

Court of Appeals No. 45658-3



COURT OF APPEALS OF THE STATE OF WASHINGTON
DIVISION TWO

In the Matter of the Guardianship of LEON V. JENSEN, Deceased and
In Re THE JENSEN 1980 TRUST AGREEMENT DATED July 23, 1980

JOSEPHINE JENSEN PAPALEO,

Trustee/Appellant,

NOVEMBER PAPLEO

Appellant,

v.

JUDY BARRETT, JODI WICKS and CHAD JENSEN,

Respondents.

RESPONDENTS' BRIEF

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I. INTRODUCTION

Judy Barrett, Jodi Wicks and Chad Jensen, Respondents herein (“Judy”, “Jodi” and/or “Chad”) and beneficiaries of the Jensen 1980 Trust Agreement dated July 23, 1980 (“Trust”), by and through counsel, hereby respond to Appellants’ Brief from Josephine Jensen Papaleo and November Papaleo, the Appellants herein.

The parties to this dispute agree that estate tax attributable to Trust assets are properly charged to and payable from Trust assets. (CP 162-163, 256 & 320-321) However, the parties differ as to the legal liability for apportionment of estate tax attributable to non-trust assets.

II. ASSIGNMENTS OF ERROR

A. APPELLANTS’ FIRST ASSIGNMENT OF ERROR IS INCOMPLETE AND MISLEADING

Appellants fail to mention that by virtue of the Order on Petition for Equitable Allocation of the Estate Tax Burden Among All Beneficiaries Pursuant to RCW 11.96A, Respondent Chad Jensen was also required to reimburse monies to the Trust. (CP 396) The Court ordered Chad to reimburse the Trust in the amount of \$10,517 (CP 396) and he has fully complied with that Order. The phrasing used by Appellants is misleading as it omits this fact.

B. APPELLANTS’ STATEMENT OF ISSUES AS TO THE FIRST ASSIGNMENT OF ERROR IS ALSO INCOMPLETE AND MISLEADING

Contrary to Appellants’ assertions, the trial court did not expressly conclude that the Trust did not “provide for the apportionment of an estate

tax”. Rather, the trial court ordered the Trustee to apportion the estate tax burden “according to the percentage of assets involved” (RP 23:17-18) since neither the decedent’s Will nor the Trust specifically addressed the payment of taxes attributable to the non-trust, non-probate assets. (RP 22:7-9) The trial court went on to say “. . . the fact that a trustee is given discretion is not the same thing as specifically directing them that certain assets will be used for estate tax purposes and certain [assets] will not. That’s what overcomes the statute. That is not in either the trust or the will, and that’s why I’ve made my ruling.” (RP 24:13-18)

III. STATEMENT OF THE CASE

A. GUARDIANSHIP FOR LEON

This matter began in July, 2007 as a Guardianship action under Clark County Superior Court Case No. 07 4 00558 8, wherein Josephine Papaleo (hereafter “Jo” or “Trustee”) petitioned the trial court for her appointment as Guardian over her then 87 year-old father, Leon Jensen (hereafter “Decedent” or “Leon”). (CP 1) The impetus for the Guardianship was Leon’s dementia and other physical and emotional conditions. (CP 1)

The Order confirming Guardianship was filed on or about September 7, 2007. (CP 4-8) Leon was deemed legally incapacitated and Jo was confirmed to be Guardian of his Estate while Pamela Robertson was confirmed as Guardian of his Person. (CP 5-8) Jo was also legally recognized as the successor Trustee of The Jensen 1980 Trust. (CP 5-8)

B. PRE-DEATH GIFTING

In November, 2007, Jo filed a Petition to, among other things, change the situs of the Trust, and the laws governing the Trust, to Washington State and to make certain gifts as a means to decrease potential estate tax. (CP 9-17). In addition to proposing annual exclusion gifts on behalf of Leon, Jo proposed a gift of \$1 million to be divided equally among the beneficiaries of the Trust – namely Jo, Judy, Jodi and Chad. (CP 13) Judy, Jodi and Chad did not object to the proposal. The unopposed Order granting all relief requested was executed by the trial court, Judge Robert Lewis, in December, 2007. (CP 70-75)

In July, 2011, Jo filed a Petition to grant her the authority to make \$4 million in gifts of Leon's assets. (CP 86) Specifically, Jo proposed that she close out the accounts that were established as Pay-on-Death ("POD") accounts and transfer the balance in those accounts to the named beneficiaries – namely herself (as to approximately \$1.7 million), her daughter November (as to approximately \$100,000) and Chad (as to approximately \$30,000). (CP 87) Jo further proposed that to the extent the POD accounts did not reach \$4 million in value of gifted assets, units of the Limited Liability Companies held by the Trust would be gifted. (CP 88)

Judy, Jodi and Chad objected to Jo's proposal because the gifts as proposed: (1) were not consistent with Leon's overall estate plan; (2) such gifts would shift the allocation of Leon's estate tax in a manner that would inappropriately and significantly benefit Jo and November, and would

inappropriately and significantly burden Judy, Jodi and Chad; and (3) the proposal would give Jo a disproportionate “time value of money” benefit over all other beneficiaries. (CP 143-145; 146-175) At that time, Judy, Jodi and Chad raised concerns about the equitable allocation of estate tax liability, Washington’s adoption of the Uniform Estate Tax Liability Apportionment Act, Washington case law interpreting the Act, and a Trustee’s duty of loyalty to beneficiaries and a duty to avoid conflicts of interest and acts of self-dealing. (CP 146-175)

