# HOUSE BILL REPORT
# SHB 2064

**As Passed House:**
May 30, 2013

**Title**: An act relating to preserving funding deposited into the education legacy trust account used to support common schools and access to higher education by restoring the application of the Washington estate and transfer tax to certain property transfers.

**Brief Description**: Preserving funding deposited into the education legacy trust account used to support common schools and access to higher education by restoring the application of the Washington estate and transfer tax to certain property transfers.

**Sponsors**: House Committee on Finance (originally sponsored by Representatives Ormsby, Reykdal and Roberts).

**Brief History:**
**Committee Activity:**
Finance: 5/29/13 [DPS].
**First Special Session**
**Floor Activity:**
Passed House: 5/30/13, 51-40.

**Brief Summary of Substitute Bill**

- Requires certain marital trust property to be included in the estate for purposes of the Washington estate tax.

## HOUSE COMMITTEE ON FINANCE

**Majority Report**: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 8 members: Representatives Carlyle, Chair; Tharinger, Vice Chair; Fitzgibbon, Hansen, Lytton, Pollet, Reykdal and Springer.

**Minority Report**: Do not pass. Signed by 3 members: Representatives Orcutt, Assistant Ranking Minority Member; Vick and Wilcox.

**Staff**: Jeffrey Mitchell (786-7139).

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*This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.*

**Background**:

In 1981 Initiative 402 repealed the state inheritance tax and replaced it with an estate tax equal to the amount allowed under federal law as a credit against the federal estate tax. This is commonly referred to as a "pick-up" tax. A pick-up tax is not an additional tax on the estate but merely shifts revenues from the federal government to the state. Federal law phased out state pick-up taxes (i.e. federal sharing), with a complete termination in 2005.

On February 3, 2005, the Washington Supreme Court (Court) invalidated Washington's estate tax by holding that Washington's "pick-up" estate tax was based on current federal law, which had ended state-sharing, and Washington law did not impose an independently operating Washington estate tax. Until the Legislature expressly created a stand-alone tax, the tax remained a pick-up tax that must be fully reimbursed by the federal credit.

In response to the Court decision, Washington created a stand-alone estate tax in 2005. The tax took effect May 17, 2005. The current Washington estate tax is imposed on every transfer of property located in Washington at the time of death of the owner. The term "property" includes real estate and other property located in this state, as well as intangible assets owned by a Washington resident, regardless of location.

The measure of the tax is based on the taxable estate as determined under federal law, as it existed on January 1, 2005. For Washington decedents dying on or after January 1, 2006, a deduction of $2 million is allowed from the taxable estate. The value of property used for qualifying farming purposes is also deductible.

After subtracting any applicable deductions (e.g., the $2 million statutory deduction and the value of qualifying farm property), the remaining Washington taxable estate is subject to a graduated rate schedule ranging from 10 to 19 percent.

As previously mentioned, the federal taxable estate is the starting point for determining Washington's estate tax. Federal law allows an unlimited marital deduction for property passed outright to a surviving spouse. Federal law also allows certain transfers of property to marital trusts to qualify for the unlimited marital deduction even though the surviving spouse does not have total control of the property. This property is referred to as qualified terminable interest property (QTIP). The QTIP is included in the federal taxable estate of the surviving spouse upon the surviving spouse's passing. Under both federal and state law, the personal representative of the first spouse to die can make a QTIP election to qualify the property for the marital deduction. Since the current Washington estate tax did not take effect until May 17, 2005, an issue arises as to whether the Washington estate tax applies to QTIP when the first spouse passed away prior to May 17, 2005.

On October 18, 2012, the Court in *Estate of Bracken*, 175 Wn.2d 549 (2012), specifically held that QTIP included in the federal taxable estate where the federal QTIP election was made prior to May 17, 2005, is not subject to Washington estate tax when the surviving spouse passes away after May 17, 2005. The Court reasoned that Washington's estate tax is specifically triggered by the transfer of property of the decedent and with QTIP, the actual transfer occurs when the first spouse passes away. The surviving spouse is an income beneficiary of QTIP, but upon the surviving spouse's death, no actual transfer occurs. Under

federal law, a fictional transfer of QTIP occurs when the second spouse dies based on the original QTIP election by the first spouse. However, since the current Washington estate tax did not exist until May 17, 2005, no state QTIP election could have been made prior to this time.

