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NO. 70514-8-I

COURT OF APPEALS, DIVISION I
OF THE STATE OF WASHINGTON

U.S. BANK, Personal Representative of the Estate of ELAINE B. GREEN-ELDRIDGE,

Respondent,

v.

THE DEPARTMENT OF REVENUE OF THE STATE OF WASHINGTON,

Appellant.

BRIEF OF APPELLANT

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I. INTRODUCTION

This case involves the Washington estate tax and whether "qualified terminable interest property" ("QTIP") included in the taxable estate of a decedent may be excluded in computing the Washington tax. QTIP is a life estate set up to take advantage of the marital deduction allowed under federal estate tax law. When a spouse dies, his or her estate can create a QTIP trust that provides income to the surviving spouse for life. The assets contributed to the QTIP trust are deducted from the taxable estate of the spouse who made the election. I.R.C. § 2056(b)(7). However, upon the surviving spouse's death, the assets remaining in the QTIP trust are included in that spouse's taxable estate. I.R.C. § 2044.

The estate of Elaine Green-Eldridge ("Estate") is seeking a refund of Washington estate tax it paid on the value of QTIP included in the Estate's federal taxable estate. The Estate asserts that QTIP is immune from the Washington tax under the holding in *Clemency v. State*, 175 Wn.2d 549, 290 P.3d 99 (2012) (hereinafter "*Bracken*" or "*In re Estate of Bracken*").[1] In *Bracken,* the Supreme Court held that the Legislature did not intend to tax QTIP passing under Internal Revenue Code § 2044. According to the Court, the Legislature intended to tax only "real" transfers of property.

[1] Carol B. Clemency was one of the personal representatives of the estate of Sharon M. Bracken. For consistency and simplicity, the Department will refer to the case as "*Bracken*" or "*In re Estate of Bracken*" rather than its reported case name.

To achieve the perceived intent of the Legislature, the Supreme Court modified the statutory definition of "Washington taxable estate" to "exclude items that are not [real] transfers." *Id.* at 570-71. The result was to exclude from the Washington estate tax the "deemed" transfer of QTIP occurring under Internal Revenue Code § 2044.

The Legislature promptly amended the estate tax code in response to the *Bracken* decision. Laws of 2013, 2d Spec. Sess., ch. 2.[2] That 2013 legislation (the "2013 Act") amended the definitions of "transfer" and "Washington taxable estate" to include QTIP in the Washington taxable estate of a decedent. *Id.* at § 2. The amended definitions are retroactive to "all estates of decedents dying on or after May 17, 2005." *Id.* at § 9. The amendment applies to the estate of Elaine Green-Eldridge, who died in December 2005.

As a result of the 2013 Act, *Bracken* is no longer controlling authority. *See Haberman v. Wash. Pub. Power Supply Sys.*, 109 Wn.2d 107, 143-44, 744 P.2d 254, 750 P.2d 254 (1987) (the Legislature may pass a law that directly impacts a case pending in Washington courts). Instead, under the estate tax code as amended, QTIP is subject to the Washington tax and the Estate is not entitled to a refund of the Washington tax it paid on the value of QTIP included in its federal taxable estate.

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[2] A copy of the 2013 session law is attached as Appendix A.

Moreover, the 2013 Act was a valid exercise of the Legislature's authority to set the tax policy of this state and to enact laws to achieve that policy. *Haberman*, 109 Wn.2d at 143 ("A statute prescribing new rules to be applied to pending litigation is generally constitutional [and] does not violate the separation of powers clause"). Thus, this Court should reverse the order entered by the Superior Court granting summary judgment in favor of the Estate and remand the case with directions to enter a judgment in favor of the Department.

II. ASSIGNMENT OF ERROR

The Superior Court erred in granting summary judgment to the Estate.

III. ISSUES PRESENTED

1. Under the Washington estate tax code as amended in 2013, is QTIP passing under Internal Revenue Code § 2044 and taxed under the federal estate tax code also subject to the Washington tax?

2. Under the Due Process Clause and separation of powers principles, did the Legislature validly exercise its authority in giving the 2013 Act retroactive effect when the exclusion of QTIP under the 2012 *Bracken* decision threatened to create a significant and unexpected loss of tax revenue used to fund education?

3. Should the Washington Supreme Court overrule *In re Estate of Bracken* when that decision applied a "real transfer" versus "deemed transfer" distinction that was inconsistent with the broad concept of "transfer" that the United States Supreme Court and the Washington Supreme Court had applied since the 1930s?[3]

IV. STATEMENT OF THE CASE

Elaine Green-Eldridge, a widow whose first spouse predeceased her in 1985, died on December 23, 2005, and was a resident of Washington at the time of her death. CP 5 at ¶ III.B-1; CP 6 at ¶ III.C-1. Shortly thereafter the Estate made an estimated payment of Washington estate tax in the amount of $10,650,000. AR 2. The Estate filed a Washington estate tax return on March 21, 2007. AR 8. On that return, the Estate deducted $45,506,561 from the gross estate, which was the value of QTIP included in the Estate's federal taxable estate under Internal Revenue Code § 2044. AR 8, Part 2, line 2b. The Estate attached a statement to the return contending that the deduction was authorized by a Department administrative rule. AR 9.

The Washington estate tax due as computed by the Estate after claiming the QTIP deduction was $1,851,380. AR 8, Part 2, line 9. After

[3] The Department recognizes that the Court of Appeals cannot overrule a decision of the Supreme Court and presents this third issue for the purpose of clearly preserving it for consideration by the Supreme Court if further review is necessary.

applying the estimated tax payment, the Estate requested a refund of $8,798,620. AR 8 (bottom line of return).

The Department reviewed the Estate's return and denied the $45,506,561 QTIP deduction. AR 86. After making that adjustment, the Department issued a refund to the Estate of $152,373 plus interest, which was the amount the Estate had overpaid with the QTIP passing under Internal Revenue Code § 2044 included in the Washington taxable estate. *Id.*

Several months later the Estate filed a refund claim with the Department asserting that it had properly deducted QTIP in computing its Washington estate tax and requesting a refund of $8,629,164, which was the amount the Estate asserts it overpaid if the QTIP deduction was allowed. AR 92-97. The Department denied the Estate refund claim. AR 183. The Estate then filed a timely petition under the Administrative Procedure Act seeking judicial review of the Department's decision letter denying the application for refund. CP 4.

On October 29, 2010, the case was stayed by agreement of the parties pending the final resolution of *In re Estate of Bracken*. CP 39. The Supreme Court issued its decision in *Bracken* on October 18, 2012, holding that the Legislature did not intend to impose estate tax on QTIP passing under Internal Revenue Code § 2044 at the death of the second spouse. *In re Estate of Bracken*, 175 Wn.2d 549, 290 P.3d 99 (2012). The Court denied the Department's motion for reconsideration on January 10, 2013.

In April 2013 the Estate filed a motion for summary judgment in this case asserting that, under the holding in *Bracken*, it was entitled to a refund of the Washington estate tax attributable to QTIP passing at Ms. Green-Eldridge's death. CP 40, 50-53. The Estate also asserted that it was entitled to an award of attorneys' fees under the Trust and Estate Dispute Resolution Act, RCW 11.96A. CP 55. The Department opposed the motion for summary judgment, arguing that the Superior Court should defer entry of an order until after the 2013 legislative session to permit the Legislature the opportunity to consider pending legislation that would retroactively amended the Washington estate tax to include QTIP in the Washington taxable estate of a decedent. CP 134, 143-44. The Department also opposed the Estate's claim for attorneys' fees, explaining that the case was governed by the APA, not the Trust and Estate Dispute Resolution Act. CP 146-150. The Superior Court, the Honorable Monica Benton, granted the Estate's motion in part. CP 187.[4]

The Department timely appealed the order granting the Estate's motion for summary judgment. CP 190. On the same day that the appeal

[4] The Superior Court denied the Estate's claim for attorneys' fees. The Estate has not appealed that issue.

was filed, the Legislature enacted Engrossed House Bill 2075. That bill, which the Governor signed on June 14, made several significant amendments to the Washington estate tax code. Two of the amendments are of primary importance in this case. First, section 2 of the 2013 Act amended the statutory definition of "transfer" to make clear that a transfer for purposes of the Washington tax is broadly defined and includes "any shifting upon death of the economic benefit in property or any power or legal privilege incidental to the ownership or enjoyment of property." Laws of 2013, 2d Spec. Sess., ch. 2, § 2 (amending and renumbering RCW 83.100.020(11) (2012)). Second, section 2 also amended the definition of "Washington taxable estate" to make clear that QTIP is properly included in the Washington taxable estate of a Washington resident decedent and is subject to the Washington tax. *Id.* (amending and renumbering RCW 83.100.020(13) (2012)). These key amendments apply retroactively to estates of decedents dying on or after May 17, 2005. *Id.* at § 9.

V. ARGUMENT

A. Standard Of Review.

This is an appeal of agency action under the APA. The agency action at issue is the Department's denial of the Estate's refund claim. Judicial review of agency action is controlled by RCW 34.05.570. This case involves "other agency action," so RCW 34.05.570(4) applies. The Estate, as the party challenging the Department's agency action, bears the burden of demonstrating that the action is invalid. RCW 34.05.570(1)(a); *Hillis v. Dep't of Ecology*, 131 Wn.2d 373, 381, 932 P.2d 139 (1997). When reviewing "other agency action," a court shall grant relief only if it determines that the action violates constitutional provisions, the agency acted outside its legal authority, the action was arbitrary or capricious, or the action was taken by someone not lawfully entitled to take such action. RCW 34.05.570(4)(c).

The Superior Court decided this case on summary judgment. Summary judgment is appropriate when no genuine issue of material fact exists and the moving party is entitled to judgment as a matter of law. CR 56. When the material facts are undisputed and the only issues to be resolved are legal in nature, the appellate court reviews the legal conclusions de novo. *Simpson Inv. Co. v. Dep't of Revenue*, 141 Wn.2d 139, 148, 3 P.3d 741 (2000). The material facts of this case are not disputed. However, because the controlling law has changed, it is the Department that is entitled to judgment as a matter of law.

B. Under The Washington Estate Tax Code As Amended In 2013, QTIP Passing Under Internal Revenue Code § 2044 And Taxed Under The Federal Estate Tax Code Is Subject To The Washington Tax.

