70514-8

70514-8

No. 70514-8-I

IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION I

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

Respondent,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Appellant.

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**SUPPLEMENTAL BRIEF OF RESPONDENT
ON IMPACT OF *HAMBLETON*
AND MOTION FOR REMAND FOR A NEW TRIAL**

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Dirk Giseburt (WSB #13949)
Richard A. Klobucher (WSB #6203)
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## I. INTRODUCTION

This Supplemental Brief is filed in response to the Court's Notation Ruling dated April 20, 2015, directing Respondent U.S. Bank to file a supplemental brief addressing the impact of *In re Estate of Hambleton,* 181 Wn.2d 802, 335 P.3d 398 (2014), on this case.

There are at least three live issues in this case. First, the legislature expressly intended to restrict the Washington estate tax to transfers taxable under federal case law and the Supreme Court in *Hambleton* did not address the issue at all. Second, the Court in *Hambleton* decided the Due Process issue incorrectly when it relied primarily on the theory espoused by Justice Scalia in his concurrence in *United States v. Carlton*, 512 U.S. 26, 40, 114 S. Ct. 2018, 129 L. Ed. 2d 22 (1994), that the revenue to be gained justifies the period of the retroactive imposition of tax.[1] Finally, the *Hambleton* Court did not rule on the issue raised in Section F of Respondent's Brief in this appeal.[2]

U.S. Bank incorporates herein the Statement of the Case set forth in its previously filed Brief of Respondent dated November 13, 2013.[3] *See* Brief of Respondent, at 4-9.

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[1] U.S. Bank moves the Court herein pursuant to RAP 17.4(d) to remand this case for a new trial and determination of these issues and related aspects of the Due Process issue.

[2] U.S. Bank argued in that section that the DOR should not be permitted to use delay as a tactic to deprive a taxpayer of an undisputed refund. Because the DOR failed and refused to carry out its duty while supporting a legislative amendment, U.S. Bank has been deprived of the refund it should have immediately received.

[3] U.S. Bank does not dispute the Statement of the Case in the Department of Revenue's Supplemental Brief filed on December 17, 2014, except that the DOR omits the fact that the retroactive amendments were not signed by the Governor and enacted until June 14, 2013—the day after this appeal was filed. *See* Laws of 2013, 2d Spec. Sess., ch. 2, § 14.

## II. SUPPORT FOR BRIEF AND MOTION

This brief and motion is supported by: (1) the Declaration of Rhys M. Farren; and (2) the Declaration of Karolyn A. Hicks.

## III. LIVE ISSUES AFTER *HAMBLETON*

*Hambleton* did not expressly overrule *Clemency v. State (In re Estate of Bracken)*, 175 Wn.2d 549, 290 P.3d 99 (2012) ("*Bracken*"), and the Department of Revenue ("DOR") has announced that it still intends to litigate "the key issue" in *Bracken*. Hicks Decl. ¶ 6. Moreover, the estates in *Hambleton* are planning to file a petition for writ of certiorari in the U.S. Supreme Court alleging errors in our Court's Due Process analysis and holding. Farren Decl. ¶ 5.[4] Finally, whether the DOR should not be permitted to delay its statutory duty while seeking a legislative change was also not addressed. Therefore, *Hambleton* did not resolve all issues in this case.

### 1. The Supreme Court Did Not Address Whether the 2013 Estate Tax Amendments Exceeded the Federal Constitutional Standard for Excise Taxes.

In the 2013 amendments to the estate tax following the *Bracken* decision, the legislature made findings that the Court's interpretation of the term "transfer" was "narrow" (impliedly too narrow) and 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] On March 31, 2015, Justice Kennedy granted the Estates an extension to June 8, 2015 to file their Petition for a Writ of Certiorari. *See* Appendix A.

Laws of 2013, 2d Sp. Sess., ch. 2 (the "2013 Amendments"), §§ 1(2), (3). In this light, the legislature stated 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.

*Id.* § 1(5) (emphasis added).