**Summary of Substitute Bill**:

The definition of "transfer" is amended to specifically include property where the decedent economically benefitted in the property, i.e., property in a QTIP marital trust. A commensurate change is made to the definition of the "Washington taxable estate" to specifically include an interest in QTIP, regardless of whether the decedent acquired the interest in the property prior to May 17, 2005.

For decedents dying prior to April 9, 2006, the personal representative of the estate is not personally liable for estate taxes on QTIP if the property is not located in Washington and the personal representative does not have possession of the property.

The changes in the bill apply prospectively as well as retroactively to decedents dying on or after May 17, 2005.

The changes in the bill do not impact the parties involved in the *Estate of Bracken* decision.

**Appropriation**: None.

**Fiscal Note**: Available. New fiscal note requested on May 29, 2013.

**Effective Date**: The bill contains an emergency clause and takes effect immediately, except for section 4 relating to qualified terminable interest property, which takes effect January 1, 2014.

**Staff Summary of Public Testimony**:

(In support) There is an ongoing, time-critical budget negotiation taking place where the state has to figure out how to provide additional funding for education. This bill seems like a great place to start. This bill will help Washington meet its education funding obligation. This bill has been adjudicated before the Legislature as well as the people. The agreement is that the money from this tax is specifically dedicated to education. This bill does not represent new revenue, but instead stops the hemorrhaging of revenue that Washington already counted on. The court decision creates disparity between single and married folks and between property transferred outright versus through a trust. This bill creates a loophole for married couples. There are recent court decisions that will require the Department of Revenue to begin making refunds. Once refunds are made, the money cannot be recovered. The legislation is constitutional. The original intent was a stand-alone tax for education. There was never any intent to tax married couples and single individuals differently. The estate tax is reasonable. There is a moral imperative to pass this bill because of the inequality in incomes and opportunities for people in this state. Washington has a very regressive tax structure. This bill will improve this situation and retain money for education.

(With concerns) There are two retroactive pieces to this bill. The first piece clarifies the law from 2005 to the present where the QTIP is created after 2005. The second retroactive piece applies the tax prior to its existence. In some cases, it would apply 20 years before the tax existed. This is unconstitutional. No attorney has made an argument that tax is not owed on a QTIP created post 2005. We do not have a problem clarifying the law for QTIP created after 2005. It is appreciated that the Legislature did not contemplate or anticipate this issue when the legislation was first enacted. However, retroactivity is very disturbing to us. It is very unfair even though it may be legal. People rely on the law in effect at the time they make decisions.

(Opposed) Initiative 1185 was a clear mandate for no tax increases. About 1.9 million people supported the initiative. The Legislature is contemplating over 15 different tax increases totaling $7 billion for the operating budget. This bill picks at the carcasses of dead people. Every tax increase adopted by the Legislature will end up on the ballot as a tax advisory vote. An emergency clause prevents a referendum by the people on the legislation. All of us occasionally make poor decisions and we have to live with those decisions. We are not able to reach back in time and change those decisions even if we really want to. The Legislature should adhere to the same rule. The retroactive component of this bill is punitive. These taxpayers are not tax cheats. These are people that followed the law. This bill should be rejected to restore people's faith in government.

(Information only) The primary argument of the tax bar is their assertion that this legislation is unconstitutional because it violates due process. The test used to determine whether retroactive legislation violates due process is whether the retroactive application is supported by a rational legislative purpose. This bill levels the playing field between marital and nonmarital estates. It will also prevent the payment of significant and unanticipated tax refund claims. The court has repeatedly upheld retroactive tax legislation, including cases where the reach-back was over 10 years. The other issue is separation of powers. The bill specifically excludes taxpayers that have received a final judgment by a court.

**Persons Testifying**: (In support) Representative Ormsby, prime sponsor; Drew Shirk, Department of Revenue; Randy Parr, Washington Education Association; Jeff Johnson, Washington State Labor Council; Lonnie Johns-Brown, League of Women Voters and Washington Coalition of Sexual Assault Programs; Michael Mitchell, Washington State Budget and Policy Center; and Nick Federici, Rebuilding Our Economic Future Coalition.

(With concerns) Kathryn Leathers, Washington State Bar Association; and Brad Tower, Community Bankers of Washington.

(Opposed) Tim Eyman, Voters Want More Choices; Amber Carter, Association of Washington Business; and Patrick Connor, National Federation of Independent Business.

(Information only) Cam Comfort, Office of the Attorney General.

**Persons Signed In To Testify But Not Testifying**: None.