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NO. 65948-1-I

COURT OF APPEALS, DIVISION I
OF THE STATE OF WASHINGTON

In re the Matter of the:

ESTATE OF JESSIE CAMPBELL MACBRIDE,

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

Appellants,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

SECOND SUPPLEMENTAL BRIEF OF RESPONDENT

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I. INTRODUCTION

After the Supreme Court held in *Clemency v. State* (*In re Estate of Bracken*), 175 Wn.2d 549, 290 P.3d 99 (2012), that Washington's estate tax statutes were not intended to apply to qualified terminable interest property ("QTIP") passing under Internal Revenue Code § 2044, the Legislature responded rapidly. Because the Court's reading of the statutes would have eliminated over $160 million in estate tax revenue dedicated to education funding in the 2013-15 biennium, and would have allowed many large estates to escape taxation, the Legislature amended the relevant statutes to expressly provide that QTIP passing under section 2044 is subject to the Washington tax as to all estates of decedents dying on or after May 17, 2005. These amendments resolve this case, and should be upheld as a valid exercise of legislative power.

In this case, the estate of Thomas Macbride avoided over $1.25 million in Washington estate tax by creating a QTIP trust for his wife, Jessie. Jessie's estate now seeks to avoid paying Washington tax on the transfer of this property occurring at her death. The Department described the relevant facts and rebutted many of the Estate's arguments in prior briefing. This brief addresses only those arguments pertaining to the recent amendments to the Washington estate tax code (the "2013 Act"), which expressly provides that QTIP must be included in the taxable estate of the second spouse to die. As explained below, the Estate has not met its burden of proving beyond a reasonable doubt that the 2013 Act violates any constitutional provision. The Court should therefore uphold the 2013 Act.

II. ARGUMENT

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

To appreciate the constitutional arguments addressed below, it is helpful to understand of the federal estate tax, the Washington estate tax as amended by the 2013 Act, and how the 2013 amendments relate to the decision in *In re Estate of Bracken*, 175 Wn.2d 549, 290 P.3d 99 (2012).

1. Overview of the federal estate tax.

The federal estate tax is set out in subtitle B, chapter 11, of the Internal Revenue Code. The tax is "imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States." I.R.C. § 2001(a).[1] The term "transfer" is construed broadly and "extends to the creation, exercise, acquisition, or relinquishment of any power or legal privilege which is incident to the ownership of property." *Fernandez v. Wiener*, 326 U.S. 340, 352, 66 S. Ct. 178, 90 L. Ed. 116 (1945). Thus, a "transfer" for federal estate tax purposes is not limited to

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

a formal conveyance of property under state property law. Rather, Congress may include within the estate tax base property that was not formally conveyed on the death of the decedent. *Id.*

The federal estate tax is computed on the "taxable estate" of the decedent. I.R.C. § 2001(b). The taxable estate is equal to the "gross estate" of the decedent less allowable deductions. I.R.C. § 2051. Generally, property passing from a decedent to a surviving spouse is not subject to the estate tax because the property qualifies for a "marital deduction." The marital deduction is codified in Internal Revenue Code § 2056 and allows the estate of the first spouse to die to deduct "the value of any interest in property which passes or has passed from the decedent to his surviving spouse." I.R.C. § 2056(a).

The deduction is limited by Internal Revenue Code § 2056(b), which provides that "terminable interests" in property—such as a life estate or other interest that will lapse due to the passing of time or the occurrence or non-occurrence of an event—do not qualify for the marital deduction. Thus, if a deceased husband in his will left property to his wife with no retractions, that transfer would qualify for the marital deduction and the value of the property passing to his wife would not be subject to estate tax. But if the husband instead placed the property into a trust and directed that the wife receive only the income from the trust during her life (i.e., a life estate), the transfer would not qualify for the marital deduction and would be subject to estate tax.

In 1981 Congress created a special category of terminable interest property—so-called "qualified terminable interest property"—that would qualify for the marital deduction. *See In re Estate of Bracken*, 175 Wn.2d at 577 n.4 (Madsen, C.J., concurring/dissenting) (quoting Boris I. Bittker & Lawrence Lokken, *Federal Taxation of Income, States and Gifts*, 1997 WL 440177 at *17). Thus, Congress created an "exception-to-the-exception" that permitted certain terminable interest property to pass untaxed to the surviving spouse. In this way, the estate of the first spouse to die can bequeath a life estate to the surviving spouse, specify who will receive the property when the surviving spouse dies, and still have the transfer qualify for the marital deduction.

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

2. Overview of the Washington estate tax as amended by the 2013 Act.

The Washington estate tax was enacted in 1981 as a result of Initiative No. 402. Laws of 1981, 2d Ex. Sess., ch. 7. Prior to that, Washington imposed an inheritance tax. Laws of 1901, ch. 55. The Washington estate tax, as enacted in 1981, imposed a tax equal to the state death tax credit allowed under I.R.C. § 2011. State estate taxes of this nature are commonly referred to as "pick-up" taxes. The Washington pick-up estate tax was "complementary with and not independent of the federal estate tax scheme" because the amount of the state tax imposed on the estate was equal to the amount of the federal tax credit that the estate was permitted to claim. *See Estate of Turner v. Dep't of Revenue*, 106 Wn.2d 649, 653, 724 P.2d 1013 (1986).

In June 2001, Congress enacted the Economic Growth and Tax Relief Reconciliation Act of 2001. Pub. L. No. 107-16, 115 Stat. 73 (2001). That act reduced the amount of the state death tax credit by 25% each year beginning in 2002, resulting in the total elimination of the credit by 2005. This reduction and eventual elimination of the state death tax credit had a serious impact on states like Washington that employed a pick-up tax. *See Estate of Hemphill v. Dep't of Revenue*, 153 Wn.2d 544, 548, 105 P.3d 391 (2005) (the Economic Growth and Tax Relief Reconciliation Act of 2001 "essentially ends the estate tax revenue sharing between the federal government and states."). To keep the Washington tax viable, the Legislature needed to establish a "stand-alone" tax that was not dependent on the federal death tax credit mechanism. *Id.* at 551. The Legislature accomplished this in 2005 when it amended the estate tax to change from a pick-up tax to a stand-alone tax. *See* Laws of 2005, ch. 516.

The stand-alone estate tax is imposed "on every transfer of property located in Washington." RCW 83.100.040(1) (2012). "Property" is defined as "property included in the gross estate." RCW 83.100.020(8) (2012). "Gross estate" is defined as "'gross estate' as defined and used in section 2031 of the Internal Revenue Code." RCW 83.100.020(5) (2012). Thus, while the 2005 Act established a stand-alone estate tax, the tax was still tied to a large extent to the federal estate tax code. *See In re Estate of Bracken*, 175 Wn.2d at 581 (Madsen, C.J., concurring/dissenting).