In briefing at the Supreme Court, the estates argued strenuously that the relevant U.S. Supreme Court precedents (which do not include *Fernandez v. Wiener*) support the analysis and result in *Bracken. See* Farren Decl. ¶ 6 & Ex. B. The DOR, by contrast, argued that *Bracken* should be overruled because, allegedly, *Wiener* and other decisions support "indirect" taxation under the U.S. Constitution of the termination of a passive lifetime income beneficial interest upon death. *See id.* ¶ 7 & Ex. C. The Washington Supreme Court did not engage with this debate at all. It omitted any reference to it in the Court's listing of the arguments presented by the estates. *Hambleton*, 181 Wn.2d at 816 ¶ 23.

Despite the position of the DOR in its Supplemental Brief that all issues have been resolved, the DOR is informing other estates that this remains a live issue. Karolyn Hicks, representing estates in similar cases, recently asked the DOR to agree to stay those cases. *See* Hicks Decl. ¶¶ 1-5. The DOR's counsel declined, stating that, even if the U.S. Supreme Court reverses *Hambleton* on Due Process grounds, the State will take the case "forward on *the key issue* of whether Bracken was wrongly decided and should be overruled." *Id.* ¶ 6 (quoting email from C. Zalesky, Assistant Attorney General).[5] This issue merits full briefing, either in this Court or on remand.

### 2. ***Hambleton*'s Due Process Analysis Is Wrong and Remains on Appeal; the DOR's "Mistake-Correction" Theory Was Not Accepted by the Court and Merits Additional Discovery.**

Under *Carlton,* a retroactive tax statute will be upheld against a Due Process challenge if it "is supported by a legitimate legislative purpose furthered by rational means." 512 U.S. at 30-31 (quoting *Pension Benefit Guar. Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 733, 104 S. Ct. 2709, 81 L. Ed. 2d 60 (1984)). While there are several grounds for complaining about the *Hambleton* opinion's faithfulness to *Carlton*'s test, the Court made an especially egregious error in holding that the amount of funds to be gained by retroactive amendment itself justified the period of retroactivity under the "rational means" prong. This is the focus of the intended petition for writ of certiorari of the estates in *Hambleton. See* Farren Decl. ¶ 5.

[5] The DOR might take the position that the Supreme Court impliedly addressed this issue in its holding that the 2013 Amendments did not violate Article VII, section 1 of the State Constitution. This constitutional provision forbids non-uniform taxation of property but does not apply to excise taxes. The Court held that taxing the type of "transfer" occurring in these cases – the termination of a passive lifetime income interest in a trust – fits within the *State's* constitutional concept of an excise tax. The Court erroneously relied for this purpose on *Wiener*, which did not involve beneficial interests held in trust. *Hambleton*, 181 Wn.2d at 832 ¶¶ 60-61. But the Court made no effort to find that *federal* constitutional law in fact permits taxation of such events as an "indirect" tax. The DOR's stated intention of litigating this issue further with Ms. Hicks's clients belies any argument that the Article VII, section 1 analysis in *Hambleton* resolved this issue.

*Hambleton*'s analysis of the "rational means" test essentially adopted the spirit of Justice Scalia's concurrence in *Carlton* (in which Justice Thomas joined). Justice Scalia wrote:

> The reasoning the Court applies to uphold the statute in this case guarantees that *all* retroactive tax laws will henceforth be valid. . . . Revenue raising is certainly a legitimate legislative purpose, see US Const. Art. I, § 8, cl. 1, and any law that retroactively adds a tax, removes a deduction, or increases a rate rationally furthers that goal. I welcome this recognition that the Due Process Clause does not prevent retroactive taxes . . . .

*Id.* at 40. In keeping with this theme, the *Hambleton* opinion states,

> Like the legitimate purpose in *Carlton*, the purpose of the 2013 amendment is largely economic. *Carlton*, 512 U.S. at 32. According to the DOR fiscal note, the legislation was anticipated to
>
> > *increase revenues* to the education legacy trust account by an estimated $118.4 million in Fiscal year 2014.

*Hambleton*, 181 Wn.2d at 826 (quoting Agency Fiscal Note to Engrossed H.B. 2075, at 3, 63d Leg., 2d Spec. Sess. (Wash. 2013)) (emphasis added). In light of this purpose of increasing revenues, the Court held that the period of retroactivity was rational because "[i]t provides the needed funds." *Id.* at 827.

