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No. 65948-1-I

IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON

In re the Matter of the:

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.

OPENING BRIEF OF APPELLANTS

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I. SUMMARY

The trial court erred when it entered summary judgment in favor of the Washington State Department of Revenue ("DOR") and upheld the DOR's refusal to refund a $638,703 overpayment of Washington state estate tax. Appellants ask that this Court reverse the trial court's decision and enter summary judgment in favor of the Estate of Jessie Campbell Macbride ("Macbride Estate" or "Jessie's Estate"). The Appellants also ask that this Court enter judgment awarding the full amount of the tax refund, with interest, and remand the case to the lower court for a determination of the amount of statutory interest.

Prior to December 31, 2004, Washington estates were taxed under a "pickup tax" scheme,[1] in which Washington "picked up" the exact amount of the allowable state death tax credit under federal law. *See Estate of Hemphill v. Dep't of Revenue*, 153 Wn.2d 544, 547, 105 P.3d 391 (2005). In *Hemphill,* the Washington Supreme Court ruled that the pickup tax was phased out with the corresponding federal elimination of the state death tax credit. In response to *Hemphill*, the Washington legislature enacted a new estate tax, effective May 17, 2005, which was independent of the

[1] The pickup tax was enacted in 1981 by Initiative 402. In 1981, the voters abolished Washington's previous inheritance tax and created a state estate tax based exclusively on the credit allowed on a decedent's federal estate tax return for estate taxes paid to a state. Laws of 1981, 2nd Ex. Sess., Ch. 7 (Initiative No. 402, approved Nov. 3, 1981).

federal tax obligation (the "Stand Alone Estate Tax" or the "Act").[2] In doing so, the legislature made it crystal clear that this new Stand Alone Estate Tax would be applied "prospectively only" to transfers of property[3] "of decedents dying on or after May 17, 2005."[4]

Effective October 20, 1999, the representatives of Thomas H. Macbride's estate ("Thomas's Estate") transferred property into certain irrevocable trusts ("Thomas's Trusts" or "Trusts") as required by Thomas's estate planning documents.[5] Thomas's Trusts vested in certain beneficiaries but paid income to Thomas's surviving spouse Jessie Campbell Macbride ("Jessie") during her life. Jessie died on October 21, 2007, and it is undisputed that Jessie's interest terminated at her death, that Jessie neither owned nor controlled the Trusts' property at her death, and Jessie could not change the terms of the irrevocable trusts. In short, there was no "transfer of property" of the Trusts from Jessie's Estate.

Under *Hemphill*, Jessie's Estate would have paid no Washington estate tax at her death. The DOR contends, however, that under the new Stand Alone Estate Tax, Jessie's Estate must pay estate tax on Thomas's

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[2] RCW 83.100.040(3). The Act is referred to herein as the "Stand Alone Estate Tax," because that is the language used in the text of RCW 83.100.040(3).
[3] RCW 83.100.040(1).
[4] Laws of 2005, ch. 516, § 20.
[5] These included the Last Will and Testament of Thomas H. Macbride, dated July 30, 1998; and the Amended and Restated Living Trust Agreement of Thomas H. Macbride and Jessie Campbell Macbride, dated July 30, 1998.

Trusts. Although only *prospective* "transfers" are subject to the imposition of tax under RCW 83.100.040(1), the DOR adds to Jessie's Estate the prior transfers by Thomas's Estate to the Trusts. The DOR argues that the Act's definition of taxable estate allows it to automatically incorporate all federal QTIPs (*i.e.*, qualified terminable interest properties) created prior to the new Act.[6]

The legislature did not intend this result. The Act carefully distinguishes between federal and state tax treatment by providing for a separate Washington QTIP election in RCW 83.100.047—for trusts created on or after May 17, 2005. (Thomas's Estate made a federal QTIP election but did not make a corresponding Washington QTIP election.) If federal QTIP property were always automatically added back into the definition of *Washington* taxable estate as the DOR contends, RCW 83.100.047 would be superfluous. Furthermore, the automatic incorporation of QTIP property into the definition of Washington taxable estate would give rise to many clearly unintended and unauthorized taxes. Ironically, the DOR's own 2006 estate tax regulations specifically excluded QTIP property from the calculation of "Washington taxable estate." The Appellants' interpretation of RCW 83.100.040 reconciles the

[6] Under federal QTIP rules, the first spouse to die may deduct QTIP property. Any remaining QTIP property held by the surviving spouse is added to the surviving spouse's federal taxable estate. *See generally*, I.R.C. § 2056(b)(7).

"prospective only" application. Moreover, Washington law is well-settled that a taxing statute must be "construed most strongly in favor of the taxpayer."

In addition, there is no "transfer" from Jessie's Estate. Jessie did not own Thomas's Trust property. Under well settled Washington law, a state cannot impose or collect an estate tax unless some interest of the decedent is transferred at the decedent's death. Because Jessie's terminable interest in Thomas's Trusts terminated at her death, she left nothing from which the state could impose or collect a tax.

Furthermore, the DOR's imposition of a tax on pre-Act irrevocable trusts is unconstitutional under the Impairment Clause of the U.S. and Washington Constitutions, and under the prohibition against unclear taxation in Washington Constitution Art. VII, § 5.

As is discussed herein, the language of the new Act, the uniform rule of law in Washington limiting the authority of estate tax laws, the established precedent of the U.S. Supreme Court, the DOR's own 2006 Regulations, and the Washington and U.S. Constitutions all lead to the inescapable conclusion that Jessie's Estate cannot be required to pay an estate tax on Thomas's irrevocable Trusts, which were created and transferred before the enactment of the new Stand Alone Estate Tax.

II. ASSIGNMENTS OF ERROR

A. Assignments of Error.

1. The trial court erred when it granted the DOR's motion for summary judgment on the Macbride Estate's application for a tax refund.

2. The trial court erred when it denied the Macbride Estate's motion for summary judgment on the Estate's application for a tax refund.

3. The trial erred when it denied the Macbride Estate's motion for reconsideration.

B. Issues Pertaining to Assignments of Error.

1. Whether the appellate court reviews the legal conclusions in a tax refund case *de novo* under the error of law standard?

2 Whether any doubt or ambiguity in the interpretation of the new Stand Alone Estate Tax must be strongly construed in favor of the Macbride Estate?

3. Whether the Washington legislature intended to apply the new Stand Alone Estate Tax only to QTIP trusts created *after* the May 17, 2005 enactment of the new tax?

4. Whether the DOR can *impose* or *collect* an estate tax on an irrevocable trust created by a predeceasing spouse who died

before May 17, 2005, when the Stand Alone Estate Tax, longstanding Washington precedent and the uniform rule in other jurisdictions require a transfer of property owned by the decedent?

5. Whether the DOR can circumvent the Supreme Court's ruling in *Hemphill* by imposing an estate tax on Thomas H. Macbride's transfer to an irrevocable trust?

6. Whether the DOR's attempt to tax property held in an irrevocable trust created before the enactment of Washington's new Stand Alone Estate Tax is unconstitutional because it violates: (a) the Impairment Clauses of the United States Constitution (Art. I, § 10) and Washington Constitution (Art. I, § 23); and (b) the prohibition against unclear taxation in Washington Constitution Art. VII, § 5?

7. Whether, if the DOR applies the new Stand Alone Tax to pre-enactment QTIP Trusts, the 2006 Regulations—which on their face exclude QTIP Trusts—also applies to exclude Thomas's Trusts from taxation in Jessie's Estate?

8. Whether the Estate of Jessie Campbell Macbride is entitled to a refund of the entire amount of tax paid, $638,703, plus interest?

III. STATEMENT OF FACTS

A. Thomas H. MacBride's Estate.

The tax imposed by the DOR relates to a transfer to a trust by Jessie's predeceasing husband under a prior tax scheme. Thus, the background of Thomas's Estate is important to the understanding of the issues on this case.

1. Thomas Transferred Property to his Marital Trusts.

Jessie was married to Thomas H. MacBride, who died on October 20, 1999. CP 172. Under Thomas's Estate Plan, Thomas's Estate transferred Thomas's property to two Marital Trusts, effective as of the date of his death. *See* CP 197-199, 201-213; 171-182, 172-173.[7] Thomas's Estate Plan also directed the ultimate disposition of the assets out of these Trusts. *Id.* Upon Jessie's death, the entirety of Thomas's Trusts would pass to other beneficiaries identified by Thomas's Estate Plan (not by Jessie's Estate). *Id.* Although she would receive a lifetime benefit, Jessie would retain no interest in Thomas's Trusts at her death. *Id.* Thomas's Estate filed a Washington estate tax return, received final clearance from the state, and his estate was closed. *See* CP 224-225; 171-182, 173. Thomas's Estate was a separate probate proceeding, now

[7] Thomas's Trusts are created and directed pursuant to Thomas's Estate Plan, specifically the Amended and Restated Living Trust Agreement, dated July 30, 1998, which created the marital trusts on his death. CP 201-213.

closed, and the DOR is not seeking any taxes from Thomas's Estate in this proceeding, which received state tax clearance. *Compare* CP 5 ¶ 9, *with* CP 35 ¶ 2.

2. After Thomas's Death, Washington's Estate Tax was Completely Phased Out.

Thomas created his Trusts when the state pickup tax was in effect. *See Estate of Hemphill*, 153 Wn.2d at 547. Under the pickup tax, the total amount of federal and state estate taxes paid by an estate would not change since the amount of estate tax paid to the state was credited against the allowable federal estate tax. *Id.* at 547-48. The pickup tax was therefore completely dependent upon the federal death tax credit.