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

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

3. ***Bracken*** **is no longer controlling authority.**

Prior to the 2013 amendment to the Washington estate tax, our Supreme Court held that the Legislature did not intend to include QTIP in the Washington estate tax computation when it amended the tax in 2005 to change from a pick-up tax to a stand-alone tax. *In re Estate of Bracken*, 175 Wn.2d at 570-71. As part of its analysis, the Supreme Court reasoned that the "real" transfer of QTIP occurs when the first spouse dies and his or her estate elects to claim the QTIP deduction under Internal Revenue Code § 2056(b)(7). *Bracken*, 175 Wn.2d at 572-74. The Court considered the transfer occurring at the death of the second spouse, when the spouse's life estate is extinguished and the property passes to the remainder beneficiaries under Internal Revenue Code § 2044, as merely a "deemed" or "fictional" transfer created by Congress. *Id.* The Court then held that the Legislature intended to tax only real transfers when it amended the Washington estate tax in 2005. *Id.* at 574.

Although constitutional considerations informed the Court's reasoning, ultimately it rested its holding solely on statutory construction grounds. *See, e.g., id.* at 571. The Court expressly declined to address the constitutional arguments made by the estates. *Id.* at 563, 575. Thus, the *Bracken* decision did not establish a constitutional barrier prohibiting the Legislature from imposing the Washington tax on QTIP passing under Internal Revenue Code § 2044. Instead, the Court ruled as a matter of statutory interpretation that the federal definition of "taxable estate," which includes the value of QTIP passing when the second spouse dies, "cannot be used without a modification necessary to conform to the [2005] Act: the definition must be read to exclude items that are not transfers." *Id.*

The *Bracken* decision caused great concern in the legislature because of its impact on education funding and its creation of a means for married couples with large estates to avoid Washington estate tax. Taxes collected from the Washington estate tax are deposited into the Education Legacy Trust Account and are used to support K-12 public schools and institutions of higher education. *See* RCW 83.100.220,.230. The fiscal impact of *Bracken* was estimated to be a loss of approximately $160.3 million in the 2013-2015 biennium alone. *See* Fiscal Note for EHB 2075.

On June 13, 2013, the Legislature addressed the fiscal and tax policy issues raised by *Bracken* by amending the Washington estate tax to make clear that the tax *does* apply to QTIP passing at the death of the second spouse. Laws of 2013, 2d Spec. Sess., ch. 2. The Legislature made three significant amendments relevant to this appeal.

First, it amended the definition of "transfer" to make clear that Washington's tax was not limited to "real" transfers recognized under state property law. Laws of 2013, 2d Spec. Sess., ch. 2, § 2 (amending and renumbering former RCW 83.100.020(11)). Instead, a "transfer" "includes any shifting upon death of the economic benefit in property." *Id.* That definition—and the "shifting of economic benefit" concept it incorporates—is consistent with the constitutional limits imposed on estate and inheritance taxes. *See In re McGrath's Estate*, 191 Wash. 496, 504, 71 P.2d 395 (1937) (state may tax as a transfer the "shifting of economic benefit" in property occurring at death).

Second, the Legislature amended the definition of "Washington taxable estate" to expressly include QTIP in the tax base. Laws of 2013, 2d Spec. Sess., ch. 2, § 2. Thus, the Washington taxable estate of a resident decedent includes "the value of any property included in the gross estate under section 2044 of the internal revenue code." *Id.* as § 2(14).

Finally, the Legislature amended RCW 83.100.047 to repudiate administrative rules issued in 2006 that inadvertently permitted a deduction of QTIP passing under Internal Revenue Code § 2044 by the estate of the second spouse to die. *Id.* at § 5.[2] As amended, RCW 83.100.047 permits a deduction for QTIP passing at the death of the second spouse under Internal Revenue Code § 2044 *only* when the estate of the first spouse to die made a separate Washington QTIP election. *See id.* (creating new subsection 83.100.047(3)(b) to permit the second spouse to die to deduct federal QTIP and add the amount of the Washington QTIP if the estate of the first spouse to die made a Washington QTIP election). Because Jessie Macbride's predeceased husband did not make a separate Washington QTIP election, the deduction authorized by RCW 83.100.047(3)(b) does not apply here.

The Legislature made these relevant provisions of the 2013 Act retroactive to "all estates of decedents dying on or after May 17, 2005." *Id.* at § 9. These key amendments closed the QTIP loophole by defining "transfer" and "Washington taxable estate" to expressly include QTIP passing under Internal Revenue Code § 2044 in the Washington taxable estate and to permit a deduction only when the estate of the first spouse to die makes a separate Washington QTIP election.

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[2] The Department's 2006 estate tax rules were poorly drafted and, as interpreted in *Bracken*, allowed a deduction for QTIP passing under Internal Revenue Code § 2044 even when no separate Washington QTIP election was made. *Bracken*, 175 Wn.2d at 571 n.5 (discussing former WAC 458-57-105(3)(q) and -115(2)(d)). The Department amended the rules in 2009 to correct the error. Wash. St. Reg. 09-04-008 (effective February 22, 2009).

As explained more fully below, the 2013 Act's changes to the Washington estate tax code are constitutional and controlling. *See Washington State Farm Bureau Fed'n v. Gregoire*, 162 Wn.2d 284, 304, 174 P.3d 1142 (2007) (the legislature may pass a law that directly impacts a case pending in Washington courts); *Haberman v. Wash. Pub. Power Supply Sys.*, 109 Wn.2d 107, 143-44, 744 P.2d 254, 750 P.2d 254 (1987) (same). Under the plain language of the amended estate tax code, the Estate cannot deduct QTIP from its taxable estate and is not entitled to a refund of the Washington estate tax it paid on the value of QTIP passing at Ms. Macbride's death. Accordingly, the Estate is not entitled to the estate tax refund it is seeking.

B. Taxing QTIP Passing Under Internal Revenue Code § 2044 Is Constitutional.

The Supreme Court in *Bracken* expressly declined to address the estates' constitutional arguments. However, part of the Court's reasoning was clearly based on constitutional limits that apply to "direct taxes" but not estate or excise taxes. *Bracken*, 175 Wn.2d at 564-66 (discussing limits imposed on the taxing authority of Congress under U.S. Const. art. I, § 9, cl. 4 and concluding that "[i]f estate taxation cannot be tied to a transfer, it fails as an un-apportioned (and therefore unconstitutional) direct tax").[3] Thus, this Court may wish to satisfy itself that taxing QTIP passing under Internal Revenue Code § 2044 does not violate any constitutional limitations. For the reasons discussed below, this inquiry need not distract the Court for long. Congress and the States have broad power to determine by statute when a transfer subject to an un-apportioned estate tax occurs. Taxing QTIP passing under Internal Revenue Code § 2044 does not exceed this broad constitutional authority.

