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NO. 70514-8

COURT OF APPEALS, DIVISION I
OF THE STATE OF WASHINGTON

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

Respondent,

v.

THE DEPARTMENT OF REVENUE OF THE STATE OF WASHINGTON,

Appellant.

APPELLANT'S REPLY BRIEF

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ORIGINAL

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I. INTRODUCTION

The Legislature responded rapidly 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. Because *Bracken* 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 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.

The estate of Elaine Green-Eldridge ("Estate") raises numerous arguments in an effort to obtain a refund of tax it paid on the value of QTIP passing at Ms. Green-Eldridge's death. All fail. As explained below and in the Department's opening brief, the Washington estate tax code as amended by the 2013 Act applies to the Estate, and the Estate has not met its burden of proving that the Act violates any constitutional provision. The Court should therefore uphold the 2013 Act and reject the Estate's refund claim.

II. ARGUMENT

A. *In Re Estate Of Bracken* Is Not Controlling Authority.

The Estate incorrectly argues that the holding in *Bracken* is controlling in this case and that the 2013 amendments to the Washington estate tax code were "ill-conceived" and expand the definition of "transfer" beyond what is constitutionally allowed. Br. of Resp. 10-12. While it is true that the Legislature amended the definition of a "transfer" to include QTIP passing at the death of the second spouse, that definition comports with constitutional constraints.

1. The 2013 Act changed the estate tax treatment of QTIP.

Prior to the 2013 amendment to the estate tax statutes, the Supreme Court in *Bracken* 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. *Bracken*, 175 Wn.2d at 570-71. Although constitutional considerations informed the Court's analysis, it rested its holding solely on statutory construction grounds. *Id.* at 571, 575.[1] Thus, *Bracken* did not establish a constitutional barrier prohibiting the Legislature from imposing estate tax on QTIP passing under Internal Revenue Code § 2044. Instead, the Court ruled that the federal statutory 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.* at 571.

[1] Part of the Court's reasoning for concluding that the Legislature did not intend to tax QTIP was 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"). But the Court stopped well short of holding that Congress had passed an illegal "direct" tax when it enacted section 2044 of the Internal Revenue Code or that the Legislature was powerless to tax QTIP.

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 *Bracken* raised 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 is 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.* at § 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 RCW 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 Ms. Green-Eldridge's predeceased spouse 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 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"

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[2] The Department's 2006 estate tax rules were poorly drafted and 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 WAC 458-115(2)(d)). The Department amended the rules in 2009 to correct the error. Wash. St. Reg. 09-04-008 (effective February 22, 2009).

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.

The 2013 Act changed the Washington estate tax code, and those changes apply to the Estate. *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 1032, 750 P.2d 254 (1987) (same). Under the plain language of the amended estate tax code, the Estate cannot exclude QTIP from its taxable estate and owes Washington tax on the value of QTIP passing at Ms. Green-Eldridge's death.

2. The amended definition of "transfer" is constitutional.

The Estate, relying on *Coolidge v. Long*, 282 U.S. 582, 51 S. Ct. 306, 75 L. Ed. 562 (1931), argues that the amended definition of "transfer" is unconstitutional because only the "present transfer" of property into a trust may be taxed. Resp. Br. at 12-17. *Coolidge* does not apply in this appeal, and the controlling law holds that Congress and the states have broad power to determine by statute when a transfer occurs. Taxing QTIP passing at the death of the second spouse falls within this broad power.

It is well-established that Congress has "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. *Fernandez v. Wiener*, 326 U.S. 340, 352, 66 S. Ct. 178, 90 L. Ed. 116 (1945). Formal distinctions based on 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). A decedent's ownership of the property is not constitutionally required so long as the decedent had an economic interest in the property that passes at death.

In *Wiener*, the United States Supreme Court expressly recognized the constitutional authority to impose an estate tax on the transfer of property that the decedent did not own or possess. 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 due process. *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 was "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 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 because the death of the first spouse, by ending the marital community, brings into being new powers and control over the surviving spouse's community property. *Id.* at 355-56.

The Court also rejected the heirs' due process arguments, holding 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, furnish 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 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.

This authority to tax as a "transfer" the passing of any economic interest in property extends to the states. As the Supreme Court explained in *Whitney*, state estate taxes are "not confined" to the passing of property "'owned' by a decedent before death, nor even to that over which he had an unrestricted power of testamentary disposition." *Whitney*, 309 U.S. at 538. Rather, "[i]t is enough that one person acquires economic interest in property through the death of another person . . . ." *Id.* The Court 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 may include the full value of the property in the measure of the tax. *Whitney*, 309 U.S. at 539-40.

Over the past seventy years 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. Mfrs. Nat'l 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).[3] It is thus well settled that an estate tax is not constitutionally

[3] Relevant portions of the Mertens treatise are attached as Appendix A.

restricted to the passing 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.

QTIP passing under Internal Revenue Code § 2044 is 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. 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. In the context of QTIP, when the second spouse dies and the life estate is extinguished, the remainder beneficiaries receive a present interest in the QTIP, including all the income generated by the property. Consistent with the Supreme Court cases cited above, 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. The Legislature has expressly exercised that power by passing the 2013 Act.

Washington law is consistent with the foregoing. For instance, in 1937, the Washington Supreme Court affirmed the Legislature's power to impose an inheritance on a "shifting of economic benefit" in property that occurs at death. *McGrath's Estate*, 191 Wash. at 504. Moreover, it is a fundamental principle of our system of government that the 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; *McGrath's Estate*, 191 Wash. at 504; *see also Prestidge v. Dep't of Reven*ue, 2012 WL 4069231 at *6 (Or. Tax 2012) (Oregon inheritance tax on QTIP was constitutional).

3. *Coolidge v. Long* does control over more recent U.S. Supreme Court authority and does not create a constitutional barrier to taxing QTIP that is placed into a trust.

To support its "no transfer" argument, the Estate relies on *Coolidge v. Long*, 282 U.S. 582, 51 S. Ct. 206, 75 L. Ed. 562 (1931). Resp. Br. at 12. According to the Estate, *Coolidge* is "dispositive" and stands for the proposition that the "only transfer" that may be taxed under the federal constitution is the transfer of property into a trust by the settlor. Resp. Br. at 12, 13. The Department respectfully disagrees. *Coolidge* has been limited by subsequent U.S. Supreme Court decisions and, to the extent its analysis is still valid, it does not apply here.

In *Coolidge*, a husband and wife created and funded an irrevocable trust in July 1907, about five weeks before Massachusetts enacted an inheritance tax that applied to property interests passing to lineal descendants. 282 U.S. at 593. The trust provided that the husband and wife would receive the income from the trust for their lives and that, upon the death of the last surviving spouse, the trust property would be distributed to their five sons. *Id.* at 593-94. The U.S. Supreme Court ruled that the imposition of the Massachusetts inheritance tax at the death of the last surviving spouse violated the contracts and due process clauses of the federal constitution because the state tax did not exist in July 1907 when the trust was funded and the rights of the remainder beneficiaries vested. *Id.* at 605-06.