Beginning in 2001, Congress phased out the state death tax credit under the Economic Growth and Tax Relief Reconciliation Act ("EGTRRA"), eliminating it completely for estates of persons dying after December 31, 2004. *Id.*; Economic Growth and Tax Relief Reconciliation Act, P.L. 107-16, § 531. Because Washington's pickup tax was matched with the federal tax scheme, EGTRRA also caused a phase out of Washington's estate tax. *Id.* at 548-49.

The DOR ignored this phase out, because the language of the Washington statute froze the state death tax credit at the 2001 level. *Id.* at 549-52. If the language of the statute were applied literally, the DOR's conclusion would have been accurate. However, the Washington Supreme Court rejected the DOR's position, ruling that the intent of the pickup tax scheme was to pickup the reduced federal credit each year after 2001 – even if the statute's definition said otherwise.[8] *Id.* On December 31, 2004, the phase out was complete and there was no Washington estate tax for the next four and half months.

3. Thomas's Estate Made a Federal QTIP Election but Did not Make a Corresponding Washington State QTIP Election.

While the pickup tax was still in effect, Thomas's Estate made an irrevocable election under I.R.C. § 2056(b)(7) to treat the Trusts as "QTIP Trusts" for purposes of federal tax law. When such a QTIP election is made, property transferred to a QTIP trust will qualify for a deduction on the taxpayer's federal return. IRC § 2056(b)(7)(B)(v). Assets remaining in the QTIP trust as of the surviving spouse's death, if any, are subject to the federal estate tax at that time. IRC § 2044(b)(1)(A). QTIP §§ 2056(b)(7) and 2044(b)(1)(A) operate together in this manner.

On its Washington estate tax return, Thomas's Estate did not make a state QTIP election. CP 171-182, 174. No similar state election *could have been made* in Jessie's state estate tax return. A Washington QTIP election is now available to Washington taxpayers under RCW

[8] "[F]or decedents dying in 2002, a 75 percent credit was allowed; in 2003, a 50 percent credit; and in 2004, a 25 percent credit." *Id.* at 548-49.

83.100.047; however, as of Thomas's death, no state QTIP deduction was available.

B. Legislature Enacts a New "Stand Alone" Estate Tax on May 17, 2005, After Thomas's Death and the Creation of Thomas's Trusts.

After Thomas's death and the transfer to his Trusts, the Washington legislature enacted the new Stand Alone Estate Tax. In *Hemphill*, the supreme court had held that "until or unless the legislature revises RCW 83.100.030 to specifically and expressly create a *stand alone* estate or inheritance tax," the state's estate tax would effectively be eliminated with the state death tax credit. *Hemphill*, 153 Wn.2d at 551-52 (emphasis added). Consequently, on May 17, 2005, the Washington Legislature enacted the new stand-along estate tax under Laws of 2005, Ch. 516 (codified in RCW Ch. 83.100). Unlike the former pickup tax, the new Washington estate tax is not tied to the federal tax obligation, but is a "stand alone tax . . . independent of the federal tax obligation" imposed "on every transfer of property located in Washington." *Id.* (The primary taxing authority of the new Stand Alone Estate Tax, RCW 83.100.040, is attached as *Appendix A*.)

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

On April 9, 2006, the DOR adopted regulations in connection with the new Act ("2006 Regulations"). *See* WAC Chapter 458-57. Among other things, the 2006 Regulations set forth the manner in which the Washington taxable estate is to be calculated. WAC 458-57-105(2006); WAC 458-57-115 (2006)[9]. Under the Act and the 2006 Regulations, the calculation of "Washington taxable estate" begins with the "federal taxable estate." RCW 83.100.020(13); WAC 458-57-105(3)(q) (2006).[10] However, IRC § 2044 property is then excluded:

> (q) "Washington taxable estate" means the "federal taxable estate":
>
> . . .
>
> (vi) <u>Less any amount included in the federal taxable estate pursuant to IRC § 2044</u> (inclusion of amounts for which a federal QTIP election was previously made).

[9] The new Tax Act also incorporates the unlimited marital deduction concept for state estate tax purposes. It allows for an irrevocable election to be made to qualify a QTIP trust for a state marital deduction. RCW 83.100.047. However, the election to qualify a QTIP trust for the state marital deduction is separate and distinct from an election to qualify the trust for the federal estate tax marital deduction. *Id.* The 2006 Regulations make clear that the federal QTIP election and Washington state WTIP election are separate and distinct, noting that a personal representative may make a larger or smaller election for Washington estate tax purposes than for federal estate tax purposes. WAC 458-57-115 (2)(c)(iii)(A)(2006).

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

WAC 458-57-105(3)(q)(vi)(2006); WAC 458-57-115(2)(d)(vi)(2006) (emphasis added). (Attached as *Appendix B.*) The 2006 Regulations further provide that only the assets remaining in a Washington QTIP trust for which a Washington QTIP election was made are to be included in the surviving spouse's Washington taxable estate. WAC 458-57-105(3)(q)(v)(2006); WAC 458-57-115(2)(d)(v)(2006).

D. Jessie Died After the Enactment of New Tax Act, and Her Estate Complied with the New Act and Regulations.

Jessie C. MacBride died on October 21, 2007, after the effective date of the new Tax Act. CP 173. By this time, the DOR asserted that it was entitled, under the new Act, to tax transfers made to marital trusts prior to the enactment of the Act. Essentially, the DOR applied its own interpretation of the new Act to reach back and capture tax the Supreme Court in *Hemphill* had rendered nontaxable.

Jessie's Estate did not agree with the DOR's position, and the Estate made a Washington state tax deposit of $642,953 "UNDER PROTEST" prior to filing the Estate's estate tax returns. *See* CP 242, 244; CP 173. Consistent with the new Act and DOR's 2006 Regulations, Jessie's Estate filed its Washington State Estate and Transfer Tax Return (for deaths occurring on or after May 17, 2005) and properly excluded marital trust property in the amount of $6,427,844. *Id.*; *see* CP 246-247;

CP 171-182, 173-174. Because Jessie's Washington Estate Tax Deposit exceeded the amount of estate tax actually due to the DOR under the DOR's own regulations and tax forms, Jessie's Estate sought a refund of taxes overpaid in the amount of $642,953.[11] CP 174. On January 27, 2009, the DOR refunded only $4,401 of the requested refund amount, leaving an outstanding refund claim of $638,703. *See* CP 24, 87, 249, 251.

E. Petitioners File this Lawsuit.

Jessie's Estate requested an internal adjudicative review with the DOR. The DOR has conceded that it did not provide the Petitioners with an internal administrative review before it deprived them of these funds. *See* CP 39.[12] Out of an abundance of caution, Jessie's Estate filed this lawsuit under RCW Ch. 34.05 within 30 days of the first indication that the DOR might be denying its refund. CP 1-24, 31. King County Superior Court Judge Jeffrey Ramsdell heard oral argument on cross-motions for summary judgment on July 30, 2010, and entered orders on both on August 2, 2010. Judge Ramsdell ruled in favor of the DOR on both motions and later denied the Appellants' motion for reconsideration.

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[11] Jessie's Estate has not yet received a final determination of federal tax liability or a final state tax release; however, the Department has not objected to the timeliness of the petition for judicial review under RCW Ch. 34.05. CP 171-182, 174.

[12] The Appellants note that the "Finding of Fact" that all administrative remedies had been exhausted is misleading because the Department of Revenue also contends that "no adjudicative proceeding was available." *See* CP 39.

F. Status of Similar Cases on Appeal.

The *Macbride Estate* appeal is one of several cases involving the same or similar issue currently on appeal in Washington appellate courts. Two other cases, *In re Estate of Sharon Bracken* (the "*Bracken Estate*") and *In re Estate of Barbara J. Nelson* (the "*Nelson Estate*"), have been consolidated for review and are now pending before the Washington Supreme Court (case no. 84114-4). The *Bracken Estate* reached the Supreme Court on a Petition for Direct Review, granted on August 5, 2010. The *Nelson Estate* first appealed to Division I but was later transferred to the Supreme Court and consolidated on October 12, 2010.

The Macbride Estate and the DOR do not dispute that the Washington Supreme Court will resolve the core issue involving the taxability of pre-Act QTIP trusts under the Stand Alone Estate Tax. However, one difference between the *Bracken Estate-Nelson Estate* cases and the *Macbride Estate* is that the former two cases involve an alleged "deficiency" of taxes not paid, while the instant case involves a request for a refund of taxes overpaid.

IV. ARGUMENT

A. The Standard of Review in a Tax Refund Case Involving the Interpretation of a Tax Statute is *De Novo.*

The standard of review in this case is *de novo*. At its core, this case involves the interpretation of a state tax statute and the Appellants' right to a refund for overpayment of tax. There are no material factual issues.[13] When the material facts in a tax refund case are undisputed and the only issues to be resolved are legal in nature, the appellate court reviews legal conclusions *de novo*. *Simpson Inv. Co. v. Dep't of Revenue*, 141 Wn.2d 139, 148, 3 P.3d 741 (2000); *Nordstrom Credit, Inc. v. Dep't of Revenue*, 120 Wn.2d 935, 940, 845 P.2d 1331 (1993).

An administrative agency's erroneous interpretation of law is also reviewable *de novo*. *See Quadrant Corp. v. State Growth Management Board*, 154 Wn.2d 224, 110 P.3d 1132 (2005) (when reviewing a challenge to an administrative action based upon the argument that the agency erroneously interpreted or applied the law, the appellate reviews the issue of law *de novo*); *see also*, *City of Olympia v. Drebick*, 156 Wn.2d 289, 295, 126 P.3d 802 (2006) (citing *Dep't of Ecology v. Campbell & Gwinn, LLC*, 146 Wn.2d 1, 9, 43 P.3d 4 (2002)). Moreover, it is a straightforward rule of law that summary judgment decisions are reviewed

[13] The parties agreed to supplement the agency record with facts introduced in the trial court record before summary judgment. *See* CP 6.

de novo. *Muckleshoot Indian Tribe v. Washington Dep't of Ecology*, 112 Wn. App. 712, 724, 50 P.3d 668 (2002).