It is well-established that "Congress has a wide latitude in the selection of objects of taxation" and may include within the federal estate tax base property that was not formally conveyed upon the death of the decedent. *Wiener*, 326 U.S. at 352. Formal distinctions pertaining to the law of real property are "irrelevant criteria in this field of [estate] taxation." *Helvering v. Hallock*, 309 U.S. 106, 111, 60 S. Ct. 444, 84 L. Ed. 604 (1940). Ownership of the property by the decedent is not constitutionally required so long as the decedent had some economic interest in the property that passes at death.

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[3] Article I, §section 9 of the United States Constitution imposes specific limits on the power of Congress and provides in relevant part that Congress may not impose a "capitation, or other direct, tax . . . unless in proportion to the census or enumeration hereinbefore directed to be taken." It has long been held that the federal estate tax is not a "direct tax" within the meaning of Article I, section 9 because the tax applies to the transfer of property at death, not to the property itself. *Knowlton v. Moore*, 178 U.S. 41, 20 S. Ct. 747, 44 L. Ed. 969 (1900).

The constitutional authority to impose an estate tax on the transfer of property that the decedent did not own was expressly recognized in *Fernandez v. Wiener*. That case involved a 1942 amendment to the federal estate tax whereby the value of community property, including the surviving spouse's community interest, was included in the gross estate of the first spouse to die. *Wiener*, 326 U.S. at 342. The heirs of a Louisiana resident decedent challenged the 1942 amendment, arguing that inclusion of the surviving wife's community property interest in the gross estate of the deceased husband imposed an unconstitutional "direct tax" and also violated the Due Process Clause. *Id.* at 342-43. According to the heirs, the 1942 amendment that taxed "the entire value of the community property on the death of either spouse is a denial of due process because the death of neither operates to transfer, relinquish or enlarge any legal or economic interest in the property of the other spouse." *Id.* at 346.

In rejecting the heirs' constitutional claims, the Court held that Congress has broad authority to define the taxable event upon which the estate tax is imposed and to determine by statute what property interests shall be included in the taxable estate of a decedent. *Id.* at 352-54. Relying on earlier precedent, the Court explained that an indirect estate tax may be imposed on the "shift in economic interest" in property that is brought about by death. *Id.* at 354 (citing *Whitney v. State Tax Comm'n*, 309 U.S. 530, 60 S. Ct. 635, 84 L. Ed. 909 (1940)). So long as there is a transfer of some interest in property occasioned by death, Congress may impose an un-apportioned, indirect, estate tax on the full value of the property passing at death. Accordingly, Congress had the authority to include in the tax base of the first spouse to die the value of the surviving spouse's community property.

The Court also rejected the heirs' due process arguments, explaining that the "cessation" of the deceased husband's powers over property "which he never 'owned', and the establishment in the wife of new powers of control over her share [of the community property], though it was always hers, furnishes appropriate occasions for the imposition of an excise tax." *Id.* at 355. In addition, the fact that the surviving wife's community property interest was created and vested prior to the enactment of the 1942 amendment did not offend due process. *Id.* In short, including the full value of the surviving spouse's share of community property in the gross estate of the first spouse to die infringed upon no constitutional provision. *Id.* at 362.[4]

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[4] A few years after *Wiener* was decided, Congress again amended the federal estate tax, striking the provision at issue in *Wiener* and enacting the marital deduction in an effort to "equalize" the disparate estate tax treatment of spouses residing in community property states and those residing in common law property states. *See United States v. Stapf*, 375 U.S. 118, 128, 84 S. Ct. 248, 11 L. Ed. 2d 195 (1963).

The authority to tax as a "transfer" the passing of any economic interest in property extends to the States. As explained in *Whitney v. State Tax Comm'n*, 309 U.S. 530, 60 S. Ct. 635, 84 L. Ed. 909 (1940), state estate taxes are "not confined" to only the passing of property "'owned' by a decedent before death, nor even to that over which he had an unrestricted power of testamentary disposition." *Id.* at 538. Rather, "[i]t is enough that one person acquires economic interest in property through the death of another person, even though such acquisition is in part the automatic consequence of death . . . ." *Id.* The Court in *Whitney* also explained that "[a] person may by his death bring into being greater interests in property than he himself has ever enjoyed," and the state having power to impose an estate or inheritance tax may include the full value of the property in the measure of the tax. *Whitney*, 309 U.S. at 539-40.

Since *Helvering v. Hallock* and *Whitney v. State Tax Commission* were decided in 1940, the U.S. Supreme Court has consistently upheld the power of Congress and state legislatures to direct by statute what property will be included in the taxable estate of a decedent. *See, e.g.*, *West v. Oklahoma Tax Comm'n*, 334 U.S. 717, 68 S. Ct. 1223, 92 L. Ed. 1676 (1948); *Commissioner v. Church's Estate*, 335 U.S. 632, 69 S. Ct. 322, 93 L. Ed. 288 (1949); *United States v. Manufacturers National Bank of Detroit*, 363 U.S. 194, 198-200, 80 S. Ct. 1103, 4 L. Ed. 2d 1158 (1960) .

These cases all recognize that a "transfer" in the constitutional sense is a broad and flexible concept, and an estate tax will withstand constitutional scrutiny "if there was a transfer of economic benefit, use, enjoyment or control [of property] at death." 1 Jacob Mertens, *The Law of Federal Gift and Estate Taxation*, § 1.04 at 9-10 (1959) (footnote omitted).[5] It is thus well settled that an estate tax is not constitutionally restricted to the passing of particular items of property from the decedent to the transferee. Instead, Courts have narrowed the inquiry to two factors: Whether the decedent had an interest in property at death, and whether the decedent's death was "the generating source of definite accessions to the survivor's property rights." *Id.* at 11. "No formal transfer of title from the decedent to the transferee is required; a mere shifting of the economic benefits of the property may be the real subject of the tax." *Id.* at 10; *see also* 42 Am. Jur. 2d *Inheritance, Estate, and Gift Taxes* § 1 (2013) (the taxable incident of "death taxes" is the "shifting of the enjoyment of property, the economic benefits thereof or economic interests therein").

