IN THE SUPREME COURT OF THE STATE OF WASHINGTON

In the Matter of the Estate of SHARON M. BRACKEN, CAROL B. CLEMENCY, LAURA B. CLOUGH, and JOHN L. BRACKEN, Personal Representatives of the Estate of SHARON M. BRACKEN, Appellants, v. STATE OF WASHINGTON, DEPARTMENT OF REVENUE, Respondent.	)	No. 84114-4 (consolidated with No. 85075-5)
In the Matter of the Estate of BARBARA J. NELSON, WILLIAM C. NELSON, BRIAN S. NELSON and JANET MCCANN, Personal Representatives of the Estate of BARBARA J. NELSON, Appellants, v. STATE OF WASHINGTON, DEPARTMENT OF REVENUE, Respondent.	)	EN BANC Filed October 18, 2012
In the Matter of the Estate of JOHN T. TOLAND,	)	

No. 84114-4

NANCY TOLAND RICHARDS and CATHERINE TOLAND LILE, Personal Representatives of the Estate of JOHN T. TOLAND,	)
Appellants,	)
v.	)
STATE OF WASHINGTON, DEPARTMENT OF REVENUE,	)
Respondent.	)

Siddoway, J.* — The Estates of Barbara J. Nelson and Sharon M. Bracken (the Estates) challenge the efforts of the Washington State Department of Revenue (DOR) to treat them as having engaged in a present taxable transfer of assets that were actually transferred years ago by Ms. Nelson's and Ms. Bracken's late husbands' estates. As authority for finding and taxing fictional present transfers, DOR relies on the legislature's adoption in 2005 of definitions from the federal estate tax regime. For federal estate tax purposes, the United States Treasury's authority to presently tax fictional transfers by the wives' estates of what is referred to as "qualified terminable interest property" (QTIP) was based on earlier consent to federal tax deferral and is clear.

We hold that DOR exceeded its authority in enacting regulations that allow it to treat transfers completed by William Nelson and Jim Bracken years ago as if the estates had

* Judge Siddoway is serving as a justice pro tempore of the Supreme Court pursuant to Washington Constitution article IV, section 2(a).

elected to defer *state* estate tax on the transfers, to be paid by their wives' estates. DOR stands on a different footing than the United States Treasury. The treasury can rely on Congress's enactment, in advance, of a taxation choice and the predecessor Nelson and Bracken estates' informed and affirmative election to defer federal taxation. DOR must rely on the asserted authority of our legislature to tax transfers years after the fact absent any deferral agreement by the taxpayer. We reject DOR's interpretation of chapter 83.100 RCW and reverse the trial court. Summary judgment should be entered in favor of the Estates.

FACTS AND PROCEDURAL BACKGROUND

The complication for Washington estate tax collections that gives rise to these cases has its genesis in the coupling and later decoupling of federal and state estate taxes. To explain the effect of the taxation changes, we begin with the estates of Ms. Nelson's and Ms. Bracken's late husbands, William Nelson and Jim Bracken.

Creation of "QTIP" by the William Nelson and Jim Bracken Estates

Jim Bracken died a Washington resident in 1984. William Nelson died a Washington resident in 2004. At the time they died, federal tax law allowed their estates an unlimited marital deduction for property passed outright to a surviving spouse or in certain other ways giving the surviving spouse control over the transferred property. Federal law had also been liberalized by the Economic Recovery Tax Act of 1981 (ERTA), Pub. L. No. 97-34, 95 Stat. 172, to permit certain transfers of "terminable interests" to qualify for the marital deduction.

See H.R. Rep. No. 97-201, at 263 (1981), *reprinted in* 1981-2 C.B. 352. For federal estate tax purposes, "terminable interests" are interests such as life estates that will terminate or fail on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur. *See* I.R.C. § 2056(b)(1).

For the most part, terminable interests are not eligible for the marital deduction. *Id.* But in ERTA, Congress saw it as desirable to allow estate plans that provide for the lifetime needs of a surviving spouse and ensure that whatever property remaining will pass to the first spouse's children to claim the marital deduction. It recognized that

> unless certain interests which do not grant the spouse total control are eligible for the unlimited marital deduction, a decedent would be forced to choose between surrendering control of the entire estate to avoid imposition of estate tax at his death or reducing his tax benefits at his death to insure inheritance by the children.

H.R. Rep. No. 97-201, at 160. Congress created QTIP as an interest that could be transferred tax free without granting the surviving spouse total control. As further explained in the house report,

> if certain conditions are met, a life interest granted to the surviving spouse will not be treated as a terminable interest. The entire property subject to such interest will be treated as passing to such spouse and no interest in such property will be considered to pass to any person other than the spouse. Accordingly, the entire interest will qualify for marital deduction.

Id. at 161.

Advantages of the QTIP option are many. The spouse who dies first controls the final

disposition of the property, while allowing the surviving spouse to use the property or receive the income it generates, unreduced by front-end estate taxation. The personal representative of the first spouse elects whether to treat the property as QTIP and claim the marital deduction, thereby maximizing flexibility. If the QTIP election is made, the transfer of the property is not taxed in the estate of the first spouse even though it is he or she who makes the actual transfer. But the statutorily required quid pro quo is that the property is deemed for federal estate tax purposes to have been transferred to the surviving spouse at the first spouse's death and is deemed to be transferred to the residuary beneficiaries from the surviving spouse upon the surviving spouse's later death. The result is to draw the property into the estate of the surviving spouse; in this way, the estate of the first spouse gets a full marital deduction, yet the property does not escape ultimate taxation.