Coolidge was decided during the *Lochner* era when the U.S. Supreme Court used the Due Process Clause to undue federal and state economic regulation that the Court deemed unwise or unnecessary. Substantive due process cases from the *Lochner* era are no longer considered authoritative. *Amunrud v. Bd. of Appeals*, 158 Wn.2d 208, 228, 143 P.3d 571 (2006). As explained in *United States v. Carlton*, 512 U.S. 26, 114 S. Ct. 2018, 129 L. Ed. 2d 22 (1994) *Coolidge* and similar due process cases from the *Lochner* era "were decided . . . under an approach that has long since been discarded." *Carlton*, 512 U.S. at 34 (internal quotation and citation omitted). As such, these *Lochner* era cases "essentially have been limited to situations involving the creation of a wholly new tax, and their authority is of limited value in assessing the constitutionality of subsequent amendments that bring about certain changes in operation of the tax laws." *Id.* (internal quotation and citation omitted).

The Washington estate tax was enacted in 1981. *See* Laws of 1981, 2d Ex. Sess., ch. 7.[4] The QTIP at issue in this case was transferred into the QTIP trust in 1985. CP 5. Thus, *Coolidge* does not apply in this appeal because the Washington estate tax was not a "wholly new tax" at the time the QTIP trust was funded.

Moreover, as discussed above at pages 5 through 10, the Supreme Court's post-*Lochner*-era cases have consistently recognized that the federal constitution does not prohibit Congress and the States from imposing an un-apportioned estate tax on the shift in economic interest in property occurring at the death. Consistent with the central holdings in these cases, 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. To the extent *Coolidge* has any remaining validity, it does not control over *Whitney*, *Wiener*, or the other more recent authority discussed above. Under these post-*Lochner*-era cases, there is no merit to the Estate's claim that the federal constitution mandates that the "only transfer" that may be taxed is the transfer of property into a trust by the settlor. *See Church's Estate*, 335 U.S. 632 (upholding federal

[4] Prior to 1981, Washington imposed an inheritance tax. Laws of 1901, ch. 55. The primary difference between an estate tax and an inheritance tax is that an estate tax is imposed on the privilege of transferring property at death while an inheritance tax is imposed on the privilege of receiving property from a decedent. *See* 2 Jerome R. Hellerstein & Walter Hellerstein, *State Taxation* ¶ 21.02[1] (3rd ed. 1998).

estate tax imposed on trust property passing to remainder beneficiaries roughly fifteen years after the trust was funded).

B. The 2013 Act Is Constitutional.

Statutes enacted by the Legislature are presumed constitutional, and a party seeking to invalidate a statute on constitutional grounds must establish that the provision is unconstitutional beyond a reasonable doubt. *Washington State Grange v. Locke*, 153 Wn.2d 475, 486, 105 P.3d 9 (2005). This presumption applies with equal force to prospective and retroactive laws. *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 15, 96 S. Ct. 2882, 49 L. Ed. 2d 752 (1976). Applying the 2013 Act to QTIP passing at Ms. Green-Eldridge's death is constitutional and should be upheld.

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

The Estate contends that the Legislature acted beyond its authority when it amended the Washington estate tax code to close the tax loophole recognized by the Supreme Court in *Bracken*. Resp. Br. at 17-24. The Estate relies on an incorrect understanding of the separation of powers doctrine and misstates the purpose and effect of the 2013 Act.

Separation of powers issues arise when "'the activity of one branch threatens the independence or integrity or invades the prerogatives of another.'" *Hale v. Wellpinit Sch. Dist. No. 49*, 165 Wn.2d 494, 507, 198 P.3d 1021 (2009) (quoting *Carrick v. Locke*, 125 Wn.2d 129, 135, 882 P.2d 173 (1994)). Applying the amended law to the transfer of QTIP occurring at Ms. Green-Eldridge's death does not threaten the independence of the judicial branch. 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 decision in *Bracken*. It changed the definitions of "transfer" and "Washington taxable estate" to ensure that QTIP passing under Internal Revenue Code § 2044 will not escape Washington tax. Enacting laws and determining the tax policy of the state are clearly within the "appropriate sphere of activity" of the legislative branch, and the 2013 Act was a valid exercise of legislative power.

Furthermore, it is of no constitutional significance that the Legislature amended a statute that had been interpreted in *Bracken*. The separation of powers doctrine is not violated when the Legislature 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. If the Legislature is careful not to overrule a final judgment or dictate how a court must decide issues of fact, it may 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 authority of the legislative branch to make policy, pass laws, and to amend laws already in effect. *Lummi*, 170 Wn.2d at 262.

The Estate argues that the Legislature may not "clarify" an existing law that has previously been construed by a court. Resp. Br. at 19-20.[5] The Estate then urges this Court to treat the 2013 Act as a clarification of the prior law, not a substantive amendment. Resp. Br. at 18. The Court should decline for two reasons. First, the actual language of the 2013 Act makes perfectly clear that the Legislature was affirmatively amending the law. Second, statutes enacted by the Legislature are presumed to be constitutional and, given a choice, a court will apply the law in a manner that renders it constitutional. *City of Seattle v. Montana*, 129 Wn.2d 583, 590, 919 P.2d 1218 (1996). In the present case, there is no compelling reason to characterize the 2013 Act as a mere "clarification" of existing law when clearly it is not.

In addition, the Department does not agree with the Estate's claim that characterizing the 2013 Act as a mere "clarification" of existing law is constitutionally significant. In *Hale*, the Supreme Court explained that an amendment to an existing law may apply retroactively "if the legislature

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[5] The Estate relies on several Court of Appeals decisions that suggest that while the Legislature may "amend" a statute that has been previously construed by the courts, it cannot "clarify" such a 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. *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. Since this was not a clarification of existing law, the 2013 Act is consistent with separation of powers principles even under the Court of Appeals cases the Estate relies on.

so intended or if it is curative." *Hale*, 165 Wn.2d at 508. When the Legislature unequivocally expresses its intent that the amended law apply retroactively, it makes no difference under the separation of powers doctrine how the legislation is classified. *Id.*

The Estate's argument in this appeal highlights the wisdom of the Supreme Court analysis in *Hale*. The Estate is asking this Court to overturn a statute based on what the Estate perceives as a technical flaw in the Legislature's stated intent. However, retroactive legislation does not run afoul of the separation of powers doctrine so long as the Legislature "does not dictate how the court should decide a factual issue" and the retroactive law does not "affect a final judgment." *Haberman*, 109 Wn.2d at 143-44. Moreover, if Legislature makes clear its intention to apply the new law retroactively, separation of powers does not require that the Legislature use specific "magic words." Thus, the Court should reject the Estate's underlying legal premise that there is some constitutional significance in how the 2013 Act is characterized. What matters for purposes of the separation of powers doctrine is that the 2013 Act did not dictate how a court must decide any issue of fact, and did not affect any final judgment. The Estate's claim that separation of powers requires more is incorrect.

2. The 2013 Act complies with substantive due process.

The Estate also contends that the retroactive reach of the 2013 Act violates substantive due process under the rational basis standard courts apply when analyzing retroactive tax legislation. Resp. Br. at 24-39. The

Estate's due process arguments are contrary to the law and should be rejected.