B. Any Question of Ambiguity in a Taxing Statute is to be Construed Strictly in Favor of the Taxpayer.

As is discussed in more detail below, the Macbride Estate and the DOR argue different interpretations of the new Stand Alone Estate Tax. One important rule of statutory construction of tax laws is applicable in the analysis of the parties' respective interpretations in this case. The longstanding rule of construction in Washington is that if *any* doubt or ambiguity exists as to the meaning of a taxing statute, "the statute must be construed most strongly against the government and in favor of the taxpayer." *Agrilink Foods, Inc. v. Dep't of Revenue*, 153 Wn.2d 392, 103 P.3d 1226 (2005); *Sacred Heart Medical Ct. v. Dep't of Revenue*, 88 Wn. App. 632, 636-37, 946 P.2d 409 (1997); *Ski Acres, Inc. v. Kittitas County*, 118 Wn.2d 852, 857, 827 P.2d 1000 (1992); *Dep't of Revenue v. Hoppe*, 82 Wn.2d 549, 552, 512 P.2d 1094 (1973); *see also*, *Gould v Gould*, 245 US 151, 38 S.Ct. 53, 62 L.Ed. 211 (1917) ("in the case of doubt [tax laws] are construed most strongly against the government, and in favor of the citizen"). The Macbride Estate contends that the tax law can be plainly read as excluding any pre-Act QTIP Trusts. However, to the extent that this Court concludes that the statutes or regulations can be read as having two meanings, the Macbride Estate must prevail under this rule construction favoring the taxpayer.

The DOR will attempt to reframe this issue to turn this presumption on its head. In arguments before the lower court, the DOR argued that the case involved a "deduction" rather than a nontaxable transfer, because ambiguities in specific deductions and tax exemptions are construed in favor of the taxing authority. CP 12. The DOR made a similar argument in *Tesoro Refining & Marketing Co. v. Dep't of Revenue*, 135 Wn.App. 411, 144 P.3d 368 (2006). In *Tesoro*, the taxpayer argued instead that the case was a "tax incidence" case as opposed to a "tax exemption" case. *Id.* at 417. The distinction was crucial, because in a tax incidence case, the court must resolve any ambiguity in the taxing statute in favor of the taxpayer; whereas in a tax exemption case, the court resolves any ambiguities in favor of the Department. *Id.* at 418. Tesoro maintained that the taxing incident did not occur because it did not possess refinery gas under the statutory definition of the statute of "possession." *Id.* Because the court held that the issue was whether the actions of Tesoro met the definition of possession of gas subject to taxation, the court held that it was a tax incidence case, and any ambiguities in the statute would be interpreted in the taxpayer's favor. *Id.*; *see First American Title Insurance Co.*, 144 Wn.2d 300, 303, 27 P.3d 604 (2001);

see also, Crown Zellerbach Corp. v. State, 45 Wn.2d 749, 756, 278 P.2d 305 (1954) (contrasting a deduction for the intrastate wholesaling of particular goods, which is *taxable*, with the activity of wholesaling particular goods in interstate commerce, which "is simply *nontaxable*.")

Similarly here, the Macbride Estate's argument is that QTIP Trusts created before the new statute are not subject to taxation. There is no tax incidence because pre-Act QTIP property is not subject to tax after the new Stand Alone Estate Tax. Any questions about doubt or ambiguity must, therefore, be most strongly construed in the favor of the Macbride Estate.

C. The Language of the New Stand Alone Estate Tax Demonstrates that the Legislature Did Not Intend to Impose a New Tax on Irrevocable QTIP Trusts Created Prior to May 17, 2005.

1. The State Legislature was Clear that the New Stand Alone Tax Act is to be Applied Prospectively Only, Not Retroactively, Only to Estates of Decedents Dying on or After May 17, 2005.

The primary objective of any statutory construction inquiry is "to ascertain and carry out the intent of the Legislature." *Homestreet, Inc. v. Dep't of Revenue*, 166 Wn.2d 444, 210 P.3d 297 (2009); *Rozner v. City of Bellevue*, 116 Wn.2d 342, 347, 804 P.2d 24 (1991). When the state legislature enacted the new Stand Alone Estate Tax, it emphasized its clear mandate that the Act operates "prospectively only and not retroactively.[14]" To ensure that this intent was crystal clear, the legislature also said specifically that "[Sections 2 through 17 of this act] "apply only to estates of decedents dying on or after May 17, 2005.[15]" The DOR does not dispute this unmistakable legislative intent. Neither does the DOR dispute that the new Stand Alone Estate Tax applies only to transfers made on or after May 17, 2005.

In an illustrative case, the U.S. Supreme Court held that where an estate tax was intended to be applied prospectively, the government could not tax transfers to an irrevocable trusts made prior to the effective date of an amendment. *See Hassett v. Welch*, 303 U.S. 303, 58 S.Ct. 559, 82 L.Ed. 858 (1938). In *Hassett*, the Court analyzed the effect of a tax law amendment that required that the gross estate include the value "at any time" of the decedent's real property, and whether transfers to a pre-amendment trust would be taxed. *Hassett,* 303 U.S. at 307-08. The Court applied two well-known principles of statutory construction: (i) that a law is presumed, in the absence of clear expression to the contrary, to operate prospectively; and (ii) if doubt exists as to the construction of a taxing statute, the doubt should be resolved in favor of the taxpayer. *Hassett*, at

[14] Laws of 2005, ch. 516, § 20 (codified in part at RCW 83.100.040).
[15] Laws of 2005, ch. 516, § 20. Sections 2 through 17 of the new session law include the changes to RCW 83.100.020, 83.100.040 and 83.100.047.

314. The Court held that the amendments did not apply to transfers with a reservation of life income made prior to the date of adoption of the amendments. *See id.*

The Washington legislature did more than simply rely on a presumption of prospectivity: the Stand Alone Estate Tax Act expressly and unequivocally states that it is to be applied prospectively only. Thus, there should be no legitimate question that the transfers Thomas made to the QTIP trusts, made irrevocable prior to the effective date of the new Act, cannot now be taxed.

Notwithstanding, the DOR argues that it can apply provisions of the Stand Alone Estate Tax retroactively to a pre-Act trust. The DOR first contends that Thomas's QTIP Trust must be added to Jessie's "Washington taxable estate" under RCW 83.100.020(13)&(14) solely by operation of IRC § 2044.[16] CP 119-120. IRC § 2044 is the federal tax

[16] The path from "IRC § 2044" to "Washington taxable estate" is not a short one. The DOR starts with the heading "Washington taxable estate" atop the left column of the table in RCW 83.100.040(2). Washington taxable estate is defined in RCW 83.100.020(13) as "federal taxable estate" less a $1.5 million exemption for decedents dying before January 1, 2006 (and $2 million after) and any RCW 83.100.046 deduction. "Federal taxable estate" in turn means the taxable estate under the Internal Revenue Code, without regard to the sunset termination of the federal estate tax or the deduction for state death taxes. RCW 83.100.020(14). The DOR then identifies IRC § 2051 (not specifically called out by section number in the Act or any of its definitions), which provides that "the value of the taxable estate shall be determined by deducting from the value of the gross estate the deductions provided for in this part." The "gross estate" is further defined in IRC § 2031 as "determined by including to the extent provided in this part [IRC §§ 2031-2046], the value at the time of [the decedent's death] of all property...." Neither IRC § 2051 nor § 2031 point specifically to IRC § 2044; however,

code provision that adds back into a surviving spouse's *federal* taxable estate for *federal* tax purposes all marital property deducted by a predeceasing spouse's estate under IRC § 2056(b)(7). Then the DOR concludes that because IRC § 2044 property is included in the surviving spouse's federal taxable estate, there is a "transfer" under RCW 83.100.040(1) subject to Washington estate tax. CP 120. In other words, the DOR is not arguing that Thomas's Trusts should be taxed at the state level because they are transfers; rather, the DOR argues they are transfers only because they are taxed at the federal level (under IRC § 2044)[17].

Section 2044[18] of the Internal Revenue Code (which had no Washington state counterpart before May 17, 2005) does not exist in isolation. It is inextricably linked to the prior action of the executor of a predeceasing spouse's estate in making certain elections, including the election under IRC § 2056(b)(7) [19] ("this section applies to any property if . . . a deduction was allowed . . . under section 2056 by reason of subsection (b)(7) thereof"). Sections 2044 and 2056(b)(7) work in

IRC § 2044(a) provides that "the *value* of the gross estate shall include the *value* of any property to which this section applies." (ital. added).

[17] As is explained below, this is not a transfer because the termination of a surviving spouse's terminable lifetime interest on her death leaves nothing to be transferred at all.

[18] Entitled "Certain Property For Which Marital Deduction Was Previously Allowed."

[19] Section 2044 property may also arise from a prior deduction under IRC § 2523 in some instances (*i.e.*, gifts to spouse). The automatic inclusion of § 2044 property in the Washington taxable estate of a donee on the basis of a prior gift under § 2523 results in the unlawful imposition of a gift tax. As discussed herein, Washington state has no gift tax.

tandem, and IRC § 2044 property does not exist but for, and only as a result of, a prior § 2056(b)(7) election.[20] In short, the only reason IRC § 2044 is implicated in Jessie's Estate at all is that a § 2056(b)(7) election was previously made in Thomas's Estate.