Mr. Bracken and Mr. Nelson established marital trusts in their wills, naming their wives as lifetime beneficiaries. The estates made the elections required to qualify the trusts as QTIP trusts for the federal estate tax marital deduction under I.R.C. § 2056(b)(7). They claimed corresponding marital deductions for the QTIP included in the trusts.

No election was made to qualify Jim Bracken's or William Nelson's QTIP trusts for a Washington marital deduction and state tax deferral. No such election or deduction existed under state estate tax law in 1984 or 2004. Between 1981 and 2004, Washington imposed an estate tax in the amount of federal estate tax that the treasury would share with a state through

a credit claimed on a decedent's federal estate tax return. State estate taxes taking advantage of this federal tax sharing were called "pickup" taxes. Some history on the pickup tax will help explain later developments.

In the 1920s, the states, which had historically been more dependent on death taxes[1] for their revenue needs than had the federal government, became engaged in a "race to the bottom" after Florida abolished its death tax. Florida reasoned that other state revenues derived from attracting wealthy Americans to live out their retirement years in Florida would more than offset lost death taxes. As Alabama followed suit and more states were forced to consider eliminating death taxes in order to compete for wealthy residents, the national solution arrived at was for states to set aside their historical objection to federal death taxes in exchange for the federal government becoming the principal death tax collector and sharing a generous percentage of the amount collected. Sharing was accomplished through a federally set credit for state death taxes. The states could share the federally collected taxes or not; if they did not, the taxes stayed with the federal government. With states able to opt into a credit that was pain-free to their residents, the change had the intended effect of eliminating state tax competition. Even Florida, after unsuccessfully challenging the federal tax, adopted its own pickup tax rather than pass up the generous credit. *See* Jeffrey A. Cooper, *Interstate Competition and State Death Taxes: A Modern Crisis in Historical Perspective*, 33 Pepp. L.

[1] "Death taxes" is a generic term for taxes such as estate, inheritance, and succession taxes.

Rev. 835 (2006).

At the time of Mr. Bracken's and Mr. Nelson's deaths, Washington relied on a pickup tax (or, as discussed below, a tax designed to mirror a pickup tax) codified at chapter 83.100 RCW. Again, at the time of the deaths of Mr. Bracken and Mr. Nelson, Washington law made no provision for a QTIP or other election to defer state estate taxes.

Enactment of EGTRRA and the Washington Response

In 2001, Congress passed the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Pub. L. No. 107-16, 115 Stat. 38, providing for the gradual elimination of federal estate taxes between 2001 and 2010 and for their return in 2011. EGTRRA also provided for the elimination of the state death tax credit over a period of four years. As the state death tax credit was eliminated, so too was the state estate tax in every state with a pickup tax.

Reduction and elimination of the state death tax credit allowed the top marginal federal estate tax rate to decrease at the same time that the effective tax rate for the federal government, based on the proportion of tax it kept, actually increased. This led one author to observe that EGTRRA "clearly is not what it at first seems to be. Touted as a massive federal tax cut, it is more properly seen as a more modest federal tax cut combined with state tax eradication." Jeffrey A. Cooper, John R. Ivimey & Donna D. Vincenti, *State Estate Taxes After EGTRRA: A Long Day's Journey into Night*, 17 Quinnipiac Prob. L.J. 317, 323 (2004).[2]

[2] Still, while the effective tax rate to the federal government increased, the amount

Following elimination of the state estate tax credit in 2005, states have been required either to modify their estate tax or forgo estate tax revenues.[3] Rather than create a new taxing scheme, our legislature's first response was to revise existing statutes to tie estate taxation to provisions of the Internal Revenue Code as they existed on January 1, 2001, prior to EGTRRA, with DOR continuing to collect the same amount of tax as before. Former RCW 83.100.020(15) (2001). In effect, DOR ignored the phase-out and continued to collect the amount of a no-longer-existing credit. In *Estate of Hemphill v. Department of Revenue*, 153 Wn.2d 544, 105 P.3d 391 (2005), this court invalidated that response, emphasizing, as it had earlier in *Estate of Turner v. Department of Revenue*, 106 Wn.2d 649, 724 P.2d 1013 (1986), that then-existing provisions of chapter 83.100 RCW were the result of a voter's initiative clearly premised on the concept that the State would impose only a pickup tax. In *Turner* and again in *Hemphill*, this court rejected DOR's argument that our statute imposed an independently operating tax, stating in *Hemphill* that "[u]ntil or unless the legislature revises [former] RCW 83.100.030 [(1988), *repealed by* Laws of 2005, ch. 516, § 17] to specifically and expressly create a stand-alone estate or inheritance tax, [former] RCW 83.100.030

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of federal estate taxes paid by taxpayers declined during the 2001-2009 time frame because of the lower marginal estate tax rates and the higher federal exemption amounts that existed before repeal of the federal estate tax in 2010 and following the Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296.