In taking Justice Scalia's part on this point, our Court broke with other states' courts of last resort, which hold that increasing or maintaining revenues justifies only a limited retroactive period. *See James Square Assocs. LP v. Mullen*, 993 N.E.2d 374, 382-83 (N.Y. 2013) (retroactivity period between 16 and 32 months was "excessive" and violated due process); *Rivers v. State*, 490 S.E.2d 261, 265 (S.C. 1997) (retroactivity period between two and three years violates due process because it is "simply excessive").

U.S. Bank believes the error in the *Hambleton* opinion merits this Court's (or the trial court's) attention through full briefing. The Washington Supreme Court will overturn its own decisions where "there is a clear showing that an established rule is incorrect and harmful." *In re Rights to Waters of Stranger Creek*, 77 Wn.2d 649, 653, 466 P.2d 508 (1970), *cited in State v. Glasman*, Wash. S. Ct. No. 88913-9, Slip op. at 8 (May 7, 2015). (This is the basis on which the DOR would seek to overturn *Bracken.*) However, for the sake of judicial economy it makes sense to defer re-evaluating *Hambleton* until after the U.S. Supreme Court has addressed the *Hambleton* estates' petition.

It is clear that the DOR views the retroactive 2013 Amendments as primarily justified on this "drafting error" theory.[6] In the email to Ms. Hicks, Assistant Attorney General Zalesky predicts that a potential reversal of *Hambleton* would "significantly restrict the ability of Congress and state legislatures to fix mistakes in a tax statute retroactively." Hicks

[6] One virtue of the *Hambleton* opinion is that it did not give credit to the DOR's argument that the original 2005 estate tax statutes contained drafting errors about the nature of "transfers" subject to tax. *Hambleton* did not even mention this feature of *Carlton* in the Court's description of that case, *id.* at 824-25, even though the drafting mistake was a critical component of *Carlton*'s own "legitimate purpose" analysis. 512 U.S. at 31-32. Instead, the Court honored its prior interpretation of the 2005 statutes, *Hambleton*, 181 Wn.2d at 812-13, and held that "[t]he decision to retroactively amend the statute was a policy decision." *Id.* at 822 n.3.

Decl. ¶ 6. If this is the "legitimate purpose" for the retroactive 2013 amendments, then the timing of administrative and legislative actions to fix the mistake is critical under the *Carlton* "rational means" analysis. *See Carlton*, 512 U.S. at 31-33 (summarizing agency and congressional actions taken promptly after discovery of disputes with estates and holding they demonstrated "legitimate legislative purpose" and "rational means").

Both of the consolidated cases in *Hambleton* were in the Court of Appeals following the 2013 Amendments were enacted and, in the middle of briefing at the Court of Appeals, both cases were certified to the State Supreme Court at the DOR's request. *Hambleton*, 181 Wn.2d at 815-16 ¶¶ 20-22; Farren Decl. ¶ 3. Given this procedural context, neither estate party had an opportunity to conduct additional discovery of the DOR's processes or nonpublic legislative processes that are relevant to the Due Process analysis of retroactive tax legislation.

Respondent U.S. Bank believes that substantial additional evidence of agency and legislative actions relevant to Due Process compliance in this case could be adduced with an opportunity for further discovery. Farren Decl. ¶ 4. The DOR made a specific decision in 2007, when it was faced with an accumulated $19 million in estate tax disputes already, not to raise the push for a legislative response, *id.* Ex. A, even though the DOR has prompted legislative action on other tax disputes while cases were in the trial stage. *See Tesoro Ref. & Mktg. Co. v. Dep't of Revenue*, 159 Wn. App. 104, 110 ¶ 6, 246 P.3d 211 (2010), *rev'd on other grounds*, 173 Wn.2d 551, 555 ¶ 8, 269 P.3d 1013 (2012). What the agency and other actors did in response to the alleged legislative mistake, and when and why, are necessarily implicated in how long a retroactive period may be considered a "rational means" for correcting the "mistake." *See Carlton*, 512 U.S. at 31-33. Discovery may well show that the State Supreme Court was under-informed of the relevant facts, through no one's fault, but to the detriment of a full Due Process analysis.

