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No. 44937-4-II

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

In re the Matter of THE ESTATE OF HELEN M. HAMBLETON,
Deceased.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,
Petitioner/Appellant,

v.

STEVEN HAMBLETON, Personal Representative for the Estate of Helen
M. Hambleton,
Respondent/Respondent.

RESPONDENT'S BRIEF

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I. INTRODUCTION

The Washington State Department of Revenue (“DOR”) seeks to collect approximately \$1.2 million of additional estate tax from the Estate of Helen Hambleton (“the Hambleton Estate” or “the Estate”). DOR appeals the judgment entered by the trial court that, under the Washington Supreme Court’s decision in Clemency v. State, 175 Wn.2d 549, 290 P.3d 99 (2012) (“Bracken”),¹ the Hambleton Estate owes no additional estate tax. Bracken unquestionably governed the issue before the trial court and dictated the trial court’s decision in favor of the Hambleton Estate. Bracken continues to govern the issues on appeal.

Indeed, DOR could not provide the trial court with any legal reason to deny the Estate’s motion to apply Bracken and grant summary judgment below, other than its hope and belief that the Legislature would (at some point) pass legislation to purportedly overrule Bracken. Not surprisingly, the trial court granted the Estate’s motion for summary judgment. DOR’s subsequent appeal of that decision, which was filed for the sole reason of delaying a final judgment until legislation could be

¹ The case is commonly referred to, and is referred to herein, as “Bracken,” which was the last name of one of the decedents in that case.

passed, was completely devoid of legal merit.² As a matter of law, at the time the judgment was entered by the trial court, it was final and, because the impact of Bracken was without dispute, the judgment was not appealable.

Despite the Legislature's eventual enactment of Engrossed House Bill 2075 ("EHB 2075") during the pendency of this appeal, DOR's argument continues to be void of merit and should be denied because, as applied to the Hambleton Estate, the statute violates due process requirements, the separation of powers between the Legislature and the judiciary, and protections against impairing existing contracts.

First, retroactive application of EHB 2075 violates due process. Because DOR seeks to impose a wholly new estate tax, retroactive application – no matter the length of retroactivity – violates due process. Further, Washington and United States Supreme Court authority strictly limit the retroactive reach of a tax statute. DOR's argument that EHB 2075 somehow applies to events from eight-plus years ago ignores well-established due process protections.

² Civil Rule 11 applies to appeals. See In re Guardianship of Lasky, 54 Wn. App. 841, 856, 776 P.2d 695 (1989). DOR's appeal, when filed, had no plausible legal or factual basis.

Second, even if EHB 2075 was not impermissibly retroactive, the Legislature's attempt to overrule Bracken via statutory fiat further violates the constitutional mandate of separation of powers.

Third, EHB 2075 violates the constitutional protections against impairing existing contracts; namely, the Hambletons' Marital Trust.

This Court's decision is not governed by EHB 2075, which cannot survive constitutional scrutiny. Instead, this Court is bound by Bracken. And, under Bracken, the Hambleton Estate respectfully submits that it does not owe any additional Washington estate tax as a matter of law.

II. ISSUES PRESENTED

Should this Court uphold the trial court's grant of the Hambleton Estate's Motion for Summary Judgment and find that the Hambleton Estate owes no additional Washington State estate tax, where:³

³ As the Court is well-aware, there are a number of similarly-situated appeals pending in this Court, with nearly identical factual and procedural circumstances. See e.g., In re Estate of Mesdag v. Wash. State Dep't of Revenue, No. 44766-5-II; In re the Estate of Phelps v. Wash. State Dep't of Revenue, No. 44917-0-11; In re the Estate of Downs v. Wash. State Dep't of Revenue, No. 44937-4-II. Given the number of different appeals on the same issues, and in the interests of judicial economy, the Hambleton Estate does not make every one of the numerous arguments made in these other appeals. Nonetheless, since all of these issues will be fully briefed for the Court, and DOR will have a chance to respond to all of these arguments, the Estate requests that the Court should consider any and all arguments made in these similarly-situated appeals in resolving the current appeal.

EHB 2075 has no application to the Hambleton Estate, where the trial court entered a final, unappealable judgment;

The new tax under EHB 2075 cannot be applied to the Hambleton Estate, where the statute of limitations has passed;

Retroactive application of newly-enacted EHB 2075 to create an estate tax obligation for the Hambleton Estate violates due process;

Application of newly-enacted EHB 2075 to create an estate tax obligation for the Hambleton Estate violates the separation of powers doctrine;

Application of EHB 2075 to the Hambletons' Marital Trust violates the protections against impairing existing contracts; and

Under Bracken, the result of which was constitutionally required and which governs this appeal, the Hambleton Estate does not owe additional Washington State estate tax as a matter of law.

III. STATEMENT OF THE CASE

A. Background.

Helen Hambleton's late husband, Floyd Hambleton, died on April 13, 2005, at a time when there was no Washington estate tax in effect. Floyd Hambleton's will left a testamentary trust for the benefit of his wife, Helen Hambleton, for her life ("the Marital Trust"). The Marital

Trust qualified for the elective federal unlimited marital deduction under federal law, pursuant to IRC § 2056(b)(7) (a so-called “QTIP Election”). The Floyd Hambleton Estate made a federal QTIP Election on the federal estate tax return. However, because there was no Washington estate tax in effect at that time, the Floyd Hambleton Estate did not make, and could not have made, a Washington QTIP Election. CP 30.

Floyd Hambleton’s wife, Helen Hambleton, died on October 11, 2006, after the enactment of the Washington estate tax. CP 1, 30. The Personal Representative for the Hambleton Estate filed both federal and Washington State estate tax returns for the Helen Hambleton Estate on or about January 11, 2008. Pursuant to federal law, the *federal* taxable estate included the value of assets in the Marital Trust as of the date of Helen Hambleton’s death, since her husband’s estate had made a federal QTIP Election to defer the imposition of estate tax on the Marital Trust’s assets until the time of her death. However, consistent with DOR’s duly promulgated regulations, Helen Hambleton’s *Washington State* taxable estate did not include the value of the assets in the Marital Trust, since no comparable election had been made to defer Washington estate tax. Indeed, no such tax existed at the time of Floyd Hambleton’s death. CP. 30.