The passing of QTIP under Internal Revenue Code § 2044 qualifies as a "transfer" in the constitutional sense. A QTIP trust creates a life estate for the benefit of the surviving spouse and a future interest in the assets for the remainder beneficiaries. When the second spouse dies,

[5] A copy of the relevant portions of the Mertens treatise has been provided as Appendix C of the Brief of Respondent filed March 3, 2011.

the life estate is extinguished and the remainder beneficiaries receive a present interest in the property. It is the death of the second spouse that causes the remainder beneficiaries' interest in the QTIP to transform from a future interest to a present interest. Moreover, it is well-established that the right to receive trust income is a valuable property interest that passes to the reminder beneficiaries at death of the income beneficiary. *Church's Estate*, 335 U.S. at 644-45. Consistent with the U.S. Supreme Court's holdings in *Helvering v. Hallock*, *Whitney v. State Tax Commission*, and *Fernandez v. Wiener*, Congress and the States are permitted to treat the shift in the economic benefit of QTIP occurring at the death of the second spouse as a "transfer" subject to estate tax. Congress has expressly exercised that power by enacting Internal Revenue Code § 2044.

The federal estate tax code includes several provisions designed to ensure that QTIP is subject to estate tax when the second spouse dies. *See* I.R.C. § 2056(b)(7)(A)(i) (QTIP is treated as passing to the surviving spouse when the first spouse dies); I.R.C. § 2044(b)(1)(A) (QTIP passing to the surviving spouse is included in that spouse's gross estate when he or she dies); I.R.C. § 2044(c) (QTIP is treated as passing from the surviving spouse when he or she dies). Under these provisions, the Code treats the entire value of the QTIP as passing from the surviving spouse to the remainder beneficiaries even though the surviving spouse held only an income interest in the property. *Estate of Morgens v. Commissioner*, 678 F.3d 769, 771 (9th Cir. 2012). Because QTIP is treated as passing from the surviving spouse, federal estate tax is not owed on the value of QTIP until the surviving spouse dies.

The same treatment applies under the Washington estate tax code as amended by the 2013 Act. The Legislature incorporated the federal definition of "taxable estate" into the Washington tax. Laws of 2013, 2d Spec. Sess., ch. 2, § 2. The federal taxable estate of the second spouse to die includes the value of QTIP passing under Internal Revenue Code § 2044. Thus, the term "federal taxable estate," as defined in the Washington estate tax code, includes QTIP passing when the second spouse dies. The QTIP is also included in the decedent's Washington taxable estate. *See id.* (amending and renumbering former RCW 83.100.020(13)). Moreover, the Legislature amended the statutory definition of "transfer" to expressly incorporate the same broad and flexible concept of that term as is employed under the federal tax code. *Id.* (amending and renumbering former RCW 83.100.020(11)).

"It is a fundamental principle of our system of government that the legislature has plenary power to enact laws, except as limited by our state and federal constitutions." *Washington State Farm Bureau*, 162 Wn.2d at 290. Accordingly, "[t]he legislature has broad plenary powers in its capacity to levy taxes." *Japan Line, Ltd. v. McCaffree*, 88 Wn.2d 93, 96, 558 P.2d 211 (1977). The Legislature may exercise its power to levy an estate tax by incorporating definitions and concepts included in the federal estate tax code. And that authority is not limited by artificial distinctions between "real" and "deemed" transfers. Instead, the shift in economic benefit of the QTIP resulting from the death of the second spouse satisfies the requirement of a "transfer" in the constitutional sense. *Wiener,* 326 U.S. at 352; *In re McGrath's Estate*, 191 Wash. at 504; *see also Prestidge v. Dep't of Revenue*, 2012 WL 4069231 at *6 (Or. T.C. Magistrate Div. 2012) (Oregon tax on QTIP was constitutional).

C. The 2013 Act Was A Valid Exercise Of Legislative Authority.

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

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

1. The 2013 Act complies with substantive due process.

Retroactive tax legislation enacted by a state is occasionally challenged under the Due Process Clause of the Fourteenth Amendment to the United States Constitution, which provides that no state shall "deprive any person of life, liberty, or property, without due process of law." U.S. Const. amend. XIV, § 1. The Due Process Clause protects private persons from arbitrary and irrational legislation. *United States v. Carlton*, 512

U.S. 26, 30, 114 S. Ct. 2018, 129 L. Ed. 2d 22 (1994).[6] However, the United States Supreme Court has repeatedly upheld retroactive tax legislation against due process challenges. *Id.* As explained in *Carlton*:

> The retroactive aspects of legislation, as well as the prospective aspect, must meet the test of due process, and the justification for the latter may not suffice for the former. . . . But that burden is met simply by showing that the retroactive application of the legislation is itself justified by a rational legislative purpose.

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

a. The 2013 Act meets the rational basis standard applied in *Carlton* and *W.R. Grace*.

Under *Carlton*, courts uphold the retroactive application of tax legislation if it serves a legitimate legislative purpose furthered by rational means. 512 U.S. at 30-31. The rational basis standard applied in *Carlton* is a deferential standard, and once it is met "judgments about the wisdom of [the subject] legislation remain within the exclusive province of the legislative and executive branches." *Id.* at 31. As pointed out in *Carlton*, the United States Supreme Court has only rarely invalidated retroactive tax legislation on due process grounds, and it has not done so since the

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

1920s. *See Nichols v. Coolidge*, 274 U.S. 531, 47 S. Ct. 710, 71 L. Ed. 1184 (1927); *Blodgett v. Holden*, 275 U.S. 142, 48 S. Ct. 105, 72 L. Ed. 206 (1928); *Untermyer v. Anderson*, 276 U.S. 440, 48 S. Ct. 353, 72 L. Ed. 645 (1928). While these *Lochner*-era cases have not been expressly overruled, they are applicable only to situations involving the creation of a wholly new tax. *Carlton*, 512 U.S. at 34. When the issue is the constitutionality of amendments to *existing* tax laws, as in this case, "their authority is of limited value." *Id. See also Japan Line*, 88 Wn. 2d at 96-98 (rejecting claim that the leasehold excise tax imposed on the private use of public property was "novel").

Washington courts apply the same rational basis standard, as demonstrated in *W.R. Grace & Co. v. Dep't of Revenue*, 137 Wn.2d 580, 602-03, 973 P.2d 1011 (1999). In that case, the Legislature had enacted a retroactive system of B&O tax credits in 1987 to replace the prior tax exemption mechanism the United States Supreme Court had invalidated on constitutional grounds. *See Tyler Pipe Indus., Inc. v. Dep't of Revenue*, 483 U.S. 232, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987). A group of corporate taxpayers challenged the legislations retroactivity, seeking refunds of taxes paid as early as January 1980, almost eight years prior to the challenged amendment. *W.R. Grace*, 137 Wn.2d at 588-89. They argued that retroactive application of the 1987 amendment violated substantive due process because it "reach[ed] back too far in time." *Id.* at 600.