[3] The American College of Trust and Estate Counsel has published a death tax chart showing how different states have responded. *See* Charles D. Fox IV & Adam M. Damerow, *The ACTEC State Death Tax Chart – Still Going Strong After Seven Years*, 35 ACTEC J. 53 (Summer 2009).

remains as a 'pickup' tax, in which all state estate tax due must be fully reimbursed as a current federal credit." *Hemphill*, 153 Wn.2d at 551.

In response to *Hemphill*, the legislature passed the Estate and Transfer Tax Act (Act), creating a stand-alone tax effective May 17, 2005. Laws of 2005, ch. 516, § 1, *codified as* ch. 83.100 RCW. The Act provides that the estate tax is "imposed on every transfer of property located in Washington." RCW 83.100.040(1). Provisions of the Act apply "prospectively only and not retroactively" and "only to estates of decedents dying on or after [May 17, 2005]." Laws of 2005, ch. 516, § 20.

While creating a stand-alone tax, the Act relies substantially on the federal estate tax regime. It incorporates concepts and definitions from federal law and operates almost entirely in tandem with taxable estate and tax calculation and reporting for federal estate tax purposes. Like the federal estate tax, the tax is not a property tax, but a tax imposed on the transfer of the taxable estate. WAC 458-57-105(2); Treas. Reg. § 20.0-2(a). Computation of the amount of state estate tax is based on the "Washington Taxable Estate," RCW 83.100.040(2)(a), which is elsewhere defined as the "federal taxable estate," with specified adjustments. *See* RCW 83.100.020(13). The Act's substantial dependence on the federal regime is qualified, however, by the proviso that the Act "incorporates only those provisions of the internal revenue code as amended or renumbered as of January 1, 2005, that do not conflict with the provisions of this chapter." RCW 83.100.040(3).

The Act authorized DOR to provide by rule for "a separate [QTIP] election on the Washington return, consistent with section 2056 or 2056A of the Internal Revenue Code, for the purpose of determining the amount of tax due under this chapter." RCW 83.100.047(1). In April 2006, DOR adopted regulations to create the state QTIP election and provide guidance on the application and interpretation of the new Act. *See* ch. 458-57 WAC. None of the parties or amicus contest the validity or operation of WAC 458-57-115(2)(c)(iii), which provides for a state QTIP election that may be made by personal representatives of Washington decedents dying after the effective date of the Act in order to defer state estate taxation until the death of the surviving spouse. As with federal law and regulation, Washington regulations provide that if a QTIP election is made the surviving spouse "must include the value of the remaining property in his or her gross estate for Washington estate tax purposes" even though the surviving spouse makes no transfer. WAC 458-57-115(2)(c)(iii)(B).

The 2006 regulations also set forth the manner in which the Washington taxable estate is to be calculated. Former WAC 458-57-105 (2006); former WAC 458-57-115 (2006). Under the Act and the 2006 regulations, the calculation of the Washington taxable estate begins with the "federal taxable estate." RCW 83.100.020(13); former WAC 458-57-105(3)(q)(vi). The 2006 regulations provide for a series of adjustments to the federal taxable estate by which the effect of federal QTIP elections is canceled out. The regulations adjust

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the estate for the effect of any Washington QTIP elections. As a result, under the 2006 regulations the only QTIP required to be included in the Washington taxable estate is QTIP for which a state QTIP election was made. Former WAC 458-57-105(3)(q)(v); former WAC 458-57-115(2)(d)(v). The validity of those regulations is not challenged by the Estates.

Assessment of the Estates

Sharon Bracken died a Washington resident on September 24, 2006. As required by I.R.C. § 2044, her federal taxable estate included the value of the QTIP that remained in the QTIP trust established upon the death of her husband. Applying the adjustments called for by DOR's 2006 regulations, the assets remaining in the QTIP trust were not included as assets in Ms. Bracken's Washington taxable estate. *See* former WAC 458-57-105(3)(q)(vi); former WAC 458-57-115(2)(d)(vi).

DOR issued a deficiency notice to the Sharon Bracken estate based on its failure to include assets remaining in the 1984 QTIP trust in her estate. It took the position that its 2006 regulations do not apply to the estate of a decedent whose federal taxable estate includes QTIP as the result of a federal tax deferral election made before May 17, 2005.[4] The result for such estates is that federal QTIP is not subtracted in calculating the Washington taxable estate. In other words, DOR asserts Washington's right to presently

[4] In 2009, DOR amended its regulations defining calculation of the Washington taxable estate to reflect this position; as revised, the regulations no longer reduce the estate by the value of assets included in the federal taxable estate of a decedent as a result of a QTIP election made before May 17, 2005. WAC 458-57-105(3)(q)(vi), -115(2)(d)(vi).

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tax assets transferred at any time before May 17, 2005, anywhere, by any decedent, as long as federal QTIP treatment was elected for the transfer and the surviving spouse dies domiciled in Washington after May 17, 2005. The result was to increase the amount of Sharon Bracken's Washington taxable estate by over $13.7 million.

The estate declined to pay the amount cited in the deficiency notice, and DOR made findings fixing the amount it asserted was due and filed its findings with the probate court as authorized by RCW 83.100.150. The estate timely filed objections to DOR's findings.