As explained in the Department's opening brief, the 2013 Act complies with substantive due process because the Act had a legitimate purpose furthered by rational means. App. Br. at 19-24. The Legislature amended the estate tax code at its first opportunity in order to fix the significant loophole recognized by *Bracken*.[6] Furthermore, it was rational for the Legislature to amend the estate tax code retroactively to May 17, 2005, because that was the effective date of the stand-alone estate tax. By amending the estate tax retroactively to May 17, 2005, the Legislature ensured that the tax loophole would be closed for all estates. 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. *See Montana Rail Link, Inc. v. United States*, 76 F.3d 991, 994 (9th Cir. 1996) (seven-year retroactive period was rational and a shorter period "would have been arbitrary and irrational" under the circumstances).

The Estate claims that the circumstances pertaining to the enactment of the 2013 Act are distinguishable from the circumstances that led the U.S. Supreme Court to uphold retroactive legislation in *Carlton* and from the circumstances that led our Supreme Court to uphold

[6] The Estate's claim that the Legislature should have amended the estate tax code years before *Bracken* was decided is nonsense. *See* Resp. Br. at 26. In *Bracken*, the Court reversed the decision of the trial court. 175 Wn.2d at 576. The trial court had granted summary judgment to the Department, implicitly holding that QTIP is not immune from the Washington tax. There was no need for the Legislature to close an unintended QTIP loophole until that loophole was recognized and successfully exploited for the first time in *Bracken*.

retroactive legislation in *W.R. Grace & Co. v. Dep't of Revenue*, 137 Wn.2d 580, 973 P.2d 1011 (1999). Resp. Br. at 30-37. But any distinguishing features of these cases are immaterial.[7] Under the facts presented here, the Legislature acted rationally when it amended the estate tax code to close the QTIP loophole recognized in *Bracken*. Permitting QTIP to escape the Washington tax would have resulted in a significant drain on education funding, estimated at over $160 during the 2013-2015 bienium. *See* Fiscal Note. Preventing unanticipated revenue losses is a legitimate legislative purpose. *Carlton*, 512 U.S. at 32; *Montana Rail Link*, 76 F.3d at 994. And the manner in which the Legislature chose to address the fiscal and tax policy concerns raised in *Bracken* was not arbitrary or irrational.

The rational basis standard applied in *Carlton* and followed in *W.R. Grace* 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." *Carlton*, 512 U.S. at 31. The 2013 Act meets this rational basis standard and should be upheld.

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[7] The Estate attempts to distinguish *Carlton* by pointing out that the retroactive tax legislation at issue in that case closed an unanticipated loophole to a tax deduction that Congress had expressly enacted, while the retroactive tax legislation at issue here closed a loophole permitting QTIP to escape the Washington tax even though the Legislature had passed no exemption or deduction. Resp. Br. at 30-31. The Estate attempts to distinguish *W.R. Grace* by arguing that the statute at issue there involved a "remedy" adopted by the Legislature to fix a business & occupation tax credit the U.S. Supreme Court had held was unconstitutional under the dormant Commerce Clause. Resp. Br. at 34-36. These differences are of no constitutional import. The standard applied in *Carlton* and *W.R. Grace* is the same—whether the retroactive law serves a legitimate legislative purpose further by rational means. The 2013 Act meets that standard.

3. The 2013 Act complies with the Contracts Clause.

The Estate's claim that Washington's estate tax violates the Contract Clause is also unfounded. Resp. Br. at 39-45. Article I, section 10 of the United States Constitution U.S. Const. art. I, § 10 provides in part that "No state shall . . . pass any . . . law impairing the obligation of contracts." The Washington Constitution contains a coextensive prohibition. Const. art. I, § 23.

The Contracts Clause "is applicable only if the legislative act complained of impairs a contractual relationship." *Haberman*, 109 Wn.2d at 145. Moreover, the Contracts Clause "does not prohibit the states from repealing or amending statutes generally, or from enacting legislation with retroactive effects." *Id.* As to "private contracts," the Contracts Clause requires only that the legislation under attack was "reasonably necessary" to achieve a legitimate public purpose. *Carlstrom v. State*, 103 Wn.2d 391, 394, 694 P.2d 1 (1985). Accordingly, the 2013 Act passes scrutiny under the Contracts Clause unless the Estate can prove that a private contractual relationship existed and that any impairment to that contract served no rational public purpose. *Ketcham v. King Cnty. Med. Serv. Corp.*, 81 Wn.2d 565, 570, 502 P.2d 1197 (1972).

Applying this test here, there is no constitutional violation. The Contracts Clause applies only to a contract "in the usual sense," 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, 869 P.2d 28 (1994) (internal quotations and citation omitted). Here, the QTIP trust created at the death of Joshua Green was not an "agreement of two or more minds, upon sufficient consideration." Instead, it was created to accomplish a testamentary gift. More importantly, the trust beneficiaries were not parties to a "contract" because they made no promise supported by consideration. The Estate fails the first element.

Even if a contract existed, there would be no impairment. Taxing a transaction that previously might have escaped taxation is insufficient to establish impairment of a private contract. *Cf., Exxon Corp. v. Eagerton*, 462 U.S. 176, 192-93, 103 S. Ct. 2296, 76 L. Ed. 2d 497 (1983) (state law prohibiting oil and gas producers from passing a tax increase on to their purchasers did not substantially impair contract rights).

Finally, even if the 2013 Act did impair a contract right, the Estate's claim would still fail because that Act served a rational public purpose—to close an unintended tax loophole that would have resulted in a significant drain on education funding. *See* Laws of 2013, 2d Spec. Sess., ch. 2, § 1. Providing dependable tax sources to fund education is one of the most important functions of government. *See* Const. art. IX, § 1. Because the 2013 Act served a rational public purpose, it does not violate the Contracts Clause. *Ketcham*, 81 Wn.2d at 570.

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

The Estate also claims that the 2013 Act violates Article VII, section 1 of the Washington Constitution, which 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." *See* Resp. Br. at 45-47. It is well-established that this provision applies only to property taxes. *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); *Quarty v. United States*, 170 F.3d 961, 970-71 (9th Cir. 1999).

The Supreme Court has described a property tax as 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. 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.

C. The Court Should Reject The Estate's Request For Attorney Fees And Sanctions Against The Department.

The Estate asks this Court to reject the Department's appeal as a sanction under CR 11 and RAP 18.9(a) because, according to the Estate, the "State of Washington has egregiously ignored its laws and regulations . . . ." Resp. Br. at 48-50. The Estate also requests an award of attorney fees. *Id.* at 50. The Court should decline both requests.

No basis exists for awarding sanctions. The Department's appeal was not frivolous or filed for an improper purpose, and all of its arguments are supported by the law and by the facts. At the time the Department filed its appeal it had (and has) a good faith belief that *Bracken* was incorrectly decided and should be overruled. *See* App. Br. at 28-41. It is beyond dispute that a party is permitted under RAP 2.2(a) to appeal in order to seek modification or reversal of existing law. In addition, the fact that the *Bracken* decision is of recent vintage is not material, as the Supreme Court has previously reversed very recent decisions. *See, e.g., State v. Berlin*, 133 Wn.2d 541, 547, 947 P.2d 700 (1997) (overruling *State v. Lucky*, 128 Wn.2d 727, 912 P.2d 483 (1996)).

