

No. 47518-9-II

DIVISION II, COURT OF APPEALS
OF THE STATE OF WASHINGTON

ESTATE OF BARRY A. ACKERLEY,

Appellant

v.

WASHINGTON DEPARTMENT OF REVENUE,

Respondent

ON APPEAL FROM THURSTON COUNTY SUPERIOR COURT
(Hon. Carol Murphy)

REPLY BRIEF

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I. INTRODUCTION

The Estate was required to include gift taxes in its federal “gross estate” for purposes of calculating its federal estate tax, and it did so. AR 12a; 26 U.S.C. § 2035(b). The DOR argues that, because the Washington Estate Tax “mirrors” the federal scheme, then the same gift taxes must be included in the Washington gross estate too. DOR’s Br. at 6-11. But it is not that simple. It is settled that the Washington Estate Tax trumps federal estate tax provisions where the two conflict. *See In re Estate of Bracken*, 175 Wn.2d 549, 570-71, 290 P.3d 99 (2012); *see also* RCW 83.100.040(3) (“The tax imposed under this section ... incorporates only those provisions of the internal revenue code ... that do not conflict with the provisions of this chapter.”); WAC 458-57-105(2)(a) (“The department will follow federal ... (Estate tax regulations), ... to the extent they do not conflict with the provisions of chapter 83.100 RCW or 458-57 WAC.”).

They do conflict here. Washington law requires a “transfer of property” as a prerequisite to taxation; federal law does not—as reflected by Section 2035(b)’s gross-up rule itself. The fact that the Washington Estate Tax defines “gross estate” and “taxable estate” with reference to federal law does not, as the DOR insists, nullify the transfer requirement. The Supreme Court rejected this same argument in *Bracken*. “[B]ecause the operative provision of the Act imposes a tax only ... on the transfer of

property, the federal definition of ‘taxable estate’ cannot be used without modification necessary to conform to the Act: the definition must be read to exclude items that are not transfers.” *Bracken*, 175 Wn.2d at 570-71.

The legislature responded to *Bracken* by clarifying the meaning of “transfer” to ensure that the term encompassed QTIP elections, but it did not (and constitutionally could not) eliminate the transfer requirement. *In re Estate of Hambleton*, 181 Wn.2d 802, 813, 335 P.3d 398 (2014). *Bracken* remains good law on this point and, at bottom, the analysis in this case is the same: are gift taxes included in the federal taxable estate as a result of a “transfer of property”? If yes, they must be included in the Washington taxable estate too; if not, they must be excluded from the Washington taxable estate. As explained in the Estate’s opening brief and below, payment of federal gift taxes on lifetime gifts does not constitute a “transfer of property” within the meaning of RCW 83.100.020 & .40.

II. ARGUMENT

There is no “transfer.” Prior to *Bracken*, the term “transfer” was defined solely with reference to the federal estate tax. *Former* RCW 83.100.020(11). Following its amendment, “transfer” is now defined as:

... “transfer” as used in section 2001 of the internal revenue code and includes any shifting upon death of the economic benefit of property or any power or legal privilege incidental to the ownership or enjoyment of property.

RCW 83.100.020(14). The clarifying language was not a departure from federal estate tax principles. Rather, in response to *Bracken's* narrow construction of “transfer,” the legislature intended to give the term its ‘broadest possible meaning *consistent with established United States supreme court precedents ...*’” *Hambleton*, 181 Wn.2d at 813 (quoting Laws of 2013, 2d Spec. Sess., ch. 2, § 1(5) (emphasis added)). And, sure enough, the added language was culled from a United States Supreme Court case, *Fernandez v. Wiener*, 326 U.S. 340, 352-53 (1945)—albeit from its discussion of Congress’s power to enact excise taxes generally.

It is here, however, where the DOR’s reliance on federal law crumbles—for the United States Supreme Court in *Fernandez* and our own Supreme Court have both recognized that, unlike Washington’s estate tax, the federal estate tax does not require a “transfer” at all—even under its most expansive definition. “It is true that the estate tax as originally devised and constitutionally supported was a tax upon transfers. But the power of Congress to impose death taxes is not limited to taxation of transfers at death.” *Fernandez v. Wiener*, 326 U.S. 340, 352 (1945); *In re Heringer’s Estate*, 38 Wn.2d 399, 230 P.2d 297 (1951) (“The fact is, however, that ... the Federal estate tax is not a transfer tax.”); *see also* Bittker & Lokken, *Federal Taxation of Income, Estates and Gifts*,

¶ 120.1.2, at 120-6 (2d ed. 1993) (a transfer of property at death is a “sufficient condition—but *not* a necessary one—for a constitutional tax”).

Indeed, whereas the Washington Estate Tax applies only to the “transfer of property,” RCW 83.100.040(1), the Internal Revenue Code “imposes the estate tax on a single ‘transfer’—the ‘transfer of the taxable estate.’” *Estate of Armstrong v. Comm’r*, 119 T.C. 220, 229 (2002) (*quoting* 26 U.S.C. § 2001(a)). In other words, Congress may include items in the federal “taxable estate” without regard to “transfer”—for the federal tax is predicated on the statutorily defined “gross estate,” not an actual “transfer of property” upon death. *Id.* (“The taxable estate is defined generally as the gross estate less allowable deductions. ... This does not mean, however ... that each constituent element of the gross estate, so defined, necessarily constitutes, depends upon, or presupposes a separate and distinct ‘transfer’ of property.” (citations omitted)).