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

The 2013 amendment to the Washington estate tax code meets the rational basis standard applied in *Carlton* and *W.R. Grace*. First and foremost, the 2013 Act served a legitimate purpose. The Legislature sought to avoid an unexpected loss of revenue to public school funding brought about by *Bracken*. Preventing unanticipated revenue losses is a legitimate legislative purpose. *Carlton*, 512 U.S. at 32; *see also Montana Rail Link, Inc. v. United States*, 76 F.3d 991, 994 (9th Cir. 1996) (same). As the Michigan Court of Appeals recently explained, "[a] legislature's action to mend a leak in the public treasury or tax revenue—whether created by poor drafting of legislation in the first instance or by a judicial decision—with retroactive legislation has almost universally been recognized as 'rationally related to a legitimate legislative purpose.'"

General Motors Corp. v. Dep't of Treasury, 803 N.W.2d 698, 710 (Mich. Ct. App. 2010) (quoting *Carlton*, 512 U.S. at 35).

In addition, the Legislature employed rational means to "mend the leak." The Legislature enacted the retroactive fix during the 2013 legislative session, which was the first opportunity to address the issue after the *Bracken* decision was issued in October 2012. In addition, the 2013 Act did not create a wholly new tax that the Estate and others could not have anticipated. Instead, the Legislature amended the statutory definitions of "transfer" and "Washington taxable estate" to make the Washington estate tax treatment of QTIP consistent with the federal treatment. Finally, the Legislature limited the retroactive reach of the Act to May 17, 2005, which was the effective date of the stand-alone tax.

As noted, section 2 of the 2013 Act has a retroactive reach of only eight years, to May 17, 2005. Courts throughout the United States have approved the retroactive application of tax statutes for similar and much longer periods. *See W.R. Grace*, 137 Wn.2d at 586-87 (more than seven years); *Montana Rail Link*, 76 F.3d at 993-95 (seven years); *Maples v. McDonald*, 668 So.2d 790, 792-93 (Ala. Civ. App. 1995) (more than eight years); *Enterprise Leasing Co. v. Arizona Dep't of Revenue*, 211 P.3d 1, 5 (Ariz. Ct. App. 2008) (six years); *Miller v. Johnson Controls, Inc.*, 296 S.W.3d 392, 400-01 (Ky. 2009) (nine years); *King v. Campbell Cnty.*, 217

S.W.3d 862, 866-67 (Ky. Ct. App. 2006) (nineteen years); *General Motors*, 803 N.W.2d at 710 (five years); *Moran Towing Corp. v. Urback*, 768 N.Y.S.2d 33, 1 A.D.3d 722 (2003) (thirteen years); *Atlantic Richfield Co. v. Oregon Dep't of Revenue*, 14 Or. Tax 212 (Or. Tax Ct. 1997) (eight years). Similarly, the United States Supreme Court has upheld economic legislation requiring an employer to pay workers' compensation benefits that had a six-year retroactive reach. *General Motors Corp. v. Romein*, 503 U.S. 181, 191-92, 112 S. Ct. 1105, 117 L. Ed. 2d 328 (1992). Thus, even if the Due Process Clause imposes a limit on the retroactive reach of tax legislation, the eight-year retroactive reach of the 2013 Act would not cross that line.[7]

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

[7] A shorter period of retroactivity would have been irrational because it would have permitted some estates, but not others, to benefit from the QTIP loophole created by the *Bracken* decision. *See Montana Rail Link*, 76 F.3d at 994 (seven-year retroactive period was rational and a shorter period "would have been arbitrary and irrational" under the circumstances).

b. The Estate's reliance on *Tesoro Refining and Marketing Co. v. Department of Revenue* and *State v. Pacific Telephone and Telegraph Co.* is misplaced.

The Estate misstates the holding in *Carlton* and completely ignores *W.R. Grace*. *See* Estate's 2d Supp. Br. at 30-31. Instead, the Estate relies on *Tesoro Refining and Marketing Co. v. Department of Revenue*, 159 Wn. App. 104, 246 P.3d 211, *rev'd on statutory grounds*, 173 Wn.2d 251 (2010), and *State v. Pacific Telephone and Telegraph Co.*, 9 Wn.2d 11, 113 P.2d 542 (1941). Neither case helps the Estate.

In *Tesoro*, the Court of Appeals held that Tesoro Refining and Marketing was entitled to deduct the amount of its offshore bunker fuel sales from the gross income it received from manufacturing petroleum fuel. *Tesoro*, 159 Wn. App. at 116. *See also Tesoro Ref. & Mktg. Co. v. Dep't of Revenue*, 173 Wn.2d 551, 553, 269 P.3d 1013 (2012) (summarizing the Court of Appeals holding). According to the Court of Appeals, the deduction was permitted under the plain language of former RCW 82.04.433. The Court of Appeals also agreed with Tesoro that "enforcement" of a retroactive amendment to the deduction statute enacted in 2009 in direct response to Tesoro's refund request "would violate due process." *Id.* a 120. While the Court of Appeals recognized that "identifying and correcting significant fiscal losses is a legitimate legislative purpose" under *Carlton*, it nonetheless concluded that "it is not reasonable for the legislature to enact a retroactive amendment spanning 24 years in direct response to a taxpayer's refund lawsuit." *Id.* at 119.

The Supreme Court reversed, holding that the deduction as initially enacted did not apply to Tesoro's manufacturing activities but, instead, was limited to wholesale and retail selling activities. 173 Wn.2d at 557-58. Because Tesoro could not take the deduction under the statute as it read prior to the 2009 amendment, the Supreme Court declined to reach the due process issue. *Id.* at 559.

The Court of Appeal's holding in *Tesoro* was reversed by the Supreme Court. 173 Wn.2d at 559 ("We reverse the Court of Appeals and affirm the . . . Superior Court's grant of summary judgment" to the Department). As a result, the Court of Appeal's due process analysis is not meaningful because the Court erred in even addressing the constitutional issue in the first instance. Moreover, the Court of Appeals in *Tesoro* never cited or discussed *W.R. Grace*, the controlling Washington case on the due process limits to retroactive tax legislation. Because *W.R. Grace* is the controlling authority, the Estate's reliance on *Tesoro* is misplaced.