1. Overview of the federal estate tax.

To better appreciate the legal arguments presented in this brief, it is helpful to have a general understanding of both the federal estate tax and the Washington estate tax. The federal estate tax is set out in subtitle B, chapter 11, of the Internal Revenue Code.[5] The tax is "imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States." I.R.C. § 2001(a). The term "transfer" is construed broadly and "extends to the creation, exercise, acquisition, or relinquishment of any power or legal privilege which is incident to the ownership of property." *Fernandez v. Wiener*, 326 U.S. 340, 352, 66 S. Ct. 178, 90 L. Ed. 116 (1945). Thus, a "transfer" for federal estate tax purposes is not limited to a formal conveyance of property under state property law. Rather, Congress may include within the estate tax base property that was not formally conveyed on the death of the decedent. *Id.*

The federal estate tax is computed on the "taxable estate" of the decedent. I.R.C. § 2001(b). In computing the taxable estate, a deduction is allowed under Internal Revenue Code § 2056 for "the value of any

[5] All references to the Internal Revenue Code will be to the Internal Revenue Code as amended as of January 1, 2005.

interest in property which passes or has passed from the decedent to his surviving spouse." I.R.C. § 2056(a). The deduction is limited by Internal Revenue Code § 2056(b), which provides that "terminable interests" in property—such as a life estate or other interest that will lapse due to the passing of time or the occurrence or non-occurrence of an event—do not qualify for the marital deduction.

As originally enacted, the marital deduction was limited to fifty percent of the decedent's separate property passing outright to the surviving spouse. Transfers of "terminable interest" property such as a life estate did not qualify. Although limited both in the amount that could be deducted and the type of property interest that qualified, the deduction provided an important estate planning tool for married couples. Separate property passing outright to the surviving spouse, up to the fifty percent limitation, was excluded from the estate tax base of the first spouse to die.

In 1981 Congress significantly changed the marital deduction by making the deduction unlimited in amount and by creating a special category of terminable interest property—so-called "qualified terminable interest property"—that would qualify for the deduction. *See In re Estate of Bracken*, 175 Wn.2d at 577 n.4 (Madsen, C.J., concurring/dissenting) (quoting Boris I. Bittker & Lawrence Lokken, *Federal Taxation of Income, States and Gifts*, 1997 WL 440177 at *17). Thus, Congress created an "exception-to-the-exception" that permitted certain terminable interest property to pass untaxed to the surviving spouse.

In order for QTIP to qualify for the marital deduction, the property must pass from the decedent to the surviving spouse, the surviving spouse must have the right to receive the income from the property for life, and the executor of the decedent's estate must make an election to have the property treated as QTIP. I.R.C. § 2056(b)(7)(B)(i). While the estate of the first spouse to die gets to claim the deduction, any QTIP still remaining when the surviving spouse dies is included in his or her gross estate. I.R.C. § 2044. In this way, QTIP does not escape taxation entirely. Instead, the estate tax applies to the remaining QTIP that passes when the surviving spouse dies. I.R.C. § 2044(c).

2. Overview of the Washington estate tax.

The Washington estate tax was enacted in 1981 as a result of Initiative No. 402. Laws of 1981, 2d Ex. Sess., ch. 7. Prior to that, Washington imposed an inheritance tax. Laws of 1901, ch. 55. The Washington estate tax, as enacted in 1981, imposed a tax equal to the state death tax credit allowed under Internal Revenue Code § 2011. State estate taxes of this nature are commonly referred to as "pick-up" taxes.

In June 2001, Congress enacted the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).[6] That act reduced the amount of the state death tax credit by 25% each year beginning in 2002, resulting in the total elimination of the credit by 2005. This reduction and eventual elimination of the state death tax credit had a serious impact on states like Washington that employed a pick-up tax. *See Estate of Hemphill v. Dep't of Revenue*, 153 Wn.2d 544, 548, 105 P.3d 391 (2005) ("EGTRRA essentially ends the estate tax revenue sharing between the federal government and states."). To keep the Washington tax viable, the Legislature needed to establish a "stand-alone" tax that was not dependent on the federal death tax credit mechanism. *Id.* at 551. The Legislature accomplished this in 2005 when it amended the Washington estate tax to change from a pick-up tax to a stand-alone tax. *See* Laws of 2005, ch. 516.

As amended in 2005, the Washington tax is imposed "on every transfer of property located in Washington." RCW 83.100.040(1) (2012). "Property" is defined as "property included in the gross estate." RCW 83.100.020(8) (2012). "Gross estate" is defined as "'gross estate' as defined and used in section 2031 of the Internal Revenue Code." RCW 83.100.020(5) (2012). Thus, while the 2005 Act established a stand-alone estate tax, the tax was still tied to a large extent to the federal estate tax

[6] Pub. L. No. 107-16, 115 Stat. 73 (2001).

code. *See In re Estate of Bracken*, 175 Wn.2d at 581 (Madsen, C.J., concurring/dissenting).

The tax is computed at a graduated rate on the value of a decedent's "Washington taxable estate." Laws of 2013, 2d Spec. Sess., ch. 2, § 4 (amending RCW 83.100.040(2)(a)). The term "Washington taxable estate" is defined as "the federal taxable estate" less specified additions and deductions. *Id.* at § 2 (amending and renumbering RCW 83.100.020(13) (2012)). "Federal taxable estate" is defined as "the taxable estate as determined under chapter 11 of the Internal Revenue Code" without regard to the termination of the federal estate tax or the deduction for state death taxes. RCW 83.100.020(14) (2012). By using "federal taxable estate" as the starting point for computing the "Washington taxable estate" of a decedent, the Legislature "avoided having to duplicate congressional effort involved in explaining all the possible inclusions, exemptions, and deductions necessary to reach the taxable estate, and also helped to avoid the complication and confusion that a different set of state rules might create." *In re Estate of Bracken*, 175 Wn.2d at 583 (Madsen, C.J., concurring/dissenting).

As with the federal estate tax, the Washington tax is imposed on the *transfer* of property. Under the Washington estate tax code, "transfer" means a "'transfer' as used in section 2001 of the Internal Revenue Code and includes any shifting upon death of the economic benefit in property or any power or legal privilege incidental to the ownership or enjoyment of property." Laws of 2013, 2d Spec. Sess., ch. 2, § 2 (amending and renumbering RCW 83.100.020(11) (2012)). Thus, the Legislature has clearly established that a "transfer" under the Washington estate tax code is not limited to formal conveyances of property owned by the decedent. Rather, the Washington tax—like its federal counterpart—extends to the "creation, exercise, acquisition, or relinquishment of any power or legal privilege which is incident to the ownership of property." *Wiener*, 326 U.S. at 352.

3. *Bracken* is no longer controlling authority.

Prior to the 2013 amendment to the Washington estate tax, the tax as construed by the Supreme Court in *Bracken* was limited to only "real" transfers of property occurring at death. *In re Estate of Bracken*, 175 Wn.2d at 570-71. *Bracken* involved a claim by the estates of Sharon Bracken and Barbara Nelson that QTIP passing under Internal Revenue Code § 2044 must be excluded in computing the Washington stand-alone estate tax. The Supreme Court agreed, holding that the Legislature did not intend to include QTIP in the Washington estate tax computation when it amended the tax in 2005 to change from a pick-up tax to a stand-alone tax.

As part of its analysis, the Supreme Court reasoned that the "real" transfer of QTIP occurs when the first spouse dies and his or her estate elects to claim the QTIP deduction under Internal Revenue Code § 2056(b)(7). *Bracken*, 175 Wn.2d at 572-74. The Court considered the transfer occurring at the death of the second spouse, when the spouse's life estate is extinguished and the property passes to the remainder beneficiaries under Internal Revenue Code § 2044, as merely a "deemed" or "fictional" transfer created by Congress. *Id.* The Court then held that the Legislature intended to tax only real transfers when it amended the Washington estate tax in 2005 to change from the former pick-up tax to the stand-alone estate tax. *Id.* at 574. To achieve what it perceived the Legislature intended, the Court judicially modified the Washington estate tax code to exclude QTIP from the Washington tax when the second spouse dies. *Id.* at 570-71. Specifically, the Court ruled that the federal definition of "taxable estate," which includes the value of QTIP passing when the second spouse dies, "cannot be used without a modification necessary to conform to the [2005] Act: the definition must be read to exclude items that are not transfers." *Id.*

The Legislature learned of the *Bracken* decision early in the 2013 legislative session and was troubled by the Court's construction of the Washington tax. Taxes collected from the Washington estate tax are deposited into the Education Legacy Trust Account and are used to support

K-12 public schools and institutions of higher education. *See* RCW 83.100.220, .230. The fiscal impact of the *Bracken* decision was estimated to be a loss of approximately $160.3 million in the 2013-2015 biennium. *See* Fiscal Note for EHB 2075.[7] In light of the Supreme Court's decision in *McCleary v. State*, 173 Wn.2d 477, 269 P.3d 227 (2012), the Legislature had good reason to be concerned with the holding in *Bracken*.[8] By excluding QTIP from the reach of the Washington estate tax, the Supreme Court made the State's constitutional obligation to "make ample provision for the education of all children" more difficult. Const. art. IX, § 1.

In addition, the holding in *Bracken* created a sizable loophole that only married couples could exploit. The Legislature understandably was concerned by that disparate tax treatment. *See* Laws of 2013, 2d Spec. Sess., ch. 2, § 1(4) (legislative finding that excluding QTIP from the Washington estate tax creates an inequity between married couples and unmarried individuals).

On June 13, 2013, the Legislature addressed the fiscal and tax policy issues raised by the *Bracken* decision by amending the Washington estate tax to make clear that the tax *does* apply to QTIP passing at the

[7] Copy attached as Appendix B.

[8] In *McCleary*, the Supreme Court held that the State is failing to meet its paramount constitutional duty to amply provide for the education of all children, and it ordered the Legislature to develop a basic education program that meets the constitutional standard and to "fully fund that program through regular and dependable tax sources." *McCleary v. State*, 173 Wn.2d 477, 546-47, 269 P.3d 227 (2012).

death of the second spouse. Laws of 2013, 2d Spec. Sess., ch. 2. The 2013 Act provides that a "transfer" subject to the Washington tax is broadly defined and that QTIP is properly included in the "Washington taxable estate." *Id.* at § 2 (amending the definitions of "transfer" and "Washington taxable estate"). These key amendments to the estate tax code apply retroactively to estates of decedents dying on or after May 17, 2005. *Id.* at § 9; *see also id.* at § 14 (emergency clause).