The DOR's brief recognizes how integral the pre-Act Section 2056(b)(7) (QTIP) election is to the framework of its analysis in this case. In its brief, the DOR points out that "[w]hile this case involves the estate tax treatment of QTIP included in the taxable estate of Jessie Campbell Macbride, facts pertaining to the QTIP election made by Jessie's husband Thomas Macbride [sic—made by executors of Thomas Macbride's estate], are important." CP 112, at 11. 7-9. Of course these facts are important. If the DOR is not able to reach back, point to, and rely upon the election of the estate of a decedent dying before the May 17, 2005 enactment date, the DOR has no case. This pre-Act application in the estate of a post-Act decedent violates the express intent of the statute.

2. RCW Ch. 83.100 can Only be Read in Harmony for End Dates Generally, and the Statute's Stated Effective Date Provision by Excluding IRC § 2044 Property in the Case of Pre-enactment QTIP Trusts.

There is no legislative intent that IRC § 2044 property would automatically be incorporated into every Washington taxable estate,

[20] It can also arise as the result of an IRC § 2523(f) election, discussed herein.

including pre-enactment QTIP trusts created before the May 17, 2005 enactment date, whether by death or otherwise. On the other hand, the legislature anticipated the potential conflict caused by its use of certain provisions of the federal Internal Revenue Code. While the legislature provided the new stand alone tax would be "independent of the federal tax obligation,[21]" the statute also calls out certain specific sections of the Internal Revenue Code for reference purposes, including IRC §§ 2001 and 2031. To reconcile this paradox, RCW 83.100.040(3) provides in part that the new Stand Alone Tax "incorporates only those provisions of the Internal Revenue Code . . . that do not conflict with the provisions of [the new Tax Act]." (emphasis added).

One conflict arising out of the "automatic IRC § 2044 property incorporation" argument is the conflict between IRC § 2044 and RCW 83.100.047.[22] RCW 83.100.047 provides for a separate Washington QTIP election. When a separate Washington QTIP election is made under

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[21] RCW 83.100.040(3).

[22] RCW 83.100.047(1) provides that:

> If the federal taxable estate on the federal return is determined by making an election under section 2056 or 2056A of the Internal Revenue Code, or if no federal return is required to be filed, the department may provide by rule for a separate election on the Washington return, consistent with section 2056 or 2056A of the Internal Revenue Code, for the purpose of determining the amount of tax due under this chapter. The election shall be binding on the estate and the beneficiaries, consistent with the Internal Revenue Code. All other elections or valuations on the Washington return shall be made in a manner consistent with the federal return, if a federal return is required, and such rules as the department may provide.

RCW 83.100.047, IRC § 2044 property must necessarily be excluded[23] - *even though the statute does not expressly provide*. If IRC § 2044 property were incorporated *automatically* as the DOR argues, RCW 83.100.047 would be superfluous. Constructions that would render a portion of a statute "meaningless or superfluous" should be avoided. *See State v. Keller*, 143 Wn.2d 267, 277, 19 P.3d 1030 (2001). Thus, the addition of RCW 83.100.047 is a legislative recognition that IRC § 2044 property will not always be added back into the Washington taxable estate, but must be excluded from the calculation of the Washington taxable estate in *some* instances.

Similarly, the "automatic IRC § 2044 property incorporation" argument also leads to the imposition of unauthorized gift tax through the backdoor of IRC § 2044(b)(1)(B). As is the case in most states, Washington has no gift tax. *See* WAC 458-57-105(2)(b) ("the state of Washington does not have a gift tax"). However, if the DOR's logic that IRC § 2044 property is automatically added into the Washington taxable estate is accepted, the DOR will also end up taxing certain gifts. For federal tax purposes, a deduction is allowed for a spouse who transfers property to a "gift QTIP trust" for the lifetime benefit of a spouse. *See*

[23] The DOR's own 2006 Regulations and 2009 Regulations acknowledge that IRC § 2044 property is not included in the calculation of the taxable estate in every single case and without exception.

IRC § 2523(f). Although the donor spouse is entitled to a deduction for inter vivos transfers to a gift QTIP trust, the donee spouse's estate must later add gift QTIP trust property to the recipient spouse's total taxable estate under IRC § 2044(b) for federal tax purposes. Under the DOR's logic, gift QTIP trust property would also be added back into the donee spouse's *Washington* taxable estate under RCW 83.100.020(12) and taxed at the donee spouse's death. Thus, notwithstanding there is no Washington gift tax, the DOR effectively creates such a tax by automatically including IRC § 2044(b) property in the Washington taxable estate. The legislature cannot have intended to permit an unauthorized tax in this manner. This is further illustration that the legislature did not intend to automatically or mechanically import, add back and impose Washington tax on IRC § 2044 property, but that certain exceptions apply.

Another example of the flaw in the "automatic IRC § 2044 property incorporation" argument is the taxation of IRC § 2044 property arising from QTIP elections made by a non-Washington decedent's estate for out of state property. Washington could not have imposed an estate tax on out of state property when the QTIP election was made, so the corresponding IRC § 2044 property should not be automatically included in the estate of the surviving spouse (who later dies a Washington resident).

Finally, the automatic incorporation of IRC § 2044 property for pre-Act QTIP Trusts leads to an inconsistent and unfair application of RCW 83.100.047. Where *both* the federal QTIP-electing spouse (*i.e.*, the first dying spouse's estate making the election under IRC § 2056(b)(7)) and the surviving spouse charged with resulting IRC § 2044 property died *before May 17, 2005*, neither the new Stand Alone Tax in RCW 83.100.040 nor the state QTIP election in RCW 83.100.047 would apply. Where both spouses die *on or after* May 17, 2005, both RCW 83.100.040 and 83.100.047 would apply. However, where the federal QTIP-electing estate is for a spouse who died before May 17, 2005, but the surviving spouse with IRC § 2044 property dies on or after May 17, 2005, the DOR applies one statutory section but not the other: it would impose the new tax in RCW 83.100.040 but would not permit the use of the corresponding state QTIP rights under RCW 83.100.047.[24]

Both RCW 83.100.040 and RCW 83.100.047 should apply here or both should not apply. To force the Marital Trusts to bear the new, independent, Stand Alone Tax under RCW 83.100.040, but bar the same Trusts from the opportunity to benefit from a separate Washington QTIP election (or nonelection) pursuant to RCW 83.100.047 is unfair, inconsistent, and further demonstrates that the new Stand Alone Tax was

[24] A chart summarizing the DOR's inconsistent application of RCW 83.100.040 and 83.100.047 is attached as *Appendix C.*

intended to apply only to estates where both decedents have died on or after its May 17, 2005 effective date.

This Court has held that all related provisions of a statute are to be read together so as to "achieve a harmonious and unified statutory scheme that maintains the integrity of the respective statutes." *Davis v. Washington Dep't of Licensing*, 137 Wn.2d 967, 963, 977 P.2d 554 (1999) (citing *Whatcom Cty. v. City of Bellingham*, 128 Wn.2d 537, 546, 909 P.2d 1303 (1996)). It is also a "golden rule" of statutory interpretation that unreasonableness of the result produced by one among alternative possible interpretations of a statute is reason for rejecting that interpretation in favor of another which would produce a reasonable result. *State v. McDougal*, 120 Wn.2d 334, 351, 841 P.2d 1232 (1993), citing 2A N. Singer, Statutory Construction § 45.12 (4th ed. 1984). A statute held invalid as applied is not void on its face or incapable of valid application in other circumstances. *See Foundation for the Handicapped v. Dep't of Soc. & Health Serv. of Washington*, 97 Wn.2d 691, 695, 648 P.2d 884 (1982), citing 1 J. Sutherland, Statutory Construction § 2.06 (4th ed. 1972).

The interpretation that pre-Act QTIP trusts of decedents dying before May 17, 2005 are not taxable in the Washington estates of decedents dying on or after the enactment of the new Stand Alone Tax Act harmoniously reconciles and unifies all of the statutory intent provisions (including "prospective only and not retroactive," "applied only to estates of decedents dying on or after May 17, 2005"); leads to consistent applications of all provisions of the statute; and avoids unjust, unfair and unreasonable results. Section 2044 property arising from pre-Act QTIP trusts should be excluded from the Stand Alone Estate Tax.[25] The statute as a whole is preserved in this manner.

D. The Expiration of Jessie's Terminable Life Interest on Her Death Is Not a "Transfer" Subject to Taxation by the State of Washington.

A fundamental prerequisite of taxation under the new Stand Alone Tax Act is that there be a "transfer of property" of the decedent. See RCW 83.100.040(1). It is axiomatic that if there is no transfer, there can be no tax. A careful examination of the legal effect of Thomas's QTIP trust will establish that the Trusts were not transferred from the Estate of Jessie Campbell Macbride.

Thomas's Trusts are irrevocable trusts created by the personal representatives of Thomas's Estate according to the terms of Thomas's Will. Thomas's Trusts were valid trusts under Washington trust law when created as of his death on October 20, 1999. *See In re Morton's Estate*, 188 Wash. 206, 61 P.2d 1309 (1946); 76 Am. Jur. 2d, Trusts, § 57 (2010);

[25] Because IRC § 2044 is a federal fiction, it can also be disregarded where appropriate. "The [QTIP] fiction is like a scaffolding in that it can be removed with ease." *See* D. Irwin, *Removing the Scaffolding – The QTIP Provisions and the Ownership Fiction*, 84 Neb.L.Rev. 571, 572 (2005)

Uniform Trust Code § 402(a)(2). It is also undisputed that there was a transfer of property by Thomas's Estate to the trusts as of Thomas's death effective as of October 20, 1999. The distribution of trust property out of Thomas's Trusts to beneficiaries of the Trusts is also controlled by Thomas's estate planning documents. The interests of the beneficiaries of Thomas's Trusts therefore vested at the time of the creation of the Trusts. *See Van Stewart v. Townsend*, 176 Wash. 311, 28 P.2d 999 (1934) (the fact that the beneficiaries were not to come into the enjoyment of the property until later, after the death of the donor does not affect the vesting of their interest). Jessie had a lifetime interest that terminated on her death. Neither Jessie nor her estate had any interest in the Trusts at her death.