### 3. ***Hambleton*'s Did Not Address the Issue of the DOR's Delay in Issuing a Refund For the Purpose of Seeking a Legislative Solution.**

In Section F of Respondent's Brief, U.S. Bank argued that the Court should not permit the DOR to intentionally withhold refunds while the DOR works toward a change in the law. It is undisputed that the DOR purposefully withheld the refund after the *Bracken* decision. Even after the Attorney General's office stipulated that *Bracken* mandated a refund, the DOR continued to withhold the taxpayer's refund. When the trial court ordered to pay the refund by May 24, the DOR completely ignored the court's order. In taking these actions, the DOR acted above the law. The fact that the DOR was ultimately successful in persuading the legislature to amend the statute does not change the fact that the taxpayer's legal right to a refund was wrongfully withheld. Respect for the rule of law requires that the taxpayer have a remedy for the DOR's conduct.

## IV. MOTION

U.S. Bank hereby moves the Court for an order of remand to King County Superior Court for: (1) an original determination, following an appropriate period of discovery and exploration whether it would profit all parties to consolidate the refund appeals of similarly situated estates, of the Due Process validity of the retroactive aspects of the 2013 Amendments: and (2) for an original interpretation of the estate tax statutes in light of the legislature's purpose to conform the meaning of "transfer" to "its broadest possible meaning consistent with established United States supreme court precedents," which the State Supreme Court failed to do. U.S. Bank would also reserve consideration in the trial court of whether *Hambleton* correctly decided the Article VII, section 1 issue under the State Constitution, in light of the court's resolution of the second issue, given the similarity (but not identity) of the issue.

RAP 9.11 permits the taking of additional evidence before the decision of a case on review, which task is usually directed to the trial court. This case presents an appropriate instance for this relief under five of the six criteria under RAP 9.11(a), because: (1) additional proof of facts is needed to fairly resolve the Due Process issues on review, *see* Farren Decl. ¶ 4; (2) the additional evidence could easily change the decision being reviewed (taking into account the Supreme Court's attention in *Carlton* to the promptness of administrative action in stimulating a legislative response to a perceived "mistake"); (3) it is equitable to excuse U.S. Bank for failing to present evidence on the issue at the trial court, given that the retroactive amendments were adopted after the trial phase was complete, *see id.* ¶ 3; (4) there was no opportunity to address this issue in post-judgment motions at the trial court, *id.*; and . . . (5) it would be inequitable to deprive U.S. Bank of the opportunity to take evidence that was not relevant to the trial court's decision in the case at the time, given that its constitutional rights are at issue.

With respect to the fifth criterion in RAP 9.11(a) (taking additional evidence at the appellate court is appropriate if "the appellate court remedy of granting a new trial is inadequate or unnecessarily expensive"), remand and a new trial would be an adequate remedy given the issues U.S. Bank seeks to pursue and it would not be unnecessarily expensive because numerous estates are already (or still) at the trial stage and could pursue these issues. It would not burden the DOR given its intention to litigate every estate's claims and even seek the reversal of *Bracken.* The option of consolidating multiple parties' claims, at the discretion of the superior courts, could actually reduce the expenses associated with these issues.

There would also be no legal prejudice to the DOR in remanding the case to the trial court, given its intent to litigate the federal constitutional issue in other cases and its contention that the 2013 Amendments were valid for Due Process purposes on a ground that the *Hambleton* court did not address.

## V. CONCLUSION

The Court should either remand this case for a new trial or retain the case and direct the trial court to take new evidence on the issues identified by U.S. Bank, and at the conclusion of the evidentiary process under RAP 9.11(b), schedule briefing on the remaining issues in the case identified herein.

RESPECTFULLY SUBMITTED this 19th day of May, 2015.