The proceedings involving the Barbara Nelson estate, which was similarly situated, were consolidated with those of the Sharon Bracken estate for purposes of discovery and trial on the objections. The parties eventually filed cross motions for summary judgment. The trial court granted DOR's motion and denied the motions of the Estates. It deferred to DOR's interpretation that its 2006 regulations do not apply to the Estates. It also found the Estates' failure to include the assets in the QTIP trust as part of the Washington taxable estate to be an impermissible deduction.

The Sharon Bracken estate paid the Washington estate tax owed and filed this appeal, seeking direct review by this court. The Barbara Nelson estate filed an appeal with Division One of the Court of Appeals. This court granted direct review and consolidated the two cases.

ANALYSIS

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This case presents an appeal from summary judgment and from a trial court's conclusions in a tax refund case, both of which we review de novo. RCW 83.100.180; RCW 11.96A.200; *Lamtec Corp. v. Dep't of Revenue*, 170 Wn.2d 838, 842, 246 P.3d 788 (2010) (citing *Dreiling v. Jain*, 151 Wn.2d 900, 908, 93 P.3d 861 (2004)), *cert. denied*, 132 S. Ct. 95 (2011); *Simpson Inv. Co. v. Dep't of Revenue*, 141 Wn.2d 139, 148, 3 P.3d 741 (2000) (citing *Nordstrom Credit, Inc. v. Dep't of Revenue*, 120 Wn.2d 935, 940, 845 P.2d 1331 (1993)). The Estates challenge DOR's findings that they are subject to Washington estate tax on the QTIP as outside of its authority for two reasons: because no transfer occurred on death on which the tax could be imposed and because DOR's 2006 regulations apply to them and allow them to exclude federally elected QTIP. *See* RCW 34.05.570(4)(c)(ii). Alternatively, they argue that if imposition of tax on the QTIP was proper under RCW 83.100.040, then it is an unconstitutional tax because it is retroactive in violation of the due process and impairment clauses of the United States and Washington Constitutions. U.S. Const. amend. XIV; U.S. Const. art. I, § 10; Wash. Const. art. I, §§ 3, 23; *see* RCW 34.05.570(4)(c)(i). We need not reach the Estates' constitutional challenges because we construe the Act to tax only transfers, either at the time they are made or where there has been a voluntary election to defer state taxation, and only prospectively.

The primary objective of statutory construction is "'to ascertain and carry out the intent of the Legislature.'" *HomeStreet, Inc. v. Dep't of Revenue*, 166 Wn.2d 444, 451, 210

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P.3d 297 (2009) (quoting *Rozner v. City of Bellevue*, 116 Wn.2d 342, 347, 804 P.2d 24 (1991)). Additional rules apply to taxing statutes. "[A] tax statute 'must be construed most strongly against the taxing power and in favor of the taxpayer,'" *Lamtec*, 170 Wn.2d at 842-43 (quoting *Ski Acres, Inc. v. Kittitas County*, 118 Wn.2d 852, 857, 827 P.2d 1000 (1992)), consistent with our constitution's requirement that "every law imposing a tax shall state distinctly the object of the same to which only it shall be applied." Wash. Const. art. VII, § 5. The legislature is "presumed to have intended a meaning consistent with the constitutionality of its enactment." *State ex rel. Dawes v. Wash. State Highway Comm'n*, 63 Wn.2d 34, 38, 385 P.2d 376 (1963).

Transfer Taxation Requires a Transfer

The stand-alone estate tax adopted by the Act is, like the federal estate tax, a transfer tax, "imposed on every transfer of property located in Washington." RCW 83.100.040(1). *Compare* RCW 83.100.040, *with* I.R.C. § 2001(a). The requirement for a transfer is constitutionally grounded and long standing. It arises from the distinction between an excise tax, which is levied upon the use or transfer of property (even though it might be measured by the property's value), and a tax levied upon the property itself. A tax on the value of either real or personal property, or income (rents, dividends, or interest) from either, is a direct tax. *Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601, 15 S. Ct. 912, 39 L. Ed. 1108 (1895), *superseded on other grounds by constitutional amendment*, U.S. Const. amend. XVI. The

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United States Constitution provides that any direct tax must be apportioned between the states. U.S. Const. art. I, § 9, cl. 4. Given the difficulties of apportioning a tax among the states, Congress has not intentionally adopted a direct tax since 1861. Erik M. Jensen, *Interpreting the Sixteenth Amendment (by Way of the Direct-Tax Clauses)*, 21 Const. Comment. 355, 357 & n.7 (2004) (citing Act of Aug. 5, 1861, ch. 45, 12 Stat. 292). It has relied for revenues on the income tax, authorized by adoption of the Sixteenth Amendment, and on excise taxes. *See* Jensen, *supra*, at 361-63.

The estate tax has long been recognized as an excise tax. *United States v. Wells Fargo Bank*, 485 U.S. 351, 355, 108 S. Ct. 1179, 99 L. Ed. 2d 368 (1988). *Knowlton v. Moore*, 178 U.S. 41, 47, 20 S. Ct. 747, 44 L. Ed. 969 (1900), which is the seminal case establishing that succession taxes, inheritance taxes, estate taxes, and other death taxes are excise taxes on the privilege of shifting or transmitting property at death, states:

> Taxes of this general character are universally deemed to relate, not to property *eo nomine*, but to its passage by will or by descent in cases of intestacy, as distinguished from taxes imposed on property, real or personal, as such, because of its ownership and possession. In other words, the public contribution which death duties exact is predicated on the passage of property as the result of death, as distinct from a tax on property disassociated from its transmission or receipt by will, or as the result of intestacy.