Despite the fact that DOR's own regulations clearly provided that the value of assets held in the Marital Trust was not part of the taxable estate of the Helen Hambleton Estate, DOR took the unreasonable position that Washington State estate tax was owed on the value of the assets in that trust. CP 32. Following the procedure set forth in RCW 83.100.150, DOR filed "findings" in the probate, Clark County Superior Court, Case No. 07-4-00575-0 ("the Litigation"), asserting additional taxes owed, including taxes attributable to the Marital Trust, in the amount of \$1,184,989.16.⁴ CP 12.

The Hambleton Estate timely filed its objections to DOR's findings, pursuant to RCW 83.100.180. CP 14.

B. The Supreme Court Decides Bracken and Re-Affirms The Estate's Position That No Estate Tax is Owed by the Hambleton Estate.

In Bracken, the Court considered and unanimously rejected DOR's position that estate tax is payable on a trust created before the enactment of the Washington tax on May 17, 2005. See Bracken, 175 Wn.2d at 562. That is the precise issue herein.

⁴ DOR's findings actually reflect a larger deficiency, with the excess being an amount the Estate properly reflected on the return but which it was unable to pay due to cash flow problems. That additional amount has now been paid in full, with interest. CP 30.

Bracken's dispositive holdings are that: (1) when one spouse creates (at death) a trust for the benefit of the surviving spouse, the only taxable transfer occurs when the first spouse dies, and (2) unless the estate of the first spouse makes an election (a QTIP Election) to defer the imposition of the tax on that trust, there is no basis for taxing the value of the trust assets when the surviving spouse dies because no transfer occurs at that time. Id. at 563.⁵ And, if the creation of a marital trust occurred before the May 17, 2005, enactment of the Washington State estate tax, there was no taxable transfer, and the value of the assets held in the marital trust are not subject to Washington State estate tax on the surviving spouse's death. Id.

Here, there is no question that Floyd Hambleton's death and the creation of the Marital Trust occurred prior to May 17, 2005. Thus, under Bracken, the assets included in the Marital Trust were not subject to Washington State estate tax when Helen Hambleton died. See id.

In other words, after Bracken, it was now even clearer that the Hambleton Estate did not owe Washington State estate tax on the value of the assets held in the Marital Trust.

⁵ DOR misrepresents the holding in Bracken when it says the Court held "that the Legislature did not intend to tax QTIP passing under Internal Revenue Code § 2044." Appeal Brief at p. 1. In fact, the Bracken Court much more narrowly held that assets in a QTIP trust are untaxable only if they were not subject to tax at the time when the trust was created.

C. The Trial Court Grants Summary Judgment in Favor of the Hambleton Estate Under Bracken and Finds That No Estate Tax is Owed.

Following the Supreme Court's decision in Bracken, the Hambleton Estate moved for summary judgment, based on the clear direction and applicability of the controlling authority in Bracken. CP 33-40. DOR did not argue that Bracken was inapplicable or somehow not dispositive in Hambleton's favor; to the contrary, it acknowledged that, under Bracken, the Estate was entitled to summary judgment. Rather, DOR argued solely that the Court should delay making a decision until the Legislature had an opportunity to change the law. CP 44-53. The trial court rejected DOR's argument and entered summary judgment in favor of the Estate on April 19, 2013. CP 153-55.

D. After the Time for Appealing the Trial Court's Judgment Expires, the Legislature Enacts EHB 2075, Which Purports to Overrule Bracken and Apply Retroactively.

At the urging of DOR, the Legislature then began entertaining bills to attempt to overrule Bracken. The proposed law would apply prospectively, as well as retroactively, to all estates that had not received a final judgment. Despite having no substantive grounds upon which to appeal the judgment entered in favor of the Hambleton Estate, DOR set upon a course to artificially and improperly delay entry of a final judgment

in this and other similarly-situated cases, in hopes that the Legislature would pass the retroactive bill.

DOR's argument at the time of summary judgment concedes the utter lack of legal or factual argument against entry of a final judgment in favor of the Hambleton Estate:

The Court should defer a decision on the Estate's Motion to await the Washington Legislature's action on a pending bill (House Bill 1920) that would retroactively clarify the Legislature's intent to tax QTIP. If that bill passes, this case would proceed on the statutory and constitutional issues raised in the Estate's petition for judicial review. Conversely, if that bill does not pass, DOR agrees that under the holding in Bracken, the Estate likely would not owe any additional Washington estate tax. Thus, DOR's findings and any lien would be dismissed.

CP 45. As of the time of the filing, DOR's appeal had no plausible legal or factual basis; resolution of the case was governed by the binding Supreme Court decision in Bracken.

Nonetheless, DOR filed the current appeal while legislation was still pending, in hopes of stalling an otherwise final judgment until after its legislation could be passed. DOR's questionable tactics initially appeared to have worked – the Legislature passed EHB 2075 on June 14, 2013, at the conclusion of the second extended legislative session.

EHB 2075 seeks to overrule Bracken by attempting to redefine two important terms: “transfer” and “Washington taxable estate.” Laws of

2013, 2d Spec. Sess., ch. 2 § 2. Also relevant here, EHB 2075 purports to apply retroactively to all estates in which the decedent died on or after the effective date of the old tax, except those which had obtained a “final judgment, no longer subject to appeal, entered by a court of competent jurisdiction before the effective date of this section.” *Id.* at § 9. In other words, EHB 2075 purports to overrule Bracken as to all estates other than those two estates involved in Bracken.