The DOR admits that the transfer from Thomas H. Macbride, via his Estate, to his Marital Trusts was a transfer of wealth subject to taxation. CP 188 (RFA no. 5). There is no dispute as to this transfer. The DOR also concedes that Jessie had only a lifetime interest in the Trusts, which interest terminated at Jessie's death.[26] Jessie had no ability to transfer Thomas's interest, because those testamentary dispositions were fixed at Thomas's death.

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[26] Indeed, the DOR concedes that William's Trusts each qualify as a "QTIP," which requires that the surviving spouse lifetime interest be "terminable." *See* CP 111, 112, citing IRC § 2056(b)(7)(B)(i).

Nevertheless, the DOR alleges a "second transfer of property" from Jessie Campbell Macbride at her death. There is absolutely no support for a second transfer as that concept is generally applied – the death of the beneficiary of a terminable lifetime interest (not created by the beneficiary for herself) has never been held to be a *second* transfer of wealth.

The Fifth Circuit explained this fundamental principle *Clayton v. Comm'r*, 976 F.2d 1486, 1491-92 (5th Cir. 1992). The court noted that after *Fernandez v. Wiener,*[27] Congress created a Marital Deduction in the Revenue Act of 1948 to equalize the disparity between community property and common-law jurisdictions. *Id.* at 1491. The Marital Deduction as applied to terminable interests created a problem for Congress, however, because "[a]n interest that terminates does not form part of the death estate of the surviving spouse." "If a terminable interest in property were deductible in the first estate, such property would escape tax in the estates of *both* spouses," because it would not be taxable at the death of the surviving spouse. *Id.* at 1491. This is because, by definition, a "terminable interest" is simply not property owned by the second spouse. "Indeed, this principle is so deeply entrenched in the structure of the

[27] *Fernandez v. Wiener*, 326 U.S. 340, 66 S. Ct. 178, 90 L. Ed. 116 (1945), involved the peculiarities of Louisiana community property law, not the extinguishment of a lifetime beneficiary's interest in an irrevocable trust, and does not control this case.

federal estate tax that formal judicial and administrative pronouncements to this effect are unnecessary and hard to find.[28]" *See* 5 B. Bittker & L. Lokken, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 125.5, at 125-11 (1993) (herein, "Bittker"); *see also*, *U.S. v. Field*, 255 U.S. 257, 41 S. Ct. 256, 65 L.Ed. 617 (1921); *Helvering v. Safe Deposit & Trust Co.*, 316 U.S. 56, 62 S. Ct. 444, 86 L.Ed. 1266 (1942) (cases that construe the termination of such trusts to not be transfers of an interest in property when the surviving spouse dies). (Copies of excerpts of the Bittker and Mertens treatises are attached as *Appendices D & E.*)

Section 2044 was created as a federal legislative fiction to serve as a necessary counterpart for § 2056(b)(7) in order to provide that deductibility by the estate of the spouse creating a QTIP Trust would also be matched with includability in the surviving spouse's federal estate, by

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[28] Estate tax treatises universally recognize that there is no transfer at the death of a lifetime beneficiary of a trust that also contains a remainder interest. *See* R. Stephens, G. Maxfield, S. Lind, D. Calfee & R. Smith, FEDERAL ESTATE AND GIFT TAXATION ¶ 4.05[5][b], at 4-157 (8TH ed. 2002) (where A grants B a life estate in Blackacre or lifetime beneficiary interest in a trust, subject to a remainder interest, "B has no interest that B can transmit to others at B's death"). This is because the death of the lifetime beneficiary is a neutral tax event because the estate and gift taxes are exactions on the transmissions of wealth. *Id.* n.51. There is no transmission of wealth by the lifetime beneficiary whose interest terminates at death. *Id.* This is also consistent with the Mertens treatise discussion of the concept of transfer cited by the DOR, which concludes that "a basic element is that the decedent must have an interest in property which is capable of transfer." *See* 1 J. Mertens, THE LAW OF FEDERAL GIFT AND ESTATE TAXATION § 1.04, at 11 (1959). The beneficiary of a terminable lifetime interest has no interest in property capable of transfer at death, and the lifetime beneficiary's interest is also not a taxable interest at death. *Id.*

virtue of the IRC § 2044 definition.[29] Because the only right the surviving spouse has is the lifetime receipt of income, which interest terminates at her death, there is otherwise no interest in the surviving spouse's estate to be taxed with respect to a QTIP Trust. If the termination of a surviving spouse's life estate *were* a taxable event standing *on its own*, it would have been unnecessary for Congress to enact IRC § 2044. Thus, there is no independent, second transfer at the death of a surviving spouse who held only a terminable lifetime beneficial interest.

E. A State Cannot Impose a New Tax On an Irrevocable Trust that was Completely Vested Prior to the Enactment of a New Tax.

The new Stand Alone Estate Tax imposes a tax on *transfers*[30] *of property* by a decedent. RCW 83.100.040(1) (emphasis added). Under longstanding Washington precedent, a state cannot impose or collect an estate tax "unless some right in it be transferred by the death of the decedent." *In re McGrath's Estate*, 191 Wn. 496, 503-05, 71 P.2d 395

[29] *See also*, *Estate of Bonner v. Comm'r*, 84 F3d 196, 199 (5th Cir. 1996); *Estate of Mellinger v. Comm'r*, 112 T.C. 26, 36 (1999) acq. 1999-2 CB.

[30] "Transfer" is defined in RCW 83.100.010(11) as meaning the same as " 'transfer' as used in section 2001 of the Internal Revenue Code." There is no further definition of "transfer" under IRC § 2001 in federal law. Although "transfer" has no special meaning in federal law, an estate tax can only be imposed on wealth *transfers*, not on wealth itself. *See* R. Stephens, G. Maxfield, S. Lind, D. Calfee & R. Smith, FEDERAL ESTATE AND GIFT TAXATION, at 2-2, ¶ 2.01 n.3 (8th ed. 2001). An indirect tax on the transmission of wealth is constitutional as long as it is imposed uniformly throughout the U.S. *Id.* In contrast, a direct tax on wealth must be apportioned across the states in accordance with their respective populations. *Id.*, citing Tribe, American Constitutional Law, at 841 (3rd ed. 2000). Thus, Washington's Estate and Transfer Tax Act may not tax Barbara's wealth, but may only tax transfers of Barbara's property.

(1937), cert. denied, *Washington v. McGrath*, 58 S.Ct. 749, 82 L.Ed. 1111; *see also*, *Blodgett v. Silberman*, 277 U.S. 1, 48 S.Ct. 410, 413, 72 L.Ed. 749 (1928) (an inheritance or death tax is a tax not upon property but upon the right or privilege of succession to the property of a deceased person); *Coolidge v. Long*, 282 U.S. 582, 51 S. Ct. 206, 75 L. Ed. 562 (1931).

In *McGrath's Estate*, the State attempted to tax an interest in life insurance policies maturing on the decedent's passing. *Id.* McGrath Candy Company had purchased life insurance policies on McGrath's life, payable to the company on his death. When McGrath died, the State attempted to impose a tax on the basis of a new law, the Revenue Act of 1935, which provided that "insurance payable upon the death of a person shall be deemed to be part of the estate for purposes of computing estate tax." *Id.* at 497-98, 502.

The Washington Supreme Court analyzed for the first time the authority of the state to impose and collect an estate tax. *Id.* at 502-03. The Court noted that the right of a sovereign to impose and collect a tax is derived solely from the act of a citizen in transferring property owned. *Id.*

> Estate taxes are not taxes in a strict sense; that is to say, they are not collected by virtue of the right of the sovereign to exact from its citizens from the corpus of their property for the support of the government. They are taken out of property to which ownership has been suspended by the death of the

> taxpayer. The sovereign is the "permissive intermediary through which the property of a decedent passes to his heirs or legatees," and the sovereign can take property out of this estate during this momentary legal custody. What is retained, in exchange for permission to a decedent to pass title to his heirs or legatees, is an estate tax. It is therefore, in the very nature of things, impossible for an estate or inheritance tax to be exacted without respect to something in which the decedent did not own or have some kind of right to at the time of his death, for in such a case there is no transfer.

McGrath's Estate, at 503[31].

Because the decedent in *McGrath's Estate* did not own the property the state attempted to tax, no tax could be imposed. *Id.* at 503-04. The beneficiaries' right had previously vested. *Id.* The Court held that "the death of McGrath added nothing[32] to the company's right to the proceeds of the policies, for the right was from the beginning complete and indefeasible." *McGrath*, at 504.

> Here, the decedent never had any ownership or right of any kind in the policies in question or in the proceeds thereof. He had no vestige of control over them. He did not

[31] The *McGrath* court supported the principle that an estate tax cannot be collected with respect to property unless some right in it be transferred by the death of the decedent by a long line of U.S. Supreme Court precedent. *Lewellyn v. Frick*, 168 U.S. 238, 45 S.Ct. 487, 69 L.Ed. 934 (1925); *Helvering v. St. Louis Union Trust Co.*, 296 U.S. 39, 56 S.Ct. 74, 80 L.Ed. 29, 100 A.L.R. 1239 (1935); *Becker v. St. Louis Union Trust Co.*, 296 U.S. 48, 56 S.Ct. 78, 80 L.Ed. 35 (1935); *Bingham v. United States*, 296 U.S. 211, 56 S.Ct. 180, 80 L.Ed. 160 (1935).