Judy, Jodi and Chad offered the Court a counterproposal to Jo’s Petition for gifting, and requested that any approved gifting be consistent with Leon’s overall estate plan provisions. (CP 147) Pursuant to that counterproposal, if Jo was to receive 45.28%, each of Judy, Jodi and Chad were to receive 17.81%, and November was to receive 1.29% of Leon’s property upon his passing, then each designated/named beneficiary should receive lifetime gifts from Leon in amounts proportionate to those percentages. (CP 147) The trial court ordered that the requested gifting to be done in a manner consistent with the Respondents’ counterproposal on or about August 17, 2011. (CP 243-247)

C. INEQUITABLE PAYMENT OF ESTATE TAXES

Leon died testate on December 29, 2011. (CP 330) At the time of his death, Leon held significant assets which resulted in the requirement to file federal and Washington estate tax returns and pay federal and Washington estate tax. (CP 330) The estate tax was due no later than nine (9) months following Leon’s death, or by September 29, 2012. (CP 330)

Judy, Jodi and Chad received copies of a United States Estate Tax Return (IRS Form 706) and a Washington State Estate and Transfer Tax Return (WA Dept. of Rev. Form 85 0049e), which were prepared on behalf of Leon's estate by a Certified Public Accountant. (CP 331) According to such copies of the estate tax returns, a federal estate tax of \$1,231,728 and a Washington estate tax of \$338,054.00, for a combined total estate tax of \$1,569,782, was due as a result of Leon's death. (CP 331) According to such returns, the total fair market value of the Decedent's assets subject to estate tax was \$4,788,403. (CP 331)

As reflected in the record, approximately \$2,927,981 of the assets comprising Leon's gross taxable estate were held in the Trust, and the remaining \$1,860,422 of assets were held in accounts which passed pursuant to Pay on Death designations ("POD accounts" or "POD assets"). (CP 331) The Trust document provides that the Trust assets will be distributed in equal shares to Jo, Judy, Jodi and Chad (25% each). (CP 331) \$1,727,074 of the POD assets were payable to Jo; \$31,212 were payable to Chad; and \$102,136 were payable to November. (CP 331) A spreadsheet setting forth allocations of assets and deductions included in Leon's taxable estate based on information contained in the estate tax returns provided to Judy, Jodi and Chad from Jo's CPA was submitted to the trial court and is part of this record. (CP 341)

On September 6, 2012, Jo, as Trustee, filed a Petition and Motion for Interlocutory Relief requesting that the Court order all estate taxes be

paid exclusively from the Trust assets or their proceeds. (CP 255; CP 331)

Hearing on the matter was set for September 21, 2012. (CP 331)

Judy, Jodi and Chad filed a Response and Memorandum to the Petition and Motion for Interlocutory Relief on September 18, 2012. (CP 315)

On September 20, 2012, the attorneys for the Trustee struck the hearing. (CP 331) Counsel for the Trustee cites hospitalization as the reason this hearing was struck. (Brief of Appellants, p. 10)

Despite the Respondents' objections, on or before September 29, 2012, with only Trust assets, Jo paid the federal estate tax of \$1,231,728 and the Washington estate tax of \$338,054. (CP 332)

Judy, Jodi and Chad objected to the payment of the estate taxes solely from the assets of the Trust because such payment of the tax inappropriately and significantly benefited Jo and November, as the primary beneficiaries of non-trust assets, and such payment from the Trust inappropriately and significantly burdened Jodi, Judy and Chad. (CP 332)

As articulated to the trial court, Leon's gross taxable estate included both the assets held by the Trust and the assets held in POD accounts. (CP 329-343) The POD accounts consisted of a brokerage account, U.S. savings bonds and cash. (CP 341) A spreadsheet and summary of the pro rata allocation of the estate tax based upon the values reported on the estate tax returns, was similarly presented to the trial court. (CP 342) This spreadsheet illustrates the appropriate allocation of estate tax among the beneficiaries of Leon's estate. (CP 342)

D. TRIAL COURT'S RULINGS AND ORDERS

On or about October 11, 2013, the trial court ruled as follows:

Okay. Well, here's how I analyze the situation. I appreciate both of your arguments, and your briefing allowed me to focus in on it, although there were a couple of questions that I had that I thought your argument answered those.

So as I understand the issues, I would make the following rulings: The Jensens, who apparently were people who were very thrifty and industrious throughout their lives and left quite a bit for the objects of their bounty and tried to anticipate with their attorneys various possibilities upon their deaths, including various tax consequences of their choices, and they did as good a job as they could do, but they did not do a complete job. In neither the will or the trust did they specifically talk about nonprobate, nontrust assets.

In the will, it talked about as if there was going to be a probate estate and a trust estate and how to deal with the taxes related to that. It turned out there wasn't a probate estate.

In the trust, they gave some discretion to pay taxes and did not really talk about apportioning taxes, except allowing certain generations keeping [sic] trust taxes to be recouped. So they talk about a few specifics, but other than that, they talked about situations, which largely don't have anything to do with what we're talking about here. I don't fault them for that.

Apparently they didn't discuss or decided later to go more with pay on death sort of assets, and so they didn't contemplate that, apparently, at the time they did their estate plan, so they didn't talk about it.

So the statute says if the will and the trust specifically provide the taxes are going to go -- be paid certain ways between probate and trust and nonprobate and nontrust assets, then that's to be honored by the Court; otherwise, the statute applies and they're to be apportioned as to their percentages. And so that's what's supposed to happen here between the probate -- I mean, between the trust assets and the pay on death or nonprobate and nontrust assets.