The Estate's reliance on *Pacific Telephone* is also misplaced. That case was decided in 1941, well before the United State Supreme Court's decision in *Carlton* or the Washington Supreme Court's decision in *W.R. Grace*. In fact, the taxpayers challenging the retroactive amendment at issue in *W.R. Grace* had cited *Pacific Telephone* as support for their assertion that the retroactive amendment "reaches back too far in time." *W.R. Grace*, 137 Wn.2d at 600. As discussed above, the Court rejected the argument, holding that the Due Process Clause as construed in *Carlton* did not establish a "specific duration to the retroactive effect of tax legislation." *Id.* at 603. Thus, the Court implicitly overruled *Pacific Telephone* to the extent that the 1941 case applied a less deferential constitutional standard for upholding retroactive tax legislation.

The 2013 Act meets the deferential due process standard set out in *Carlton* and *W.R. Grace*. The Estate's claim to the contrary is incorrect as a matter of law.

c. The 2013 Act does not apply to transfers occurring before May 17, 2005.

There is also no merit to the Estate's argument that retroactive application of the 2013 Act "falls well outside" due process limits because, according to the estate, the Washington tax reaches back "decades" to "capture property transferred and vested long before the Stand Alone Tax even existed." Estate's 2d Supp. Br. at 30-31. Contrary to the Estate's hyperbole, the stand-alone estate tax as amended by the 2013

Act applies only to decedents dying on or after May 17, 2005, and only to transfers that occur on or after that date. *See* Laws of 2013, 2d Spec. Sess., ch. 2, § 9.

The Estate's retroactivity argument is built on the false premise that the taxable "transfer" of the QTIP occurred when the first spouse died and the QTIP was transferred into the QTIP trust. Estate's 2d Supp. Br. at 31; *see also* Br. of App. at 39. The Estate is simply incorrect. Under the Washington estate tax codes as amended by the 2013 Act, the transfer subject to tax occurred when Jessie Macbride died in 2007.

Moreover, it is well established that an estate tax "does not operate retroactively merely because some of the facts or conditions upon which its application depends came into being prior to the enactment of the tax." *United States v. Mfrs Nat'l Bank of Detroit*, 363 U.S. 194, 200, 80 S. Ct. 1103, 4 L. Ed. 2d 1158 (1960) (quoting *United States v. Jacobs*, 306 U.S. 363, 367, 59 S. Ct. 551, 83 L. Ed. 763 (1939)). In the present case, the life estate Jessie Macbride held in the QTIP was extinguished when she died in 2007 and the interest the remainder beneficiaries held in the property was converted from a future interest to a present interest. Ms. Macbride's death was the "crucial last step" that resulted in the income interest in the QTIP passing to the reminder beneficiaries. *Mfrs Nat'l Bank*, 363 U.S. at 198. That "crucial last step" occurred after May 17, 2005. Thus, the

Washington estate tax imposed on the QTIP passing at Ms. Macbride's death does not "reach back decades" or "fall outside" due process limits.

d. The 2013 Act does not deprive the remainder beneficiaries of any "vested right."

The Estate also argues that the 2013 Act "deprives" the remainder beneficiaries of "their vested right" to the QTIP passing at Ms. Macbride's death. Estate's 2d Supp. Br. at 26. The Estate is incorrect.

The Estate's "vested rights" argument was largely disposed of in *Carlton*, where the United States Supreme Court held that tax legislation is not a promise, and no taxpayer has a "vested right" in the continuation of a particular tax law. *Carlton*, 512 U.S. at 33; *see generally* 16A C.J.S. *Constitutional Law*, § 394 (2013) (in general, a taxpayer has no vested rights in a tax statute or in the continuance of a particular tax law). Consistent with the holding in *Carlton*, the retroactive amendment to the Washington estate tax code did not impact any "vested right" belonging to the remainder beneficiaries because the tax code as construed by the Supreme Court in *Bracken* was "not a promise."

In addition, the Estate makes no effort to explain what "vested right" the remainder beneficiaries held in the QTIP that was impacted by the 2013 Act. Presumably the remainder beneficiaries received the property that remained in the QTIP trust at the death of Jessie Macbride. There is no evidence in the record suggesting otherwise. And the legal nature of the beneficiaries' property rights was not impacted by the 2013 Act. Prior to Ms. Macbride's death the beneficiaries of the QTIP trust had a vested *remainder* interest in the assets of the trust. After Ms. Macbride died, the remainder beneficiaries held a vested *present* interest in the assets of the trust. The 2013 Act, and the Washington estate tax imposed under that Act, did not change in any way the nature of property rights held by the remainder beneficiaries, and it did not take any "vested right" from those beneficiaries.

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

In addition to being a rational means of achieving a legitimate legislative purpose, the 2013 Act satisfies separation of powers principles. The separation of powers doctrine is grounded in the notion that "each branch of government has its own appropriate sphere of activity" and seeks to ensure that "the fundamental functions of each branch remain inviolate." *Hale v. Wellpinit Sch. Dist. No. 49*, 165 Wn.2d 494, 504, 198 P.3d 1021 (2009). The Legislature's role is to set policy and to draft and enact laws, while the judiciary's role is to interpret the law. *Id.* at 505-06. Separation of powers issues arise when "'the activity of one branch threatens the independence or integrity or invades the prerogatives of another.'" *Id.* at 507 (quoting *Carrick v. Locke*, 125 Wn.2d 129, 135, 882 P.2d 173 (1994)).

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

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

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

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

In addition, it is of no constitutional significance that the Legislature amended a statute that had been previously construed by the Supreme Court. It is well established that the Legislature does not violate the separation of powers doctrine when it amends a previously construed statute. *Lummi Indian Nation v. State*, 170 Wn.2d 247, 262, 241 P.3d 1220 (2010); *Hale*, 165 Wn.2d at 509-10.[8] A statute does not become a

[8] Some Washington courts have stated that there is a distinction between legislation that attempts to "clarify" the meaning of a statute that has been previously construed by the courts and legislation that amends a previously construed statute. *See, e.g.*, *State v. Mann*, 146 Wn. App. 349, 358, 189 P.3d 843 (2008) (citing *Marine Power & Equip. Co. v. Human Rights Comm'n Hearing Tribunal*, 39 Wn. App. 609, 615 n.2, 694 P.2d 697 (1985)). However, the Supreme Court in *Hale* strongly suggested that this analysis is incorrect. *See Hale*, 165 Wn.2d at 508 ("The legislature has expressed its intent unequivocally" and the nature of the legislation, whether it was clarifying, restorative, curative, or remedial, is "unhelpful in analyzing the separation of powers issue"). In any event, the 2013 Act amended the Washington estate tax code to expressly provide that QTIP passing under section 2044 is subject to the Washington tax as to all estates of decedents dying on or after May 17, 2005. This was not a clarification of

"super law" once it is construed by the courts, and treating a statute that has been judicially construed as being constitutionally immune to retroactive amendment makes no logical sense. If the Legislature is careful not to attempt to "overrule" a final judgment, there is no reason why it cannot retroactively amend a statute to affirmatively change the law. To conclude otherwise would likely violate separation of powers because the judicial branch would be invading the sphere of authority of the legislative branch to make policy, pass laws, and to amend laws already in effect. *Lummi*, 170 Wn.2d at 262.