[32] "As the trial judge somewhat whimsically, but very pertinently, remarked in his memorandum opinion, he furnished nothing except the death." *McGrath*, at 510.

> take them out. He did not pay the premiums.

McGrath, at 510. Thus, the court concluded, no tax could be imposed on the insurance proceeds or collected on the value of the insurance proceeds by virtue of McGrath's death, despite the language of the statute imposing a tax.

McGrath's Estate remains good law and has not been overruled. In *Japan Lines v. McCaffree*, 88 Wn.2d 93, 96-97, 558 P.2d 211 (1977), this Court reaffirmed *McGrath's Estate*, noting that "[w]e have imposed narrow and specific limits on the legislature's broad powers in regard to a retroactive tax" under prior cases, including *McGrath's Estate*.[33] *Japan Lines*, at 96-97. Just as in *McGrath's Estate*, Thomas's Trusts were fixed as of the creation of the Trusts, effective as of the date of his death. Jessie could not change the terms of the Trusts or the class of beneficiaries during her life or at her death. When she died, she had no property interest in the Trusts and nothing to transfer. The QTIP Trust interests created by Thomas's Estate were defined, fixed and vested as of the date of Thomas's death effective October 20, 1999. Jessie's lifetime interest in

[33] The *Japan Lines* court said that a statute would be stricken as retroactive when it taxed a privilege which had formerly been freely enjoyed, or changed the expectation of the parties. As explained in the opening of this Reply, Washington's pickup tax, which required a matching federal reimbursement, was repealed, and William's Estate had an expectation under *Hemphill* that it would not be burdened by a new layer of state tax unaccompanied by a federal reimbursement. The DOR's new tax would impose an entirely new, unexpected tax burden.

these Trusts terminated at her death, and she had therefore no interest to shift.[34] The rights of Thomas's Trusts were irrevocably fixed as of the date of his death. Therefore, the legislature has no authority to reach back and impose a wholly new tax on Thomas's irrevocable trusts—even if wished to do so. *See also Indiana Dep't of State Revenue v. Estate of Morris*, 486 N.E. 2nd 1100 (Ind. 1986).

F. Applying the New Stand Alone Tax to Thomas's Pre-Act Trusts Imposes a New Tax Burden in Violation of *Hemphill* and *Turner*.

Appellants anticipate that the DOR will argue that the Macbride Estate is trying to avoid a "deferral" of Washington state estate tax. This argument is misleading for several reasons. *First*, there was no actual deferral. Thomas's QTIP Trust was created under the former pickup tax regime, which had no deferral provisions. The DOR cites federal QTIP provisions as the basis for a deferral, but IRC §§ 2056 and 2044 are *federal* statutes that defer *federal* taxes, not *state* taxes. No corresponding state QTIP provisions existed prior to May 17, 2005.

Second, the former "pickup tax" was *predicated upon* a matching federal reimbursement. As the Supreme Court explained in *Hemphill* and *Turner*:

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[34] As noted in a treatise cited by the DOR to the trial court, the modern concept of transfer requires "that decedent ha[ve] an interest in property at death." 1 J. Mertens, THE LAW OF FEDERAL GIFT AND ESTATE TAXATION § 1.04 (1959). Jessie had no interest in Thomas's Trusts at Jessie's death.

> [P]ickup statutes "do not increase the amount of the combined state and federal tax liability, but merely authorize the state to share in the proceeds of the federal estate tax to the extent of the allowable credit...."

Estate of Hemphill v. Dep't of Revenue, 153 Wn.2d 544, 547, 105 P.3d 391 (2005) (emphasis added); *Estate of Turner v. Dep't of Revenue*, 106 Wn.2d 649, 655, 724 P.2d 1013 (1986) (quoting 42 Am. Jur. 2d, Inheritance, Estate and Gift Taxes § 244, at 452 (1969)). "The estate tax scheme in Washington as currently written, though not automatically adopting specific federal law, must be administered complementary to federal law to guarantee that a separate state tax does not burden estates." *Hemphill*, 153 Wn.2d at 551; *Turner*, 106 Wn.2d at 653-54. "All state estate tax due must be fully reimbursed as a current federal credit." *Id.*

Thus, when Thomas executed his Will on December 21, 2001 and Codicil on August 20, 2003 (CP 858, 239) under the pickup tax regime (which tax law had not changed prior to his death), he knew and expected that the state estate tax obligation would be fully absorbed and reimbursed by a matching federal credit, so that the combined state and federal tax obligation would not be greater than the federal tax bill alone. *See Hemphill*, 153 Wn.2d at 552. The net effect to the Washington estate would be as if the state tax had been zero.

Third, the state estate tax was completely eliminated shortly after Thomas's Trust's were created. As of January 1, 2005, there was no Washington estate tax. *See* C. Mitchell & F. Mitchell, 26B Wash. Prac., Probate Law and Practice § 7.21 (2009). Washington's estate tax was eliminated because EGTRRA (P.L. 107-16, § 531) phased out and eliminated the federal death tax credit for states. *Hemphill*, 153 Wn.2d at 548-49 (otherwise, the amount of the combined state and federal tax liability would impose an impermissible increase to the total tax burden).

From January 1, 2005 to May 17, 2005 (the "Repeal Period"), no Washington state estate tax existed, and none could be assessed against any Washington estate. *See id.* The DOR's deferral argument is turned on its head for QTIP trusts made during the Repeal Period: no Washington estate tax could have been imposed on estates of decedents dying during the Repeal Period, yet the DOR wishes to impose a tax on the estates of surviving spouses dying on or after May 17, 2005 under the new Stand Alone Tax for all QTIP Trusts created during the Repeal Period.

G. Imposition of the New Stand Alone Estate Tax to Pre-enactment Irrevocable Trusts Violates the U.S. and Washington Constitutions.

1. Impairment Clause Violation.

A retroactive statute is unconstitutional when it takes away or impairs vested rights acquired under existing laws. *In re Martin*, 129 Wn.

App. 135, 145, 118 P.3d 387 (2005) (*quoting I.N.S. v. St. Cyr*, 533 U.S. 289, 321, 121 S. Ct. 2271, 150 L. Ed. 347 (2001)); *Wash. Farm Bureau Fed. v. Gregoire*, 162 Wn.2d 284, 304-05, 174 P.3d 1142 (2007) (holding that the legislature may not give an amendment retroactive effect where the effect would be to interfere with vested rights). An interest in an estate vests immediately upon the death of the ancestor in the heir or devisee entitled thereto, subject only to the rights of creditors. *In re Verchot's Estate*, 4 Wn.2d 574, 582, 104 P.2d 490 (1940); *see also Estate of Burns v. Olver*, 131 Wn.2d 104, 118 n.4, 928 P.2d 1094 (1997) (recognizing that heirs' rights vest upon testator's death). The Legislature may not interfere with or divest estates with rights that have already become vested through the death of the testator. *Strand v. Stewart*, 51 Wash. 685, 687-88, 99 P. 1027 (1909). The rights of the remainder beneficiaries of Thomas's Trusts vested at the time of Thomas's death, before Jessie MacBride died.

Application of the Washington estate tax to property (1) held in an irrevocable marital trust created prior to May 17, 2005, and (2) that was never previously subject to the stand-alone Washington estate tax is violative of the Impairment clauses[35] of the United States and Washington State constitutions. The Washington Supreme Court has held that

[35] Article I, Section 10 of the U.S. Constitution provides that "[n]o state shall . . . pass any bill of attainder, ex post facto law, or law impairing the obligation of contracts." Article

a state's imposition and collection of tax for transfers predating the tax violates both the state and federal constitutions:

> An act, subsequently passed, authorizing the taking from those sums of an exaction in the guise of an inheritance tax, would impair the obligation of those contracts, within the meaning of section 10, article 1 of the Federal Constitution: "No State shall . . . pass any . . . Law impairing the Obligation of Contacts" and it would at the same time conflict with section 23, article 1 of our own Constitution, which is as follows: "No . . . law impairing the obligations of contracts shall ever be passed."

In re McGrath's Estate, 191 Wash. 496, 71 P.2d 395 (1937). The *McGrath* Court found that McGrath Candy Company's right to proceeds of the life insurance arose and vested in the company when it executed the insurance contracts, before any change in the tax law. *Id.* Any subsequent statute that attempted to tax the same insurance proceeds would, if enforced, impair the company's contractual rights because the company would receive less than it was entitled to receive under the terms of the contract. *Id.* at 508-09; *see also Blodgett v. Holden*, 275 U.S. 142, 147, 48 S. Ct. 105, 72 L. Ed. 206 (1927) (assessing a tax upon gifts completed before effective date of gift tax was unconstitutional and wholly unreasonable).

I, section 23 of the Washington Constitution provides that "[n]o bill of attainder, ex post facto law, or law impairing the obligations of contracts shall ever be passed."

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

2. Constitutional Prohibition Against Unclear Taxation.

A new tax burden can be created only by law that clearly states such a purpose. *See Hemphill*, at 551. Washington Constitution Art. VII, § 5 provides that:

> No tax shall be levied except in pursuance of law; and every law imposing a tax shall state distinctly the object of the same to which only it shall be applied.

The purpose of the new Act was to create a "stand-alone tax" imposed prospectively on "transfers of property" of decedents dying on or after May 17, 2005, independent of any federal tax obligation. There is no clear statement that pre-Act trusts were the object of the new Act, particularly in light of the prospective-only mandate. Such an unclear objective cannot be upheld under the Washington Constitution.