I don't fault anybody for paying the taxes on time. That would be kind of ludicrous to have a trustee faulted for paying the taxes on time and using the assets that were immediately at her disposal to pay those taxes on time. But payment of the taxes, the actual cash payment of taxes and the apportionment of the responsibility of those taxes are two different things. And the liability here for the apportionment of the estate tax should be according to the percentage of assets involved, and so I will order that be done. It may be that there's some recoupment from people that are not part of the trust or it may be an adjustment of the remaining trust assets, but that needs to be taken into account.

The fact that I've ruled differently from the choices that the trustee made is not a basis for either removal of the trustee or for determining that she acted in a breach of her fiduciary duty so that she should have to pay attorney's fees. Each party can bear their own fees.

...

And the fact that a trustee is given discretion is not the same thing as specifically directing them that certain assets will be used for estate tax purposes and certain [assets] will not. That's what overcomes the statute. That is not in either the trust or the will, and that's why I've made my ruling.

(RP 21-24)

Two additional hearings followed the above proceeding. On or about November 6, 2013, the trial court further ruled as follows:

Well, the IRS obviously doesn't control the definitions and the interpretation of Washington state law, and it may be that the Washington state legislature decided that they thought in those circumstances where the estate tax has to be paid that people who got lifetime gifts should have to assist the people who get after death gifts. I mean, that's certainly something that the legislature could do. I suppose that there might be some preemption questions, that sort of thing. But it's an interesting argument.

And I don't think it's extremely clear, but when you first look at it, because of all these different definitions of apportionable estate and taxable estate and gross estate in

both the state and federal, but it appears to me that after reviewing it carefully, that your position is correct, that the apportionment needs to be done without consideration of the gifts. In other words, it needs to be consideration of the apportionment of the property that's subject to the estate tax, and subject to the tax is what I'm talking about.

It may be that in setting that up, the IRS was saying to people, if you're alive and you want to give away your property, we'll give you an incentive to do so. You can give it to those people and you don't have to pay tax on the first 5 million. They get it tax free. And so you can favor living gifts over gifts later by saying, well, if you exceed your credit, you have an estate bigger than that, then you have some of it left when you die, then you will have the tax there or you don't get the credit there. You can't have the credit both times.

In this case, Mr. Jensen -- or in the other case, the guardianship of Mr. Jensen decided that they were going to make some lifetime gifts, give the property away during Mr. Jensen's lifetime. He wouldn't have to pay tax on those gifts and the gifts would be received tax free. And that's what we did. And that's what I authorized. It would defeat the purpose of doing all of that if after it was done and Mr. Jensen died, I then said, well, even though you got lifetime gifts that were tax free, now you have to contribute. So that was something that was contemplated all along, that if there was going to be a tax liability on the assets that were left at Mr. Jensen's death, that the people would have to pay that tax liability are the people that get that property. And that's the apportionable estate.

So that's how we're going to do it. I don't find specifically that the gifts are folded back in. They're not part of the gross estate because they are used -- they are considered by the federal estate tax only for the purpose of determining whether there's any credit left, and so they are not subject to the tax and, therefore, they are not subject to being apportioned under Washington law.

(RP 43-45)

On or about November 6, 2013, the Order on Petition for Equitable Allocation of the Estate Tax Burden Among all Beneficiaries Pursuant to RCW 11.96A was executed and filed with the Clark County Superior

Court. (CP 395-397) Said Order required all estate taxes to be retroactively apportioned in accordance with RCW 83.110A.030(1) consistent with the graph on page 5 of CP 379 within 30 days and as follows:

a. Since Josephine received 37.112% of the assets of the apportionable estate, she shall reimburse \$582,578 to the Trust;

b. Since November received 2.195% of the assets of the apportionable estate, she shall reimburse \$34,457 to the Trust; and

c. Since Chad received 0.670% of the assets of the apportionable estate, he shall reimburse \$10,517 to the Trust.

(CP 396)

Thereafter, Jo appealed the decision of the trial court.

IV. ARGUMENT

A. ASSETS SUBJECT TO ESTATE TAX

When Leon passed away, the total value of assets he owned (“Gross Estate” for federal tax purposes) was \$4,788,403. (CP 377) Following Leon’s death, his estate or Trust incurred or paid \$134,709 of deductible claims and expenses, leaving a taxable estate of \$4,653,694 (\$4,788,403 less \$134,709). (CP 377). The claim and expenses paid or incurred by Leon’s estate were allocated to and paid from the Trust. (CP 378). Of the \$4,653,694 of Leon’s assets subject to estate tax, \$2,793,272 of such assets were held in the Trust, and the other \$1,860,422 of assets were held in the POD accounts. (CP 331, 378) With reference to these figures, the Trust assets comprised approximately 60.02% ($\$2,793,272$ (Trust assets) \div $\$4,653,694$ (taxable estate)) of the value of

Leon's taxable estate. (CP 378) Accordingly, the non-trust assets (the POD accounts) comprised the other 39.98% of the value of Leon's taxable estate. (CP 378) The total federal and Washington estate tax owed on account of Leon Jensen's death was \$1,569,782. (CP 379) Of the \$1,569,782 total estate tax, \$942,230 was attributable to Trust Assets (*i.e.*, 60.02%) and \$627,552 was attributable to non-trust assets (*i.e.*, 39.98%). (CP 379)