Davis Wright Tremaine LLP
Attorneys for Respondent

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Dirk Giseburt (WSB #13949)
Richard A. Klobucher (WSB #6203)
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PROOF OF SERVICE

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

On this date, I caused to be delivered a true copy of the foregoing document to be sent by First Class U.S. Mail and electronic mail on the following:

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

Executed at Bellevue, Washington this 19th day of May, 2015.

Susan Bright

Susan Bright

No. 70514-8-I

IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION I

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

Respondent,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Appellant.

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**DECLARATION OF RHYS M. FARREN IN SUPPORT OF SUPPLEMENTAL BRIEF OF RESPONDENT ON IMPACT OF *HAMBLETON* AND MOTION FOR REMAND FOR A NEW TRIAL**

---

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## DECLARATION

The undersigned declares as follows:

1. I am one of the attorneys representing the above-captioned Estate. I make this declaration based upon my personal knowledge or knowledge of regularly maintained business records.

2. My firm also represented the Estate of Jessie Campbell Macbride, appellants in the matter of *Macbride et al. v. State* (S. Ct. Docket No. 89500-7), which was decided by *In re Estate of Hambleton*, reported at 181 Wn.2d 802, 335 P.3d 398 (2014).

3. The *Macbride* matter was pending at the Court of Appeals at the time when the retroactive amendments of the Washington Estate and Transfer Tax Act were enacted in 2013. The case was transferred to the Supreme Court at the request of the Department of Revenue and we did not have a chance to develop a record in the trial court on facts relevant to the framework for assessing the validity of a retroactive tax change made in response to legislative drafting errors for Due Process purposes as announced in *United States v. Carlton*, 512 U.S. 26, 114 S. Ct. 2018, 129 L. Ed. 2d 22 (1994). The *Hambleton* matter was similarly situated. Our Supreme Court ultimately did not analyze the 2013 amendments as a response to a drafting mistake, but upheld the retroactive changes under Due Process for other reasons. *Hambleton*, 181 Wn.2d at 827-28.

4. The *Carlton* analysis of the validity of a retroactive tax change to fix a legislative drafting error focuses on the timing of response to the problem by the administrative agency and its coordination with the

legislative branch to fix the problem promptly. We believe that substantial additional evidence of this kind could be produced through additional discovery. One piece of evidence in the existing record in the *Macbride* matter indicates Department of Revenue consciousness of the legal issue as early as six years before the legislature amended the statutes. *See* Exhibit A (C. Holmstrom email to C. Zehnder, Dec. 20, 2007). The background of this communication should be explored to discover the agency's process of deciding whether and when to communicate an apparent "mistake" in the drafting of the statute to the legislature.

5. My firm has been engaged by all the taxpayer parties in *Hambleton*, both the Hambleton parties and the Macbride parties, to file a petition for writ of certiorari in the U.S. Supreme Court. The petition is due on June 8, 2015, in accordance with an extension granted by Justice Kennedy in Docket No. 14A1012. At this time, the central argument we anticipate making in the petition is that *Hambleton*'s Due Process analysis did not comport with the standards announced in *Carlton.* In particular, our Court relied on the legislature's goal of increasing revenue by a certain amount through a retroactive amendment to justify the period of retroactivity that would generate such a revenue increase. This circular, self-justifying analysis is not consistent with *Carlton*'s concept of a "rational means" of furthering a "legitimate legislative purpose." *See* *Carlton,* 512 U.S. at 30-31 (internal quotations and citations omitted).

6. In briefing at the Washington Supreme Court in *Hambleton*, we argued on behalf of the Macbride parties that the Court's

analysis in *Clemency v. State (In re Estate of Bracken)*, 175 Wn.2d 549, 290 P.3d 99 (2012) ("*Bracken*"), accurately applied the federal constitutional precedents relating to limits on the taxability of the termination of a lifetime income interest in a trust and, in light of the legislature's stated intent of adhering to such precedents, the 2013 retroactive amendments in fact did not increase the scope of the tax. Attached as Exhibit B is an excerpt of a copy of the Appellant's Supplemental Reply Brief we filed in the Supreme Court on behalf the Macbride parties. The referenced argument is on pages 2 through 13. The Supreme Court did not address the argument.