Finally, the Estate's claim that the 2013 Act "interferes" with a judicial function by "misapplying federal law" is without merit. *See* Estate's 2d Supp. Br. at 12-16. Separation of powers does not prohibit the legislative branch from defining terms or from incorporating terminology developed by the federal courts. More importantly, nothing in the 2013 Act "interferes" with the ability of the judicial branch to make reasoned conclusions as to the meaning of the term "transfer" under the federal estate tax code. What the 2013 Act does is to define the term "transfer" broadly to encompass more than just "real" transfers recognized under state property law or common law. The Washington estate tax as amended also applies to "deemed" or "fictional" transfers so long as there

existing law, and the 2013 Act would be consistent with separation of powers principles even under those Court of Appeals cases decided before *Hale*.

is a "transfer" of property in the constitutional sense. The Department believes that the weight of authority supports its assertion that Congress and the Legislature can constitutionally tax QTIP passing at the death of the second spouse. *See* discussion *supra* at pages 12-20. But the judiciary retains the ultimate responsibility to determine whether the passing of QTIP under Internal Revenue Code § 2044 is a "transfer" within established constitutional constraints, and nothing in the 2013 Act limits or "interferes" with that judicial function.

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

3. The 2013 Act does not violate the Impairment Clause.

The Estate's claim that the Washington estate tax violates the Impairment Clause is also unfounded. *See* Estate's 2d Supp. Br. at 31-35. Article I, section 10 of the United States Constitution provides in part that "No state shall . . . pass any . . . law impairing the obligation of contracts." The Washington constitution contains a similar prohibition. Const. art. I, § 23. These constitutional provisions are coextensive. *Tyrpak v. Daniels*, 124 Wn.2d 146, 151, 874 P.2d 1374 (1994).

The Impairment Clause—sometimes referred to as the "Contracts Clause"—"is applicable only if the legislative act complained of impairs a contractual relationship." *Haberman*, 109 Wn.2d at 145. The burden is on the plaintiff to prove beyond a reasonable doubt that (1) a contractual relationship existed, (2) the legislation at issue substantially impaired that contractual relationship, and (3) that any impairment was not reasonable and served no legitimate public purpose. *Pierce County v. State*, 159 Wn.2d 16, 28, 148 P.3d 1002 (2006).

Applying this test to the facts in this case, there is no constitutional violation. As to the first element, the Washington Supreme Court has held that a "contract" for purposes of the Impairment Clause must be a contract "in the usual sense" of that word, i.e., "an agreement of two or more minds, upon sufficient consideration, to do or not to do certain acts." *Caritas Servs., Inc. v. Dep't of Soc. & Health Servs.*, 123 Wn.2d 391, 403, 896 P.2d 28 (1994) (internal quotations and citation omitted). In the present case, the QTIP trust created when Mr. Macbride died was not part of any "agreement of two or more minds, upon sufficient consideration." Instead, the trust was created to accomplish a testamentary gift.

A gift is not a contract in the usual sense. *Oman v. Yates*, 70 Wn.2d 181, 185-86, 422 P.2d 489 (1967) ("owing to the absence of consideration, a gift inter vivos does not come within the legal definition of a contract") (quoting 24 Am. Jur., *Gifts* § 11 (1939)). It follows that a trust created to complete a testamentary gift is not a "contract in the usual sense." At a minimum, the Estate cannot dispute that the *beneficiaries* of the trust were not parties to any "contract" because the beneficiaries made no promise supported by consideration. Because the Impairment Clause applies to contracts, not gifts, the Estate fails the first element.

The Estate has also not established that the 2013 Act substantially impairs to a contractual relationship. An "impairment is substantial if the complaining party relied on the supplanted part of the contract." *Margola Assoc. v. Seattle*, 121 Wn.2d 625, 653, 854 P.2d 23 (1993). Moreover, "[a] contract is not considered impaired by a statute in force when the contract was made, as parties are presumed to enter into contracts in contemplation of existing law." *Shoreline Cmty. Coll. Dist. No. 7 v. Emp't Sec. Dep't*, 120 Wn.2d 394, 410, 842 P.2d 938 (1992). In this case, the estate tax treatment of QTIP under the stand-alone tax as amended by the 2013 Act is not materially different from the treatment under the former pick-up tax. Thus, it is reasonable to conclude that Thomas Macbride was aware that Washington estate tax would likely be owed on the QTIP when Jessie died. As a result, there is no substantial impairment even if a contract existed. *Margola*, 121 Wn.2d at 653 ("a party who enters into a contract regarding an activity already regulated in the particular to which he now objects is deemed to have contracted subject to further legislation upon the same topic").

Finally, the third prong is a balancing of interests and recognizes that substantial impairment may still be valid if the state has "a significant and legitimate public purpose behind the regulation." *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411, 103 S. Ct. 697, 74 L. Ed. 2d 569 (1983). Here, the balancing of interests weighs most heavily in favor of the 2013 Act and against its invalidation. Washington has had an estate or inheritance tax since 1901. Voters enacted the current estate tax in 1981. Laws of 1981, 2d Ex. Sess., ch. 7. It cannot come as a surprise that Washington estate tax will be owed by estates with sufficient assets to qualify for the tax. Moreover, the estate of Thomas Macbride saved over $1.2 million in Washington estate tax by electing the benefit of the QTIP deduction when it filed its federal and state estate tax returns.[9] Thus, even if application of the Washington tax to QTIP passing at the death of Jessie Macbride qualifies as an "impairment," it is a minimal impairment under *Margola Associates* and *Shoreline Community College*.

By contrast, the State's sovereign authority and responsibility to provide for the general welfare of its citizens through its taxing power is

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[9] See Brief of Respondent, Appendix A.

vitally important. The purpose of Washington's estate tax is to fund education. RCW 83.100.220, .230. Providing dependable tax sources to fund education is one of the most important functions of government. *See* Const. art. IX, § 1. When the justification for the tax (funding education) is balanced against the "impairment" the Estate is claiming, the Estate also fails the third prong of the three-part test.