Washington law dictates that the beneficiaries of the POD accounts must bear the responsibility for \$627,552 in proportion to the value of the POD account assets they received. Pursuant to the beneficiary designations of the POD accounts, Jo received 92.8%; November received 5.5%; and Chad received 1.7% of the combined value of all assets held in POD accounts following Leon's death. (CP 373)

B. BASED ON THE TERMS OF THE WILL AND TRUST AND IN LIGHT OF RCW 83.110A AND IN RE ESTATE OF MUMBY, TAXES ATTRIBUTABLE TO PAY ON DEATH ASSETS MUST BE PAID BY RECIPIENTS OF THOSE ASSETS

While Leon may have adequately articulated his intent to apportion estate tax attributable to Trust assets (*see* CP 162-163), he failed to specifically express his intent as to the apportionment of estate tax attributable to the POD accounts. In the absence of a specific direction for the payment of estate tax attributable to the POD assets, the Washington Uniform Estate Tax Apportionment Act (RCW Chapter 83.110A and hereinafter referred to as the "Apportionment Act"), requires

the recipients of such assets to bear the financial burden of paying such tax ratably, in proportion to the value of the interests they received in such assets. Accordingly, the Apportionment Act applies to the apportionment of the \$627,556 estate tax that is attributable to the POD assets and the estate tax attributable to such assets should be allocated to, and borne by, Jo, November, and Chad in proportion to their respective interests in the POD assets. That is what the trial court ordered on November 6, 2013. (CP 395-397)

1. The Apportionment Act

The Apportionment Act provides that estate taxes are apportioned to and paid out of each beneficiary's share of the estate unless the testator specifies another source of payment. RCW 83.110A.020, .030 and *In re Estate of Mumby*, 97 Wn. App. 385, 395, 982 P.2d 1219 (1999). Thus, a testator may require certain beneficiaries to carry the tax burden and exempt others if the testator does so specifically in his will or trust. *Mumby*, 97 Wn. App. at 396 (citing *In re Estate of Wilson*, 8 Wn. App. 519, 522, 507 P.2d 902 (1973)). Unless this intent is specifically expressed by the decedent (testator), the imposition of estate taxes is governed by law. *Id.* Therefore, in the event the applicable instruments fail to expressly exonerate the POD assets from apportionment of estate taxes, the Apportionment Act applies and taxes must be paid pro rata by the recipients of the POD assets. Because Leon failed to specifically exonerate the POD assets from apportionment of estate taxes, the Apportionment Act requires that the estate tax attributable to the POD

assets must be paid ratably by the recipients of the POD assets. By reviewing Leon's dispositive instruments, reasonably construing intent at the time the documents were drafted, reconciling all applicable provisions, and then applying relevant Washington law, it is clear that the provisions in Leon's dispositive instruments are insufficient to overcome the statutory direction to apportion taxes among the beneficiaries of the POD assets or to exonerate such assets from bearing any liability for estate taxes.

2. Leon's Last Will And Testament

The Apportionment Act provides that the provisions for the apportionment of estate taxes imposed upon a decedent's estate will be determined first in accordance with the terms of the decedent's will. RCW 83.110A.020(1)(a) The only provision of Leon's Will that addresses the payment of estate tax is Paragraph VI, which provides as follows:

All inheritance, estate, or other death taxes that may, by reason of my death, be attributable to my probate estate or to any property not a part of my probate estate *shall be paid* by my Executor *out of the residue of my probate estate* provided, however, that *to the extent such taxes are attributable to properties which become, prior to my death, a part of the Trust referred to in this Will, then such taxes shall be charged to and collected from the Trustee of said Trust.* (Emphasis added)

Leon's Will clearly specifies his intent to apportion his estate taxes. All of his estate taxes attributable to the assets in his probate and non-probate estate, will be paid by the residue of the probate estate; provided, however, taxes attributable to the assets held in his Trust will be paid by the Trust. It is the Respondents' understanding that the parties on both sides of this

dispute are in agreement that Leon's Will provides for the apportionment of estate tax attributable to the Trust assets and the parties agree that the Trust should pay the tax attributable to the assets contained in the Trust at the time of Leon's death. Leon also clearly stated his intent with respect to the payment of tax attributable to the POD assets; the taxes attributable to the POD assets should be paid by the residue of his probate estate. However, as no assets were included in Leon's probate estate, the tax payment provision of his Will fails to specify how taxes attributable to the POD assets are apportioned and paid. While none of Leon's dispositive documents specify how the taxes attributable to the POD assets should be paid, the provision in his Will is clear that the Trust is to bear the estate tax liability attributable to the Trust assets, and the Trust was not to bear the estate tax liability attributable to the POD assets as those taxes were to be paid by the probate estate.

Appellants argue that based on historical context, events that have transpired which Jo orchestrated, provisions in Leon's Will, and other related but mostly irrelevant factors, Leon specifically intended the Trust to pay tax attributable to the POD assets. Appellants' argument fails to provide adequate cause to overcome the apportionment of the estate tax in accordance with the terms of Leon's Will and the application of the Apportionment Act as discussed above and in *Mumby*.