Knowlton concluded that the "tax laws of this nature in all countries rest in their essence upon the principle that death is the generating source from which the particular taxing power takes its being, and that it is the power to transmit, or the transmission from the dead to the living,

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on which such taxes are more immediately rested." *Id.* at 56. The principle remains unchanged. *See* Treas. Reg. §§ 20.2033-1(a) ("the estate tax . . . is an excise tax on the transfer of property at death and is not a tax on the property transferred"). If estate taxation cannot be tied to a transfer, it fails as an unapportioned (and therefore unconstitutional) direct tax. *Levy v. Wardell*, 258 U.S. 542, 42 S. Ct. 395, 66 L. Ed. 758 (1922) (attempt to tax, at death, a lifetime transfer of stock with retained income interest would be an unapportioned direct tax, not a transfer tax). *Fernandez v. Wiener*, 326 U.S. 340, 352, 66 S. Ct. 178, 90 L. Ed. 116 (1945) recognizes that Congress may tax real estate or personal property "if the tax is apportioned," and, absent apportionment, may tax "a particular use or enjoyment of property or the shifting from one to another of any power or privilege incidental to the ownership or enjoyment of property." More recently the United States Supreme Court has recognized that "[i]f there is any taxable event . . . which can fairly be said to be a 'transfer,'" the tax is constitutional without apportionment. *United States v. Mfrs. Nat'l Bank of Detroit*, 363 U.S. 194, 198, 80 S. Ct. 1103, 4 L. Ed. 2d 1158 (1960).

The same principles that require a transfer for federal estate tax purposes were held to require a transfer for Washington's former inheritance tax in *In re Estate of McGrath*, 191 Wash. 496, 505, 71 P.2d 395 (1937), *cert. denied*, 303 U.S. 651 (1938), "for in neither case can there be any tax unless there is a transfer." The court observed in *McGrath* that the transfer requirement would apply equally to any Washington estate tax, stating:

> It is universally agreed that the right of the sovereign to control the

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> transfer is the sanction upon which all such exactions rest, whether they be called estate taxes, succession taxes, inheritance taxes, or privilege taxes. It is, therefore, in the very nature of things, impossible for an estate or inheritance tax to be exacted with respect to something in which the decedent did not own or have some kind of right at the time of his death, for in such a case there is no transfer.

Id. at 503.

Faced with arguments by the Estates and amicus that DOR is attempting to tax something other than a transfer, DOR too readily concludes that a fictional or deemed transfer is something that Congress or the legislature can substitute for an actual transfer. When DOR argues that "'the power of Congress to change the common-law rule is not to be doubted,'" it fails to consider that a transfer—a real transfer—is the sanction for the tax. Resp't's Br. at 28 (quoting *United States v. A&P Trucking Co.*, 358 U.S. 121, 124, 79 S. Ct. 203, 3 L. Ed. 2d 165 (1958) (Congress need not abide by the common law distinction between corporations and partnerships in regulating common carriers)).

QTIP Is Transferred by the Electing Spouse, Not the Surviving Spouse

Barbara Nelson, Sharon Bracken, and the Estates never transferred, in any manner, the QTIP that passed to the residuary beneficiaries of the QTIP trust. Property is transferred from a trustor when a trust is created, not when an income interest in the trust expires. *Coolidge v. Long*, 282 U.S. 582, 605, 51 S. Ct. 306, 75 L. Ed. 562 (1931). QTIP does not actually pass to or from the surviving spouse. *Estate of Bonner v. United States*, 84 F.3d 196, 198 (5th Cir. 1996). Contrary to the suggestion of the concurrence/dissent, the Internal Revenue Code does

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not regard the death of the surviving spouse as giving rise to a taxable transfer even though the deemed transfer on the death of the surviving spouse is the taxable event. A transfer supporting taxation has occurred, but federal law and regulation recognize that it occurred upon the death of the first spouse. The transfer is taxed later at a time when there is no transfer, by virtue of the deferral election.

The Internal Revenue Code and its regulations provide, with their characteristic precision, that the first spouse engages in the transfer of QTIP and that passage of QTIP to and from the surviving spouse is a fiction. The value of the QTIP assets was required to be included in Mr. Bracken's gross estate, to be taxed, net of deductions, by virtue of the transfer of his estate. I.R.C. § 2033 (value of gross estate includes the value of all property to the extent of the interest of the decedent), § 2001(a) (tax is imposed on the transfer of the estate); Treas. Regs. §§ 20.0-2(a), 20.2033-1(a), 20.2044-1(e) (Ex. 1). Mr. Bracken's transfer of an income interest in property to his wife with the remainder to others would not ordinarily qualify for the marital deduction under § 2056(a) because Ms. Bracken's interest was terminable within the meaning of § 2056(b)(1). However, § 2056(b)(7)(A) provides an exception to this terminable interest rule for qualifying transfers for which an election is made. Notably, I.R.C. § 2056(b)(7)(B)(i)(I) provides that property could not qualify as QTIP unless it actually passed from Mr. Bracken. The QTIP was not taxed in his estate, however, because by virtue of the election, his estate was allowed to take the marital deduction on the

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basis of an explicit fiction that the entire property had passed to her. "For purposes of § 2056(a), [QTIP] *is treated as passing to the surviving spouse*, and no part of the property *is treated as passing to any person other than the surviving spouse*." Rev. Proc. 2001-38, 2001-1 C.B. 1335 (emphasis added); I.R.C. § 2056(b)(7)(A). DOR agreed in proceedings below that QTIP is property of the estate of the first spouse to die and that transfer to a QTIP trust takes place when the first spouse dies and the trust is created.