Moreover, the Department did not "ignore" the law. While it is true that the Department did not finalize any estate tax refund claims during the 2013 legislative session, it put off processing these returns in light of proposed legislation to change the estate tax code.[8] There is

[8] A proposed amendment to the estate tax code was introduced early in the 2013 legislative session. *See* H.B. 1920, 63rd Leg. (Wash. 2013) (introduced February 18, 2013). Several other bills were introduced during the 2013 legislative session that would have impacted the Estate's refund claim. *See* H.B. 2064, 63rd Leg., 1st Spec. Sess. (Wash. 2013); S.B. 5939, 63rd Leg., 1st Spec. Sess. (Wash. 2013); H.B. 2075, 63rd Leg.,

nothing improper about the Executive branch of state government permitting the co-equal Legislative branch a reasonable opportunity to consider the fiscal and tax policy impact of the *Bracken* decision and to take corrective action should it choose to do so. In light of the Legislature's paramount duty to adequately fund education, it was entirely appropriate for the other branches of government to give some deference to the Legislature and to permit the Legislature a reasonable opportunity to consider whether to change the Washington estate tax code to prevent QTIP from escaping tax. *Cf.*, *McCleary v. State*, 173 Wn.2d 477, 517, 269 P.3d 227 (2012) (The Legislature has "general authority to select the *means* of discharging" its duty to address "the difficult policy questions inherent in forming the details of an education system").

The Department's decision to wait five months for the Legislature to take action was not unlawful. Rather, it was a prudent exercise of agency discretion. Had the Legislature taken no action, all timely refund claims would have been paid, with interest, in due course. Conversely, if the Legislature chose—as it did—to change the estate tax code to prevent QTIP from escaping tax, no *Bracken* refunds would be paid pending final resolution of this appeal and others challenging the constitutionality of the legislation. Paying refunds to some estates during the 2013 legislative session would have severely complicated the Legislature's efforts to craft

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2d Spec. Sess. (Wash. 2013). In deference to the Legislature, the Department did not begin processing estate tax refund claims seeking a return of estate tax paid on QTIP until June 2013.

a workable solution to the issues raised in *Bracken*, and likely could have led to protracted and costly litigation with those estates that received refunds to which they were not entitled under the amended law. Under these circumstances, waiting for the Legislature to act was rational.

The Estate also requests an award of attorneys' fees, citing RAP 18.1, RAP 18.9(a), and CR 11. Resp. Br. at 50. The Court should decline this request. Prevailing parties may recover attorneys' fees on appeal under RAP 18.1(a) "[i]f applicable law grants to a party the right to recover" such fees. In this case, no "applicable law" supports the Estate's claim for attorneys' fees. Thus, RAP 18.1(a) does not apply.

In addition, Civil Rule 11 does not apply in the appellate court. *See* CR 1. The appellate equivalent of CR 11 is RAP 18.9(a), which permits an award of attorneys' fees if, considering the entire record, "the court is convinced that the appeal presents no debatable issues upon which reasonable minds might differ" and "is so devoid of merit that there is no possibility of reversal." *Advocates for Responsible Dev. v. W. Wash. Growth Mgmt. Hearings Bd.*, 170 Wn.2d 577, 580, 245 P.3d 764 (2010). All doubts as to whether an appeal is frivolous are resolved in favor of the appellant. *Id.*

In this case, the Department's appeal is not devoid of merit, and the arguments presented are rational and supported by the law and by the undisputed facts. Consequently, the Estate is not entitled to an award of attorneys' fees under RAP 18.9(a).

III. CONCLUSION

This Court should reverse the order granting the Estate's motion for summary judgment and remand the case with instructions to enter judgment in favor of the Department.

RESPECTFULLY SUBMITTED this 21st day of January, 2014.

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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 21st day of January, 2014, at Tumwater, WA.

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APPENDIX A

THE LAW OF FEDERAL GIFT AND ESTATE TAXATION

BY

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IN SIX VOLUMES

VOLUME ONE

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II. Limitations on the Exercise by Congress of the Taxing Power

A. ESTATE AND GIFT TAXES AS INDIRECT TAXES

§ 1.02. ESTATE AND GIFT TAXES ARE IMPOSED ON THE PRIVILEGE OF TRANSFER. The modern estate and gift tax laws have been upheld as an excise tax on the privilege of transfer of property,[9]

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life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation."

[9] It is well settled that the federal estate tax is an excise tax requiring no apportionment, as is required where the statute imposes a direct tax on property. See Chase Nat'l Bank of City of N.Y., Ex'rs v. U.S., 278 U.S. 327, 49 S.Ct. 126, 73 L.Ed. 405 (1929), 7AFTR8844; Greiner, Exec. v. Lewellyn, 258 U.S. 384, 42 S.Ct. 324, 66 L.Ed. 676 (1922), 3AFTR3136; New York Trust Co., Ex'rs v. Eisner, 256 U.S. 345, 41 S.Ct. 506, 65 L.Ed. 963 (1921), 3AFTR3110. See also Mertens, LOFIT, § 4.08.

The Supreme Court first sustained the constitutionality of a federal estate tax in 1874 when the succession tax of 1864 was upheld against an attack on the ground that it was invalid as an unapportioned direct tax. Scholey v. Rew, 90 U.S. (23 Wall.) 331, 23 L.Ed. 99 (1874), 2AFTR2345. The 1864 tax had already been repealed at the time of this decision and the issue remained moot thereafter until 1894. In that year Congress passed an income tax act which contained a provision including as income property acquired by gift or inheritance. The Supreme Court declared this act unconstitutional as it applied to income from real estate. Pollock v. Farmers Loan & Trust Co., 157 U.S. 429, 15 S.Ct. 673, 39 L.Ed. 759 (1895), 3AFTR2557, on rehearing 158 U.S. 601, 15 S.Ct. 912, 39 L.Ed. 1108 (1895), 3AFTR2602(i.t.).

However, when, in 1898, another succession tax was passed, its constitutionality was upheld in the leading case of Knowlton, Ex'rs v. Moore, 178 U.S. 41, 20 S.Ct. 747, 44 L.Ed. 969 (1900), 3AFTR2684. In a lengthy and exhaustive opinion, the Court found that the arguments under which the 1894 Act had been declared unconstitutional applied only to the income tax features of the act, that the succession tax was not a direct tax, that it was uniform and that it did adhere to due process.

The reasoning of the Court in the Knowlton case was so definitive that when the modern estate tax was passed in 1916, its constitutionality was upheld practically without discussion. New York Trust Co., Ex'rs v. Eisner, supra. The fact that the 1916 Act was an estate tax whereas the prior acts had imposed succession taxes made no difference.

The answer to the question of the validity of the gift tax was simplified by the fact that the Supreme Court did not have to face the issue until the estate tax cases, referred to above, had been decided. When the case did thus avoiding the prohibition against direct taxes on property without apportionment. The distinction between a direct tax on property and an excise on the transfer of property is neither illusory nor inconsequential. It is so fundamental that it has been made the basis for sustaining a tax of the latter character even though the subject of the transfer itself was tax-exempt. Thus the Federal Government may impose an estate tax on a gross estate which consists wholly of tax-exempt state or municipal bonds.[10] Such transfer concept supports a tax, without apportionment, on the shifting from one to another of any power or legal privilege incidental to the ownership or enjoyment of property. The Supreme Court in holding that the gift tax did not constitute a direct tax has rejected the proposition that taxes on the exercise of all rights and powers incident to ownership amounted to a direct tax on the property itself; hence, a tax on the exercise of individual rights and powers is clearly distinguishable from a tax which falls upon the owner merely because he is owner, regardless of the use or disposition made of his prop-

come up, the Court upheld the gift tax against the usual objections after finding that there was no "intelligible distinction", for constitutional purposes, between the estate and gift taxes. Bromley v. McCaughn, 280 U.S. 124, 50 S.Ct. 46, 74 L.Ed. 226 (1929), 8AFTR10251 (g.t.).