H. If RCW 83.100.040 Applies, the 2006 Regulations Must Also Apply as Written.

If RCW 83.100.040 applies to pre-Act QTIP trusts (which Appellants contend does not), then RCW 83.100.047 and the 2006 Regulations should apply as well, and as plainly written. The 2006 Regulations correctly exclude IRC § 2044 (that would include amounts for which a federal QTIP election was previously made) from the computation of Washington taxable estate. WAC 458-57-105(3)(q) (2006); WAC 458-57-115(2)(d) (2006) (the "2006 Regulations"). Where a rule is unambiguous, a court does not speculate as to its intent, nor question the wisdom of a particular regulation. *Multicare Med Ctr. v. Dep't of Soc. & Health Servs.*, 114 Wn.2d 572, 790 P.2d 124 (1990). The DOR's 2006 Regulations are entirely consistent with the "prospective only" admonition in the statute and avoid the inconsistent incorporation of IRC § 2044 as applied to pre-Act trusts. However, if this Court determines that RCW 83.100.047 and the 2006 Regulations do not apply to pre-Act QTIP trusts, then, as argued above, the tax under RCW 83.100.040 should not apply, either.

I. The Macbride Estate is Entitled to a Full Refund and a Determination of Interest.

Under RCW 83.100.130(1), if the DOR determines that an application for a tax refund has been filed within the statutory period for assessment of taxes, penalties, or interest prescribed by RCW 83.100.095, and the applicant taxpayer has overpaid estate tax due, the DOR shall refund the amount of the overpayment, together with interest as provided in RCW 83.100.130(2). RCW 83.100.130(1). There is no dispute that the Macbride Estate made proper application for a tax refund within the statutory deadline for requesting such a refund. This Court should order the DOR to issue a refund for the amount of tax overpaid, $638,703, together with an award of interest to be determined by the trial court or the agency on remand. *See Hemphill*, at 551.

V. CONCLUSION

For the reasons set forth above, the trial court's orders should be reversed, and summary judgment should be entered in favor of the Personal Representatives of the Estate of Jessie Campbell Macbride.

Respectfully submitted this 6th day of December 2010.

By: ______________________

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PROOF OF SERVICE

I, Rhys Farren, 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 OPENING BRIEF OF APPELLANTS 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
Charles Zalesky, WSBA #37777
Office of the Attorney General, Rob McKenna
PO Box 40123
Olympia, WA 98504-0123
360.586.0756

Executed at Bellevue, Washington this 6th day of December, 2010.

Rhys Farren

APPENDIX A

RCW 83.100.040
Estate tax imposed — Amount of tax.
(EMPHASIS ADDED.)

(1) **A tax** in an amount computed as provided in this section **<u>is imposed on every transfer</u> of property located in Washington**. For the purposes of this section, any intangible property owned by a resident is located in Washington.

(2)(a) Except as provided in (b) of this subsection, the amount of tax is the amount provided in the following table:

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

(b) If any property in the decedent's estate is located outside of Washington, the amount of tax is the amount determined in (a) of this subsection multiplied by a fraction. The numerator of the fraction is the value of the property located in Washington. The denominator of the fraction is the value of the decedent's gross estate. Property qualifying for a deduction under RCW 83.100.046 shall be excluded from the numerator and denominator of the fraction.

(3) The tax imposed under this section **<u>is a stand-alone estate tax</u>** that **<u>incorporates only those provisions of the Internal Revenue Code</u>** as amended or renumbered as of January 1, 2005, **<u>that do not conflict with the provisions of this chapter</u>**. The tax imposed under this chapter is **<u>independent of any federal estate tax</u>** obligation and is not affected by termination of the federal estate tax.

[2005 c 516 § 3; 1988 c 64 § 4; 1981 2nd ex.s. c 7 § 83.100.040 (Initiative Measure No. 402, approved November 3, 1981).]

Notes:

Finding -- Intent--2005 c 516: "The legislature recognizes that on February 3, 2005, the Washington state supreme court decided in *Estate of Hemphill v. Dep't of Rev.*,

. . . .

Application -- 2005 c 516: "**<u>This act applies prospectively only and not retroactively</u>**. Sections 2 through 17 of this act apply only to estates of decedents dying on or after May 17, 2005." [2005 c 516 § 20.]

. . . .

Document2

APPENDIX B

WAC 458-57-105

Nature of estate tax, definitions.

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

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

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

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

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

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

(b) "Decedent" means a deceased individual;

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

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

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

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

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

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

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

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

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

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

(k) "Person required to file the federal return" means any person required to file a return required by chapter 11 of the Internal Revenue Code, such as the personal representative (executor) of an estate;

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

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

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

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

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

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

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

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

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

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

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

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

[Statutory Authority: RCW 82.32.300 and 82.01.060(2). § 458-57-105, filed 3/9/06, effective 4/9/06. Statutory Authority: RCW 83.100.047 and 83.100.200.]

APPENDIX C

ESTATE OF MACBRIDE v. DEP'T OF REVENUE

CHART OF VARIOUS SCENARIOS UNDER DOR'S POSITION

A. Assumptions for All Scenarios:

- First Dying Spouse ("FDS") elects federal QTIP treatment under I.R.C. § 2056(b)(7).
- Surviving Spouse ("SS") dies with I.R.C. § 2044 QTIP property.

B. Comparison of Three Scenarios:

- First Dying Spouse and Surviving Spouse both die before new Act, May 17, 2005.
- FDS dies before May 17, 2005; SS dies after May 16, 2005.
- FDS and SS both die after the enactment of the new Act, May 17, 2005.

	(1) FDS and SS Both Die Before the New Act, 5/17/2005	**(2) FDS Dies Before 5/17/2005; SS Dies After 5/16/2005**	**(3) FDS and SS Both Die On or After the New Act, 5/17/2005**
83.100.040	Does not apply	Applies	Applies
83.100.047	Does not apply	Does not apply	Applies
2006 Regulations	Does not apply	Does not apply	Applies

APPENDIX D

THE LAW OF FEDERAL GIFT AND ESTATE TAXATION

BY

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IN SIX VOLUMES

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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,

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The courts in upholding the constitutionality of the dower provisions have pointed to the extensive rights (incidents of ownership) in such property determined under state law which ceased at the decedent's death and hence constituted a proper occasion for the levying of an estate tax. See, e.g., Allen v. Henggeler, Adm., 32 F(2d) 69 (8th Cir.1929), 7AFTR8680, cert.den. 280 U.S. 594, 50 S.Ct. 40, 74 L.Ed. 642 (1929), upholding the constitutionality of the 1924 Act, Sec.302(b). See also Nyberg, Adm. v. U.S., 66 Ct.Cl. 153 (1928), 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.[38] Both of these standards fall within the general principle that the underlying justification for imposing the estate tax on an inter vivos transfer is that it remains "incomplete" at death. The question is, not whether there has been, in the strict sense of that word, a "transfer" of the property by the death of the decedent, or a receipt of it by right of succession, but whether the death has brought into being or ripened for the survivor, property rights of such character as to make appropriate the imposition of a tax upon that result to be measured, in whole or in part, by the value of such rights.[39] The essential difference between the old and new rationalization of such justification is that incompleteness can be demonstrated either by ascertaining whether interests remained in the grantor or by determining whether the interests of the beneficiaries were enlarged, improved, or "ripened" at the time of the grantor's death. In demonstrating such incompleteness, substance rather than form or any particular device, is controlling.[40] Both factors had been previously expressed in several early constitutional cases,[41] although their influence was submerged by the fact that a number of the important decisions were rendered in cases which employed the "incomplete" test to determine whether a provision was arbitrarily retroactive under the Fifth Amendment.[42]

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

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

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

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

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

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

APPENDIX E

FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS

SECOND EDITION

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Volume 5

WARREN, GORHAM & LAMONT
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exceeds $600,000,[5] and a six-year statute of limitations applies to the assessment of taxes (in place of the normal three-year period) if an omission from the gross estate exceeds 25 percent of the gross estate reported on the return.[6]

¶125.5 INTERESTS TERMINATING AT DEATH

Section 2033 encompasses property "to the extent of the interest therein of the decedent at the time of his death." Do the words "the time of his death" reach interests that had a value and could have been transferred just before the decedent's death but are extinguished by death? Assume Jones, age 21 and in good health, is entitled to the income for life of a trust created by Smith; the actuarial value of the interest is $100,000, and the trust instrument allows beneficiaries to assign their interests. If Jones dies in a plane crash, is $100,000 includable in her gross estate as an "interest" in the trust assets "at the time of his death"?

Clearly not, but the underlying rationale is not wholly clear. The statutory language, "at the time of his death," could, with equal plausibility, be interpreted to fix upon either the instant before death or the instant after death. Turning for guidance from the letter of the law to its spirit, one finds equally inconclusive raw material. On the one hand, it is sometimes said that the intended target of the federal estate tax is "the power to transmit, or the transmission of" property at death.[1] If so, Jones' interest in the trust income should not be included in her gross estate because, although she could have sold the interest during life and bequeathed the proceeds, she could not have transferred the life estate itself by will. On the other hand, the Supreme Court has said that "the occasion of the tax is the bringing into being or the enlargement of property rights" at death,[2]

[5] IRC §6018(a)(1), discussed infra ¶137.3.

[6] IRC §6501(e)(2), discussed infra ¶137.9. See Rodiek v. Helvering, 87 F2d 328, 331–32 (2d Cir. 1937) (securities included in gross estate; claims allowed as deductions; tax burden affected because, under law then in effect, decedent, a nonresident alien, could take certain deductions only as percentage of "whole estate").