In the end, however, DOR’s delay tactics and goliath attempts to overturn Bracken do not change the outcome of this appeal because EHB 2075 does not apply to the Hambleton Estate and otherwise cannot withstand constitutional scrutiny.

IV. ARGUMENT

A. Standard of Review.

This Court reviews summary judgment determinations *de novo*. Hubbard v. Spokane Cy., 146 Wn.2d 699, 706-07, 50 P.3d 602 (2002). Summary judgment is warranted only if “there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law.” Ellis v. City of Seattle, 142 Wn.2d 450, 458, 13 P.3d 1065 (2000).

Similarly, whether a statute may be applied retroactively consistent with the due process clause is a question of law, for which this Court’s

review is *de novo*. Licari v. Commissioner, 946 F.2d 690, 692 (9th Cir. 1991).

B. EHB 2075 Does Not Apply to the Hambleton Estate Because the Trial Court's Decision Was Final At the Time EHB 2075 Was Enacted.

While there are a number of serious constitutional flaws with DOR's arguments on appeal, this Court need not reach any of them. This Court can deny DOR's appeal on the non-constitutional basis that EHB 2075 does not apply to the final judgment entered by the trial court with regard to this Estate. See HJS Dev., Inc. v. Pierce Cy., 148 Wn.2d 451, 469 n. 74, 61 P.3d 1141 (2003) (a court should decide a case on nonconstitutional grounds if at all possible). DOR's appeal was a subterfuge; a final unappealable judgment was entered on April 19, 2013.⁶

By its terms, EHB 2075 does not apply to "any final judgment, no longer subject to appeal, entered by a court of competent jurisdiction," before June 14, 2013, the effective date of the statute. Laws of 2013, 2d Spec. Sess., ch. 2 § 10.

When the trial court entered summary judgment in favor of the Hambleton Estate on April 19, 2013, the judgment was final and not

⁶ In fact, under RCW 83.100.080, DOR was required to issue a release "when the tax due under" the statute has been paid, which it failed to do. There was no basis for DOR to withhold a release after Bracken was decided, because, as of that time, the Hambleton Estate had paid all of the tax due under Washington State law.

subject to appeal, since DOR's arguments concede that it had no legitimate grounds to appeal. At the time of summary judgment, DOR agreed that under Bracken, the Hambleton Estate owed no estate tax:

....DOR agrees that under the holding in Bracken, the Estate likely would not owe any additional Washington estate tax. Thus, DOR's findings and any lien would be dismissed.

CP 45. DOR's sole argument was that the trial court should "defer" the summary judgment decision until the Legislature could pass the pending legislation. Id.

Despite having no legal or factual basis to distinguish Bracken, and despite admitting that the Hambleton Estate owed no tax under Bracken, DOR filed the current appeal for the sole and impermissible basis of artificially delaying a final judgment until the pending legislation could be passed.⁷ On the date on which an appeal had to be filed (on or about May 19, 2013), DOR had no basis, other than wrongful delay and a hoped for change in the law, for filing its appeal. DOR should not be rewarded for filing a frivolous and artificial appeal – in all likelihood in violation of Civil Rule 11, RCW 4.84.185 and RAP 18.9 – and for wrongfully refusing to recognize the finality of the trial court's judgment.

⁷ RAP 18.9(b) and (c) provide for dismissal if an appeal is brought solely for purposes of delay.

Because there was no legal basis to appeal, this Court should hold that the trial court's judgment was final and not subject to appeal when it was entered on April 19, 2013. By its own terms, EHB 2075 does not apply to the Hambleton Estate, because, by the time it was enacted, the Estate had a final judgment no longer subject to appeal.

C. **The Statute of Limitations for Applying the New Tax Imposed by EHB 2075 Has Passed.**

As applied to the Hambleton Estate, EHB 2075 creates an entirely new estate tax. The first problem with attempting to now apply this new tax to the Hambleton Estate for the first time on appeal is that the statute of limitations for doing so has long passed.⁸

As applied to the Hambleton Estate, newly-enacted EHB 2075 imposes an estate tax on property in a trust: (1) that was not subject to tax when the trust was created, and (2) upon property that Helen Hambleton did not own, control, or transfer. Under the binding decision in Bracken, EHB 2075 seeks to impose a tax where the Supreme Court has held that no tax previously existed.

The Legislature enacted this new tax as an amendment to part of the existing statutory framework in chapter 83.100 RCW. See RCW 83.100.020 and .047. Thus, the new tax is subject to the procedural

⁸ Retroactive application of a new tax also violates due process requirements, a second argument that is also addressed herein.

provisions of that chapter, including the four-year statute of limitations for assessing additional taxes under RCW 83.100.095(3):

(3) No assessment or correction of an assessment for additional taxes, penalties, or interest due may be made by the department more than *four years after the close of the calendar year in which a Washington return is due* under this chapter, including any extension of time for filing, except upon a showing of fraud or of misrepresentation of a material fact by the taxpayer or as provided under subsection (4) or (5) of this section or as otherwise provided in this chapter.

(emphasis added).

Helen Hambleton died October 11, 2006. Her estate tax return was therefore initially due nine months later, on July 11, 2007, but the due date was extended an additional six months, to January 11, 2008.⁹ Thus, the statute of limitations for assessing additional taxes, penalties, or interest expired on the close of the 2012 calendar year, December 31, 2012, six months before the new tax in EHB 2075 was imposed. While a decision on DOR's attempt to collect additional estate taxes under previously-existing law was pending in the trial court at the time the statute of limitations ran, it is inescapable no attempt to collect the new tax imposed

⁹ RCW 83.100.050 requires the estate of a decedent to file a Washington estate tax return at the same time as the federal return, no later than nine months after the date of death, but with an automatic extension to 15 months after the date of death if requested.

by EHB 2075 was pending (or could have been pending at that time) because the tax did not exist.