In *Mumby*, the relevant issue is whether the decedent's estate tax was apportionable among all beneficiaries of the decedent's trust (including recipients of both specific and residual bequests) or if such tax

was to be paid solely out of the trust residue. The applicable tax provision was contained in the decedent's trust and the relevant trust document stated:

Upon the death of the original Trustor, ***the Trustee is directed to pay*** all legal debts (except unmatured mortgages and/or Trust Deeds on real estate) and all expenses of the last illness, funeral and burial as well as ***all estate, inheritance, succession or other death taxes imposed upon, or in relation to any property required by any tax law to be included in the gross Estate***, and then distribute the remaining assets of the Estate including any accumulation thereon in the following manner. (Emphasis added)

Mumby, 97 Wn. App. at 396. This Court upheld the trial court's ruling that the testator intended with this language that estate taxes be paid from the residue of the trust estate rather than apportioned among all the beneficiaries, including the recipients of specific bequests. *Mumby*, 97 Wn. App. at 400. As confirmed by this Court, the trial court in *Mumby* reached the correct conclusion as the above-referenced trust provision, in conjunction with its sequential placement in the trust document, was a clear and unambiguous statement by the decedent, Dr. Mumby, as to the apportionment of the applicable estate tax.

The case at bar differs from *Mumby* in that Leon's instruments do not specifically provide for apportionment of estate tax attributable to the POD accounts because the assets specifically chosen to pay for such taxes do not exist (*i.e.* the assets of Leon's probate estate). Unlike Dr. Mumby, Leon did not impose a mandate or clear directive on the source of funds required to be used to pay tax attributable to the POD assets as there are

non-trust, non-probate assets, but no probate assets with which to pay the tax.

3. The Jensen 1980 Trust Agreement

Appellants argue that a provision in Leon's Trust specifically apportions all of the federal and state estate taxes attributable to his death. The provision referenced by Appellants is Section 8.04 of the Trust, which provides:

...the Trustee in its discretion may first pay out of any of the principal of the Survivor's Trust not so appointed... any federal or state taxes including penalties and interest arising by reason of said Trustor's death. [Emphasis added]

Appellants argue that this provision constitutes a clear and unambiguous direction that all taxes attributable to Leon's death are to be paid solely by the Trust. Respondents Judy, Jodi and Chad maintain that this provision is not a specific directive on the apportionment of tax and cannot be used to apportion taxes to the extent there are both trust assets and non-trust assets, such provision is contrary to the express provisions of Leon's Will.

Apparently, Appellants believe that Leon specifically intended for all estate taxes to be paid by the Trust as his Trust instrument both names Jo as the initial successor Trustee and purportedly provides her with the discretionary authority to pass the estate tax liability attributable to the \$1,727,074 of POD assets she received outside of her interest in the Trust onto the beneficiaries of the Trust. Appellants' argument regarding Leon's purported intent is based on the assumption that Leon knew with

almost certainty that, by giving Jo the discretion to shift the tax burden onto others to her sole benefit, there was little authority the tax would be allocated and paid in any other manner, and, as such, Leon must have intended for the tax to be paid in that manner. While Leon designated Jo as the initial successor trustee of the Trust in July of 1980, he also anticipated the possibility that she would not serve or be serving as Trustee following his incapacity or death as indicated in Sections 4.08 and 4.09 of the Trust. (CP 205-206) Since Leon contemplated the fact that Jo may not have been able or willing to serve as Trustee following his incapacity or death, it cannot be concluded that Leon intended for the Trust to pay all estate taxes merely by the fact by placing Jo in a position to favor herself over the Respondents by naming her as the initial successor trustee.

Appellants also argue that Leon's specific intent for the payment of estate taxes is evidenced by the Trust's provision that the Trustee is only required to collect any generation skipping transfer tax or special valuation recapture tax from the relevant beneficiaries. Section 8.04 of the Trust, provides, in part:

Notwithstanding the foregoing, the Trustee shall pay and charge to, prorata among, and/or recover, to the extent provided by any tax law or other statute, from the persons entitled to the benefits giving rise to such tax, any additional recapture tax imposed by reason of Section 2032A of the Code or any generation skipping transfer ["GST"] tax imposed by reason of Chapter 13 of the Code."

The requirement imposed upon the Trustee to seek recovery, or charge to, the recipient beneficiaries any GST tax or recapture tax attributable to special use property is not indicative of the Jensens' intent regarding the apportionment of the estate tax. The imposition of the GST and special use recapture taxes is based upon the status, classification, or actions of the recipient beneficiaries, and are not imposed merely by reason of the owner's death.

The GST tax is imposed upon the transfer of property to a "skip person." IRC § 2601 and 2611. Generally, a "skip person" is a natural person which is two or more generations below the generation assignment of the transferor. IRC § 2613. The GST tax is imposed upon lifetime transfers (gifts) and testamentary transfers (upon the transferor's death). Unlike the federal or Washington estate tax, the GST tax is imposed upon the transfer of assets to a skip person. The death of the transferor is not the tax triggering event. Transfers to skip persons upon the death of the transferor can be subject to both estate tax and GST tax. IRC § 2603 provides that the GST tax imposed on a direct transfer to a skip person is paid by the transferor; however, it would typically be inequitable to apportion GST tax attributable to a testamentary transfer to a skip person to all beneficiaries of an estate (both skip and nonskip persons) since the tax is only attributable to a transfer to a skip person (and not imposed upon all assets by reason of the transferor's death). The Jensens apparently recognized the inequity that could result if GST tax attributable to the transfer of Trust assets to a skip person (*i.e.*, Jodi) was paid by the residue

of the Trust and, as a result, apportioned ratably to the other trust beneficiaries. To remedy that inequity, the Trust provides that any GST tax imposed upon the transfer of assets to a skip person, will be charged to that skip person. The approach the Jensens took with respect to the payment of GST taxes in the Trust is exactly how the GST tax would be apportioned in accordance with the Apportionment Act in RCW 83.110A.030(2). Accordingly, the Jensens' provision for the payment of GST tax does not evidence any intent for the Trust to pay for estate tax attributable to the POD assets.

