax law. *See* Second Supp. Brief of Resp. at 31 (citing *Carlton,* 512 U.S. at 33, and C.J.S.). To the contrary, when an unprecedented tax is imposed on the termination of a passive trust income interest, the vested remainders recognized by Washington property law are "a title, legal or equitable, to the present or future enjoyment of property," *In re Pers. Restraint of Carrier,* 173 Wn.2d 791, 811, 272 P.3d 209 (2012) (internal quotations and citations omitted), *i.e.,* vested rights that cannot be infringed *retroactively.*

3. The 2013 Amendments Violate the Impairment Clause.

The DOR's response to the Impairment Clause issue simply sidesteps the cases directly on point without a mention. *See* Appellant's (Second) Supp. Br. at 32-33 (discussing *Coolidge v. Long*, 282 U.S. at 595 ("trust deeds are contracts within the meaning of the contract clause of the Federal Constitution"), and *McGrath*, 191 Wash. at 497-98).

The DOR says the creation of an irrevocable trust is like a gift and is not a contract. Second Supp. Brief of Resp. at 38-39. *But see Coolidge v. Long,* 282 U.S. at 595; *Farrell v. Mentzer*, 102 Wash. 629, 174 P. 482 (1918) ("express trusts are created by contract of the parties"); *In re Estate of Bodger*, 130 Cal. App. 2d 416, 279 P.2d 61 (1955) (act of trust creation "is nothing more than a third party beneficiary contract").

The DOR says that there has been no impairment because Thomas Macbride created the trust in contemplation of the Washington pick-up tax. Second Supp. Brief of Resp. at 39. However, the trust structure and beneficiaries' expectations were based only on the federal estate tax. *See* CP 203-07 (trust provisions). The pick-up tax had no impact. Enacting an unprecedented state tax on fictional transfers "made by" passive income beneficiaries, however, was not within anyone's reasonable expectations.

C. The 2013 Amendments Violate Article VII, § 1 of the Washington Constitution.

It is a given that the Washington Estate Tax is not *intended* to be a "property tax," *Bracken,* 175 Wn.2d at 559 (citation omitted), but purporting to tax a privilege can mask the real nature of a tax act. "The character of a tax is determined by its incidents, not by its name." *Jensen* *v. Henneford,* 185 Wash. 209, 217, 53 P.2d 607 (1936), *quoted in Harbour Vill. Apts. v. City of Mukilteo,* 139 Wn.2d 604, 607, 989 P.2d 542 (1999).

Jessie's Estate does not argue that the Estate Tax as amended is a property tax in its entirety. However, the Legislature's amendment to capture tax specifically on property that was *in fact* "transferred" before the 2005 Act was adopted is not a valid excise tax. The Court in *Bracken* has already determined as a matter of fact that the Estates did not exercise any privilege with respect to QTIP. 175 Wn.2d at 566. The decisions in *Rogers* and *Whitney* support this conclusion directly, as does IRS practice. This part of the tax would function only as a property tax on property that "escaped" taxation because the actually taxable transfer occurred before the 2005 Act was adopted. Given the inequality of variations built into the Estate Tax, the retroactive provisions provide for non-uniform taxation of QTIP in violation of Article VII, section 1.

D. The DOR is Estopped from Applying the 2013 Amendments to the Macbride Estate, Which Was Prejudiced by the Stay Pending the Outcome of *Bracken*.

The DOR claims it has no authority to bind itself in advance to apply a controlling, pending judicial decision to another taxpayer after the decision has been rendered. Second Supp. Brief of Resp. at 44-45. This is surely nonsense. The Legislature itself seeks to honor the reliance of taxpayers faced with the taxing power of the State. *See, e.g.,* RCW 82.32A.020(2) (right to rely on DOR's written advice and reporting instructions); RCW 82.32.660 (taxpayers not subject to retroactive "tax avoidance" amendments where they relied on DOR's written instructions or other published DOR documents). Similarly, the DOR argues that Jessie's Estate should not have the benefit of representations made by the DOR to the courts. *Id.* The injustice of a bait-and-switch, which equitable estoppel seeks to prevent, should not be enabled by this distinction.

In any event, the estoppel claim is fact-bound and it may be appropriate, if the Court finds that the tax applies, to remand the matter for development of an appropriate record on this issue (which arose, of course, after termination of trial-court proceedings).

III. CONCLUSION

For the reasons set forth above, this Court should grant Jessie's Macbride Estate the relief requested.

RESPECTFULLY SUBMITTED this 10th day of January, 2014.

Davis Wright Tremaine LLP
Attorneys for Appellants

By ______________________________
Rhys M. Farren, WSBA #19398
Dirk Giseburt, WSBA #13949
Richard A. Klobucher WSBA #6203

PROOF OF SERVICE

I, Susan Bright, the undersigned, hereby certify and declare under penalty of perjury under the laws of the State of Washington that the following statements are true and correct:

On this date, I caused to be served a true copy of the document entitled APPELLANTS' SUPPLEMENTAL REPLY BRIEF to which this is attached, by First Class U.S. Mail and electronic mail on the following:

Washington State Department of Revenue
David M. Hankins, WSBA #19194
davidh1@atg.wa.gov
Charles Zalesky, WSBA #37777
chuckz@atg.wa.gov
Office of the Attorney General, Robert Ferguson
P.O. Box 40123
Olympia, WA 98504-0123

Executed at Bellevue, Washington this 10th day of January, 2014.