Under the current law as amended by the 2013 Act, the Estate is simply not permitted to deduct QTIP in computing its Washington estate tax liability. Moreover, it is the current law, not the prior law, which applies in this case. As explained in *Washington State Farm Bureau Federation v. Gregoire*, 162 Wn.2d 284, 174 P.3d 1142 (2007), the Legislature may pass a law that directly impacts a case pending in Washington courts. *Id.* at 304. And it is the obligation of the appellate court to apply that new law in deciding the case "even if the new law alters the outcome." *Port of Seattle v. Pollution Control Hearings Bd.*, 151 Wn.2d 568, 627, 90 P.3d 659 (2004) (citing *Plaut v. Spendthrift Farms, Inc.*, 514 U.S. 211, 226-27, 115 S. Ct. 1447, 131 L. Ed. 2d 328 (1995)).

Because the Estate is not entitled to deduct QTIP passing under Internal Revenue Code § 2044 in computing its Washington estate tax liability, the Department did not err when it denied the Estate's refund claim. Consequently, the Estate has not met its burden under the APA to show that the Department's action was invalid, and the agency action should be affirmed. *See* RCW 34.05.570(1)(a); .570(4)(c); .574(1)(a).

C. The 2013 Act Was A Valid Exercise Of Legislative Authority Under The Due Process Clause And Separation Of Powers Principles.

The 2013 Act was a valid exercise of the Legislature's authority to enact law establishing the tax policy of this state and to amend existing laws. The Legislature's power to enact and amend the laws of this state "is unrestrained except where, either expressly or by fair inference, it is prohibited by the state and federal constitutions." *Washington State Farm Bureau*, 162 Wn.2d at 300-01 (quoting *State ex rel. Citizens Against Tolls v. Murphy*, 151 Wn.2d 226, 248, 88 P.3d 375 (2004)). Moreover, courts give "great deference" to the legislative process and will invalidate a statute only when the court is "fully convinced, after a searching legal analysis, that the statute violates the constitution." *School Dists. Alliance for Adequate Funding of Special Educ. v. State*, 170 Wn.2d 599, 606, 244 P.3d 1 (2010) (quoting *Island Cnty. v. State*, 135 Wn.2d 141, 147, 955 P.2d 377 (1998)).

Legislation affecting economic matters is presumed to be constitutional, even when retroactive. *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 15, 96 S. Ct. 2882, 49 L. Ed. 2d 752 (1976). Simply put, the strong deference the judiciary accords to the co-equal legislative branch in the field of economic policy "is no less applicable when that legislation is applied retroactively." *Pension Benefit Guar. Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 729, 104 S. Ct. 2709, 81 L. Ed. 2d 601 (1984). The 2013 legislation at issue in this case was constitutional and should be upheld.

1. The 2013 Act complies with substantive due process.

Retroactive tax legislation enacted by a state is occasionally challenged under the Due Process Clause of the Fourteenth Amendment to the United States Constitution, which provides that no state shall "deprive any person of life, liberty, or property, without due process of law." U.S. Const. amend. XIV, § 1. As a matter of "substantive" due process, the Due Process Clause protects private persons from arbitrary and irrational legislation. *United States v. Carlton*, 512 U.S. 26, 30, 114 S. Ct. 2018, 129 L. Ed. 2d 22 (1994).[9] However, the United States Supreme Court repeatedly upholds retroactive tax legislation against due process challenges. *Id.* As explained in *Carlton*:

> The retroactive aspects of legislation, as well as the prospective aspect, must meet the test of due process, and

[9] Article I, section 3, of the Washington Constitution provides equal, but not greater, due process protections than those provided by the Fourteenth Amendment of the United States Constitution. *See In re Dyer*, 143 Wn.2d 384, 394, 20 P.3d 907 (2001). Consequently, Washington courts analyze due process challenges under the Fourteenth Amendment. *Amunrud v. Bd. of Appeals*, 158 Wn.2d 208, 216 n.2, 143 P.3d 571 (2006).

> the justification for the latter may not suffice for the former. . . . But that burden is met simply by showing that the retroactive application of the legislation is itself justified by a rational legislative purpose.

Id. at 31 (internal quotation marks omitted) (quoting *Pension Benefit Guar. Corp.*, 467 U.S. at 730).

Under *Carlton*, courts uphold the retroactive application of tax legislation if it serves a legitimate legislative purpose furthered by rational means. *Id.* at 30-31. The rational basis standard applied in *Carlton* is a deferential standard, and once it is met "judgments about the wisdom of [the subject] legislation remain within the exclusive province of the legislative and executive branches." *Carlton*, 512 U.S. at 31.[10]

Washington courts apply the same rational basis standard, as demonstrated in *W.R. Grace & Co. v. Dep't of Revenue*, 137 Wn.2d 580, 602-03, 973 P.2d 1011 (1999). In that case, a group of corporate taxpayers argued that retroactively applying the system of multiple activities B&O tax credits provided in RCW 82.04.440 violated their due process rights. The Legislature had enacted the tax credit mechanism in 1987 to replace the former multiple activities tax exemption that the

[10] The United States Supreme Court has only rarely invalidated retroactive tax legislation on due process grounds, and it has not done so since the 1920s. *See Nichols v. Coolidge*, 274 U.S. 531, 47 S. Ct. 710, 71 L. Ed. 1184 (1927); *Blodgett v. Holden*, 275 U.S. 142, 48 S. Ct. 105, 72 L. Ed. 206 (1928); *Untermyer v. Anderson*, 276 U.S. 440, 48 S. Ct. 353, 72 L. Ed. 645 (1928). While these *Lochner*-era cases have not been overruled, they are applicable only to situations involving the creation of a wholly new tax. When the issue is the constitutionality of amendments to *existing* tax laws, as in this case, "their authority is of limited value." *Carlton*, 512 U.S. at 34.

United States Supreme Court invalidated on constitutional grounds. *See Tyler Pipe Indus., Inc. v. Dep't of Revenue*, 483 U.S. 232, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987). The taxpayers filed actions seeking full refunds of taxes paid as early as January 1980, almost eight years prior to the challenged statutory amendment. 137 Wn.2d at 588-89. The taxpayers argued that retroactive application of the 1987 amendment violated substantive due process because it "reach[ed] back too far in time." *Id.* at 600.

The Supreme Court squarely rejected the taxpayers' due process argument. Relying on *Carlton*, the Court concluded that tax legislation will satisfy due process constraints if the retroactive application of the statute is justified by a rational legislative purpose. *Id.* at 603. Moreover, the Court noted that "[t]he United States Supreme Court has not set a specific duration to the retroactive effect of tax legislation, preferring to rely on legislative decisions in this context." *Id.*

The 2013 amendment to the Washington estate tax code meets the rational basis standard applied in *Carlton* and *W.R. Grace*. First and foremost, the 2013 Act served a legitimate purpose. The Legislature sought to avoid an unexpected loss of revenue to public school funding brought about by the Supreme Court's holding in *Bracken*. Preventing unanticipated revenue losses is a legitimate legislative purpose. *Carlton*, 512 U.S. at 32; *see also Montana Rail Link, Inc. v. United States*, 76 F.3d 991, 994 (9th Cir. 1996) (same). As the Michigan Court of Appeals recently explained, "[a] legislature's action to mend a leak in the public treasury or tax revenue—whether created by poor drafting of legislation in the first instance or by a judicial decision—with retroactive legislation has almost universally been recognized as 'rationally related to a legitimate legislative purpose.'" *General Motors Corp. v. Dep't of Treasury*, 803 N.W.2d 698, 710 (Mich. Ct. App. 2010) (quoting *Carlton*, 512 U.S. at 35).

In addition, the Legislature employed rational means to "mend the leak" created by the Supreme Court's construction of the Washington estate tax as applied to QTIP. The Legislature enacted the retroactive fix during the 2013 legislative session, which was the first opportunity to address the issue after the Supreme Court's decision in October 2012. In addition, the 2013 Act did not create a wholly new tax that the Estate and others could not have anticipated. Instead, the Legislature amended the statutory definitions of "transfer" and "Washington taxable estate" to make the Washington estate tax treatment of QTIP consistent with the federal treatment and to conform those key definitions to the perceived intent of the Legislature when it amended the Washington estate tax in 2005. *See* Laws of 2013, 2d Spec. Sess., ch. 2, § 1(5). Finally, the

Legislature limited the retroactive reach of the Act to May 17, 2005, which was the effective date of the 2005 Act.[11]

As noted, section 2 of the 2013 Act has a retroactive reach of only eight years, to May 17, 2005. Courts throughout the United States have approved the retroactive application of tax statutes for similar and much longer periods. *See W.R. Grace*, 137 Wn.2d at 586-87 (more than seven years); *Montana Rail Link*, 76 F.3d at 993-95 (seven years); *Maples v. McDonald*, 668 So.2d 790, 792-93 (Ala. Civ. App. 1995) (more than eight years); *Enterprise Leasing Co. v. Arizona Dep't of Revenue*, 211 P.3d 1, 5 (Ariz. Ct. App. 2008) (six years); *Miller v. Johnson Controls, Inc.*, 296 S.W.3d 392, 400-01 (Ky. 2009) (nine years); *King v. Campbell Cnty.*, 217 S.W.3d 862, 866-67 (Ky. Ct. App. 2006) (nineteen years); *General Motors*, 803 N.W.2d at 710 (five years); *Moran Towing Corp. v. Urback*, 768 N.Y.S.2d 33, 1 A.D.3d 722 (2003) (thirteen years); *Atlantic Richfield Co. v. Oregon Dep't of Revenue*, 14 Or. Tax 212 (Or. Tax Ct. 1997) (eight years). Similarly, the United States Supreme Court upheld retroactive economic legislation going back six years in *General Motors Corp. v. Romein*, 503 U.S. 181, 191-92, 112 S. Ct. 1105, 117 L. Ed. 2d 328 (1992).

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[11] Only sections 2 and 5 of the 2013 Act apply retroactively. *See* Laws of 2013, 2d Spec. Sess., ch. 2, § 9. Section 5 specifies the manner in which the Washington taxable estate is to be computed if the first spouse to die had made a separate Washington QTIP election under RCW 83.100.047. This case does not involve a separate Washington QTIP election, so section 5 of the 2013 Act is not material.

Thus, even if the Due Process Clause imposes a limit on the retroactive reach of tax legislation, the eight-year retroactive reach of the 2013 Act would not cross that line.