The Legislature could have enacted a new statute of limitations for the new tax, but it did not do so. Even if EHB can be applied retroactively (which it cannot), it can only be applied retroactively to estates with returns due in calendar year 2009 and later under the applicable statute of limitations. This Court should find that EHB 2075 cannot be applied to the Hambleton Estate because the statute of limitations has expired.

D. If EHB 2075 is Retroactively Applied to the Hambleton Estate, it Violates Due Process.

DOR argues that EHB 2075 can be applied retroactively back to 2005, despite the fact that it creates a wholly new tax where no tax previously existed, and despite the fact that the United States Supreme Court and the Washington Supreme Court strictly proscribe retroactivity periods.

The United States Supreme Court has consistently applied the same standard to determine whether a tax statute may be applied retroactively under the Due Process Clause. A court “must consider the nature of the tax and the circumstances in which it is laid” to determine whether the application “is so harsh and oppressive as to transgress the constitutional limitation.” United States v. Hemme, 476 U.S. 558, 568-69

(1986) (quoting Welch v. Henry, 305 U.S. 134, 147 (1938)); accord U.S. v. Darusmont, 449 U.S. 292, 299 (1981); U.S. v. Carlton, 114 S. Ct. 2018 (1996). “[R]etroactive questions cannot be given simplistic answers, but require analysis of the fairness of the provision under all the circumstances.” Estate of Downs v. U.S., 215 Ct. Cl. 44, 48 (1977).

DOR appears to argue that there is no limit to the retroactive application of a tax statute. While it is clear that retroactive application of a tax statute is not *per se* unconstitutional, it is just as clear that tax statutes are not automatically entitled to retroactive application, no matter the circumstances. Instead, the Court must consider: (1) the nature of the tax; and (2) the circumstances in which it is laid, in order to determine whether the statute is impermissibly “harsh and oppressive.” See Hemme, Welch, Darusmont, Carlton, *supra*.

Here, the nature of the tax imposed by EHB 2075 – a wholly new estate tax – militates against *any* period of retroactivity. Even if EHB 2075 did not create a new State estate tax, the lengthy period of retroactivity sought by DOR violates due process as a matter of law. Finally, DOR cannot provide a rational basis for targeting the Hambleton Estate, and other similarly-situated estates, for retroactive application of EHB 2075.

1. **Retroactive Application of the Wholly New Estate Tax Imposed by EHB 2075 Violates Due Process.**

The Supreme Court has drawn a critical distinction between retroactive statutes involving “the creation of a wholly new tax” and “amendments that bring about certain changes in operation of the tax laws.” Carlton, 512 U.S. at 34. A statute that creates a wholly new tax while imposing retroactive application “may run afoul of due process.” Caprio v. N.Y. State Dep’t of Taxation & Finance, 37 Misc.3d 964, 955 N.Y.S. 2d 734 (2012).

A tax is viewed as a “wholly new tax,” where “the taxpayer has no reason to suppose that any transactions of the sort will be taxed at all.” Darusmont, 449 U.S. at 300; see also Comptroller of the Treasury v. Glenn L. Martin Co., 216 Md. 235, 140 A.2d 288 (1958) (invalidating statute imposing a new tax: “we think that [the statute] seeks to place a tax where none was imposed before and to reach transactions completed long before its enactment.”).

EHB 2075 imposes an estate tax on property that was previously not subject to estate tax. Before the Legislation’s enactment of EHB 2075, the value of assets transferred to a marital trust were not subject to estate tax if the first spouse died prior to May 17, 2005. Bracken, 175 Wn.2d at 562-63. Here, there is no question that Floyd Hambleton’s death and the

creation of the Hambletons' Marital Trust occurred prior to May 17, 2005. Thus, prior to the passage of EHB 2075, the assets included in the Hambleton's Marital Trust were not subject to Washington State estate tax. See id.

At the time of the transfer to the Marital Trust, the Hambletons had "no reason to suppose" that the assets held in the Marital Trust would be subject to Washington State estate tax at some date in the future. See Darusmont, 449 U.S. at 300. The Hambletons' reasonable expectations were confirmed when DOR subsequently adopted regulations that excluded such pre-enactment trusts from the Washington taxable estate.¹⁰

Given the binding holding in Bracken that no estate tax previously existed for these estates, it is axiomatic that EHB 2075 seeks to impose a tax where no tax previously existed. The Legislature's newly-enacted attempt to impose such a tax through EHB 2075 is a prime example of a "wholly new tax."

A trio of United States Supreme Court cases continue to govern the due process analysis for the narrow circumstance in which the government attempts retroactive imposition of a wholly new tax, such as that sought to be imposed by DOR – Nichols v. Coolidge, 274 U.S. 531 (1927), Blodgett

¹⁰ The regulations are discussed in more detail in Section G of the Response Brief.

v. Holden, 275 U.S. 142 (1927), and Untermeyer v. Anderson, 276 U.S. 440 (1928). See Carlton, 114 U.S. at 2024 (recognizing that these cases continue to have application in the narrow circumstance where the government is attempting to retroactively apply a new tax); Netjets Aviation, Inc. v. Guillory, 207 Cal. App. 4th 26, 54 (2012) (applying these cases to the attempted retroactive application of a new tax and finding that no period of retroactivity could be sustained). Under this authority, DOR's attempted retroactive application of a wholly new tax is simply impermissible.

In Nichols, the Court held retroactive application of the federal estate tax to be unconstitutional. Mrs. Coolidge had transferred property into a trust for the care of Mrs. Coolidge and her husband in 1907, with the corpus of the trust to be distributed upon the death of both spouses. Twelve years later, Congress amended the federal estate tax to include certain pre-death transfers, including the transfer made by Mrs. Coolidge 12 years earlier. In concluding that any length of retroactive application of the 1919 law was sufficiently arbitrary and capricious as to offend due process, the Court noted that the transaction in question was “testamentary in character and beyond recall.” Id. at 542.