Section 2035(b), in particular, is an element of the federal gross estate by virtue of statutory definition, not because it “constitutes, depends upon, or presupposes” a transfer of property—as the federal taxing authorities recognize. *Armstrong*, 119 T.C. at 228; *see also* Chief Counsel Advisory 201020009, 2010 WL 2020507 (May 21, 2010) (“the applicability of § 2035(b) does not depend on a ‘transfer’”). The DOR claims that the Estate “fails to grasp the import” of these authorities, yet

concedes they expressly “rejected the notion” that Section 2035(b) depends upon a transfer. DOR’s Br. at 17-18. In the end, the DOR falls back on its go-to argument: “[r]egardless of whether federal gift tax paid under 26 U.S.C. § 2035(b) is considered a transfer, its incorporation in the federal taxable estate requires incorporation in the Washington taxable estate.” *Id.* However, RCW 81.100.040(1) and *Bracken* say otherwise.

For all the same reasons, there is no “property” either. The DOR conceded this point below, RP (3/20/15) at 17—for good reason. Property means “property included in the gross estate” as that term is “defined and used in section 2031 of the internal revenue code.” RCW 83.100.042(7), (11). Thus, only those components of the federal gross estate that consist of “property” count for purposes of the Washington Estate Tax—not the entire federal gross estate itself. This distinction matters because, liberated from the concept of “transfer,” the federal gross estate includes far more than just “property.” Federal gift taxes in particular are included in the federal gross estate—not because they are “property”—but simply because Congress mandated that the “the gross estate ... be *increased* by the *amount* of” gift taxes paid within three years of death. 26 U.S.C. § 2035(b). An “increase” in the “amount” of tax is not “property.”

Finding no support in federal law for the notion that Section 2035(b) reflects a transfer of property, the DOR argues that payment of

federal gift taxes on lifetime gifts falls within the Washington Estate Tax's amended definition of "transfer"—noting that there is no requirement for a "formal conveyance." DOR's Br. at 5 & 13. True enough, but to be a "transfer," there still must be a "shifting upon death" of an "economic benefit" or "legal privilege" related to property. RCW 81.100.020(14). In short, death must confer the decedent's spouse, heirs or beneficiaries some right to own, use or benefit from property. A surviving spouse might receive full control over his or her half of community property (*see, e.g., Fernandez*) or a remainder beneficiary might receive a present interest in QTIP assets (*see, e.g., Hambleton*)—but they must receive *something*.

Here, the Estate's beneficiaries got *nothing* upon Mr. Ackerley's death as a result of the federal taxes he paid on gifts made during the last three years of his life. Both Mr. Ackerley's lifetime gifts and the federal taxes paid on those gifts removed property from the Estate that otherwise would have passed to Mr. Ackerley's beneficiaries. The federal gift taxes were Mr. Ackerley's "debt" to the United States, which he paid. *Diedrich v. Comm'r*, 457 U.S. 191, 197 (1982). Mr. Ackerley's subsequent death did not "shift" the parties' rights or privileges with respect to those funds, RCW 81.100.020(14), or otherwise bring about any "changes in legal relationships affecting property," *Hambleton*, 181 Wn.2d at 832-33

(quoting *Chickering v. Comm'r*, 118 F.2d 254 (1st Cir. 1941))—for the funds no longer belonged to Mr. Ackerley or his Estate when he died.

Rather than explaining how one’s payment of federal gift taxes shifts an economic benefit in property to others upon one’s death—they don’t—the DOR argues that by “giving away property prior to death, Mr. Ackerley reduced the amount of his estate that would be subject to estate tax, thereby reducing the total tax bill and protecting more of his assets to be distributed to his beneficiaries.” DOR’s Br. at 16. But that is an argument why the value of the *gifts* themselves, not the *taxes* paid on those gifts, should be included in the taxable estate—for by that strained logic, all lifetime gifts (or, for that matter, any lifetime expenditure) “benefits” an estate by reducing its “total tax bill.” DOR’s Br. at 16. Of course, the value of Mr. Ackerley’s lifetime gifts was not included in the federal taxable estate, *see* U.S.C. § 2035(a), nor did the DOR claim they should be included in the Washington taxable estate either.

The fallacy of the DOR’s logic simply proves the point. Federal law, unlike Washington law, imposes a unified gift and estate tax—and, to reduce the tax incentive of “death bed” gifts (gifts made within three years of death), Congress enacted Section 2035(b)’s gross-up rule to adjust the federal gross estate upward in the amount of the gift tax paid to eliminate the tax advantages of such gifts. *Brown v. United States*, 329 F.3d 664,

667-68 (9th Cir. 2003). Section 2035(b) is a function of federal tax policy, not a “transfer of property.” Our state has no gift tax and, while the DOR may wish to increase revenue by treating the Washington gross estate as equivalent to the federal gross estate in all respects, it cannot do so: “the definition must be read to exclude items that are not transfers.” *Bracken*, 175 Wn.2d at 570-71. Unlike the QTIP interest at issue in *Hambleton*, the DOR has not, and cannot, identify a “transfer of property” here.

III. CONCLUSION

Congress included the amount of federal gift taxes paid during the last three years of life in the federal gross estate to further its unified gift and estate tax regime—not because that amount reflects a “transfer of property.” While the Washington Estate Tax can piggy-back on federal law up to a point, federal law cannot be applied if it would circumvent the Estate Tax’s operative and constitutionally required “transfer of property” provision. The DOR’s effort to assess Washington estate tax on federal gift taxes included in the federal gross estate under Section 2035(b) violates that tenet. The trial court’s judgment must be reversed.

RESPECTFULLY SUBMITTED this 23rd day of October, 2015.

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I hereby declare under the penalty of perjury of the laws of the State of Washington that on October 23, 2015, I caused a copy of the **Reply Brief** to be served in the manner indicated below to the following person at the following address:

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DATED: October 23, 2015

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