4. The 2013 Act does not violate Article VII, § 1 of the Washington Constitution.

The Estate also argues that the 2013 Act violates article VII, § 1 of the Washington Constitution. Estate's 2d Supp. Br. at 35-38. The Estate is mistaken.

Article VII, section 1 provides in relevant part that "[a]ll taxes shall be uniform upon the same class of property within the territorial limits of the authority levying the tax and shall be levied and collected for public purposes only." It is well-established that this provision applies only to property taxes. *See, e.g.*, *Black v. State*, 67 Wn.2d 97, 100, 406 P.2d 761 (1965); *Cosro, Inc. v. Liquor Control Bd.*, 107 Wn.2d 754, 761, 733 P.2d 539 (1987). Estate taxes are not property taxes. Instead, an estate tax is a form of excise tax imposed on the transfer of property. *United States v. Wells Fargo Bank*, 485 U.S. 351, 355, 108 S. Ct. 1179, 99 L. Ed. 2d 368 (1988); *In re Lloyd's Estate*, 53 Wn.2d 196, 199-200, 332

P.2d 44 (1958); *see generally*, *Quarty v. United States*, 170 F.3d 961, 970-71 (9th Cir. 1999) (discussing numerous cases holding that the federal estate tax is not a "direct" tax on property, but an indirect tax on the transfer of property). Contrary to the Estate's argument, the transfer subject to an estate tax does not have to be voluntary, but may occur as a result of the decedent's death. *See, e.g.*, *West v. Oklahoma Tax Comm*, 334 U.S. at 727.

The Washington Supreme Court has described a property tax as a tax on ownership and involving "an absolute and unavoidable demand against property or the ownership of property." *Samis Land Co. v. City of Soap Lake*, 143 Wn.2d 798, 814, 23 P.3d 477 (2001) (quoting *Covell v. City of Seattle*, 127 Wn.2d 874, 890, 905 P.2d 324 (1995)). The estate tax as applied to QTIP passing under Internal Revenue Code § 2044 has none of the characteristics of a property tax. The tax is not imposed on mere ownership and does not involve "an absolute and unavoidable demand against property or the ownership of property." *Samis Land*, 143 Wn.2d at 814. Instead, the tax is imposed on the transfer of property occurring at the death of the second spouse when that spouse's life estate is extinguished and the property passes to the remainder beneficiaries.

Because the Washington estate tax is not a property tax, there is no merit to the Estate's assertion that the tax as amended by the 2013 Act is unconstitutional under article VII, section 1 of the state Constitution.

D. Equitable Estoppel Does Not Apply.

The Estate also argues that the Department should be estopped from arguing in this case that the 2013 Act is controlling. Estate's 2d Supp. Br. at 38-40. The Estate is incorrect.

When a party asserts equitable estoppel against the government, that party must present clear and cogent proof of (1) an admission, statement or act inconsistent with a claim later asserted; (2) reasonable reliance by the other party; (3) injury to the relying party; (4) that estoppel against the government is necessary to prevent a manifest injustice; and (5) that application of the doctrine will not impair a government function. *Dep't of Ecology v. Theodoratus*, 135 Wn.2d 582, 599, 957 P.2d 1241 (1998). "Equitable estoppel against the government is not favored," and "'[c]ourts should be most reluctant to find the government equitable estopped when public revenues are involved,'" as here. *Campbell v. Dep't of Soc. & Health Servs.*, 150 Wn.2d 881, 902, 903, 83 P.3d 999 (2004) (quoting *Kramarevcky v. Dep't of Soc. & Health Servs.*, 122 Wn.2d 738, 744, 863 P.2d 535 (1993)).

The Estate presents no cogent evidence to support its estoppel claim. Instead, the Estate argues that it would not have agreed to a stay of the appellate proceedings in this case had it known that *Bracken* would not be binding in this appeal. Estate's 2d Supp. Br. at 38. The Estate also argues that it was "prepared to transfer its case to the state Supreme Court" but was dissuaded by the Department's motion to stay the proceedings in this appeal. *Id.*[10] However, the record shows that the Estate *opposed* the Department's motion for stay. *See* Estate's Response to Motion to Stay filed January 18, 2011. And the Estate did not seek to have this case transferred to the Supreme Court even though this Court initially denied the Department's motion. *See* Order entered January 31, 2011 denying motion for stay of proceedings. Thus, the Estate's contention that it "agreed" to the stay as a result of a statement, admission, or action by the Department is not supported by the evidence in the record.

In addition, the Department did not state or imply in its motion for stay that the statute would not be retroactively amended by the Legislature. The Legislature has the ultimate responsibility for determining the tax policy of this state, and the Department had no authority to promise that the Legislature would not amend the law in a

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[10] The Department's motion for stay of proceedings asserted that the Supreme Court's decision in the *Bracken* appeal would "likely resolve this appeal and make any further proceedings moot." Motion to Stay Proceedings at 2.

manner that would impact this litigation. The Estate could not have reasonably relied on a statement that the Department never made and had no power to make.

Finally, applying the amended law to the facts of this case is not manifestly unjust. The estate of Thomas Macbride elected and accepted the benefit of the QTIP marital deduction when it filed its federal and Washington estate tax returns, saving over $1.25 million in Washington estate tax. *See* Brief of Respondent, Appendix A (worksheet showing that the estate of Thomas Macbride, by claiming the QTIP marital deduction, reduced its Washington estate tax liability by $1,272,842). Requiring the estate of Jessie Macbride to pay Washington estate tax measured by the remaining QTIP that passed to the remainder beneficiaries upon Jessie's death is not unjust. There is no constitutional reason, nor any sound policy justification, for excluding QTIP from the measure of the estate tax when the second spouse dies. And the Estate is not "justly" entitled to a refund of Washington estate tax imposed on QTIP passing under Internal Revenue Code § 2044 based on its conjecture that it could have had this appeal transferred to the Supreme Court in 2011 and could have enjoyed the short-lived QTIP exemption created by the *Bracken* decision.

The Estate has not met the necessary elements supporting its estoppel claim. As a result, the Court should reject the claim as a matter of law.

II. CONCLUSION

The decision in *Bracken* does not control this appeal as a result of retroactive legislation clearly providing that QTIP passing under Internal Revenue Code § 2044 is properly included in the Washington taxable estate of a Washington resident decedent. That legislation was a valid exercise of legislative authority and should be upheld. Under the Washington estate tax code as amended, the Estate is not entitled to deduct QTIP passing under Internal Revenue Code § 2044. Accordingly, the trial court's decision granting summary judgment to the Department should be affirmed.

RESPECTFULLY SUBMITTED this 6th day of November, 2013.

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

DATED this 6th day of November, 2013, at Tumwater, WA.

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