The next term, the United States Supreme Court faced a challenge to the retroactive application of a federal gift tax statute. In Blodgett, 275

U.S. at 147, a plurality of the Court viewed a retroactive application of the federal gift tax as violating a due process. In that case, Blodgett made gifts in January 1924. The gift tax provision in question was passed on June 2, 1924. In finding any amount of retroactive application of the statute to be unconstitutional, the Court held: “It seems unreasonable that one who, in entire good faith and without the slightest premonition of such consequence, made absolute disposition of his property by gifts should thereafter be required to pay a charge for so doing.” Id.

Later in that same term, the Court revisited the question of retroactive application of the 1924 federal gift tax legislation. In Untermeyer, 276 U.S. at 445-46, the gift in question was made while the changes to the federal gift tax were being contemplated by Congress. Nonetheless, the Court again found that the retroactive imposition of the new tax on gifts would violate due process. Id.

The circumstances relating to the Hambletons' Marital Trust are indistinguishable from these three controlling cases. A testamentary transfer was made in good faith and in reliance on existing law. Under this authority and consistent with due process requirements, any period of retroactivity is impermissible for the imposition of the wholly new tax on the Hambletons' Marital Trust under EHB 2075.

The cases cited by DOR as allowing retroactive application of a tax statute have no application here because they did not involve the application of a new tax. In the cited cases, the retroactive application of the tax in question was allowed as merely a change or adjustment to a prior sales, income, or corporate tax.¹¹ This makes sense because notice to taxpayers of a potential change in the rate or basis of an existing tax is generally implied. See e.g., Estate of Ekins v. Commissioner, 797 F.2d 481, 484 (7th Cir. 1986) (“a change in the tax rate is considered by its very nature to be reasonably foreseeable”).

In contrast, EHB 2075 is not merely a change in the rate or basis of an existing tax rate. The Hambletons had no similar constructive notice that the value of property transferred to the Marital Trust, which was unquestionably not subject to tax at the time the transfer was made, would somehow be subject to tax at some point in the distant future, after their

¹¹ See Montana Rail Link v. United States, 76 F.3d 991, 994 (9th Cir. 1996) (railroad retirement taxes); Maples v. McDonald, 668 So.2d 790 (Ala. Civ. App. 1995) (amendment to sales and use tax); Enterprise Leasing Co. v. Arizona Dep’t of Revenue, 211 P.3d 1, 5 (Ariz. Ct. App. 2008) (income taxes); Miller v. Johnson Controls, 296 S.W.3d 862, 866-67 (Ky. Ct. App. 2006) (changes to allowance for filing combined income tax); General Motors Corp. v. Dep’t of Treasury, 803 N.W.2d 698, 710 (Mich. Ct. App. 2010) (tax on employee use of corporate vehicles); Moran Towing Corp. v. Urback, 768 N.Y.S.2d 33 (2003) (retroactive application of business tax); Atlantic Richfield Co. v. Oregon Dep’t of Revenue, 14 Or. Tax 212 (Or. Tax Ct. 1997) (corporate excise tax).

deaths, and after their reasonable expectations had been eliminated by the enactment of a new estate tax.

The Court should find that retroactive application of EHB 2075 to impose a wholly new tax on the Hambleton Estate violates due process as a matter of law.

2. **In Any Case, the Eight-Year Period of Retroactivity Sought by DOR Violates Due Process as a Matter of Law.**

“Retroactive tax legislation may be treated as valid, unless it reaches so far into the past or so unfairly as to constitute a deprivation of property without due process.” Hemme, 476 U.S. at 568-69.

The Supreme Court’s most recent review of the issue of retroactive application of a tax statute is Carlton, 114 S. Ct. 2018. The Carlton Court upheld a retroactive statute that applied to tax certain transactions from one year prior, recognizing that the Court’s approval of retroactive tax legislation “generally has been ‘confined to short and limited periods required by the practicalities of producing national legislation.’” Id. at 2023. Justice O’Connor’s concurrence expounded: “A period of retroactivity longer than the year preceding the legislative session in which the law was enacted would raise ... serious constitutional questions.” Id. at 2025-26 (1994) (J. O’Connor, concurring).

In the cases in which the United States Supreme Court has upheld a retroactive federal tax statute against a due process challenge, the law applied retroactively only for a relatively short period before retroactivity; generally, the time reasonably necessary to pass a new law. See e.g., Carlton, 114 S. Ct. at 2025-26 (1994) (J. O'Connor, concurring) (upholding a one-year retroactive application and recognizing the very limited retroactivity periods that had been upheld by the Court) (citing Hemme, 476 U.S. at 562 (one month)); Darusmont, 449 U.S. at 294-95 (10 months); U.S. v. Hudson, 299 U.S. 501 (1937) (one month); Welch, 305 U.S. at 151 (allowing a two-year period of retroactivity, but only on the express basis that the Legislature met only biannually and made the revision "at the first opportunity after the tax year in which the income was received").

Consistent with this authority, binding Washington State Supreme Court cases have previously invalidated tax statutes that sought to apply retroactively back to four years prior – *four years less than the period of retroactivity currently sought by the State herein*. See Northern Pac. Ry. Co. v. Henneford, 9 Wn.2d 18, 113 P.2d 545 (1941) (attempt to reach back four years to collect excise taxes invalidated); State v. Pacific Telephone & Telegraph Co., 9 Wn.2d 11, 113 P.2d 542 (1941) (same).

In reliance on this well-established history, this Court has more recently rejected DOR's current contention that the legislature has unlimited discretion to retroactively tax:

DOR relies on United States v. Carlton, 512 U.S. 26, 114 S. Ct. 2018, 129 L.Ed.2d 22 (1994), for the proposition that the due process clause does not impose *any* fixed limit on the retroactive reach of tax statutes. DOR's reliance on Carlton, however, is misguided. In Carlton, Congress amended a provision of a federal estate tax statute by limiting the availability of a deduction to specific stock ownership plans. The deduction had been initially created in 1986, and the amendment passed just over one year later in December 1987.