Considering the totality of the facts and circumstances, the Estate cannot meet its difficult burden of establishing that the 2013 amendment to the stand-alone estate tax transgressed due process limitations on retroactive tax legislation. Rather, because the 2013 amendment serves a legitimate legislative purpose furthered by rational means, the retroactive application of that statute meets the standard applied in *Carlton* and *W.R. Grace* and does not violate due process.

2. The 2013 Act complies with the separation of powers doctrine.

In addition to being a rational means of achieving a legitimate legislative purpose, the 2013 Act does not transgress separation of powers principles. The separation of powers doctrine is grounded in the notion that "each branch of government has its own appropriate sphere of activity" and seeks to insure that "the fundamental functions of each branch remain inviolate." *Hale v. Wellpinit Sch. Dist. No. 49*, 165 Wn.2d 494, 504, 198 P.3d 1021 (2009). The Legislature's role is to set policy and to draft and enact laws, while the role of the judiciary is to interpret the law. *Id.* at 505-06. Separation of powers issues arise when "'the activity of one branch threatens the independence or integrity or invades the prerogatives of another.'" *Id.* at 507 (quoting *Carrick v. Locke*, 125 Wn.2d 129, 135, 882 P.2d 173 (1994)).

A retroactive amendment to a statute does not intrude on the court's responsibility to apply new law to the facts of a case being litigated where that retroactive legislation "does not dictate how the court should decide a factual issue" and does not "affect a final judgment." *Haberman v. Wash. Pub. Power Supply Sys.*, 109 Wn.2d 107, 143-44, 744 P.2d 254, 750 P.2d 254 (1987). On the other hand, "[w]hen retroactive legislation requires its own application *in a case already finally adjudicated*, it does no more and no less than 'reverse a determination once made, in a particular case.'" *Plaut v. Spendthrift Farms, Inc.*, 514 U.S. 211, 225, 115 S. Ct. 1447, 131 L. Ed. 2d 328 (1995) (emphasis added) (quoting *The Federalist No. 81*, at 545 (J. Cooke ed. 1961)). Consequently, Congress, and by analogy the Washington Legislature, lacks the power to "reopen," "reverse," "vacate," or "annul" a final court judgment. *Id.* at 219, 220, and 224. As explained in *Plaut*, "[h]aving achieved finality, . . . a judicial decision becomes the last word of the judicial department with regard to a particular case or controversy, and Congress may not declare by retroactive legislation that the law applicable *to that very case* was something other than what the courts said it was." *Id.* at 227 (emphasis in original).

Retroactive legislation does not run afoul of the separation of powers doctrine when applied to a case that has not been finally decided. *Plaut*, 514 U.S. at 226-27. Rather, separation of powers principles are offended only to the extent that a statute changes the outcome of a case that has been finally determined by the courts or dictates how a court should decide an issue of fact. *Haberman*, 109 Wn.2d at 144.

The 2013 Act that retroactively amended the statutory definitions of "transfer" and "Washington taxable estate" does not violate the separation of powers doctrine. Section 10 of the Act provides that "[t]his act does not affect *any final judgments, no longer subject to appeal*, entered by a court of competent jurisdiction before the effective date of this section." Laws of 2013, 2d Spec. Sess., ch. 2, § 10 (emphasis added). That section became effective on June 14, 2013, when the Governor signed the law. *Id.* at § 14 (emergency clause). Thus, the amended law preserved the final judgments entered in favor of the estates of Sharon Bracken and Barbara Nelson, and any other final judgment entered prior to June 14, 2013.

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

In addition, it is of no constitutional significance that the Legislature amended a statute that had been previously construed by the Supreme Court. It is well established that the separation of powers doctrine is not violated when the Legislature affirmatively amends a previously construed statute. *Lummi Indian Nation v. State*, 170 Wn.2d 247, 262, 241 P.3d 1220 (2010); *Hale*, 165 Wn.2d at 509-10. A statute does not become a "super law" once it is construed by the courts. Thus, treating a statute that has been construed by the judiciary as being constitutionally immune to a retroactive amendment makes no logical sense. So long as the Legislature is careful not to attempt to "overrule" a final judgment, there is no reason why it cannot retroactively amend a statute to affirmatively change the law. To conclude otherwise would likely violate separation of powers because the judicial branch would be invading the sphere of authority of the legislative branch to make policy, pass laws, and to amend laws already in effect. *Lummi*, 170 Wn.2d at 262.

The 2013 Act amended the Washington estate tax code by changing the statutory definitions of "transfer" and "Washington taxable estate." The Legislature did not, however, invade the province of the judiciary by overruling any final judgment. Under the analysis in *Lummi* and *Hale*, the 2013 Act does not violate separation of powers.

D. The Supreme Court Should Overrule *Bracken*.

The 2013 Act comports with the due process limits on retroactive tax legislation and does not violate separation of powers. Consequently, the 2013 Act sets out the controlling law and there is no need for this Court to address whether *In re Estate of Bracken* was correctly decided. However, if the Supreme Court were to accept review of this case it should overrule *Bracken* for the reasons discussed below.

1. The Supreme Court's narrow construction of the term "transfer" is inconsistent with established case law.

In *Bracken*, the Court narrowly construed the term "transfer" as applying only to "real transfers" of property occurring at death. 175

Wn.2d at 570-71. Limiting the Washington tax only to "real transfers" was directly contrary to established case law that has been consistently applied by the United States Supreme Court and the Washington Supreme Court since the 1930s. Under this established law, Congress and state legislatures may impose estate taxes on "deemed" or "fictional" transfers if a "shifting of economic benefit" in property occurs at death. *In re McGrath's Estate*, 191 Wash. 496, 504, 71 P.2d 395 (1937).

a. Congress may include within the federal estate tax base property the decedent did not formally transfer.

The federal estate tax is "imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States." I.R.C. § 2001(a). Courts broadly construe the term "transfer" as used in the federal estate tax code, and the term "extends to the creation, exercise, acquisition, or relinquishment of any power or legal privilege which is incident to the ownership of property." *Wiener*, 326 U.S. at 352. Thus, a "transfer" for federal estate tax purposes is not limited to a formal conveyance of property under state statutory or common law. Rather, "Congress has a wide latitude in the selection of objects of taxation" and may include within the federal estate tax base property that was not formally conveyed upon the death of the decedent. *Id.*

In 1940, the United States Supreme Court conclusively established the power of Congress to include within the measure of the federal estate tax property that was not formally conveyed by the decedent in *Helvering v. Hallock*, 309 U.S. 106, 60 S. Ct. 444, 84 L. Ed. 604 (1940). In discussing an earlier case, *Klein v. United States*, 283 U.S. 231, 51 S. Ct. 398, 75 L. Ed. 996 (1931), the Court noted that *Klein* "rejected formal distinctions pertaining to the law of real property as irrelevant criteria in this field of [estate] taxation." *Hallock,* 309 U.S. at 111. The Court explained that the "inescapable rationale" of *Klein* was that the federal estate tax code "taxes not merely those interests which are deemed to pass at death according to refined technicalities of the law of property [but] also taxes *inter vivos* transfers that are too much akin to testamentary dispositions not to be subjected to the same excise." *Id.* at 112.[12]

A few years after it decided *Hallock*, the United States Supreme Court again addressed the power of Congress to determine by statute when a taxable transfer occurs under the federal estate tax in *Fernandez v. Wiene*r. As previously discussed, the Court in *Wiener* recognized that Congress has broad constitutional power to define the taxable event upon which the estate tax is imposed and to dictate what property interests shall

[12] The Court in *Hallock* followed the analysis in *Klein* and expressly overruled two cases that were inconsistent with "the Klein doctrine." *Id.* at 122 (overruling *Helvering v. St. Louis Union Trust Co.*, 296 U.S. 39, 56 S. Ct. 74, 80 L. Ed. 29 (1935), and *Becker v. St. Louis Union Trust Co.*, 296 U.S. 48, 56 S. Ct. 78, 80 L. Ed. 35 (1935)).

be included in the taxable estate of a decedent. The Court found "no basis for the contention that the tax is arbitrary and capricious because it taxes transfers at death and also *the shifting at death of particular incidents of property*. Congress is free to tax either or both, and here it has taxed both, as it may constitutionally do . . . ." *Wiener*, 326 U.S. at 358 (emphasis added). Thus, while there was no "real transfer" (i.e., formal conveyance) at issue in *Wiener*, Congress nonetheless had the power to tax the "deemed transfer" (i.e., shifting of incidents of property) that occurred at death.[13]

A few years later, the Court again emphasized that a "real transfer" is not required in order to include property in the measure of an estate or inheritance tax. *West v. Oklahoma Tax Comm'n*, 334 U.S. 717, 68 S. Ct. 1223, 92 L. Ed. 1676 (1948). In upholding the Oklahoma inheritance tax at issue, the Court explained that "[a]n inheritance or estate tax is not levied on the property of which an estate is composed. Rather it is imposed upon the shifting of economic benefits and the privilege of transmitting or receiving such benefits." *Id.* at 727.

Likewise, the Supreme Court reiterated in 1960 that Congress may include in the estate tax base the value of property that is not formally

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[13] *Fernandez v. Wiener* also effectively overruled *Coolidge v. Long*, 282 U.S. 582, 51 S. Ct. 306, 75 L. Ed. 562 (1931), which *Bracken* cites with approval for the proposition that property "is transferred from a trustor when a trust is created, not when an income interest in the trust expires." *Bracken*, 175 Wn.2d at 566. *See Wiener*, 326 U.S. at 357 (expressly limiting the holding in *Coolidge*).

transferred by the decedent. *United States v. Manufacturers Nat'l Bank of Detroit*, 363 U.S. 194, 80 S. Ct. 1103, 4 L. Ed. 2d 1158 (1960). The Court explained that "the word 'transfer' in the statute, or the privilege which may constitutionally 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." *Id.* at 199 (quoting *Chase Nat'l Bank v. United States*, 278 U.S. 327, 337, 49 S. Ct. 126, 73 L. Ed. 405 (1929)). Rather, Congress may include within the measure of the tax proceeds from life insurance policies that the decedent had assigned to his wife before his death where his death "create[d] a genuine enlargement of the beneficiaries' rights" and was "the 'generating source' of the full value of the proceeds." *Id.* at 198.