Laws and regulations applicable to the taxation of Ms. Bracken's estate are similarly precise in recognizing that she did not make the transfer, and that the inclusion of QTIP in her estate is fictional, by virtue of the election made by Mr. Bracken's estate. I.R.C. § 2044(c) provides that where the QTIP election has been made and the marital deduction earlier allowed, then, for purposes of the estate tax, QTIP "includible in the gross estate of the decedent under subsection (a) *shall be treated as property passing from the decedent*." (Emphasis added.)

Voluntary Deferral Provides a Basis for Later Taxation

Where a basis for taxation exists, a taxpayer can agree to defer the taxation, and federal estate tax can be assessed on fictional QTIP transfers by the Estates on rationales that also support Washington's creation of a state QTIP election that operates prospectively. But those rationales do not support the retroactive estate taxation of federal QTIP that DOR attempted to impose here.

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In *Milliken v. United States*, 283 U.S. 15, 24, 51 S. Ct. 324, 75 L. Ed. 809 (1931), which held that the Commissioner of the Internal Revenue could levy and assess estate tax on a gift in contemplation of death, the United States Supreme Court relied on the fact that a federal tax on such gifts existed at the time the gift was made and that imposing such a tax was an appropriate and necessary measure to secure the effective administration of a system of death taxes. In *Estate of Mellinger v. Comm'r*, 112 T.C. 26, 35 (1999), a case dealing with Congress's basis for taxing QTIP to the estate of the surviving spouse, the tax court characterized its inclusion in the survivor's estate as "the quid pro quo for allowing the marital deduction for the estate of the first spouse to die," even though "QTIP property does not actually pass to or from the surviving spouse." *Estate of Morgens v. Comm'r*, 133 T.C. 402, 412-14 (2009), *aff'd*, 678 F.3d 769 (9th Cir. 2012), also recognized that the QTIP regime employs a fiction but adopted *Mellinger*'s quid pro quo rationale as a sufficient basis for taxing QTIP in the estate of the surviving spouse.

Where an election to claim a marital deduction for QTIP is made by the first spouse, taxing the foreseeable inclusion of the QTIP in the survivor's estate as a quid pro quo also accords with the duty of consistency under federal tax law, also referred to as quasi-estoppel. The duty of consistency prevents a taxpayer who has benefited from a past representation from adopting a position inconsistent with that taken in a year barred by the statute of limitations. *Estate of Letts v. Comm'r*, 109 T.C. 290, 296 (1997). For the duty to apply, there

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must have been (1) a representation by the taxpayer; (2) reliance on the representation by the Internal Revenue Service; and (3) an attempt by the taxpayer, after the statute of limitation on assessment has expired, to change the representation. *Cluck v. Comm'r*, 105 T.C. 324, 332 (1995). The duty of consistency can bind one person to a representation made by another where the two are deemed to be in privity, including, where privity exists, binding a beneficiary of an estate to a representation made on the estate's federal estate tax return. *Beltzer v. United States*, 495 F.2d 211, 212 (8th Cir. 1974). A QTIP income beneficiary has been held bound by the duty of consistency to her spouse's claim of a marital deduction for the QTIP. *Letts*, 109 T.C. at 301 (estate of surviving wife bound by husband's estate's treatment of marital trust as deductible).

The Estates Have Not Transferred the Federal QTIP at Issue or Benefited from a State Tax Election

The personal representatives of Mr. Nelson's and Mr. Bracken's estates made the election required by I.R.C. § 2056(b)(7) for federal estate tax deferral, thereby subjecting the surviving wives' estates to later federal taxation in light of these recognized rationales of notice, election, benefit, and consistency. The personal representatives made no state election. No state election existed. The predecessor estates received no benefit from Washington State. The amount of estate tax the first Nelson and Bracken estates avoided by the marital deduction was unaffected by the fact that, by virtue of the pickup tax, any additional tax those estates had paid would have been shared with Washington State.

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Given this difference between the taxing posture of the federal government and the State, DOR appropriately read the Act initially to permit creation of a state QTIP election that would operate only prospectively. This was consistent with the legislature's directive that the Act was to apply prospectively, not retroactively, to "estates of decedents dying on or after the effective date of this section." Laws of 2005, ch. 516, § 20. DOR's 2006 regulations were valid and were justifiably relied upon by the Estates. Of course, DOR thereafter changed its position and issued notices of deficiency to these and other estates, giving rise to the parties' dispute.