[10] Greiner v. Lewellyn, 258 U.S. 384, 42 S.Ct. 324, 66 L.Ed. 676 (1922), 3AFTR3136; U.S. Trust Co. of N.Y., Exec. v. Helvering, 307 U.S. 57, 59 S.Ct. 692, 83 L.Ed. 1104 (1939), 22AFTR327. See § 14.17.

In Landman v. Comm., 123 F(2d) 787 (10th Cir.1941), 28AFTR417, aff'g 42 BTA 958, cert.den. 315 U.S. 810, 62 S.Ct. 799, 86 L.Ed. 1209 (1942), the estate of a member of an Indian tribe granted certain tax exemptions was held subject to estate tax, since the latter fell "upon the transfer or shifting of the economic benefits and not upon the property of which the estate [was] composed." Consequently, there was not available in this instance "any constitutional immunity growing out of [agreements] between the United States and Creek Indian".

The statement in the text is in part from the opinion in 42 BTA 958, supra, in which it is also said:

"Likewise it was held in United States Trust Co. v. Helvering, 307 U.S. 57, that the proceeds of a War Risk Insurance policy payable to a deceased veteran's widow was subject to Federal estate tax. In that case the executor of the estate contended that the proceeds of such policy should not be included in the estate because of the provisions of the World War Veterans Act, 43 Stat. 607, which provided that 'insurance . . . shall be exempt from all taxation.'"

But compare Landman v. U.S., 71 F.Supp. 640 (Ct.Cl.1947), 35AFTR1331, erty.[11] The Supreme Court has said[12] that the power to impose estate taxes:

> "extends to the creation, exercise, acquisition, or relinquishment of any power or legal privilege which is incident to the ownership of property, and when any of these is occasioned by death, it may as readily be the subject of the federal tax as the transfer of the property at death",[13]

and that:

> "The power to tax the whole necessarily embraces the power to tax any of its incidents or the use or enjoyment of them. If the property itself may constitutionally be taxed, obviously it is competent to tax the use of it . . . or the gift of

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cert.den. 332 U.S. 815, 68 S.Ct. 153, 92 L.Ed. 392 (1947), and Landman v. U.S., (Ct.Cl.1945), 34AFTR1662, superseding 58 F.Supp. 836 (Ct.Cl.1945), 33AFTR 811.

[11] In Bromley v. McCaughn, 280 U.S. 124, 50 S.Ct. 46, 74 L.Ed. 226 (1929), 8AFTR10251 (g.t.), the Supreme Court stated: "Even if we assume that a tax levied upon all the uses to which property may be put, or upon the exercise of a single power indispensable to the enjoyment of all others over it, would be in effect a tax upon property, . . . and hence a direct tax requiring apportionment, that is not the case before us."

The same contention was made 10 years later in Dupont v. Deputy, 26 F. Supp. 773 (D.Del.1939), 22AFTR788 (g.t.), the taxpayer emphasizing what he felt to be the netlike incidences of taxes in connection with the ownership of stock: income taxes imposed on dividends and on capital gains following its sale, estate taxes on its devolution at death, and gift taxes on its transfer without consideration during life. The court summarily rejected this argument, citing Bromley v. McCaughn, supra, and added that the "controlling authority of that case" was not affected by a provision in the 1932 Act rendering the gift tax a lien upon the property given and the donee personally liable for payment to the extent of its value.

[12] Fernandez v. Wiener, 326 U.S. 340, 66 S.Ct. 178, 90 L.Ed. 116 (1945), 34AFTR276, reh.den. 327 U.S. 814, 66 S.Ct. 525, 90 L.Ed. 1038 (1946).

[13] A broader view was expressed in Chickering, Adm. v. Comm., 118 F(2d) 254 (1st Cir.1941), 26AFTR663, cert.den. 314 U.S. 636, 62 S.Ct. 70, 86 L.Ed. 511 (1941), to the effect that:

> ". . . the estate tax is not a direct tax upon the property; nor is it in a strict sense a tax upon a 'transfer' of the property by the death of the decedent. It is an excise tax upon the happening of an event, namely, death, where the death brings about certain described changes in legal relationships affecting property. The value of the property so affected is merely used as a factor in the measurement of the excise tax."

But this view has never been adopted by the Supreme Court.

> it . . . . It may tax the exercise, non-exercise, or relinquishment of a power of disposition of property, where other important indicia of ownership are lacking."

In line therewith taxation of the proceeds of life insurance payable to third persons was upheld where decedent retained the power to change the beneficiary and to surrender or pledge the policy, since these incidents of ownership were, in effect, transferred on death.[14]

§ 1.03. DEVELOPMENT OF THE MODERN CONCEPT OF A TRANSFER. The courts in applying the indirect tax theory to particular provisions of the estate tax law have evidenced considerable ingenuity in expanding the term "transfer" to meet the necessities of each new challenge.[15] The earlier cases rested on the fact that there was a "passing" of property from decedent at death.[16] Such passing concept did not require, however, that the term "transfer" be limited to those situations where there was a transfer in the technical, local law sense of the term, since Congress can completely disregard the refinements of state property law and rely on more realistic classifications.[17] Thus local characteristics of dower,[18] joint tenancies and tenancies by the entirety,[19] community property,[20] and life insurance proceeds[21]

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[14] Chase Nat'l Bank of City of N.Y., Ex'rs v. U.S., 278 U.S. 327, 49 S.Ct. 126, 73 L.Ed. 405 (1929), 7AFTR8844.

[15] Since taxes are based on the "fundamental and imperious necessity of all government", it is obvious that the Supreme Court will reach for theories, definitions, and apologia to avoid a successful constitutional attack. This task has been ably performed.

[16] See §§ 19.26, 23.17 discussing the "passing" requirement.

[17] Fernandez v. Wiener, supra, n.12. See especially the concurring opinion of Mr. Justice Douglas.

[18] See Mayer, Trustees v. Reinecke, 130 F(2d) 350 (7th Cir.1942), 29AFTR 1156, cert.den. 317 U.S. 684, 63 S.Ct. 257, 87 L.Ed. 548 (1942); Allen v. Henggeler, Adm., 32 F(2d) 69 (8th Cir.1929), 7AFTR8680, cert.den. 280 U.S. 594, 50 S.Ct. 40, 74 L.Ed. 642 (1929); Nyberg, Adm. v. U.S., 66 Ct.Cl. 153 (1928), 6AFTR7845, cert.den. 278 U.S. 646, 49 S.Ct. 82, 73 L.Ed. 559 (1928).