Similarly the Jensens' provision for the payment of special valuation recapture taxes does not indicate the intent espoused by the Appellants. IRC § 2032A provides that if an election is made, certain types of property ("special use property") may be valued below fair market value for estate tax purposes; however, the subject property must be used by the recipient heir for a "qualified use" for ten years following the decedent's death. If the recipient heir disposes of the special use property or ceases its qualified use of the property within ten years of the decedent's death, additional estate tax (referred to as "recapture tax" in the Trust) is imposed upon the property. IRC § 2032A(c). Since the recapture tax is imposed when the recipient heir disposes the special use property or ceases his or her qualified use, it is typically more equitable for the recipient heir to pay the recapture tax triggered by his or her actions. It would be unfair to impose a tax triggered by the actions of one

of the Trust beneficiaries upon all Trust beneficiaries, and avoiding that result is what the Jensens intended in Section 8.04 of the Trust.

In addition, the approach the Jensens took with respect to the payment of recapture taxes is consistent with the default provisions of the Apportionment Act. RCW 83.110A.060(3) provides that special elective benefit recapture taxes (*i.e.*, § 2032A recapture taxes) must be charged to the persons that are liable for such taxes under the law providing for recapture. IRC § 2032A(c)(5) provides that the recipient heir is personally liable for recapture taxes imposed under § 2032A. The Jensens explicit provision for the apportionment of recapture taxes, as well as their *specific* provisions for all other taxes (*i.e.*, estate tax, generation skipping transfer tax, etc.) are consistent with the default provisions of the Apportionment Act.

Despite the Appellants' arguments or reasoning that Section 8.04 of Leon's Trust indicates his specific and unambiguous intent to apportion all estate taxes solely to the Trust, such arguments and reasoning fail to clear the hurdles imposed by the Apportionment Act and standards established by *Mumby*. As mentioned previously, a decedent may exonerate an asset from the ratable apportionment of tax only if he does so "specifically." *Mumby*, 97 Wn.App. at 396. The provision of a non-mandatory discretionary power to pay estate taxes is not a "specific" exoneration of the ratable application of estate tax upon POD assets. Leon's failure to exonerate the POD assets "specifically" from estate tax requires ratable apportionment of tax as to those assets.

4. Specificity Is Required To Overcome The Apportionment Act

The Trustee misstates and minimizes the threshold of specificity required to overcome the statutory direction to apportion taxes among the beneficiaries as to the POD assets. Appellants erroneously believe “all that is required to avoid statutory apportionment is a statement in a trust that ‘provides’ for the apportionment of the estate tax.” (CP 354) That is inaccurate. Respondents acknowledge that the statute uses the word “provides” but that is not all that is required under Washington law. The specificity necessary to overcome statutory apportionment is set forth in *Mumby* and its progeny. If Leon wanted the POD assets to be exonerated, he must have stated so and expressed his intentions specifically. It would not have been difficult for Leon to clearly state that he intended for the Trust to pay the estate taxes attributable to the POD assets and thereby exonerate them from the application of the tax. However, Leon did not specifically provide that the POD assets were not to bear any tax or that the Trust shall pay all estate taxes attributable to his death. Because Leon did not specifically exonerate the POD assets from the payment of estate taxes, the Apportionment Act applies and controls the allocation of taxes attributable to the POD accounts.

5. Trustee’s Duty Of Loyalty To Beneficiaries

Even if the Apportionment Act did not apply in this case, the Trustee would be precluded from exercising her discretion to pay estate taxes attributable to the POD assets with Trust assets, as such exercise of discretion would breach her fiduciary duties to the beneficiaries of the

Trust and would be deemed an abuse of discretion under Washington law. In exercising discretion in such manner, her actions would violate the *Restatement (Third) of Trusts* § 78 (General Comment a.); and her actions would violate other common law and statutory duties. A trustee, as a fiduciary, owes beneficiaries the “highest degree of good faith, care, loyalty and integrity.” *Esmieu v. Schrag*, 88 Wn.2d 490, 498, 563 P.2d 203 (1977). “It is the duty of a trustee to administer the trust in the interest of the beneficiaries.” *Tucker v. Brown*, 20 Wn.2d 740, 768, 150 P.2d 604 (1944). “A trustee's duties and powers are determined by the terms of the trust, by common law and by statute.” *In re Estate of Ehlers*, 80 Wn. App. 751, 757, 911 P.2d 1017 (1996). At common law, Washington courts “have defined a trustee's duty of care, skill and diligence to be that degree of care, skill and diligence that would be exercised by an ordinary prudent man engaged in similar affairs.” *In re Trust of Parks*, 39 Wn.2d 763, 767, 238 P.2d 1205 (1951); *Monroe v. Winn*, 16 Wn.2d 497, 508, 133 P.2d 952 (1943).

It is agreed that a discretionary decision by the Trustee regarding the manner taxes are paid inevitably benefits some parties and burdens others. A key distinction that Appellants fail to recognize is that a decision to pay all taxes only with Trust assets is detrimental to the Trust beneficiaries and benefits parties who are not Trust beneficiaries. We recognize that Jo and Chad are both POD asset recipients and Trust beneficiaries; however, they must be viewed in different capacities with respect to their interests in the Trust and interests in the POD assets.