Tesoro Refining & Marketing Co. v. State, 159 Wn. App. 104, 117, 246 P.2d 211 (2010) (overruled on other grounds at 173 Wn.2d 551, 269 P.3d 1013 (2012)).

The Tesoro Court recognized and adopted Carlton's limitation of retroactivity to situations where it is "confined to short and limited periods required by the practicalities of producing national legislation." Id. at 118 (emphasis added). On that basis, this Court easily found that the 24-year period of retroactivity in question failed this test:

The facts of Carlton are readily distinguishable from the instant case. Here, the deduction statute at issue ... was enacted in 1985. The legislature had ample opportunity since 1985 to restrict its applicability to only retail and wholesale B&O tax. DOR attempts to analogize the instant case with Carlton by framing the 2009 amendment as a "clarifying amendment." But the legislature may not apply a "clarification" retroactively for 24 years when it is in

direct conflict with the reasonable expectations of qualifying taxpayers.

Id.

DOR's citation to W.R. Grace & Co. v. Dep't of Revenue, 137 Wn.2d 580, 973 P.2d 1011 (1999), for the proposition that Washington allows lengthy periods of retroactivity, is misleading. In W.R. Grace, the Court did find that retroactive application of a B&O tax statute of four-plus years was consistent with due process. However, the B&O tax statute in question was "curative" because it was meant to "cure the constitutional infirmities of the B&O tax scheme."¹² Id. at 1021. The amendment to the tax law served as a post-deprivation remedy for prior constitutional violations and was "designed to benefit taxpayers." Id. The Court recognized that such curative legislation was given "greater tolerance toward retroactive application," and that curative legislation is to be "liberally construed." Id.

Further, the W.R. Grace Court focused on whether the tax statute "unreasonably disappointed" the taxpayers' expectations as to taxation in making its decision:

¹² The tax statute at issue in W.R. Grace was remedial legislation passed in response to the United States Supreme Court's opinion in Tyler Pipe Indus., Inc. v. Dep't of Revenue, 483 U.S. 240 (1987), which held that Washington's B&O tax was unconstitutional as applied to interstate sales and manufacturing. See generally, W.R. Grace, 137 Wn.2d 580.

Retroactive taxation is not so arbitrary and oppressive as to be unconstitutional if it is no more burdensome than the taxpayer should have expected it to be when he did the thing which created the tax liability....And when it is not, whether the period of retroactivity is long or short is of little consequence provided it isn't too long to be within reason.

Id. at 1021-22. The Court went on to find that “it cannot be said taxpayers here have had their ‘expectations as to taxation unreasonably disappointed,’ or retroactive application of the 1987 curative credit, designed to benefit taxpayers, has made their tax liability more burdensome.” Id. at 1022.

Certainly, that is not the case here. EHB 2075 was not enacted to “cure” a prior constitutional infirmity or provide a post-deprivation benefit to taxpayers. For that reason alone, the holding in W.R. Grace and the more “liberal” standard applied therein simply does not apply here. Moreover, as discussed above, the estate tax now sought to be imposed is not something the Hambleton Estate could have anticipated at the time of the transfer to the Marital Trust, a time when no estate tax liability for the value of the assets transferred to the Hambletons’ Marital Trust existed. It is an understatement to say that retroactive application of EHB 2075 would make the Hambletons’ tax liability more burdensome than anticipated. The “liberal” standard applied in W.R. Grace and its holding are inapplicable.

DOR otherwise provides the Court with a string of outside jurisdiction income, sales, and corporate tax cases, which have allowed lengthier periods of retroactivity.¹³ See Appeal Brief at pp. 22-23. However, these cases are at odds with United States Supreme Court authority and binding Washington State Supreme Court cases, which have strictly limited the retroactive application of tax statutes under the circumstances implicated here.

Under this authority, it is likely that anything more than one year of retroactivity (*i.e.*, the time it takes to pass a new law) violates due process. See Tesoro. But, at the very least, we know that even four years of retroactivity is too long under on-point Washington jurisprudence. See Northern Pacific Railroad Company, and Pacific Telephone & Telegraph Company, supra. As a matter of law, the eight-plus year period of retroactivity sought by DOR violates due process.

¹³ In any case, contrary to what the State would like the Court to believe, there is a clear split of authority on whether a tax statute can reach back before the calendar year that precedes its enactment. The State's string-cited cases can be countered with out-of-jurisdiction authority to the contrary, as well as the cited Washington State Supreme Court authority. See Comptroller of the Treasury v. Glenn L. Martin Co., 216 Md. 235, 140 A.2d 288 (Md. 1958) (finding a 10-year retroactive period to be unconstitutional); City of Modesto v. Nat'l Med, Inc., 128 Cal. App. 4th 518 (2005) (eight-year period of retroactivity found to violate due process and recognizing that California had upheld retroactivity only when it was limited to the prior tax year).

3. **There is No Rational Basis for Retroactive Application of EHB 2075 to the Hambleton Estate.**

Even if DOR could overcome the other due process hurdles prohibiting its attempted retroactive application of EHB 2075, it must still establish that retroactive application is supported by a rational basis. The circumstances underlying the enactment of EHB 2075 and the reasons for the retroactivity do not meet even this minimum rational basis standard.

“The retroactive aspects of legislation, as well as the prospective aspects, must meet the [rational basis] test of due process, *and the justifications for the latter may not suffice for the former.*” Pension Benefit Guaranty Corp. v. R.A. Gray & Co., 467 U.S. 717 (1984) (emphasis added). In other words, even if the Court accepts DOR’s argument that raising revenue for education is a rational basis for prospective application of EHB 2075 (a point which the Estate does not dispute), DOR cannot use this same justification for applying EHB 2075 retroactively. Instead, the retroactive application of EHB 2075 must be supported by independent justification. See id. DOR has provided none.