Susan Bright

Susan Bright

APPENDIX A

IRS

Small Business/Self-Employed

- Industries/Professions
- International Taxpayers
- Self-Employed
- **Small Business/Self-Employed Home**

Small Business/Self-Employed Topics

- A-Z Index for Business
- Forms & Pubs
- Starting a Business
- Deducting Expenses
- Businesses with Employees
- Filing/Paying Taxes
- Post-Filing Issues
- Closing Your Business

Frequently Asked Questions on Estate Taxes

Below are some of the more common questions and answers about Estate Tax iss also find additional information in Publication 950 or some of the other forms and p on our Forms Page. Included in this area are the instructions to Forms 706 and 70 instructions, you will find the tax rate schedules to the related returns. If the answe questions can not be found in these resources, we strongly recommend visiting wi practitioner.

- When can I expect the Estate Tax Closing Letter?
- What is included in the Estate?
- I own a 1/2 interest in a farm (or building or business) with my brother (sister, fr is included?
- What is excluded from the Estate?
- What deductions are available to reduce the Estate Tax?
- What other information do I need to include with the return?
- What is "Fair Market Value?"
- What about the value of my family business/farm?
- What if I do not have everything ready for filing by the due date?
- Who should I hire to represent me and prepare and file the return?
- Do I have to talk to the IRS during an examination?
- What if I disagree with the examination proposals?
- What happens if I sell property that I have inherited?
- INTERNATIONAL: In a Form 706NA, how do I claim a pro-rata unified credit pu treaty?
- INTERNATIONAL: In a Form 706NA, how do I claim an exemption from U.S. e to a treaty?
- INTERNATIONAL: How do I secure a transfer certificate (U.S. Citizen)?
- INTERNATIONAL: How do I secure a transfer certificate (Non-U.S. Citizen)?

When can I expect the Estate Tax Closing Letter?

There can be some variation, but for returns that are accepted as filed and contain special circumstances, you should expect to wait about 4 to 6 months after the retu receive your closing letter. Returns that are selected for examination or reviewed fo purposes will take longer.

What is included in the Estate?

The Gross Estate of the decedent consists of an accounting of everything you own interests in at the date of death (Refer to Form 706 (PDF)). The fair market value c used, not necessarily what you paid for them or what their values were when you a The total of all of these items is your "Gross Estate." The includible property may c securities, real estate, insurance, trusts, annuities, business interests and other as that the Gross Estate will likely include non-probate as well as probate property.

I own a 1/2 interest in a farm (or building or business) with my brother (sister, friend, other). What is included?
Depending on how your 1/2 interest is held and treated under state law, and how it was acquired, you would probably only include 1/2 of its value in your gross estate. However, many other factors influence this answer, so you would need to visit with a tax or legal professional to make that determination.

What is excluded from the Estate?
Generally, the Gross Estate does not include property owned solely by the decedent's spouse or other individuals. Lifetime gifts that are complete (no powers or other control over the gifts are retained) are not included in the Gross Estate (but taxable gifts are used in the computation of the estate tax). Life estates given to the decedent by others in which the decedent has no further control or power at the date of death are not included.

What deductions are available to reduce the Estate Tax?

1. Marital Deduction: One of the primary deductions for married decedents is the Marital Deduction. All property that is included in the gross estate and passes to the surviving spouse is eligible for the marital deduction. The property must pass "outright." In some cases, certain life estates also qualify for the marital deduction.
2. Charitable Deduction: If the decedent leaves property to a qualifying charity, it is deductible from the gross estate.
3. Mortgages and Debt.
4. Administration expenses of the estate.
5. Losses during estate administration.

What other information do I need to include with the return?
See Form 706 (PDF) and Instructions (PDF) and Publication 950. Among other items listed:

1. Copies of the death certificate
2. Copies of the decedent's will and/or relevant trusts
3. Copies of appraisals
4. Copies of relevant documents regarding litigation involving the estate
5. Documentation of any unusual items shown on the return (partially included assets, losses, near date of death transfers, others).

What is "Fair Market Value?"
Fair Market Value is defined as: "The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. The fair market value of a particular item of property includible in the decedent's gross estate is not to be determined by a forced sale price. Nor is the fair market value of an item of property to be determined by the sale price of the item in a market other than that in which such item is most commonly sold to the public, taking into account the location of the item wherever appropriate." Regulation §20.2031-1.

What about the value of my family business/farm?

Generally, the fair market value of such interests owned by the decedent are includible in the gross estate at date of death. However, for certain farms operated as a family farm, reductions to these amounts may be available.

In the case of a qualifying Family Farm, IRC 2032A allows a reduction from value of up to $1,070,000.

A similar deduction for a qualifying family owned business (IRC 2057) was revoked beginning in 2004.