[19] See U.S. v. Jacobs, Exec., 306 U.S. 363, 59 S.Ct. 551, 83 L.Ed. 763 (1939), 22AFTR282, motion to set aside judgment denied 306 U.S. 620, 59 S.Ct. 640, 83 L.Ed. 1026 (1939); Dimock, Exec. v. Corwin, 306 U.S. 363, 59 S.Ct. 551, 83 L.Ed. 763 (1939), 22AFTR282 (companion cases); Gwinn v. Comm., 287 U.S. 224, 53 S.Ct. 157, 77 L.Ed. 270 (1932), 11AFTR1092; Phillips v. Dime

have been disregarded. The constitutionality of a federal taxing act is not dependent upon conformity with state law. If such were the case, then an admittedly constitutional federal act could be rendered unconstitutional by a subsequent state enactment.[21] None of the successful constitutional attacks on the federal estate and gift tax provisions cases affected the established freedom of Congress to ignore the local law of property in the absence of arbitrariness or capriciousness.[23] On the con-

Trust & Safe Deposit Co., Exec., 284 U.S. 160, 52 S.Ct. 46, 76 L.Ed. 220 (1931), 10AFTR459; Tyler, Jr., Adm'rs v. U.S., 281 U.S. 497, 50 S.Ct. 356, 74 L.Ed. 991 (1930), 8AFTR10912.

[20] See Fernandez v. Wiener, 326 U.S. 340, 66 S.Ct. 178, 90 L.Ed. 116 (1945), 34AFTR276, reh.den. 327 U.S. 814, 66 S.Ct. 525, 90 L.Ed. 1038 (1946); U.S. v. Rompel, Jr., Adm., 326 U.S. 367, 66 S.Ct. 191, 90 L.Ed. 187 (1946), 34AFTR 289, reh.den. 327 U.S. 814, 66 S.Ct. 526, 90 L.Ed. 1038 (1946); Beavers v. Comm., 165 F(2d) 208 (5th Cir.1947), 36AFTR514, cert.den. 334 U.S. 811, 68 S.Ct. 1017, 92 L.Ed. 1743 (1948) (g.t.); Charles L. Francis, 8 TC 822 (g.t.).

[21] See Chase Nat'l Bank of City of N.Y., Ex'rs v. U.S., 278 U.S. 327, 49 S.Ct. 126, 73 L.Ed. 405 (1929), 7AFTR8844; Lewellyn v. Frick, Ex'rs, 268 U.S. 238, 45 S.Ct. 487, 69 L.Ed. 934 (1925), 5AFTR5383, had earlier held contra, at least by inference; but see Kohl, Ex'rs v. U.S., 226 F(2d) 381 (7th Cir.1955), 47 AFTR2022, which involved the "payment of premiums" test which was then applied in determining what insurance should be included in the gross estate, and in which the tax in effect was held unconstitutional as imposing an unapportioned direct tax.

[22] Continental Ill. Bank & Trust Co., Exec. v. U.S., 65 F(2d) 506 (7th Cir. 1933), 12AFTR816, cert.den. 290 U.S. 663, 54 S.Ct. 77, 78 L.Ed. 573 (1933), rejecting the contention that a provision, requiring the inclusion of property in the gross estate only if subject to payment of administration expenses, violated the uniformity requirement because state laws vary as to whether real estate was subject to payment of administration expenses. See discussion in § 1.06 of the due process requirement.

[23] See (1) Nichols v. Coolidge, Ex'rs, 274 U.S. 531, 47 S.Ct. 710, 71 L.Ed. 1184 (1927), 6AFTR6758, holding Sec.402(c) of the 1919 Act unconstitutional as confiscatory and in violation of the Fifth Amendment insofar as it applied the possession and enjoyment section to transfers made prior to the act, where the transfers were not in fact testamentary or designed for tax evasion; (2) Untermyer v. Anderson, 276 U.S. 440, 48 S.Ct. 353, 72 L.Ed. 645 (1928), 6AFTR 7789, rev'g 18 F(2d) 1023 (2d Cir.1927), which had aff'd an unreported district court opinion (g.t.), holding retroactive application of the gift tax provisions of the 1924 Act invalid under the Fifth Amendment; and (3) Heiner v. Donnan, Ex'rs, 285 U.S. 312, 52 S.Ct. 358, 76 L.Ed. 772 (1932), 10AFTR1609, holding unconstitutional, under the due process provisions of the Fifth Amendment, that part of Sec.302(a) of the 1926 Act which called for a conclusive pre-

trary, it has been held that the Tenth Amendment constituted no limitation on congressional power to tax even though there might be some incidental regulatory effect of such taxation on local community property systems.[24] The Fifth Amendment, which invalidates a tax which is so arbitrary and capricious as to constitute confiscation of property and hence a deprivation of property without due process of law, has similarly failed to restrain congressional power to disregard local characterizations in designating the objects to be taxed under the federal estate and gift tax law where the provision prevents avoidance.[25]

In accord with the view above expressed that congressional power is not limited to an imposition upon the "passing" of property, it is equally well settled with respect to the imposition of estate taxes that the power to tax is not limited to "substitutes for testamentary disposition", although the phrase may be relevant in interpreting the purpose and scope of a statutory provision. Applying this principle to property jointly held and tenancies by the entirety the Supreme Court has clearly indicated that the basis for the estate tax thereon was not that the creation of the tenancy was a substitute for a testamentary transfer, nor a taxable event which antedated the death of one of the joint owners, but rather the practical effect of death in bringing about a shift in economic interests permitting the legislature to fasten on that shift as the occasion for a tax.[26]

§ 1.04. — TRANSFER AS PRESENTLY DEFINED. The modern concept of a transfer, in the constitutional sense, is premised on the recognition that taxation is "eminently practical".[27] In the

sumption that gifts made within 2 years of decedent's death were made in contemplation of death.

[24] Fernandez v. Wiener, supra, n.20.

[25] See discussion of due process in § 1.06.

[26] Fernandez v. Wiener, supra, n.20.

[27] In Tyler, Jr., Adm'rs v. U.S., 281 U.S. 497, 50 S.Ct. 356, 74 L.Ed. 991 (1930), 8AFTR10912, the Court made the following statement:

"Taxation, as it many times has been said, is eminently practical, and a practical mind, considering results, would have some difficulty in accepting the conclusion that the death of one of the tenants in each of these cases did not have the effect of passing to the survivor substantial rights, in respect of the property, theretofore never enjoyed by such survivor."

process of ruling out the "shadowy and intricate distinctions of common law property concepts"[28] and artificial rules which delimit the title, rights, and powers of tenants by the entirety (or joint tenancies) at common law,[29] the courts have striven to develop a concept of the term "transfer" which was both broad and flexible. The courts have said[30] that the estate tax provision was constitutional if there was a transfer of economic benefit,

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[28] See U.S. v. Jacobs, Exec., supra, n.19. This description as applied to the extent of congressional power to impose the tax is quite different from recourse to such common law precepts to determine the characteristics of such tenancies.

In this case it is also said: "By virtue of this feudal fiction of complete ownership in each of two persons, the surviving tenant by the entirety is conceived to be the recipient of all the property upon the death of the cotenant, and therefore—it is said—all the property can be taxed." As to this suggestion the Court says: "The constitutionality of an exercise of the taxing power of Congress is not to be determined by such shadowy and intricate distinctions of common law property concepts and ancient fictions."

The provisions with respect to dower are essentially aimed at those state decisions and local laws providing that dower interests are not includible in decedent's estate since they passed by operation of law and not by virtue of death. The dower provision was, therefore, inserted into the Code and the prior statutes to assure that the gross estate of a decedent would not be diminished by the value of dower or curtesy interests or statutory interests in lieu of dower or curtesy. See Estate of Harry E. Byram, 9 TC 1.