Under these precedents, a "real transfer" of property owned by the decedent is not required before that property can be included in the measure of an estate or inheritance tax. Instead, Congress has the power to direct by statute what property will be included in the taxable estate of a decedent so long as there is some shift in the economic benefit of that property occurring at death. The passing of QTIP under Internal Revenue Code § 2044 undoubtedly qualifies as such a "transfer." A QTIP trust established by the first spouse to die creates a life estate for the surviving spouse and a future interest in the trust assets for the remainder beneficiaries. When the second spouse dies, the life estate is extinguished and the remainder beneficiaries receive a present interest in the property. The death of the second spouse brings about a shift in economic benefits in the assets of the QTIP trust. Congress has the power to tax that transfer, and it has expressly exercised that power in Internal Revenue Code § 2044.

b. Like Congress, the Washington Legislature may include within the estate tax base property the decedent did not formally transfer.

The Washington estate tax, like the federal tax, is imposed on the transfer of property at death. RCW 83.100.040(1) (2012). Under the Washington tax as amended in 2005, a "transfer" was defined as a "'transfer' as used in section 2001 of the Internal Revenue Code." *See* former RCW 83.100.020(11) (2012). Thus, when the Legislature created the stand-alone estate tax in 2005 it clearly expressed its intent that a "transfer" subject to the federal estate tax is also a "transfer" subject to the Washington tax.

"It is a fundamental principle of our system of government that the legislature has plenary power to enact laws, except as limited by our state and federal constitutions." *Washington State Farm Bureau*, 162 Wn.2d at 290. Accordingly, "[t]he legislature has broad plenary powers in its capacity to levy taxes." *Japan Line, Ltd. v. McCaffree*, 88 Wn.2d 93, 96, 558 P.2d 211 (1977). The Legislature may exercise its power to levy an estate tax by incorporating by reference definitions and concepts included in the federal estate tax code.

There is no evidence that the Legislature intended to limit the term "transfer" only to real transfers when it amended the Washington estate tax code in 2005 to change from the pick-up tax to the stand-alone tax. In fact, the stated purpose for the 2005 legislation was to make up for "the revenue loss resulting from the *Estate of Hemphill* decision" by creating a stand-alone estate tax to fund education. Laws of 2005, ch. 516, §§ 1, 16 (referring to *Estate of Hemphill v. Dep't of Revenue*, 153 Wn.2d 544, 105 P.3d 391 (2005)). Had the Legislature also intended QTIP included in the federal taxable estate to be excluded in computing the Washington tax, it would have specifically enacted a deduction designed to accomplish that purpose. *See Belas v. Kiga*, 135 Wn.2d 913, 934-35, 959 P.2d 1037 (1998) (tax exemptions and tax deductions are a matter of legislative grace and "may not be created by implication").

Moreover, the definition of "transfer" in former RCW 83.100.020(11)—which incorporated by reference the broad concept of "transfer" under the Internal Revenue Code—was consistent with Washington case law, specifically *In re McGrath's Estate*, 191 Wash. 496, 71 P.2d 395 (1937). In that case, William McGrath, president of McGrath Candy Company, died in 1935. *Id.* at 497. At the time of his death there were three insurance policies on his life naming McGrath Candy Company as the beneficiary. *Id.* McGrath purchased one of the policies (the "Union Central" policy), and reserved the right to change the beneficiaries. *Id.* at 501. The candy company purchased the other two policies (the "Northwestern Mutual" policies), and McGrath had no right to change the beneficiaries "or do anything with relation to them." *Id.* at 501-02.

The Supreme Court held that the proceeds of the Union Central policy were properly subject to the Washington inheritance tax upon McGrath's death, while the proceeds of the Northwestern Mutual policies were not. *Id.* at 503-03. In distinguishing the Union Central policy from the Northwestern Mutual policies, the Court did not hold that a formal conveyance of property owned by the decedent was required to include the life insurance proceeds within the measure of the inheritance tax. Rather, relying on the holding in *Chase National Bank v. United States*, 278 U.S. 327, 49 S. Ct. 126, 73 L. Ed. 405 (1929), the Court upheld the Washington tax on the proceeds from the Union Central policy because McGrath's death extinguished his right to change the beneficiary, thereby causing a "shifting of economic benefit." *McGrath's Estate*, 191 Wash. at 503-04.

The analysis in *In re McGrath's Estate* is consistent with the concept of "transfer" embodied in the federal estate tax cases decided by the United States Supreme Court. Because there was a "shifting of economic benefit" in the Union Central insurance policy brought about by McGrath's death, the Washington Legislature had the plenary power to include the insurance proceeds in the decedent's inheritance tax base.

2. The power of Congress to tax QTIP passing on the death of the second spouse is not based on contract law concepts of quid pro quo or the duty of consistency.

In *Bracken*, the Court asserted that QTIP passes only once, when the first spouse dies and the property is transferred into the QTIP trust. 175 Wn.2d at 566 (citing *Coolidge v. Long*, 282 U.S. at 605). Consistent with this "single transfer" theory, the Court asserted that the reason the federal tax can be imposed when the second spouse dies is based on "the quid pro quo for allowing the marital deduction for the estate of the first spouse to die" and upon the "duty of consistency" applied by federal courts to prevent taxpayers from adopting inconsistent positions. *Id.* at 568-69 (quoting *Estate of Morgens v. Comm'r*, 133 T.C. 402, 412 (2009)).

The power of Congress to tax QTIP passing on the death of the second spouse is not based on contract law principles such as "quid pro quo" or quasi-estoppel. Rather, as explained above, Congress has broad constitutional power to tax as a "transfer" a shifting of any power or privilege incidental to the ownership or enjoyment of property. Consistent with that broad power, Congress may tax QTIP when the second spouse dies because that death is the generating event causing a shift of interests in the property.

In addition, the power of Congress and the Washington Legislature to tax QTIP is not based on a taxpayer's duty of consistency. "The duty of consistency prevents a taxpayer from benefitting in a later year from an error or omission in an earlier year which cannot be corrected because the time to assess tax for the earlier year has expired." *Estate of Letts v. Comm'r*, 109 T.C. 290, 296 (1997). The doctrine applies only when (1) the taxpayer has made a representation or reported an item for tax purposes in one year, (2) the IRS has acquiesced in or relied on that fact for that year, and (3) the taxpayer desires to change the representation in a later year after the statute of limitations on assessments bars adjustments to the taxes paid in the initial year. *Beltzer v. United States*, 495 F.2d 211, 212 (8th Cir. 1974). Whether the doctrine applies depends on the facts of the particular case and applies only when there has been an omission or misstatement of fact. *Id.* at 213 (citing *Crosley Corp. v. United States*, 229 F.2d 376 (6th Cir. 1956)).

The duty of consistency would not apply when the estate of the first spouse to die elects a marital deduction under Internal Revenue Code § 2056(b)(7) for QTIP passing to the surviving spouse. Under this typical circumstance there is no omission or misstatement of fact because

Congress has authorized the deduction by statute. If the estate of the second spouse to die argues that the QTIP is not subject to estate tax, the argument would be rejected as a matter of law because it is clearly refuted by the express language of Internal Revenue Code § 2044.

While the duty of consistency does not apply in the typical situation involving QTIP, it may apply in unusual cases where the provisions in Internal Revenue Code § 2056(b)(7) were not followed. *Estate of Letts*, 109 T.C. 290 (1997), is a good example. In that case, the estate of James Letts transferred terminable interest property to his surviving spouse, deducted the value of that property in computing the federal estate tax owed, but did not formally elect QTIP treatment on the return. *Id.* at 292-93. Because the estate did not make a QTIP election, it erred in deducting the value of the property in computing the tax owed by the estate. The IRS did not audit the return, and the statute of limitations for assessing the estate of James Letts lapsed prior to the death of his spouse, Mildred. When Mildred died, her estate argued that the terminable interest property was not includable in her gross estate under Internal Revenue Code § 2044 because no formal QTIP election had been made by the estate of James Letts. *Id.* at 293-94. Under these facts, the United States Tax Court held that the duty of consistency applied to bar

Mildred's estate from excluding the QTIP as part of her gross estate. *Id.* at 299-301.

It should be beyond dispute that Congress did not rely on the duty of consistency as its legal justification for enacting Internal Revenue Code § 2044. That doctrine does not even apply under normal circumstances where the statutory QTIP provisions are followed correctly. More importantly, Congress had a more straightforward basis for imposing estate tax on QTIP when the second spouse dies—its broad power to determine by statute when a taxable transfer occurs. It had no need to rely on an equitable doctrine applied by courts on a case-by-case basis.

3. The federal definition of "taxable estate" could have been incorporated into the Washington estate tax without modifying the statute.

Based on a belief that QTIP is transferred only when the first spouse dies, and that the federal estate tax imposed on QTIP when the second spouse dies is premised on "recognized rationales of notice, election, benefit, and consistency," the Court in *Bracken* held that the statutory definition of Washington taxable estate must be "modified." Specifically, the Court held that "because the operative provision of the Act imposes a tax only prospectively, on the transfer of property, the federal definition of 'taxable estate' cannot be used without a modification necessary to conform to the Act: the definition must be read to exclude items that are not transfers." 175 Wn.2d at 570-71.

The Court's holding was incorrect because its underlying premise was incorrect. As explained above, Congress and the Washington Legislature are not powerless to determine when a taxable transfer occurs for estate tax purposes. The passing of QTIP under Internal Revenue Code § 2044 qualifies as a "transfer" under the "shifting of interest" test that has been consistently employed by the United States Supreme Court and Washington courts. Characterizing the transfer as merely "deemed or fictional" does not undercut the authority of Congress or the Washington Legislature to tax it.

Moreover, as the dissent in *Bracken* correctly recognized, under the federal estate tax code QTIP is treated as passing at two distinct points in time: when the first spouse dies and again when the surviving spouse dies. *See Bracken*, 175 Wn.2d at 595-98 (Madsen, C.J., concurring/ dissenting). No tax is owed on the first transfer as a result of the marital deduction. I.R.C. § 2056(b)(7). But estate tax is owed on the second transfer.

The same treatment applied under the Washington tax as amended in 2005. The Legislature expressly incorporated the federal definition of "taxable estate" into the Washington tax. *See* former RCW

83.100.020(14) (2012) (defining "federal taxable estate"). The federal taxable estate of a surviving spouse includes the value of QTIP passing under Internal Revenue Code § 2044. Thus, the term "federal taxable estate" includes QTIP passing when the second spouse dies. Because the QTIP is included in the "federal taxable estate" of the second spouse, it is also included in the Washington taxable estate. *See* former RCW 83.100.020(13) (2012) (defining "Washington taxable estate" as "the federal taxable estate" less certain deductions not related to QTIP). These unambiguous provisions did not require judicial modification.