[1] Knowlton v. Moore, 178 US 41, 56, 57 (1900), quoted with approval in New York Trust Co. v. Eisner, 256 US 345, 349 (1921), and Tyler v. US, 281 US 497, 502 (1930). See Goodman v. Granger, 243 F2d 264, 268 (3d Cir.), cert. denied, 355 US 835 (1957) (interests that "terminate on or before death are not a proper subject of the tax"). Section 2001 states that the tax is "imposed on the transfer of the [decedent's] taxable estate," a phrase that could, but does not necessarily, mean transfer by the decedent's volition or action.

[2] Tyler v. US, supra note 1, at 502. See Fernandez v. Wiener, 326 US 340, 358 (1945) (federal estate tax is imposed "upon the surrender of old incidents of property by the decedent and the acquisition of new by the survivor"); Draper's Est. v. CIR, 536 F2d 944 (1st Cir. 1976) (gross estate of decedent who committed suicide after murdering his spouse did not include proceeds of insurance on her life payable to decedent; because local law barred decedent from receiving proceeds, they were not subject of transfer on his death).

language that seemingly covers the conversion, on Jones' death, of the remainder from a postponed interest into a present one.

However the issue might be decided by a court writing on a clean slate, that this is an occasion when "a page of history is worth a volume of logic."[3] As early as 1919, the regulations provided that the value of a life estate in the decedent was not includable in the decedent's gross estate.[4] In 1930, the Supreme Court held in *May v. Heiner* that nothing was includable in the gross estate of an income beneficiary of a trust, even though she was the grantor of the trust as well as a beneficiary, because "at [her] death, . . . no interest in the property . . . passed from her to the living; title thereto had been definitely fixed by the trust deed. The interest therein which she possessed immediately prior to her death was obliterated by that event."[5]

In *May v. Heiner*, the government unsuccessfully sought to include the corpus of the trust in the decedent's gross estate under the statutory predecessor of §2036, under which property transferred by the decedent during life is included in the gross estate if the decedent reserved a right to income.[6] However, the decision necessarily assumed and impliedly held that the value of the decedent's income interest was not includable in the gross estate under the statutory predecessor of §2033. Indeed, this principle is so deeply entrenched in the structure of the federal estate tax that formal judicial or administrative pronouncements to this effect are unnecessary and hence hard to find. It is sometimes necessary to determine whether the decedent owned property outright or was only a life tenant,[7] but these disputes over the private-law consequences of

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[3] New York Trust Co. v. Eisner, supra note 1, at 349.

[4] Reg. 37, Art. 12 (1919).

[5] May v. Heiner, 281 US 238, 243 (1930). In *May v. Heiner*, the taxpayer's husband was the primary life tenant and the taxpayer reserved a secondary life estate conditioned on surviving him, but the same principle was applied in Burnet v. Northern Trust Co., 41 F2d 732 (7th Cir. 1930), aff'd per curiam, 283 US 782 (1931), to a trust whose grantor reserved a primary life estate.

[6] See infra ¶126.6.1. The decision was overruled prospectively by regulations implementing a 1931 amendment of the statutory predecessor of §§2036(a)(1) and (c). See infra ¶126.6.8.

[7] E.g., CIR v. Childs' Est., 147 F2d 368 (3d Cir. 1945) (decedent received fee interest under husband's will, not life estate with limited power to consume); Ellis v. US, 280 F. Supp. 786 (D. Md. 1968) (under grandmother's will, decedent inherited life estate plus general testamentary power of appointment over one third of corpus, not outright ownership of one third; §2033 not applicable); Zietz's Est. v. CIR, 34 TC 351 (1960) (acq.) (under German law, decedent acquired life estate with power to consume, not outright ownership); Milner's Est. v. CIR, 6 TC 874 (1946) (acq.) (under settlement of will contest, decedent acquired life estate rather than outright ownership of disputed property); Rhodes v. CIR, 41 BTA 62 (1940), aff'd, 117 F2d 509 (8th Cir. 1941) (state court ruling that decedent was life tenant rather than outright owner of property held conclusive).

Sometimes a life tenant who has an unrestricted right to consume property is treated not as the outright owner under §2033, but as beneficiary of the income with a general power of appointment over the property. Property subject to a general power of appointambiguous transactions arise only because a life estate does not bring §2033 into force.

The same principle applies to other interests terminating at the decedent's death, such as a right to receive the corpus of a trust conditioned on survival to a particular future date. Although an interest of this kind may have a substantial actuarial value while the decedent is alive, it is not included in the decedent's gross estate if it was snuffed out by death before the crucial date.[8] Similarly, a widow's right to elect against her husband's will is not an interest in property within the meaning of §2033 if she dies before exercising it.[9] Also, in valuing proprietorships, partnerships, and the stock of closely held corporations, any reduction in value resulting from the loss of the decedent's experience and business skills is not included in the gross estate.[10]

However, it does not follow that property interests are necessarily immune to tax if they terminate at death. The most conspicuous counter-example is the cancellation of a debt by will. Even though the decedent's claim is extinguished when the will becomes effective at death, it is included in the gross estate under §2033 to the extent of its fair market value just before death.[11] The testamentary cancellation of a debt is fundamentally different from the termination of a life estate at death because the decedent's power to change, revoke, or amend the will means that the cancellation is merely tentative until the decedent's death and is therefore the functional equivalent of a bequest.[12]

In a 1980 decision, the Tax Court held that a debt cancelled at death was not

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ment is included in the gross estate by §2041, discussed infra ¶128.1. See Vaughn v. US, 536 F. Supp. 498, 502–03 (WD Va. 1982).

[8] E.g., Knipp's Est. v. CIR, 244 F2d 436 (4th Cir.), cert. denied, 355 US 827 (1957) (deceased partner's interest in firm's income, contingent on survival to end of firm's fiscal year, excluded from gross estate because survivorship condition not satisfied); CIR v. Rosser, 64 F2d 631 (3d Cir. 1933) (no inclusion for right to share of estate of decedent's father because conditioned on survival to date when business was discontinued); Maryland Nat'l Bank v. US, 236 F. Supp. 532 (D. Md. 1964) (reversionary interest that would have passed to decedent's estate or heirs in default of exercise of power of appointment not included because she exercised power); Williams' Est. v. CIR, 62 TC 400 (1974) (decedent's right to receive corpus and income of trust if he survived until 21 years after death of aunt not included because he died before crucial date); Nelson's Est. v. CIR, 47 TC 279 (1966) (nonacq.), rev'd on other grounds, 396 F2d 519 (2d Cir. 1968) (reversionary interest dependent on wife's predecease without remarrying, where decedent died first; not included); Bergan's Est. v. CIR, 1 TC 543 (1943) (acq.) (right to be supported for life not included); Rev. Rul. 55-438, 1955-2 CB 601 (contingent remainder lapsing at decedent's death not included). See Huggins v. US, 684 F2d 417 (6th Cir. 1982) (decedent's interest in trust created by uncle's will construed as fee simple rather than as contingent on surviving uncle and termination of trust).

[9] Rev. Rul. 74-492, 1974-2 CB 298. The ruling also holds that if the widow's right is viewed as a general power of appointment, it was in effect disclaimed or renounced by her failure to assert it. See infra ¶128.3.5.

[10] Gannon's Est. v. CIR, 21 TC 1073, 1081–83 (1954) (acq.). See infra ¶135.3.5.

[11] Reg. §20.2033-1(b) (third sentence).

[12] See Buckwalter's Est. v. CIR, 46 TC 805, 816 (1966).

included in the gross estate where the cancellation provision was a bargained-for term of the underlying obligation.[13] The decedent sold his shares in a closely held corporation for about $185,000, evidenced by a promissory note payable at the rate of $1,946 per month, with any unpaid installments to be cancelled on his death. The note would have been fully paid in 115 months, but the decedent died after receiving only 20 monthly payments. Since the parties stipulated that the transaction was a bona fide sale for adequate and full consideration, the court quite properly held that the value of the unpaid installments was not includable in the gross estate under §2033 because the transaction was tantamount to a sale of the stock for $1,946 a month for 115 months or the seller's life, whichever was shorter. As an integral provision of the note, the cancellation provision could not be unilaterally rescinded by the decedent, and hence it was no more comparable to a bequest than the automatic termination of an installment contract when the agreed payments have been made.

The foregoing discussion is limited to the application of §2033. Several other provisions, examined below, expand the gross estate to include property in which the decedent's interest terminates at death. For example, if the decedent transferred property subject to a reserved life estate, the life estate is not included in the gross estate under §2033, but the entire property is included under §2036.[14]

¶125.6 INTERESTS CREATED BY DEATH

By referring to "property to the extent of the interest therein of the decedent at the time of his death," §2033 seems to cover only property in which the decedent had some interest while living. This implication is buttressed by §2001, which imposes the federal estate tax "on the transfer of the taxable estate of every decedent." Thus, if a philanthropist learns of the death of a talented but penniless author and sends a check to the author's surviving spouse or children, the amount is not included in the author's gross estate under §2033, even though the donor's benevolence is attributable to pleasure derived from the decedent's books and is occasioned by the latter's death. Although §2033 is clearly inapplicable to windfalls in which the decedent had no interest, its reach is more debatable if a closer nexus between the decedent and the property can be established. The most important postdeath benefits raising this issue are examined below.

1. *Wrongful death recoveries*. Although a tortfeasor's liability to pay damages for causing a wrongful death does not exist during the victim's life but is created by the latter's death, the recovery usually takes account of the decedent's earning

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[13] Moss' Est. v. CIR, 74 TC 1239 (1980) (acq.). See generally Roszak, Installment Sales Terminating at Death Versus Private Annuities as Estate Planning Devices, 59 J. Tax'n 20 (1983).

[14] See infra ¶126.6.