This is especially problematic for DOR because the retroactive aspect of EHB 2075 is simply the result of DOR’s purposeful targeting of certain identifiable estates (including the Hambleton Estate), in which no tax obligation would be due to DOR, or in which a large refund would be

owed by DOR, and which were pending on appeal at the time the statute was passed. This Court has previously rejected this type of targeted, retroactive legislation for pending cases.

In Tesoro, 159 Wn. App. at 117 , this Court found that the retroactive application of a B&O tax amendment violated due process because, like here, the legislation was targeted at a specific case:

....the legislative history of the 2009 act shows the recent amendment was in direct response to Tesoro's refund request...the direct references to Tesoro's lawsuit and the fact that the 2009 act became effective the day before trial was set to begin evidences the type of improper taxpayer targeting identified by the Carlton Court.

See also Carlton, 114 Ct. Ct. 2023 (recognizing that targeting estates for taxes after "inducing" them to take action was an improper purpose under a due process analysis: "There is no plausible contention that Congress acted with an improper motive, as by targeting estate representatives such as Carlton after deliberately inducing them to engage in ESOP transactions.").

Here, DOR has acted with the precise type of "improper" motive that this Court has indicated does not constitute a rational basis for retroactive application of a statute. EHB 2075 was in direct response to the Hambleton Estate's (and those of other similarly-situated estates) contention that it owed no estate tax on the assets transferred to the

Marital Trust, a contention with which the Washington Supreme Court agreed. The statute was passed while these appeals were pending and after DOR had artificially delayed entry of final judgments. Under the circumstances, there is no rational basis for retroactive application of EHB 2075 to the Hambleton Estate.

E. Retroactive Application of EHB 2075 Violates the Separation of Powers Doctrine.

After DOR's position as to the interpretation of what constitutes a "transfer" for purposes of transfer tax was rejected by the Washington State Supreme Court in Bracken, the Legislature stepped in to impermissibly function as a court of last resort for DOR – effectively granting DOR relief the Court said it was not entitled to receive. The Legislature's actions in enacting EHB 2075 and attempting to overrule the Court's judicial determinations regarding what constitutes a "transfer" violate the separation of powers doctrine.

The separation of powers doctrine arises out of the "constitutional distribution of the government's authority in to three branches of government." Port of Seattle v. Pollution Control Hearing Board, 151 Wn.2d 568, 625, 90 P.3d 659 (2004). The doctrine recognizes that each branch of the government has its own "appropriate sphere of activity." Hale v. Wellpinit School District No. 49, 165 Wn.2d 494, 504, 198 P.2d

1021 (2009). Within this framework, the judicial branch's function is judicial review, including the authority to interpret and apply the law. Id. at 505.

The Legislature is precluded by the doctrine of separation of powers from making "judicial determinations." Washington State Farm Bureau Federation v. Gregoire, 162 Wn.2d 284, 304, 174 P.3d 1142 (2007). Moreover, "[i]t is a fundamental rule of statutory construction that once a statute has been construed by the highest court of the State, that construction operates as if it were originally written in to the statute." Id. at 506. "In other words, it is within [the judicial branch]'s 'appropriate sphere of activity' to determine what a particular statute means, and that determination relates back to the time of the statute's enactment." Id.

EHB 2075 makes a number of impermissible judicial determinations regarding who makes a transfer and when a transfer occurs for purposes of a marital trust. Under EHB 2075, a "transfer" occurs by the second spouse and when the second spouse dies, regardless of whether an in-fact transfer has taken place. As an initial matter, EHB 2075 violates the separation of powers doctrine because the Legislature has invaded the function of the Court in making "judicial determinations," such as what constitutes a transfer for purposes of a marital trust.

EHB 2075 further violates the separation of powers doctrine by attempting to overrule Bracken's prior judicial determination of what constitutes a "transfer" for purposes of the imposition of a transfer tax. The Bracken Court made certain determinations related to the circumstances under which a "transfer" is made for purposes of a marital trust. Specifically, the Court determined: (1) that the trustor makes a transfer at the marital trust is created; and (2) that the transfer occurs when the marital trust is established. See Bracken, 175 Wn.2d at 554, 566. EHB 2075's determination of what constitutes a "transfer" completely contradicts the judicial determinations in Bracken.

It is a fundamental tenet of the separation of powers doctrine that the legislature "may not retroactively overrule a decision of the state's highest court." Port of Seattle, 151 Wn.2d at 625 (citations omitted). Thus, "separation of powers problems are raised when a subsequent legislative enactment ... contravenes the construction placed on the original statute by this court." Gregoire, 162 Wn.2d at 304 (citing Overton v. Econ. Assistance Auth., 96 Wn.2d 552, 558, 637 P.2d 652 (1981)).

The Bracken Court previously decided what constitutes a "transfer" for purposes of a transfer tax. The Legislature's actions in retroactively amending a statute that the Washington State Supreme Court

has already interpreted in order to re-define what constitutes a “transfer” for purposes of a marital trust, violates the separation of powers doctrine. DOR’s attempt to legislate around the Bracken decision is unconstitutional.

F. Application of EHB 2075 to the Hambleton Estate Violates the Protections Against Impairment of Contracts.

If the strong due process and separation of powers arguments against applying EHB 2075 to the Hambleton Estate were not enough, the statute also violates the Contracts Clause.

The Washington State and United States Constitutions prohibit the passing of laws “impairing the obligations of contracts.” Wash. Const. art. I, § 231 U.S. Cons. art I, § 10, cl. 1. The constitutional protection against impairment of contracts is implicated where: (1) a contractual relationship exists; and (2) legislations substantially impairs the contractual relationship. Caritas Serv., Inc. v. Dep’t of Social & Health Serv., 123 Wn.2d 391, 402-03, 869 P.2d 28 (1994). Within this context, impairment means “alter[ing] terms, impos[ing] new conditions, or lessen[ing] its value.” Id. at 404.