The problem with DOR's justification for its position—the Act's definition of "Washington Taxable Estate"—is that it elevates a single component of one incorporated definition over both the operative taxing provision of the Act, which imposes the tax on transfers, and the Act's clearly intended (and, the taxpayers argue, its constitutionally required) prospective operation.[5] The principal purpose of the Act is to create a state estate tax whose calculation parallels the method for calculating the federal estate. But because the operative provision of the Act imposes a tax only prospectively, on the transfer of property, the federal definition of "taxable estate" cannot be used without a modification necessary to conform to the Act: the definition must be read to exclude items that are not transfers.

[5] DOR's argument for strict adherence to the statutory definition of "Washington Taxable Estate" is also inconsistent; in carrying out its duty and authority to enact regulations, DOR has modified the definition in the other respects needed to accommodate a state QTIP election. *See* WAC 458-57-105(3)(q), -115(2)(d).

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DOR's 2006 regulations made this necessary modification. Given the subject, nature, and purpose of the legislation, the statute and regulation present no ambiguity. They can be plainly read to create a state estate tax scheme which, like its federal counterpart, has a QTIP election that is designed to operate prospectively.

DOR emphasizes the large marital deduction that was taken in 1984 by the Jim Bracken estate and the growth in the QTIP that will escape state estate taxation in Sharon Bracken's estate, implicitly arguing that these and other estates will enjoy a windfall if the QTIP is not presently taxed. Elimination of the pickup tax went hand-in-hand with changes in federal tax rates that, for these two estates, are substantially reduced. The point is not lost on us; we recognize that because of EGTRRA (and ignoring any other tax planning the wives might have done) the Sharon Bracken estate and other similarly situated estates would be money-ahead even if required to pay state estate tax on the federal deferrals.[6]

But the Estates and amicus have identified other scenarios, likely to occur, under which DOR's position penalizes taxpayers and produces a windfall for the State. The Barbara Nelson estate points out that when the William Nelson estate made its federal QTIP election, effective in September 2004, the state pickup tax rate was less than 4 percent; by deeming his estate to have made a state deferral election that it never made,

[6] We recognize that there is no guarantee this result will exist in the future, even for similarly situated taxpayers. To deal with its own budgetary issues, Congress may yet impose higher federal estate tax burdens on surviving spouses whose husband or wife elected only federal, not state deferral, prior to 2005.

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DOR subjects QTIP in the Barbara Nelson estate to taxation at the maximum 19 percent tax rate adopted in 2005. Reply Br. of Appellants at 13. The Estates point out that for the estate of a decedent who died during the period in which Washington had no estate tax (from January 1, 2005 to May 17, 2005) and which elected QTIP treatment for federal purposes, property that would have passed free of state estate tax will be subject, under DOR's view, to taxation in the estate of the surviving spouse—with no ability on the part of the estate to avoid that result. They note that DOR's position will allow it to impose Washington estate tax on gifts, despite Washington having no gift tax, and to tax transfers made years ago by decedents who never lived in Washington, but whose surviving spouse relocated to the State—even if that relocation was only shortly before the death of the surviving spouse.

We will not be distracted from reasonably construing the Act by DOR's concern about asserted windfalls to some taxpayers. Individuals who elected QTIP treatment for federal tax purposes before May 17, 2005 assumed the risk of what future changes in federal tax law might mean for the deferral. They did not invite or assume the risk of a state reaching into the grave and taxing a transfer 25 years after the fact.

"Transfer" Versus Washington QTIP as the Basis for Decision

We finally and briefly address the position of the concurrence/dissent, which agrees with the outcome of our decision for these two Estates but disagrees with the rationale and

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unfortunately mischaracterizes our discussion of federal tax law. Obviously QTIP is taxed in the estate of the surviving spouse.[7]

Its principal disagreement is with our insistence on distinguishing between real transfers and deemed, or fictional, transfers—a distinction central to our principled basis for rejecting DOR's interpretation of its 2006 regulations. It is not a contrived distinction. "From its inception, the estate tax has been a tax on a class of events which Congress has chosen to label, in the provision which actually imposes the tax, 'the *transfer* of the net estate of every decedent.'" *Mfrs. Nat'l Bank of Detroit*, 363 U.S. at 198.

As Lily Kahng, a tax professor at Seattle University, has observed:

> In tax, fictions abound. A taxpayer can be in "constructive receipt" of income; foreign taxes can be "deemed paid" by a foreign corporation's U.S. shareholder; "transitory" corporations can be "disregarded" in a corporate reorganization. . . . However, tax fictions can be dangerous. They can mask underlying motives and biases and they can cause unforeseen harms.

Lily Kahng, *Fiction in Tax*, *in* Taxing America 26 (Karen B. Brown & Mary Louise Fellows eds., 1996) (footnotes omitted). Ms. Kahng cites Lon Fuller and John C. Gray as "emphasiz[ing] the importance of recognizing that fictions are fictions and warn[ing] that the

[7] See discussion *supra* pp. 17-18; *e.g.*, "The transfer is taxed later at a time when there is no transfer, by virtue of the deferral election," and "The QTIP was not taxed in [Mr. Bracken's] estate, however, because by virtue of the deferral election, his estate was allowed to take the marital deduction on the basis of an explicit fiction that the entire property had passed to her." *Morgens*, 133 T.C. at 412 ("[T]he entire QTIP obtains the deferral benefit of the marital deduction and escapes inclusion in the gross estate of the first spouse to die."); Rev. Rul. 98-8, 1998-1 C.B. 541 (describing sections 2519 and 2044 as acting "to defer the taxable event on the marital deduction property only so long as the surviving spouse continues to hold the lifetime income interest").