Appellants Jo and November, are the primary beneficiaries of the POD assets. In choosing to pay the taxes attributable to the POD assets solely from trust assets, Jo is favoring her daughter, who is not a Trust beneficiary, and herself in a capacity other than as a Trust beneficiary. The Trustee's duty of loyalty runs to the beneficiaries of the Trust, but only in their capacities as beneficiaries of the Trust. Jo's exercise of a discretionary decision to benefit individuals who are either not Trust beneficiaries or beneficiaries in capacities outside that of a Trust beneficiary is a violation of the duty of loyalty owed to the Trust beneficiaries.

The Appellants have argued that the trial court held that Jo did not breach any of her fiduciary duties to the trust beneficiaries in paying all of the estate taxes solely from Trust assets. However, the trial court did not consider whether the exercise of the Trustee's discretion to pay estate taxes in a manner that only benefited her and November would violate her fiduciary duties to the beneficiaries. The trial court indicated that using Trust assets to pay the estate tax was not the same issue as the apportionment of the estate tax, and the Trustee's use of Trust assets to pay the tax liability pending resolution of the dispute was reasonable. (RP 23) The Court saw no need to rule on whether the Trustee's exercise of discretionary authority would breach her fiduciary duties, as the Court determined that the Apportionment Act applied and whether or not the Trustee abused her discretion with respect to estate taxes became a moot point.

If the default Apportionment Act provisions do not apply in this case, the Court should determine that the Trustee's exercise of discretion to apportion estate taxes in a manner that significantly harms the beneficiaries of the Trust constitutes a breach of her fiduciary duties to the Trust and its beneficiaries. It is Respondents' position that the Trustee abused her discretion under Washington law. "Where the trust confers discretion on a trustee to carry out the trust, we [the Court of Appeals] review the trustee's actions for an abuse of discretion." *Casterline v. Roberts*, 168 Wn. App. 376, 383, 284 P.3d 743 (2012). Indeed, a trustee who engages in self-dealing breaches her fiduciary duty of loyalty, even where the trustee eventually replaces the funds and the trust suffers no loss. *Id.* Jo's actions in exercising her discretion to pay estate taxes exclusively with Trust funds, constitutes self-dealing and is inconsistent with and contrary to the interests of the beneficiaries. Her actions violated her duties of good faith, care, loyalty and integrity.

Jo also argues that despite the fact that she intends to exercise her discretion in a manner to benefit only herself and her daughter, she would not violate any fiduciary duty as she is required to exercise her discretion in that manner in order to follow Leon's intent. As discussed above, this Court should conclude and find there is no indication in Mr. Jensen's Will or Trust that he intended the recipients of the POD accounts to receive such assets free of estate tax. Had that been Leon's intent, he would have clearly and specifically stated such intent through a clear mandate in his Trust. Since there was no such mandate, this Court should hold that Jo's

intended exercise of discretionary authority was not required by Leon, but would violate her fiduciary duties to the beneficiaries.

C. IMPACT OF LIFETIME GIFTS

Appellants argue that the apportionment of estate tax should be based on the relative values of both the interests each person had in the apportionable estate and the gifts such persons received from Leon during his lifetime. The Apportionment Act only apportions “estate taxes” imposed by reason of the relevant individual’s death. RCW 83.110A.010 (2). Under the Apportionment Act estate taxes are apportioned only among the persons interested in the apportionable estate, and only to the extent of their interests in the apportionable estate. The apportionable estate is defined as the gross estate as finally determined for purposes of the estate tax reduced by certain amounts. RCW 83.110A.010(1). The gross estate for purposes of the Apportionment Act is defined as all interests in property subject to estate taxes. RCW 83.110A.010(3). The operative term for determining which interests in property are included in the apportionable estate is “subject to.” Only the assets that are “subject to” an estate tax, are considered part of the gross estate and thereby included in the apportionable estate and subject to apportionment under the Apportionment Act.

The property gifted to persons before Leon’s death are not subject to any estate tax, nor are such assets included in the federal or Washington gross estate. If property transferred by Leon during his life was subject to a federal transfer tax, it would be the federal gift tax. Because gift tax

applies to the gratuitous transfer of property during an individual's life, it is not an "estate tax." The Apportionment Act, defines the term "estate tax" as a tax imposed because of an individual's death. RCW 83.110A.010(2).

Appellants argue that because lifetime gifts in excess of the annual exclusion (currently \$14,000 per year, per individual donee) made by a decedent after 1976 impact the amount of estate tax that may be owed upon that decedent's death, such lifetime transfers should be a factor for purposes of apportioning the estate tax under Washington law. That argument fails. Lifetime gifting impacts the amount of estate tax owed upon a decedent's death due to the mechanics of the federal unified gift and estate tax credit; however, the federal estate tax is only levied upon the federal "taxable estate." IRC § 2001. For purposes of the federal tax, the "taxable estate" is equal to the value of the gross estate less deductions. IRC § 2051. In accordance with IRC § 2031, the gross estate of a decedent includes only property in which the decedent held an interest, or retained control over, at the time of death and does not include property effectively transferred by gift over which the decedent retained no right or control. Accordingly, the federal estate tax is not imposed upon the value of lifetime gifts, despite the fact that lifetime gifts may impact the amount of estate tax owed.