By judicially modifying the definition of "transfer" to limit the Washington estate tax to only "real transfers," the Court in *Bracken* thwarted the clear intent of the Legislature. When the Legislature enacted the stand-alone estate tax in 2005, it did not limit the tax only to "real transfers." The contrary holding in *Bracken* is incorrect and should be overruled.

4. ***Bracken* was incorrectly decided, is harmful, and should be overruled.**

The Supreme Court will overrule a prior decision if the holding is incorrect and harmful. *Hardee v. Dep't of Soc. & Health Servs.*, 172 Wn.2d 1, 15, 256 P.3d 339 (2011). The Department has made that showing here. Simply put, the Supreme Court's decision in *Bracken* ignored the "shifting of any interest" concept that is the central theme of the modern federal estate tax cases and, instead, applied a "real transfer" versus "deemed transfer" distinction that is not found in any relevant authority. This flawed reasoning created a serious problem for the Legislature and, if not rectified legislatively, would have adversely impacted the State's ability to fund education in this state. Under these circumstances, *Bracken* should be overruled.

VI. CONCLUSION

For the reasons set forth, the Department respectfully requests that the Court reverse the Superior Court's order granting the Estate's motion for summary judgment and remand the case with instructions to enter judgment affirming the Department's agency action.

RESPECTFULLY SUBMITTED this 23rd day of September, 2013.

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

DATED this 23rd day of September, 2013, at Tumwater, WA.

Carrie A. Parker

Carrie A. Parker, Legal Assistant

CERTIFICATION OF ENROLLMENT

ENGROSSED HOUSE BILL 2075

Chapter 2, Laws of 2013

63rd Legislature
2013 2nd Special Session

EDUCATION LEGACY TRUST ACCOUNT--ESTATE AND TRANSFER TAX

EFFECTIVE DATE: 06/14/13 - Except for sections 3, 4, and 6, which become effective 01/01/14.

Passed by the House June 13, 2013
Yeas 53 Nays 33

FRANK CHOPP

Speaker of the House of Representatives

Passed by the Senate June 13, 2013
Yeas 30 Nays 19

TIM SHELDON

President of the Senate

Approved June 14, 2013, 12:30 a.m.

JAY INSLEE

Governor of the State of Washington

CERTIFICATE

I, Barbara Baker, Chief Clerk of the House of Representatives of the State of Washington, do hereby certify that the attached is **ENGROSSED HOUSE BILL 2075** as passed by the House of Representatives and the Senate on the dates hereon set forth.

BARBARA BAKER

Chief Clerk

FILED

June 14, 2013

Secretary of State
State of Washington

APPENDIX A

ENGROSSED HOUSE BILL 2075

Passed Legislature - 2013 2nd Special Session

State of Washington 63rd Legislature 2013 2nd Special Session

By Representatives Carlyle and Roberts

Read first time 06/12/13.

AN ACT Relating to preserving funding deposited into the education legacy trust account used to support common schools and access to higher education by restoring the application of the Washington estate and transfer tax to certain property transfers while modifying the estate and transfer tax to provide tax relief for certain estates; amending RCW 83.100.020, 83.100.040, 83.100.047, 83.100.047, 83.100.120, and 83.100.210; adding a new section to chapter 83.100 RCW; creating new sections; providing an effective date; providing an expiration date; and declaring an emergency.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

NEW SECTION. **Sec. 1.** (1) In 2005, to address an unexpected significant loss of tax revenue resulting from the *Estate of Hemphill* decision and to provide additional funding for public education, the legislature enacted a stand-alone estate and transfer tax, effective May 17, 2005. The stand-alone estate and transfer tax applies to the transfer of property at death. By defining the term "transfer" to mean a "transfer as used in section 2001 of the internal revenue code," the legislature clearly expressed its intent that a "transfer" for purposes of determining the federal taxable estate is also a "transfer" for purposes of determining the Washington taxable estate.

(2) In *In re Estate of Bracken*, Docket No. 84114-4, the Washington supreme court narrowly construed the term "transfer" as defined in the Washington estate tax code.

(3) The legislature finds that it is well established that the term "transfer" as used in the federal estate tax code is construed broadly and extends to the "shifting from one to another of any power or privilege incidental to the ownership or enjoyment of property" that occurs at death. *Fernandez v. Wiener*, 326 U.S. 340, 352 (1945).

(4) The legislature further finds that: The Bracken decision held certain qualified terminable interest property (QTIP) of married couples was transferred without incurring Washington state estate tax liability, which: (a) Creates an inequity never intended by the legislature because unmarried individuals did not enjoy any similar opportunities to avoid or greatly reduce their potential Washington estate tax liability; and (b) may create disparate treatment between QTIP property and other property transferred between spouses that is eligible for the marital deduction.

(5) Therefore, the legislature finds that it is necessary to reinstate the legislature's intended meaning when it enacted the estate tax, restore parity between married couples and unmarried individuals, restore parity between QTIP property and other property eligible for the marital deduction, and prevent the adverse fiscal impacts of the Bracken decision by reaffirming its intent that the term "transfer" as used in the Washington estate and transfer tax is to be given its broadest possible meaning consistent with established United States supreme court precedents, subject only to the limits and exceptions expressly provided by the legislature.

(6) As curative, clarifying, and remedial, the legislature intends for this act to apply both prospectively and retroactively to estates of decedents dying on or after May 17, 2005.

Sec. 2. RCW 83.100.020 and 2013 c 23 s 341 are each amended to read as follows:

((~~As used in this chapter:~~)) The definitions in this section apply throughout this chapter unless the context clearly requires otherwise.

(1) (a) "Applicable exclusion amount" means:

(i) One million five hundred thousand dollars for decedents dying before January 1, 2006;

(ii) Two million dollars for estates of decedents dying on or after January 1, 2006, and before January 1, 2014; and

(iii) For estates of decedents dying in calendar year 2014 and each calendar year thereafter, the amount in (a)(ii) of this subsection must be adjusted annually, except as otherwise provided in this subsection (1)(a)(iii). The annual adjustment is determined by multiplying two million dollars by one plus the percentage by which the most recent October consumer price index exceeds the consumer price index for October 2012, and rounding the result to the nearest one thousand dollars. No adjustment is made for a calendar year if the adjustment would result in the same or a lesser applicable exclusion amount than the applicable exclusion amount for the immediately preceding calendar year. The applicable exclusion amount under this subsection (1)(a)(iii) for the decedent's estate is the applicable exclusion amount in effect as of the date of the decedent's death.

(b) For purposes of this subsection, "consumer price index" means the consumer price index for all urban consumers, all items, for the Seattle-Tacoma-Bremerton metropolitan area as calculated by the United States bureau of labor statistics.

(2) "Decedent" means a deceased individual((~~;~~)).

((~~(2)~~)) (3) "Department" means the department of revenue, the director of that department, or any employee of the department exercising authority lawfully delegated to him or her by the director((~~;~~)).

((~~(3)~~)) (4) "Federal return" means any tax return required by chapter 11 of the internal revenue code((~~;~~)).

((~~(4)~~)) (5) "Federal tax" means a tax under chapter 11 of the internal revenue code((~~;~~)).

((~~(5)~~)) (6) "Gross estate" means "gross estate" as defined and used in section 2031 of the internal revenue code((~~;~~)).

((~~(6)~~)) (7) "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((~~;~~)).

((~~(7)~~)) (8) "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 of an estate((~~;~~)).

((~~(8)~~)) (9) "Property" means property included in the gross estate((~~;~~)).

((~~(9)~~)) (10) "Resident" means a decedent who was domiciled in Washington at time of death((~~;~~)).

((~~(10)~~)) (11) "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((~~;~~)).

((~~(11)~~)) (12) "Transfer" means "transfer" as used in section 2001 of the internal revenue code and includes any shifting upon death of the economic benefit in property or any power or legal privilege incidental to the ownership or enjoyment of property. However, "transfer" does not include a qualified heir disposing of an interest in property qualifying for a deduction under RCW 83.100.046 or ceasing to use the property for farming purposes((~~;~~)).

((~~(12)~~)) (13) "Internal revenue code" means((~~, for the purposes of this chapter and RCW 83.110.010,~~)) the United States internal revenue code of 1986, as amended or renumbered as of January 1, 2005((~~;~~)).

((~~(13)~~)) (14) "Washington taxable estate" means the federal taxable estate((~~, less: (a) One million five hundred thousand dollars for decedents dying before January 1, 2006; and (b) two million dollars for decedents dying on or after January 1, 2006; and (c) the amount of any deduction allowed under RCW 83.100.046; and~~)) and includes, but is not limited to, the value of any property included in the gross estate under section 2044 of the internal revenue code, regardless of whether the decedent's interest in such property was acquired before May 17, 2005, (a) plus amounts required to be added to the Washington taxable estate under RCW 83.100.047, (b) less: (i) The applicable exclusion amount; (ii) the amount of any deduction allowed under RCW 83.100.046; (iii) amounts allowed to be deducted from the Washington taxable estate under RCW 83.100.047; and (iv) the amount of any deduction allowed under section 3 of this act.

((~~(14)~~)) (15) "Federal taxable estate" means the taxable estate as determined under chapter 11 of the internal revenue code without regard to: (a) The termination of the federal estate tax under section 2210 of the internal revenue code or any other provision of law, and (b) the deduction for state estate, inheritance, legacy, or succession taxes allowable under section 2058 of the internal revenue code.

NEW SECTION. **Sec. 3.** A new section is added to chapter 83.100 RCW to read as follows:

(1) For the purposes of determining the tax due under this chapter, a deduction is allowed for the value of the decedent's qualified family-owned business interests, not to exceed two million five hundred thousand dollars, if:

(a) The value of the decedent's qualified family-owned business interests exceed fifty percent of the decedent's Washington taxable estate determined without regard to the deduction for the applicable exclusion amount;

(b) During the eight-year period ending on the date of the decedent's death, there have been periods aggregating five years or more during which:

(i) Such interests were owned by the decedent or a member of the decedent's family;

(ii) There was material participation, within the meaning of section 2032A(e)(6) of the internal revenue code, by the decedent or a member of the decedent's family in the operation of the trade or business to which such interests relate;

(c) The qualified family-owned business interests are acquired by any qualified heir from, or passed to any qualified heir from, the decedent, within the meaning of RCW 83.100.046(2), and the decedent was at the time of his or her death a citizen or resident of the United States; and

(d) The value of the decedent's qualified family-owned business interests is not more than six million dollars.

