

Stokes Lawrence Wins Major Appeal for Washington Estates

The Washington Supreme Court recently released its long-awaited opinion in *Estate of Bracken v. State Department of Revenue*, 175 Wn.2d 549, 290 P.3d 99 (2012). A divided court was unanimous in one conclusion: that the Estates properly excluded federal QTIP property when computing their state taxable estates. Scott Johnson, Doug Lawrence and Rosemary Reed of Stokes Lawrence represented the Bracken estate throughout the probate and appeal process.

The federal government has in recent years acted as the primary collector of estate taxes. States were allowed to “pickup” from estates a portion of the amount the feds collected and estates could take a credit on their federal estate tax return in that amount. The federal government substantially reduced estate taxes beginning in 2001 primarily by eliminating the state death tax credits and thus the state estate tax. An attempt by Washington’s Department of Revenue to continue collecting the amount of the no-longer-existing credit was struck down in *Estate of Hemphill v. Department of Revenue*, 153 Wn.2d 544, 105 P.3d 391 (2005). The legislature then created a new separate Washington estate tax by its Estate and Transfer Tax Act effective May 17, 2005; the Act incorporated federal estate tax concepts including the definition of each spouse’s taxable estate.

Congress created the QTIP election at issue here in 1981. Where a decedent creates a life interest favoring the surviving spouse, the decedent’s personal representative can elect to treat the property as “qualified terminable interest property.” The property will for federal estate tax purposes be deemed to pass entirely to the surviving spouse allowing the decedent’s estate a full marital deduction; taxation is deferred until the property is later treated as if it were transferred by the surviving spouse. This allows the surviving spouse to use the property unreduced by front-end taxation while allowing the decedent spouse to control the ultimate disposition of the property.

The new Washington act also provides for a QTIP election. Regulations issued by the Department of Revenue in 2006 effectively canceled out the effect of federal QTIP elections so that only QTIP for which a state election is made would be included in the surviving spouse’s Washington taxable estate.

The *Bracken* dispute arose when the Department of Revenue later decided that its 2006 regulations did not apply to surviving spouses whose federal taxable estate includes QTIP as a result of a federal QTIP election made before May 17, 2005. The Department contended that federal QTIP would not be subtracted in such cases in calculating the Washington taxable estate. The Washington Supreme Court found it unnecessary to consider arguments by the estates that doing so would create an unconstitutional

retroactive tax. It instead construed the state 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 only transfer here occurred when the first spouse died and the trust was created. The surviving spouse’s estate retained no property to transfer. Inclusion of federal QTIP in the federal taxable estate is justified by the original decedent’s agreement to defer federal estate taxation of the property transferred. There was no then-existing state QTIP election, no agreement made with the state to defer taxes, and the first decedent’s estate received no state estate tax benefit. In a concurring opinion, Chief Justice Madsen disagreed with the majority’s conclusion that there was only one transfer. However, that does not change the result. The concurring Justices agreed that the Washington act and regulations read as a whole required that the state estate tax be computed without regard to any federal QTIP election, and only QTIP property for which a state QTIP election has been made can be included in the Washington taxable estate.