In 2011 (the year of Leon's death), the unified credit allowed an individual to transfer up to \$5,000,000 ("unified exemption amount") without incurring a federal transfer tax. With this exemption, an

individual (U.S. citizen) could gratuitously transfer up to \$5,000,000 by way of lifetime gift or transfers at death, without incurring federal gift or estate tax. However, if the individual chose to use the \$5,000,000 exemption to shelter transfers made by lifetime gifts from gift tax, it reduced the amount of the exemption available to shelter transfers occurring by reason of that individual's death from federal estate tax.

While Respondents acknowledge that the use of Leon's federal unified exemption to shelter his lifetime gifts from tax reduced the amount of exemption available to offset estate tax, it does not change the fact that the Apportionment Act only applies to apportion the tax to assets subject to estate tax upon Leon's death. If the Appellants' position regarding this issue was correct, a recipient of a gift would never know whether the asset she received as a gift was truly her property or whether she would be required pay the applicable donor's estate tax when the donor died. For example, assume a donor made a \$100,000 gift to his niece in 1980, then subsequently died in 2014, leaving no additional bequests to his niece but incurring a significant estate tax the payment of which was subject to the Apportionment Act. According to the Appellants' position, the niece who received the \$100,000 gift 34 years earlier would have to contribute to pay the donor's estate tax liability. Clearly, that is not a result the legislature intended when it adopted the existing form of the Apportionment Act.

Despite the Appellants' arguments, neither federal nor Washington estate tax is imposed on assets effectively transferred before an individual dies, and that is the primary reason Jo requested the Court to authorize

gifts during Leon's lifetime. To subsequently argue that the value of lifetime gifts should be considered to be part of Leon's "gross estate" for purposes of the Apportionment Act requires the Appellants to reconcile diametrically opposite positions. The trial court touched on this point when the judge stated:

In this case, Mr. Jensen -- or in the other case, the guardianship of Mr. Jensen decided that they were going to make some lifetime gifts, give the property away during Mr. Jensen's lifetime. He wouldn't have to pay tax on those gifts and the gifts would be received tax free. And that's what we did. And that's what I authorized. It would defeat the purpose of doing all of that if after it was done and Mr. Jensen died, I then said, well, even though you got lifetime gifts that were tax free, now you have to contribute. So that was something that was contemplated all along, that if there was going to be a tax liability on the assets that were left at Mr. Jensen's death, that the people would have to pay that tax liability are the people that get that property. And that's the apportionable estate.

So that's how we're going to do it.

(RP 44:17-45:7)

The trial court did not err in its decision.

D. AN AWARD OF ATTORNEYS' FEES AND COSTS TO RESPONDENTS HEREIN IS APPROPRIATE

RCW 11.96A.150 provides that the Court may, in its discretion, order costs and reasonable attorneys' fees to be awarded to any party from any party to the proceedings or from the assets of the trust involved in the proceedings. Further, such statute provides that the Court may order the costs and reasonable attorneys' fees to be paid as the Court determines to be equitable. RAP 18.1 provides for similar authority. This Court has

discretion to consider any and all factors that it deems to be relevant and appropriate.

Judy, Jodi and Chad, on numerous occasions, attempted to resolve this matter without judicial involvement. Their efforts in bringing these issues to light were clearly in the best interests of the parties to this matter. But for their initiation of this action, Appellants would have gained a substantial financial benefit contrary to Washington law. Therefore, Judy, Jodi and Chad respectfully request an Order that Appellants pay for fees and costs incurred for having to respond to this appeal, along with clear direction on whether the Appellants shall pay such fees and costs from the Trust's assets or from the Appellants' personal assets.

V. CONCLUSION

Even though Leon adequately articulated his intent to apportion estate tax attributable to Trust assets (*see* CP 162-163), he failed to specifically express his intent as to the apportionment of estate tax attributable to the POD accounts. Washington law is clear and requires that in the absence of a specific direction for the payment of estate tax attributable to the POD assets, the Apportionment Act dictates that the recipients of such assets bear the financial burden of such tax ratably, in proportion to the value of the interests they received in such assets. The trial court did not err in concluding that the Apportionment Act requires that the \$627,556 estate tax liability that is attributable to the POD assets

is apportioned to, and borne by, Jo, November, and Chad in proportion to the respective interests they received in the POD assets.

Respondents' respectfully request this Court affirm the trial court's November 6, 2013 Order on Petition for Equitable Allocation of the Estate Tax Burden Among all Beneficiaries Pursuant to RCW 11.96A.

Similarly, the trial court did not err in its ruling that the value of lifetime gifts are not included in the apportionable estate to which estate taxes are apportioned under the Apportionment Act. Respondents respectfully request this Court to affirm the trial court's ruling on this issue as well.

In addition, this Court should hold that Jo is precluded from exercising any discretion as Trustee in order to shift the burden of estate tax attributable to the POD assets to the Trust and its beneficiaries because such exercise of discretionary authority would breach her duty of loyalty to the Trust beneficiaries and would constitute an abuse of her discretion.

DATED this 30th day of May, 2014.

Respectfully Submitted,

LANDERHOLM, P.S.



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Court of Appeals No. 45658-3

COURT OF APPEALS OF THE STATE OF WASHINGTON
DIVISION TWO

In the Matter of the Guardianship of LEON V. JENSEN, Deceased and
In Re THE JENSEN 1980 TRUST AGREEMENT DATED July 23, 1980

JOSEPHINE JENSEN PAPALEO,

Trustee/Appellant,

NOVEMBER PAPLEO

Appellant,

v.

JUDY BARRETT, JODI WICKS and CHAD JENSEN,

Respondents.

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