[29] Tyler, Jr., Adm'rs v. U.S., supra. See also Foster, Exec. v. Comm., 90 F(2d) 486 (9th Cir.1937), 19AFTR864, aff'd 303 U.S. 618, 58 S.Ct. 525, 82 L.Ed. 1083 (1938), 19AFTR1266, per curiam, reh.den. 303 U.S. 667, 58 S.Ct. 748, 82 L.Ed. 1124 (1938); O'Shaughnessy, Exec. v. Comm., 60 F(2d) 235 (6th Cir.1932), 11AFTR738, cert.den. 288 U.S. 605, 53 S.Ct. 397, 77 L.Ed. 980 (1933); Comm. v. Emery, Exec., 62 F(2d) 591 (7th Cir.1932), 11AFTR1340, rev'g and remanding 21 BTA 1038.

[30] The Supreme Court in Saltonstall v. Saltonstall, 276 U.S. 260, 48 S.Ct. 225, 72 L.Ed. 565 (1928), 7AFTR9303, in holding that a state inheritance tax could be levied on the value of an inter vivos trust set up by the decedent under which he retained the power to alter and revoke, said:

"So long as the privilege of succession has not been fully exercised it may be reached by the tax. [Citing cases.] And in determining whether it has been so exercised technical distinctions between vested remainders and other interests are of little avail, for the shifting of the economic benefits and burdens of property, which is the subject of a succession tax, may even in the case of a vested remainder be restricted or suspended by other legal devices."

The fact that, under state law, a power of appointment is not part of the probate estate, and that its transmission is not technically a "transfer" under local concepts, does not limit the federal power to tax such property. The use, enjoyment or control at death,[31] and it is now accepted that a passing or transfer of economic benefit is not required, though it may, of itself, justify the imposition of the tax.

It is well settled that, as used in the section imposing a tax "on the transfer of the taxable estate",[32] the word "transfer", or the privilege which constitutionally may be taxed, cannot be taken in such a restricted sense as to refer only to the passing of particular items of property directly from the decedent to the transferee. It includes the "transfer of property procured through expenditures by the decedent with the purpose, effected at his death, of having it pass to another."[33] No formal transfer of title from the decedent to the transferee is required; a mere shifting of the economic benefits of property may be the real subject of the tax.[34] It also now seems settled that nothing need "pass" at death, in the testamentary sense. The Supreme Court, in upholding the taxation of the full value of property held by the decedent and his wife as tenants by the entirety, has suggested that when applied to a taxing act the amiable fiction of the common law that husband and wife are but one person and that accordingly by the death of one party to this unit no interest in

constitutional limitations as to due process and direct taxation are satisfied since there is under local law a shifting of economic benefits at the time of death even though there is no technical transfer under local law.

[31] U.S. v. Jacobs, Exec., supra, n.19.

See also U.S. v. Waite, Ex'rs, 33 F(2d) 567 (8th Cir.1929), 7AFTR9184, rev'g and remanding 29 F(2d) 149 (W.D.Mo.1927), 7AFTR8288, cert.den. 280 U.S. 608, 50 S.Ct. 157, 74 L.Ed. 651 (1930); Estate of Laura Nelson Kirkwood, 23 BTA 955; Mercantile-Commerce Nat'l Bank in St. Louis, Ex'rs, 21 BTA 1347; Mary S. Garrison, Ex'rs, 21 BTA 904; Mattie McMullin, Exec., 20 BTA 527. See also Kurz, Ex'rs v. U.S., 156 F.Supp. 99 (S.D.N.Y.1957), aff'd — F(2d) — (2d Cir.1958), per curiam.

[32] I.R.C.1954, Sec.2001.

[33] Chase Nat'l Bank of City of N.Y., Ex'rs v. U.S., supra, n.14. This principle has been applied in numerous cases involving annuities. See, e.g., Hanner v. Glenn, 111 F.Supp. 52 (W.D.Ky.1953), 43AFTR748, aff'd 212 F(2d) 483 (6th Cir.1954), 45AFTR1444; Estate of Eugene F. Saxton, 12 TC 569; Estate of Isidor M. Stettenheim, 24 TC 1169 (1955-158); Estate of Paul G. Leoni, 11 TC 1140 (Memo.). See § 20.24.

[34] Chase Nat'l Bank of City of N.Y., Ex'rs v. U.S., supra, n.14; Tyler, Jr., Adm'rs v. U.S., supra, n.27 (tenancy by entirety); Fernandez v. Wiener, supra, n.20 (community property).

property held by them as tenants by the entirety passes to the other to be quite unsubstantial and that the power of taxation being, as it is, a fundamental and imperious necessity of all government was not to be restricted by such legal fictions. Whether such power so construed has been properly exercised as to any specific statutory enactment is to be determined by the actual results brought about by the death rather than by a consideration of the artificial rules which limit the title, rights, and powers of tenants by the entirety at common law.[35]

The modern explanations have been narrowed down to two factors: that decedent had an interest in property at death,[36] and that death became the generating source of definite accessions to the survivor's property rights.[37] His death is the source

[35] See discussion in § 23.17 of cases of Comm. v. Estate of Church, 335 U.S. 632, 69 S.Ct. 322, 93 L.Ed. 288 (1949), 37AFTR480, and Estate of Spiegel v. Comm., 335 U.S. 701, 69 S.Ct. 301, 93 L.Ed. 330 (1949), 37AFTR459.

As to the application of the principle to a tenancy by the entirety see Tyler, Jr., Adm'rs v. U.S., supra, n.27.

[36] The dower provisions, it has been pointed out, are in no way a departure from the fundamental excise character of the federal estate tax: ". . . the statute does not tax the widow's dower, it merely uses it as a measure of that part of the deceased husband's interest in his realty which was beyond his testamentary control and which ceased at his death." Mayer, Trustees v. Reinecke, 130 F(2d) 350 (7th Cir.1942), 29AFTR1156, cert.den. 317 U.S. 684, 63 S.Ct. 257, 87 L.Ed. 548 (1942) (1921 Act, Sec.402(b)).

The courts in upholding the constitutionality of the dower provisions have pointed to the extensive rights (incidents of ownership) in such property determined under state law which ceased at the decedent's death and hence constituted a proper occasion for the levying of an estate tax. See, e.g., Allen v. Henggeler, Adm., 32 F(2d) 69 (8th Cir.1929), 7AFTR8680, cert.den. 280 U.S. 594, 50 S.Ct. 40, 74 L.Ed. 642 (1929), upholding the constitutionality of the 1924 Act, Sec.302(b). See also Nyberg, Adm. v. U.S., 66 Ct.Cl. 153 (1928), 6AFTR7845, cert.den. 278 U.S. 646, 49 S.Ct. 82, 73 L.Ed. 559 (1928), involving the 1921 Act, Sec.402(b).

[37] In Estate of Levy v. Comm., 65 F(2d) 412 (2d Cir.1933), 12AFTR791, involving certain insurance policies in which the insured retained no rights, the circuit court, in response to an argument of unconstitutionality as to their inclusion, cited other cases, stating: "By these cases, we think it is authoritatively established that the death of a tenant by the entirety results in the enjoyment of property rights in the survivor and furnishes the occasion for the imposition of the tax, if that event takes place after the passage of the taxing statute, regardless of when the tenancy was created."