(2)(a) Only amounts included in the decedent's federal taxable estate may be deducted under this subsection.

(b) Amounts deductible under RCW 83.100.046 may not be deducted under this section.

(3)(a) There is imposed an additional estate tax on a qualified heir if, within three years of the decedent's death and before the date of the qualified heir's death:

(i) The material participation requirements described in section 2032A(c)(6)(b)(ii) of the internal revenue code are not met with respect to the qualified family-owned business interest which was acquired or passed from the decedent;

(ii) The qualified heir disposes of any portion of a qualified family-owned business interest, other than by a disposition to a member of the qualified heir's family or a person with an ownership interest in the qualified family-owned business or through a qualified conservation contribution under section 170(h) of the internal revenue code;

(iii) The qualified heir loses United States citizenship within the meaning of section 877 of the internal revenue code or with respect to whom section 877(e)(1) applies, and such heir does not comply with the requirements of section 877(g) of the internal revenue code; or

(iv) The principal place of business of a trade or business of the qualified family-owned business interest ceases to be located in the United States.

(b) The amount of the additional estate tax imposed under this subsection is equal to the amount of tax savings under this section with respect to the qualified family-owned business interest acquired or passed from the decedent.

(c) Interest applies to the tax due under this subsection for the period beginning on the date that the estate tax liability was due under this chapter and ending on the date the additional estate tax due under this subsection is paid. Interest under this subsection must be computed as provided in RCW 83.100.070(2).

(d) The tax imposed by this subsection is due the day that is six months after any taxable event described in (a) of this subsection occurred and must be reported on a return as provided by the department.

(e) The qualified heir is personally liable for the additional tax imposed by this subsection unless he or she has furnished a bond in favor of the department for such amount and for such time as the department determines necessary to secure the payment of amounts due under this subsection. The qualified heir, on furnishing a bond satisfactory to the department, is discharged from personal liability for any additional tax and interest under this subsection and is entitled to a receipt or writing showing such discharge.

(f) Amounts due under this subsection attributable to any qualified family-owned business interest are secured by a lien in favor of the state on the property in respect to which such interest relates. The lien under this subsection (3)(f) arises at the time the Washington return is filed on which a deduction under this section is taken and continues in effect until: (i) The tax liability under this subsection has been satisfied or has become unenforceable by reason of lapse of time; or (ii) the department is satisfied that no further tax liability will arise under this subsection.

(g) Security acceptable to the department may be substituted for the lien imposed by (f) of this subsection.

(h) For purposes of the assessment or correction of an assessment for additional taxes and interest imposed under this subsection, the limitations period in RCW 83.100.095 begins to run on the due date of the return required under (d) of this subsection.

(i) For purposes of this subsection, a qualified heir may not be treated as disposing of an interest described in section 2057(e)(1)(A) of the internal revenue code by reason of ceasing to be engaged in a trade or business so long as the property to which such interest relates is used in a trade or business by any member of the qualified heir's family.

(4)(a) The department may require a taxpayer claiming a deduction under this section to provide the department with the names and contact information of all qualified heirs.

(b) The department may also require any qualified heir to submit to the department on an ongoing basis such information as the department determines necessary or useful in determining whether the qualified heir is subject to the additional tax imposed in subsection (3) of this section. The department may not require such information more frequently than twice per year. The department may impose a penalty on a qualified heir who fails to provide the information requested within thirty days of the date the department's written request for the information was sent to the qualified heir. The amount of the penalty under this subsection is five hundred dollars and may be collected in the same manner as the tax imposed under subsection (3) of this section.

(5) For purposes of this section, references to section 2057 of the

internal revenue code refer to section 2057 of the internal revenue code, as existing on December 31, 2003.

(6) For purposes of this section, the following definitions apply:

(a) "Member of the decedent's family" and "member of the qualified heir's family" have the same meaning as "member of the family" in RCW 83.100.046(10).

(b) "Qualified family-owned business interest" has the same meaning as provided in section 2057(e) of the internal revenue code of 1986.

(c) "Qualified heir" has the same meaning as provided in section 2057(i) of the internal revenue code of 1986.

(7) This section applies to the estates of decedents dying on or after January 1, 2014.

Sec. 4. RCW 83.100.040 and 2010 c 106 s 234 are each amended to read as follows:

(1) A tax in an amount computed as provided in this section is imposed on every transfer 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%~~)) 18.00%	$4,000,000
$6,000,000	$7,000,000	((~~$890,000~~)) $910,000	((~~18.00%~~)) 19.00%	$6,000,000
$7,000,000	$9,000,000	((~~$1,070,000~~)) $1,100,000	((~~18.50%~~)) 19.50%	$7,000,000

$9,000,000	((~~$1,440,000~~)) $1,490,000	((~~19.00%~~)) 20.00%	$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 must be excluded from the numerator and denominator of the fraction.

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

Sec. 5. RCW 83.100.047 and 2005 c 516 s 13 are each amended to read as follows:

(1) 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~~)) is binding on the estate and the beneficiaries, consistent with the internal revenue code. All other elections or valuations on the Washington return ((~~shall~~)) must be made in a manner consistent with the federal return, if a federal return is required, and such rules as the department may provide.

(2) Amounts deducted for federal income tax purposes under section 642(g) of the internal revenue code of 1986((~~, shall~~)) are not ((~~be~~)) allowed as deductions in computing the amount of tax due under this chapter.

(3) Notwithstanding any department rule, if a taxpayer makes an election consistent with section 2056 of the internal revenue code as

permitted under this section, the taxpayer's Washington taxable estate, and the surviving spouse's Washington taxable estate, must be adjusted as follows:

(a) For the taxpayer that made the election, any amount deducted by reason of section 2056(b)(7) of the internal revenue code is added to, and the value of property for which a Washington election under this section was made is deducted from, the Washington taxable estate.

(b) For the estate of the surviving spouse, the amount included in the estate's gross estate pursuant to section 2044 (a) and (b)(1)(A) of the internal revenue code is deducted from, and the value of any property for which an election under this section was previously made is added to, the Washington taxable estate.

Sec. 6. RCW 83.100.047 and 2009 c 521 s 192 are each amended to read as follows:

(1)(a) 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 and (b) of this subsection, for the purpose of determining the amount of tax due under this chapter. The election ((~~shall be~~)) is binding on the estate and the beneficiaries, consistent with the internal revenue code and (b) of this subsection. All other elections or valuations on the Washington return ((~~shall~~)) must be made in a manner consistent with the federal return, if a federal return is required, and such rules as the department may provide.

(b) The department ((~~shall~~)) must provide by rule that a state registered domestic partner is deemed to be a surviving spouse and entitled to a deduction from the Washington taxable estate for any interest passing from the decedent to his or her domestic partner, consistent with section 2056 or 2056A of the internal revenue code but regardless of whether such interest would be deductible from the federal gross estate under section 2056 or 2056A of the internal revenue code.

(2) Amounts deducted for federal income tax purposes under section 642(g) of the internal revenue code of 1986 ((~~shall~~)) are not ((~~be~~))

allowed as deductions in computing the amount of tax due under this chapter.

(3) Notwithstanding any department rule, if a taxpayer makes an election consistent with section 2056 of the internal revenue code as permitted under this section, the taxpayer's Washington taxable estate, and the surviving spouse's Washington taxable estate, must be adjusted as follows:

(a) For the taxpayer that made the election, any amount deducted by reason of section 2056(b)(7) of the internal revenue code is added to, and the value of property for which a Washington election under this section was made is deducted from, the Washington taxable estate.

(b) For the estate of the surviving spouse, the amount included in the estate's gross estate pursuant to section 2044 (a) and (b)(1)(A) of the internal revenue code is deducted from, and the value of any property for which an election under this section was previously made is added to, the Washington taxable estate.

Sec. 7. RCW 83.100.120 and 1981 2nd ex.s. c 7 s 83.100.120 are each amended to read as follows:

(1)(a) Except as otherwise provided in this subsection, any personal representative who distributes any property without first paying, securing another's payment of, or furnishing security for payment of the taxes due under this chapter is personally liable for the taxes due to the extent of the value of any property that may come or may have come into the possession of the personal representative. Security for payment of the taxes due under this chapter ((~~shall~~)) must be in an amount equal to or greater than the value of all property that is or has come into the possession of the personal representative, as of the time the security is furnished.

(b) For the estates of decedents dying prior to April 9, 2006, a personal representative is not personally liable for taxes due on the value of any property included in the gross estate and the Washington taxable estate as a result of section 2044 of the internal revenue code unless the property is located in the state of Washington or the property has or will come into the possession or control of the personal representative.

(2) Any person who has the control, custody, or possession of any property and who delivers any of the property to the personal

representative or legal representative of the decedent outside Washington without first paying, securing another's payment of, or furnishing security for payment of the taxes due under this chapter is liable for the taxes due under this chapter to the extent of the value of the property delivered. Security for payment of the taxes due under this chapter ((~~shall~~)) <u>must</u> be in an amount equal to or greater than the value of all property delivered to the personal representative or legal representative of the decedent outside Washington by such a person.

(3) For the purposes of this section, persons who do not have possession of a decedent's property include anyone not responsible primarily for paying the tax due under this section or their transferees, which includes but is not limited to mortgagees or pledgees, stockbrokers or stock transfer agents, banks and other depositories of checking and savings accounts, safe-deposit companies, and life insurance companies.

(4) For the purposes of this section, any person who has the control, custody, or possession of any property and who delivers any of the property to the personal representative or legal representative of the decedent may rely upon the release certificate or the release of nonliability certificate, furnished by the department to the personal representative, as evidence of compliance with the requirements of this chapter, and make such deliveries and transfers as the personal representative may direct without being liable for any taxes due under this chapter.

Sec. 8. RCW 83.100.210 and 2010 c 106 s 111 are each amended to read as follows:

(1) The following provisions of chapter 82.32 RCW have full force and application with respect to the taxes imposed under this chapter unless the context clearly requires otherwise: RCW 82.32.110, 82.32.120, 82.32.130, 82.32.320, 82.32.330, and 82.32.340. The definitions in this chapter have full force and application with respect to the application of chapter 82.32 RCW to this chapter unless the context clearly requires otherwise.