Trusts have long been treated as contractual rights for purposes of impairment analysis. See Coolidge v. Long, 282 U.S. 582 (1931); In re McGrath’s Estate, 191 Wash. 496, 71 P.2d 395 (1937).

At the very least, EHB 2075 impairs the contractual rights of the beneficiaries of the Trust by “lessening its value,” by approximately \$1.2 million. See Caritas, 123 Wn.2d at 404. DOR’s stated purpose of raising revenue is insufficient to justify the impairment of the Trust. See Carlstrom v. State, 103 Wn.2d 391, 396, 694 P.2d 1 (1985).

EHB 2075 cannot be applied to the Hambleton Estate without violating the Washington and federal Contracts Clauses.

G. Under Bracken, the Hambleton Estate Owes No Estate Tax as a Matter of Law, and the Summary Judgment Dismissal Should be Upheld.

Because EHB 2075 has no application to this case as a matter of law, this Court must apply the binding authority in Bracken to the nearly identical facts of this case. Under Bracken, the Estate owes no estate tax as a matter of law.

In Bracken, the Washington Supreme Court held that DOR exceeded its authority by attempting to tax trusts left by spouses who died before the effective date of the Washington estate tax, May 17, 2005. The majority opinion in Bracken held that the taxable transfer in such a situation occurs when the spouse establishing the trust dies, not when the surviving spouse/beneficiary dies. Since the otherwise taxable transfer occurred before the effective date of the Washington estate tax, the assets in the trust were not subject to Washington estate tax.

The Washington estate tax, set forth in RCW 83.100, is imposed pursuant to the Estate and Transfer Tax Act, Chapter 516 of the Session Laws of 2005 (“Estate and Transfer Tax Act”). The Estate and Transfer Tax Act became effective on May 17, 2005, for decedents dying after the effective date. Pursuant to RCW 83.100.020(13), the Washington taxable estate is determined by making various adjustments to the federal taxable estate.

Pursuant to IRC § 2057(b)(7), in calculating the Federal taxable estate, an estate may deduct (as a marital deduction) amounts passing from the deceased spouse to a trust for a surviving spouse if the trust meets certain requirements which make it a “qualified terminable interest property trust,” *i.e.*, a QTIP trust. In exchange for that deduction granted the estate of the first spouse to die, IRC § 2044 requires that the value of the assets included in the trust be included in the federal taxable estate of the surviving spouse.

In RCW 83.100.047(1), the Legislature directed DOR to promulgate rules analogous to the foregoing QTIP principles. DOR complied by promulgating WAC 458-57-105(3)(q) and WAC 458-57-115(2)(d), which require the estate of a surviving spouse to include in the tax calculation the value of a trust for which a *Washington* QTIP election was made by the estate of the predeceased spouse. In both this estate and

in the Bracken estate, no Washington QTIP election could have been made because the spouse establishing the trust died before the effective date of the Washington estate tax:

The 2006 regulations provide for a series of adjustments to the federal taxable estate by which the effect of federal QTIP elections is canceled out. The regulations adjust the estate for the effect of any Washington QTIP elections. As a result, under the 2006 regulations *the only QTIP required to be included in the Washington taxable estate is QTIP for which a state QTIP election was made.*

Id. at 560-61 (emphasis added).

The Bracken Court went on to hold that that exclusion of pre-enactment QTIPs was not only consistent with DOR's regulations, it was required by the statute: "[W]e construe the Act to tax only transfers, either at the time they are made or where there has been a voluntary election to defer state taxation, and only prospectively." Id. at 563.

The requirement for a transfer is constitutionally grounded and long standing.

Property is transferred from a trustor when a trust is created, not when an income interest in the trust expires. *Coolidge v. Long*, 282 U.S. 582, 605, 51 S. Ct. 306, 75 L. Ed. 562 (1931). QTIP does not actually pass to or from the surviving spouse. Estate of Bonner v. United States, 84 F.3d 196, 198 (5th Cir. 1996). . . . [T]he Internal Revenue Code does not regard the death of the surviving spouse as giving rise to a taxable transfer even though the deemed transfer at the death of the surviving spouse is the taxable event. A transfer supporting taxation has occurred, but federal law and regulation recognize that it occurred upon

the death of the first spouse. The transfer is taxed later at the time when there is no transfer, by virtue of the deferral election.

175 Wn.2d at 566-67.

In other words, the transfer which is the taxable event occurs upon the death of the first spouse. When the first spouse's estate makes an appropriate election, the imposition of the tax can be deferred to the estate of the surviving spouse. Absent such an election, an estate tax may be imposed on a trust such as this one only when the trust is created, since that is the only time a taxable transfer occurs.

Here, as in Bracken, the death of Floyd Hambleton was not a taxable event since it occurred before the enactment of the Washington estate tax. Therefore, there was no deferral of tax by the making of a state election because no such election existed, and there was no tax to defer to the time of the second death.

Under Bracken, the Hambleton Estate owes no additional estate tax.

H. The Hambleton Estate is Entitled to Recover its Attorneys' Fees and Costs on Appeal.

As discussed, this appeal was entirely frivolous at the time of filing. DOR had no basis, other than delay, to file the appeal. For this, and all of the additional reasons for denial of the appeal outlined herein, the Hambleton Estate respectfully requests that the Court award it the

reasonable attorneys' fees and costs on appeal under RCW 4.84.185, Civil Rule 11, RAP 18.9(a), and any other basis deemed appropriate by the Court.

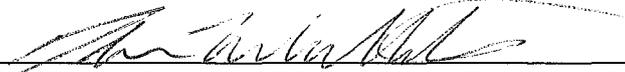
V. CONCLUSION

For the foregoing reasons, the Hambleton Estate respectfully requests that the Court affirm the trial court's decision that the Hambleton Estate does not owe additional estate taxes and deny DOR's appeal.

RESPECTFULLY SUBMITTED this 25th day of September, 2013.

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By


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

DATED this 25th day of September, 2013, at Spokane, WA

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