7. Also in briefing in *Hambleton*, the Department of Revenue argued that *Bracken*'s interpretation of state law and of the federal constitutional precedents on the limits on the taxability of the termination of a lifetime income interest was wrong and should be overruled. Attached as Exhibit C is an excerpt of a copy of the Brief of Appellant filed by the Department originally in the Court of Appeals in *Hambleton*. The referenced argument is on pages 28 through 42. The Supreme Court did not address the argument.

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge and belief.

EXECUTED at Bellevue, Washington this 19th day of May, 2015.

Rhys M. Farren

## PROOF OF SERVICE

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

On this date, I caused to be delivered a true copy of the foregoing document to be sent by First Class U.S. Mail and electronic mail on the following:

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

Executed at Bellevue, Washington this 19th day of May, 2015.

Susan Bright
Susan Bright

# EXHIBIT A

| | |
|---|---|
| **From:** | Burnham, Shellie (DOR) |
| **Sent:** | Wednesday, January 02, 2008 1:35 PM |
| **To:** | Clark, Stefanie (DOR) |
| **Subject:** | FW: Estate Tax Issue - QTIP - Heads up |

Log, thanks

Shellie Burnham
Executive Assistant to the Director
Department of Revenue
(360) 664-2794

*Working Together to Fund Washington's Future*

| | |
|---|---|
| **From:** | Holmstrom, Cindi (DOR) |
| **Sent:** | Thursday, December 20, 2007 9:21 AM |
| **To:** | Zehnder, Cindy (GOV); Turner, Joyce (GOV); Brown, Marty (GOV); Moore, Victor (OFM) |
| **Cc:** | Merriman, Scott (OFM); Schmidt, Jim (OFM); Baldwin, Marc (GOV) |
| **Subject:** | Estate Tax Issue - QTIP - Heads up |

Cindy,

***This is a heads up on a potential issue you might hear about, it is not an emergency.***

We have recently encountered an estate tax issue known as the Qualified Terminable Interest Property Trust (QTIP) issue. DOR differs with the interpretation of the Washington State Bar Association. The amount of tax at issue is currently approximately $19 million on 13 estates. This issue arises only if the first spouse died prior to the effective date of the new estate tax (May 17, 2005,) thus will apply only to a limited set of taxpayers.

**Who's estate is being taxed under the QTIP scenario?**

- In general the estate tax applies to deaths on or after the enactment of the 2005 estate tax. However, the Washington estate tax will also apply to those estates where a descendant died prior to the enactment of the 2005 estate tax, in other words before May 17, 2005.
- If the first spouse (A) dies before May 17, 2005 but leaves the second spouse (B) all the money in a trust for life, these monies are not subject to tax upon the death of spouse A.
- When spouse B dies, the monies from spouse A's trust are included in spouse B's taxable estate.

**Washington State Bar Association's Analysis:**
Monies from spouse A's trust are not taxable because the expiration of a life estate is not a taxable "transfer."

**DOR's Analysis:**
The definition of "property" to be included in the "gross estate" of spouse B includes the assets from Spouse A's trust. Therefore, contrary to the Bar's analysis, the Department would be taxing spouse B's estate (the AGO agrees with the Department's position).

**Next Steps:**

- Assessments will not be delivered until after this email.
- DOR will notify legislative contacts in the event they are contacted.
- The Department will notify the Washington State Bar Association and other stakeholders of the rule revision process once it's begun. This process is necessary to provide clarity to the issue.

# EXHIBIT B

NO. 89500-7
[Consolidated with No. 89419-1]

IN THE SUPREME COURT
OF THE STATE OF WASHINGTON

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

---

ESTATE OF JESSIE CAMPBELL MACBRIDE,

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

Appellants,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

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# APPELLANTS' SUPPLEMENTAL REPLY BRIEF

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

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

## II. ARGUMENT

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

> [T]he power of Congress to impose *death taxes* is not limited to the taxation of *transfers* at death. It extends to the creation, exercise, acquisition, or relinquishment of any power or legal privilege

> which is incident to the *ownership* of property, and when any of these is occasioned by death, it may as readily be the subject of the federal tax as the transfer of the property at death.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

2013 Amendments § 2 (underscoring language added).

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

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

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

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

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

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

# EXHIBIT C

89419-1

NO. 44937-4-II

**COURT OF APPEALS, DIVISION II**
**OF THE STATE OF WASHINGTON**

In re the Matter of the:

ESTATE OF HELEN M. HAMBLETON, Deceased.