(2) <u>In addition to the provisions stated in subsection (1) of this section, the following provisions of chapter 82.32 RCW have full force and application with respect to the taxes, penalties, and interest</u>

imposed under section 3 of this act: RCW 82.32.090, 82.32.117, 82.32.135, 82.32.210, 82.32.220, 82.32.230, 82.32.235, 82.32.237, 82.32.245, and 82.32.265.

(3) The department may enter into closing agreements as provided in RCW 82.32.350 and 82.32.360.

NEW SECTION. **Sec. 9.** Sections 2 and 5 of this act apply both prospectively and retroactively to all estates of decedents dying on or after May 17, 2005.

NEW SECTION. **Sec. 10.** This act does not affect any final judgment, no longer subject to appeal, entered by a court of competent jurisdiction before the effective date of this section.

NEW SECTION. **Sec. 11.** Section 4 of this act applies to estates of decedents dying on or after January 1, 2014.

NEW SECTION. **Sec. 12.** If any provision of this act or its application to any person or circumstance is held invalid, the remainder of the act or the application of the provision to other persons or circumstances is not affected.

NEW SECTION. **Sec. 13.** Section 5 of this act expires January 1, 2014.

NEW SECTION. **Sec. 14.** This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and takes effect immediately, except for sections 3, 4, and 6 of this act which take effect January 1, 2014.

Passed by the House June 13, 2013.
Passed by the Senate June 13, 2013.
Approved by the Governor June 14, 2013.
Filed in Office of Secretary of State June 14, 2013.

Department of Revenue Fiscal Note

Bill Number: 2075 E HB	Title: Estate, transfer tx/edu acct	Agency: 140-Department of Revenue

Part I: Estimates

☐ No Fiscal Impact

Estimated Cash Receipts to:

Account	FY 2014	FY 2015	2013-15	2015-17	2017-19
Education Legacy Trust Account-State 01 - Taxes 55 - Inheritance Tax	109,700,000	39,300,000	149,000,000	74,600,000	74,400,000
Education Legacy Trust Account-State 01 - Taxes 75 - Penalties and Intrst	8,700,000	1,700,000	10,400,000	900,000	
Total $	118,400,000	41,000,000	159,400,000	75,500,000	74,400,000

Estimated Expenditures from:

	FY 2014	FY 2015	2013-15	2015-17	2017-19
FTE Staff Years	0.2		0.1		
Account					
GF-STATE-State 001-1	20,600		20,600		
Total $	20,600		20,600		

Estimated Capital Budget Impact:

NONE

This bill was identified as a proposal governed by the requirements of RCW 43.135.031 (Initiative 960). Therefore, this fiscal analysis includes a projection showing the ten-year cost to tax or fee payers of the proposed taxes or fees.

The cash receipts and expenditure estimates on this page represent the most likely fiscal impact. Factors impacting the precision of these estimates, and alternate ranges (if appropriate), are explained in Part II.

Check applicable boxes and follow corresponding instructions:

☒ If fiscal impact is greater than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete entire fiscal note form Parts I-V.

☐ If fiscal impact is less than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete this page only (Part I).

☐ Capital budget impact, complete Part IV.

☐ Requires new rule making, complete Part V.

Legislative Contact:	Dean Carlson	Phone: (360)786-7305	Date: 06/14/2013
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Request # 2075-3-1

APPENDIX B

Part II: Narrative Explanation

II. A - Brief Description Of What The Measure Does That Has Fiscal Impact

Briefly describe, by section number, the significant provisions of the bill, and any related workload or policy assumptions, that have revenue or expenditure impact on the responding agency.

Note: This fiscal note reflects language in EHB 2075, 2013 Second Special Legislative Session.

This legislation clarifies the meaning of the terms "transfer" and "Washington taxable estate" as used in the Washington estate tax. The Legislature enacted a stand-alone estate tax, which took effect May 17, 2005. The tax applies to the transfer of property at death. A recent Washington Supreme Court decision has effectively exempted qualified terminable interest property (QTIP) from Washington's estate tax when the taxpayer makes a federal QTIP election and no separate Washington QTIP election. This legislation is intended to restore the estate tax as it existed before that recent court decision.

The definition of "transfer" is amended to clarify that a transfer includes the shifting upon death of the economic benefit in property or any power or legal privilege incidental to the ownership or enjoyment of property.

New language is also added to the definition of "Washington taxable estate" to include the value of any property included in the gross estate under Section 2044 of the Internal Revenue Code, regardless of whether the decedent's interest in such property was acquired before May 17, 2005.

The bill also provides that if a taxpayer makes a separate Washington QTIP election, the Washington taxable estate of the taxpayer and his or her surviving spouse must be adjusted as follows:

- For the taxpayer, any amount deducted from the federal gross estate by reason of Section 2056(b)(7) of the Internal Revenue Code is added to, and the value of property for which a Washington QTIP election is made is deducted from, the Washington taxable estate.
- Upon the surviving spouse's death, the amount included in the estate's federal gross estate pursuant to Section 2044(a) and (b)(1)(A) of the Internal Revenue Code is deducted from, and the value of any property for which a Washington QTIP election was previously made is added to, the Washington taxable estate.

New language adjusts the Washington filing threshold annually using the Seattle-Tacoma-Bremerton metropolitan area consumer price index to determine the adjustment.

A new deduction is created for the value of the decedent's qualified family-owned business interests with the following limitations:

- The value of qualified interests must exceed 50 percent of the Washington taxable estate without regard to the threshold deduction,
- Material participation requirements must be met before and after the death of the decedent,
- The value of the decedent's qualified family-owned business interests is not more than $6 million, and
- The deduction allowed may not exceed $2.5 million.

The top four rates in the Washington estate tax table are each increased:

- From 17 percent to 18 percent,
- From 18 percent to 19 percent,
- From 18.5 percent to 19.5 percent, and
- From 19 percent to 20 percent.

The bill also eliminates liability for a personal representative for estate taxes on QTIP if the decedent dies prior to April 9, 2006, and the property is not located in Washington or under the control of the personal representative.

Sections 2 and 5 of this act apply both prospectively and retroactively to all estates of decedents dying on or after May 17, 2005.

This legislation has an emergency clause and takes effect immediately upon signature, except for Sections 3, 4, and 6 which take effect January 1, 2014.

II. B - Cash receipts Impact

Briefly describe and quantify the cash receipts impact of the legislation on the responding agency, identifying the cash receipts provisions by section number and when appropriate the detail of the revenue sources. Briefly describe the factual basis of the assumptions and the method by which the cash receipts impact is derived. Explain how workload assumptions translate into estimates. Distinguish between one time and ongoing functions.

This estimate reflects a change in the Department's application of current law due to a recent court case. On January 10, 2013, the Washington Supreme Court denied the Department's petition for reconsideration of its consolidated Estate of Bracken and Estate of Nelson decision.

ASSUMPTIONS

- All estates that have filed a return excluding QTIP assets will file an amended return, so the state will realize all revenues.
- Assumes limiting liability for personal representatives impacts few than 10 estates.
- The entire impact for limiting liability for personal representatives is reflected in Fiscal Year 2014 because all returns for deaths prior to April 9, 2006 have been received by the Department of Revenue.
- All payments are made timely at the 9 month due date.
- The first payments would be due on October 1, 2014, which will result in 9 months of impact in Fiscal Year 2015.
- Federal data of Estate Tax Returns filed for 2007 decedents was used for this estimate.
- Business assets include: 25% of closely held stock, 100% of investment real estate, 100% of non-corporate business assets, and 100% of other limited partnership assets.

DATA SOURCES

- Department of Revenue (Department) Estate Tax data
- Estate Tax Forecast Model (November 2012)
- Federal Estate Tax data

REVENUE ESTIMATES

This legislation will increase revenues to the education legacy trust account by an estimated $118.4 million in Fiscal Year 2014. The estimated revenue increase reflects the retroactive clarifications of the definitions of "transfer" and "Washington taxable estate" to conform to the Department's interpretation, thereby eliminating any refund claims resulting from the recent court decision, other than for the Estate of Bracken. It also reflects other changes made to existing estate tax law.

TOTAL REVENUE IMPACT:

State Government (cash basis, $000):

FY 2014 -	$118,400
FY 2015 -	$ 41,000
FY 2016 -	$ 40,200
FY 2017 -	$ 35,300
FY 2018 -	$ 34,400
FY 2019 -	$ 40,000

Local Government, if applicable (cash basis, $000): None.

II. C - Expenditures

Briefly describe the agency expenditures necessary to implement this legislation (or savings resulting from this legislation), identifying by section number the provisions of the legislation that result in the expenditures (or savings). Briefly describe the factual basis of the assumptions and the method by which the expenditure impact is derived. Explain how workload assumptions translate into cost estimates. Distinguish between one time and ongoing

FIRST YEAR COSTS:

The Department will incur total costs of $20,600 in Fiscal Year 2014. These costs include:

Labor Costs - Time and effort equates to 0.2 FTEs.

- One significant rule-making process to create one new rule and amend three existing rules.

Part III: Expenditure Detail

III. A - Expenditures by Object Or Purpose

	FY 2014	FY 2015	2013-15	2015-17	2017-19
FTE Staff Years	0.2		0.1		
A-Salaries and Wages	12,700		12,700		
B-Employee Benefits	3,800		3,800		
E-Goods and Other Services	2,900		2,900		
J-Capital Outlays	1,200		1,200		
Total $	$20,600		$20,600		

III. B - Detail: *List FTEs by classification and corresponding annual compensation. Totals need to agree with total FTEs in Part I and Part IIIA*

Job Classification	Salary	FY 2014	FY 2015	2013-15	2015-17	2017-19
HEARINGS SCHEDULER	32,688	0.0		0.0		
TAX POLICY SP 2	61,628	0.0		0.0		
TAX POLICY SP 3	69,756	0.1		0.1		
WMS BAND 3	88,546	0.0		0.0		
Total FTE's	252,618	0.2		0.1		

Part IV: Capital Budget Impact

Identify acquisition and construction costs not reflected elsewhere on the fiscal note and describe potential financing methods

NONE

None.

Part V: New Rule Making Required

Identify provisions of the measure that require the agency to adopt new administrative rules or repeal/revise existing rules.

Should this legislation become law, the Department will use the significant rule making process to create one new rule; and amend the following: WAC 458-57-105, titled: "Nature of estate tax, definitions"; WAC 458-57-115, titled: "Valuation of property, property subject to estate tax, and how to calculate the tax"; and WAC 458-57-125, titled: "Apportionment of tax when there are out-of-state assets". Persons affected by this rule-making would include those required to pay estate tax and estate tax professionals.