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danger of a legal fiction lay in its user's unawareness of its fictional nature." *Id.* (citing Lon Fuller, Legal Fictions 10-11 (1967); John C. Gray, The Nature and Sources of the Law 37 (1921)). Elsewhere, she points out that one danger of "fail[ing] to recognize the fictional nature of [a] fiction" is the risk of relying on the fiction to trivialize important differences in underlying realities. *See id.* at 29. Here, the concurrence/dissent relies on Ms. Bracken's fictional receipt and transfer of property for federal tax purposes to ignore the fact that, for purposes of imposing a state estate tax, she has not received or transferred the property at all.

Our disagreement with the concurrence/dissent on that score would be academic if the different analysis did not have important ramifications. But it does, as recognized by the appellants and amicus, each of whom has urged us to recognize the distinction between real and fictional transfers reflected in the Internal Revenue Code and regulations.[8]

Any rejection of DOR's interpretation of its 2006 regulations must respond to its premise—supported by the language of the Act—that because the Washington taxable estate is based on the federal taxable estate, which includes federally elected QTIP in which the decedent had a qualifying income interest, then Washington estates must also include this

[8] *See, e.g.*, Br. of Appellant Bracken at 20 ("To give effect to the tax deferral, the property is *treated* as having *passed* from the surviving spouse, but the *transfer* occurs, under federal estate tax law and, thus, for purposes of Washington estate tax when the trust was established and the income interest was transferred."), 19-25; Br. of Appellant Nelson at 28-30 (Section F: "Nothing in Federal Tax Law Warrants a Conclusion that the Decedent Transferred the Marital Trust Property."); Br. of Amicus Curiae Mesdag at 8 ("DOR is attempting to tax estate transfers that predate the enactment of Washington's new tax law, ignoring both the Legislature's direction that the tax is to be applied prospectively only, and that it must be interpreted in favor of the taxpayer.").

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federal QTIP unless permitted to subtract it by DOR's regulations. DOR's 2006 regulations, as it interprets them, do not apply and allow federal QTIP to be subtracted if the QTIP is included in the estate as the result of an election made before May 17, 2005. The result is to tax QTIP on which federal tax was deferred (and, by extension, current payment of state pickup tax was avoided) before the law provided for a state QTIP election.

We respond to DOR's premise by relying on RCW 83.100.040(1), which imposes tax only on transfers; on Laws of 2005, ch. 516, § 20, providing that the Act's provisions apply "prospectively only and not retroactively" and "only to estates of decedents dying on or after [May 17, 2005]"; and on RCW 83.100.040(3), providing that the Act incorporates "only those provisions of the internal revenue code as amended . . . that do not conflict with the provisions of this chapter" and that imposes a tax "independent of any federal estate tax obligation." By adopting a principled analysis that the legislature has not attempted to tax transfers retroactively, we need not reach the Estates' arguments that such a tax would be unconstitutional.

The concurrence/dissent, on the other hand, accepts DOR's position that the legislature "could and did" import the federal tax regime even to the extent of taxing transfers, like Mr. Bracken's, that took place in 1984. Concurrence/dissent at 9. But it reasons that the 2006 regulations on their face do not support taxation of federal QTIP in these estates, dismisses DOR's interpretation of its own 2006 regulations to the contrary, and finds

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additional support for its narrow regulation-based decision on the fact that including federal QTIP in a Washington estate would lead to unequal treatment and absurd results. In asserting that the legislature "could and did" import a definition of transfer that would tax retroactively, the concurrence/dissent implicitly dismisses, without analysis, the Estates' vigorous arguments that such a definition of transfer is contrary to *McGrath* and would offend the United States and Washington Constitutions.

The distinction between real and deemed transfers is a consequential one, scrupulously recognized in federal statutes, regulations, and case law, and is appropriately the basis of our decision.

CONCLUSION

The trial court deferred to DOR's interpretation that the 2006 regulations implicitly do not apply to the Estates even if, on their face, they do. Because the statute and regulations are not ambiguous, deference was not warranted. *Waste Mgmt. of Seattle, Inc. v. Utils. & Transp. Comm'n*, 123 Wn.2d 621, 627-28, 869 P.2d 1034 (1994). An agency's interpretation that is not plausible or that is contrary to legislative intent is not entitled to deference. *Bostain v. Food Express, Inc.*, 159 Wn.2d 700, 716, 153 P.3d 846, *cert. denied*, 552 U.S. 1040 (2007). DOR's position improperly imposes estate tax without a present transfer—contrary to RCW 83.100.040; to the legislature's directive that the Act apply only prospectively; and to *McGrath*, among other authority.

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The trial court's orders granting summary judgment are reversed, and the cases are remanded for entry of judgment in favor of the Estates.

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AUTHOR:
Laurel H. Siddoway, Justice Pro Tem.

WE CONCUR:

	Justice Debra L. Stephens
Justice Tom Chambers	Gerry L. Alexander, Justice Pro Tem.
Justice Susan Owens	Christine Quinn-Brintnall, Justice Pro Tem.

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