As to the effect of a required consent of a person having an adverse interest of assurance to the beneficiaries that their rights are secure.[34] Both of these standards fall within the general principle that the underlying justification for imposing the estate tax on an inter vivos transfer is that it remains "incomplete" at death. The question is, not whether there has been, in the strict sense of that word, a "transfer" of the property by the death of the decedent, or a receipt of it by right of succession, but whether the death has brought into being or ripened for the survivor, property rights of such character as to make appropriate the imposition of a tax upon that result to be measured, in whole or in part, by the value of such rights.[39] The essential difference between the old and new rationalization of such justification is that incompleteness can be demonstrated either by ascertaining whether interests remained in the grantor or by determining whether the interests of the beneficiaries were enlarged, improved, or "ripened" at the time of the grantor's death. In demonstrating such incompleteness, substance rather than form or any particular device, is controlling.[40] Both factors had been previously expressed in several early constitutional cases,[41] although their influence was submerged by the fact that a number of the important decisions were rendered in cases which employed the "incomplete" test to determine whether a provision was arbitrarily retroactive under the Fifth Amendment.[42]

to an exercise of a power of revocation by decedent where there was a transfer prior to 1924, see §§ 25.42, 25.43.

[38] Porter, Ex'rs v. Comm., 288 U.S. 436, 53 S.Ct. 451, 77 L.Ed. 880 (1933), 12AFTR25.

[39] The position of the Supreme Court in the Church and Spiegel cases was anticipated in Tyler, Jr., Adm'rs v. U.S., 281 U.S. 497, 50 S.Ct. 356, 74 L.Ed. 991 (1930), 8AFTR10912, which uses the language stated in the text. See §§ 23.17, 23.20 discussing I.R.C.1954, Sec.2037, covering the reversionary interest test under the transfer to take effect at death section.

[40] Comm. v. Estate of Church, supra, n.35.

[41] Phillips v. Dime Trust & Safe Deposit Co., Exec., 284 U.S. 160, 52 S.Ct. 46, 76 L.Ed. 220 (1931), 10AFTR459; Third Nat'l Bank & Trust Co. of Springfield, Ex'rs v. White, 287 U.S. 577, 53 S.Ct. 290, 77 L.Ed. 505 (1932), 11AFTR 1128, per curiam, involving property held by the decedent and spouse as tenants by the entirety. See also § 1.07, and Gwinn v. Comm., 287 U.S. 224, 53 S.Ct. 157, 77 L.Ed. 270 (1932), 11AFTR1092, involving property held by decedent and her son as joint tenants.

[42] Whether the transfer is complete, or something remains to be gained by

An "incomplete" transfer concept is also applicable to the gift tax,[43] although such concept has been formulated almost entirely on the basis of statutory interpretation rather than constitutional power.[44]

In applying both the estate and gift tax provisions, a basic element is that decedent have an interest in property which is capable of transfer, otherwise there could be no transfer, and any asserted tax would fail to satisfy the constitutional requirements that the tax involve the privilege of transfer and be not arbitrary and capricious. It has been held[45] that a taxable gift results when an inheritance is renounced. It has been argued,[46] however, that such a tax is so arbitrary and capricious as to violate the Fifth Amendment. Setting aside the merits of imposing such a tax,[47] it would appear that the tax can withstand a constitutional attack.[48] In a renunciation of a valid testa-

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the survivors or lost by the decedent, so that decedent's death may be taken as the event which justifies at that time the imposition of an estate tax, has also been a material issue in determining whether particular provisions are arbitrarily retroactive or capricious and prohibited by the Fifth Amendment. See § 1.07.

[43] The nature of a transfer under the gift tax provisions is discussed in §§ 34.29, 34.51 and 34.56.

[44] As in the case of the estate tax, state law concepts do not furnish the standards for the definition of a completed transfer.

[45] Hardenbergh v. Comm., 198 F(2d) 63 (8th Cir.1952), 42AFTR314, cert.den. 344 U.S. 836, 73 S.Ct. 45, 97 L.Ed. 650 (1952) (g.t.); William L. Maxwell, 17 TC 1589 (g.t.).

[46] Roehner and Roehner, "Renunciation as Taxable Gift—An Unconstitutional Federal Tax Decision", 8 Tax L.Rev. 289 (1953). Contra, Lauritzen, "Only God Can Make An Heir", 48 Northwestern U.L.Rev. 568 (1953).

[47] A.L.I. Tent.Draft No.11, Sec.X1007(h), specifically excludes the renunciation from the gift tax. See discussion therein, pp.31–40.

[48] In A.L.I. Tent.Draft No.11, at p.39, there is a good statement in support of this view and the distinctions that must be drawn:

"If it were proposed to impose a tax on a transfer of property which came about by a mere refusal to accept a gratuitous proffer of that property, which the profferor was under no obligation to deliver even if his proffer were accepted, an argument might be made against the constitutionality of such a tax, since the taxpayer never received the property or any attribute of ownership over it. The proffer never became a gift and there would be no tax on the intended donor. It would be incongruous to tax the intended donee in this situation, and here we need not even consider the constitutional aspects of this mentary power the necessary property interest is clearly present and the renunciation would qualify as a "transfer" for the purpose of determining whether the tax is indirect; there is nothing "arbitrary" in the due process sense of that term, particularly since renunciation is a voluntary act. That the imposition of a tax would not violate the necessity of "uniformity" is obviously not any longer a debatable question.

§ 1.05. —— SITUATIONS AKIN TO TRANSFERS AT DEATH. Although the estate tax "contemplation of death" statutory provision involves a complete and full transfer by decedent of all incidents

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situation. But where there is a renunciation in the case of a gift which is complete as far as the donor is concerned, as in the case of a trust or testamentary situation, as contrasted with a situation where the donor still had the power to make the gift incomplete regardless of whether it was accepted or not, different considerations arise. Here, the tax would be imposed on the only affirmative act which could result in an effective gratuitous transfer to someone other than the person intended by the decedent or donor to be the first taker—and a strong argument in favor of the validity of this proposal can be made. There would be no immediate hardships involved if the intended first taker knew he would be subject to the tax, since he could then not renounce, pay the tax, and then give away the balance. However, there would be an effect on his subsequent tax bracket. Since the federal laws are not governed by local property law concepts of when title passes but with the realities of the exercise of control over a bundle of rights, all in all this proposal should be able to withstand a challenge as to its constitutionality. It would not seem unconstitutional to tax the exercise of control of the property here possessed by the intended first taker, even though he got into this position of control involuntarily.

"If the argument of unconstitutionality were to prevail where the person who renounced the property never received under local law any attribute of ownership over it other than the ability to renounce, then this result would preclude a rule which operated with reasonable uniformity throughout the United States. For the tax would then be able to withstand a challenge to its constitutionality only where, under the applicable state law, some attribute of ownership other than the power to renounce vested in the person, such as vesting of title or ability of his judgment creditors to reach the property despite his desire to reject it. But the consequent limitation of the tax to situations where the renouncing taxpayer had some such attribute of ownership over the renounced property under the applicable local law would hardly be a satisfactory result. It may well be that this result of non-uniformity in operation of the tax would have some supporting effect on the argument of constitutionality in the situation where no local law attributes of ownership were received. At any event, it is a consideration in favor of the rule adopted in the Draft."