What if I do not have everything ready for filing by the due date?

The estate's representative may request an extension of time to file for up to six months from the due date of the return. However, the correct amount of tax is still due by the due date and interest is accrued on any amounts still owed by the due date that are not paid at that time.

Who should I hire to represent me and prepare and file the return?

The Internal Revenue Service cannot make recommendations about specific individuals, but there are several factors to consider:

1. How complex is the estate? By the time most estates reach $1,000,000, there is usually some complexity involved.
2. How large is the estate?
3. In what condition are the decedent's records?
4. How many beneficiaries are there and are they cooperative?
5. Do I need an estate tax professional?

With these questions in mind, it is a good idea to discuss the matter with several estate tax professionals. Ask about how much experience they have had and ask for referrals. This process should be similar to locating a good physician. Locate other individuals that have had similar experiences and ask for recommendations. Finally, after the individual(s) are employed and begin to work on estate matters, make sure the lines of communication remain open so that there are no surprises during administration or if the estate tax return is examined.

Finally, most estates engage the services of both attorneys and CPAs or Enrolled Agents (EA). The attorney usually handles probate matters and reviews the impact of documents on the estate tax return. The CPA or EA often handles the actual return preparation and some representation of the estate in matters with the IRS. However, some attorneys handle all of the work. CPAs and EAs may also handle most of the work, but cannot take care of probate matters and other situations where a law license is required. In addition, other professionals (such as appraisers, surveyors, financial advisors and others) may need to be engaged during this time.

Do I have to talk to the IRS during an examination?

You do not have to be present during an examination unless an IRS representative needs to ask specific questions. Although you may represent yourself during an examination, most executors prefer that professional(s) they have employed handle this phase of administration. They may delegate authority for this by signing a designation on the Form 706 (PDF) itself, or executing Form 2848 "Power of Attorney" (PDF).

What if I disagree with the examination proposals?

You have many rights and avenues of appeal if you disagree with any proposals made by the IRS. See Publications 1 (PDF) and 5 (PDF) for an explanation of these options.

What happens if I sell property that I have inherited?

The sale of such property is usually considered the sale of a capital asset and may be subject to capital gains (or loss) treatment. However, IRC §1014 provides that the basis of property acquired from a decedent is its fair market value at the date of death, so there is usually little or no gain to account for if the sale occurs soon after the date of death. (Remember, the rules are different for determining the basis of property received as a lifetime gift). Refer to Gift Tax FAQ.

INTERNATIONAL: In a Form 706NA, how do I claim a pro-rata unified credit pursuant to a treaty?

Complete the entries for Lines 1 through 3 in Schedule B on the second page of the return. Attach a statement to the return that refers to the particular treaty applicable to the estate, and write that the estate is claiming its benefits. Show your computation of the pro-rata unified credit in the statement, and enter that figure in the Tax Computation on Line 7 on the front page of the return. Attach to the Form 706NA a copy of the return filed with the treaty partner. If no estate or inheritance tax return has been filed with the treaty partner, explain in your statement why no foreign return was due. If there was no foreign return, attach a copy of an inventory that sets forth the decedents assets and their values at the date of death, and explains how the figure shown on Line 3 of Schedule B was computed.

INTERNATIONAL: In a Form 706NA, how do I claim an exemption from U.S. estate tax pursuant to a treaty?

In Schedule A of the return, list the estates U.S. assets, but show no values for those that are exempt from U.S. estate tax pursuant to a treaty. Attach a statement to the return that refers to the particular treaty applicable to the estate, and write that the estate is claiming its benefits. Entries for the gross estate in the U.S., the taxable estate, and the tax amounts, should be "0" if all of the decedents U.S. assets are exempt from U.S. estate tax pursuant to the applicable treaty. Attach to the Form 706NA a copy of the return filed with the treaty partner. If no estate or inheritance tax return has been filed with the treaty partner, explain in your statement why no foreign return was due.

Most information for this page came from the Internal Revenue Code: Chapter 11--Estate Tax (generally Internal Revenue Code §2000 and following, related regulations and other sources.)

If you have suggestions or comments (or suggested FAQs) for the Estate and Gift Tax Web site, please contact us: CONTACT ESTATE AND GIFT TAX. We will not be able to respond to your email, but will consider it when making improvements or additions to this site.

Note: *This page contains one or more references to the Internal Revenue Code (IRC), Treasury Regulations, court cases, or other official tax guidance. References to these legal authorities are included for the convenience of those who would like to read the technical reference material. To access the applicable IRC sections, Treasury Regulations, or other official tax guidance, visit the Tax Code, Regulations, and Official Guidance* page. To access any Tax Court case opinions issued after September 24, 1995, visit the Opinions Search page of the United States Tax Court.

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Dear Clerk,

I respectfully submit the attached document for filing with the Supreme Court.

Document: Appellants' Supplemental Reply Brief

Case Name: Thomas H. Macbride III and Philip C. Macbride (Estate of Jessie Campbell Macbride) v. State of Washington, Department of Revenue

Case Number: Supreme Court No. 89500-7 [Consolidated with No. 89419-1]

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Thank you,

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