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

Respondent,

v.

THE DEPARTMENT OF REVENUE OF THE STATE OF WASHINGTON,

Appellant.

**BRIEF OF APPELLANT**


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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, that 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 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 1930's. 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.[13]

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. Wiener*. 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 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

[13] 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)).

transfer" (i.e., shifting of incidents of property) that occurred at death.[14]

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 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)).

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[14] *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*).

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). As described 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 Nat'l 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 is *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 trial court's order granting the Estate's motion for summary judgment and remand the case with instructions to enter judgment affirming the Department's findings of additional tax due.

RESPECTFULLY SUBMITTED this 26th day of August, 2013.

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No. 70514-8-I

IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION I

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

Respondent,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Appellant.

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**DECLARATION OF KAROLYN A. HICKS**

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Rhys M. Farren (WSB #19398)
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Richard A. Klobucher (WSB #6203)
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## DECLARATION

The undersigned declares as follows:

1. I am one of the attorneys representing the Trust in *Nylene E. Swaby Trust vs. v. Department of Revenue* pending in Thurston County Superior Court, Case No. 13-2-02171-1 (the "Swaby Case"). I make this declaration based upon my personal knowledge.

2. The Swaby Case was filed under the Administrative Procedure Act from the denial of refund of Washington estate tax. The decedent, Nylene Swaby, died after May 17, 2005, and was the lifetime beneficiary of a QTIP trust established by her predeceased husband, C. William Swaby, who died in 1992 in Illinois, long before the enactment of the Washington estate tax.

3. Because the factual and legal context of the Swaby Case is similar to the context in the cases that ultimately resulted in *In re Estate of Hambleton*, 181 Wn.2d 802, 335 P.3d 398, the Swaby Case was stayed in the superior court pending the result in *Hambleton.*

4. I have been informed by counsel to the taxpayers in *Hambleton* that they plan to file a petition for certiorari with respect to *Hambleton* in the U.S. Supreme Court, with a due date of June 8, 2015.

5. On behalf of the estate in the Swaby Case, I asked the Attorney General's Office to agree to a further stay of the Swaby Case pending a decision on the *Hambleton* certiorari petition.

6. Charles Zalesky, Assistant Attorney General, responded in an email on April 10, 2015, that the State would not agree to a stay. His rationale was in part as follows (quoting the email):

> There are several reasons why this case should not be stayed. First, as a matter of statistics, it is unlikely the U.S. Supreme Court will grant a cert. petition regardless of when it is filed. Second, even if the U.S. Supreme Court did accept cert., it is unlikely that it would overrule or significantly modify the Carlton due process standard based on the facts in Hambleton. Hambleton is the poster-child for why the Carlton rational basis standard makes sense. Third, even if the U.S. Supreme Court were to significantly restrict the ability of Congress and state legislatures to fix mistakes in a tax statute retroactively, this case would still go forward on the key issue of whether Bracken was wrongly decided and should be overruled, and on the Department's 1st affirmative defense. In short, there are other important issues that will need to be decided in this APA appeal even if the U.S. Supreme Court were to accept cert. in Hambleton.

7. In the Swaby Case, there have been no further filings to date on the State's position on these issues.

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge and belief.

EXECUTED at Seattle, Washington this 14th day of May, 2015.

Karolyn A. Hicks



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PROOF OF SERVICE

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

On this date, I caused to be delivered a true copy of the foregoing document to be sent by First Class U.S. Mail and electronic mail on the following:

Washington State Department of Revenue
David M. Hankins, WSBA #19194
Charles Zalesky, WSBA #37777
Office of the Attorney General, Robert W. Ferguson
P.O. Box 40123
Olympia, WA 98504-0123
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Executed at Bellevue, Washington this 19th day of May, 2015.

Susan Bright
Susan Bright



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