DEPARTMENT OF THE TREASURY
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OFFICE OF
CHIEF COUNSEL

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MEMORANDUM FOR Sherri Wilder
Associate Area Counsel
Attn.: Louis Jack
CC:SB:8:LN:1

FROM: George Masnik
Chief, CC:PSI:4

SUBJECT: Legislation Reversing Hoffman v. Connell
Our Control No.: FREV-114229-00

You asked for our comments regarding the allowance of a state death tax credit under section 2011 with respect to California estate tax paid pursuant to California Assembly Bill 2818, reversing the result in Hoffman v. Connell, 73 Cal. App. 4th 1194, 87 Cal. Rptr. 2d 272 (Cal. Ct. App. 1999). We have been informed that the Comptroller of the State of California has taken the position that AB 2818 applies retroactively to estates of decedent's dying before September 7, 2000, and a notice of deficiency will issued on the authority of AB 2818 where QTIP property is excluded from the California tax base. As discussed below, we believe a credit should be allowed under § 2011 for state death tax paid pursuant to the legislation with respect to estates of decedents dying prior to September 7, 2000, the date of enactment.

Under § 2011(a), in computing the federal estate tax, each estate is allowed as a credit, subject to certain limitations, an amount equal to any estate, inheritance, legacy, or succession tax actually paid to any state. Under § 2011(b) the allowable credit cannot exceed an amount determined using a table contained in that section.

Section 2016 generally provides that if any tax claimed as a credit under § 2011 is recovered from the state, then the person receiving the refund must give notice to the Service of the refund. The Service can redetermine the tax due to reflect the reduced credit at any time.

California imposes a pick-up tax equal to the maximum federal estate tax credit allowable under § 2011.

In Hoffman v. Connell, the court concluded that qualified terminable interest property (QTIP) included in the federal gross estate under §2044 is not subject to California estate tax. In response to this decision, the California legislature enacted AB 2818 on September 7, 2000, amending § 13402 of the California Revenue and

Taxation Code to subject all property included in the federal gross estate of a decedent or transferor to California estate tax. Although the bill does not contain an effective date for this provision, the bill, as enacted provides, in part, as follows:

> Section 1. The legislature finds and declares all of the following:
>
> (a) It is and always has been the intent of the legislature in enacting the California Estate Tax Law (Chapters 327 and 1533 of the Statutes of 1982), to implement the intent of Section 13302 of the Revenue and Taxation Code (adopted by Proposition 6, initiative Statute, June 8, 1982) and that California be entitled to collect the maximum allowable amount of the credit for state death taxes, allowable under the federal estate tax law, that is attributable to property located in California.
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> (b) Despite this requirement, an appellate court decision has held that, under California property law, certain transfers included in a decedent's gross estate under the federal estate tax law are not subject to tax under the California Estate Tax Law because the decedent under California law was not the owner..
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> (c) The Legislature expressly declares that this appellate court decision is contrary to the Legislature's intent, and the amendments made by this act are intended to clarify what the Legislature declares was and continues to be the law.

The question presented is whether AB 2818 applies retroactively such that a §2011 state death tax credit is allowable for California estate tax paid with respect to QTIP property if the decedent died before the enactment of the statute.

As noted above, in AB 2818, the Legislature expressly states that the estate tax provisions were intended to entitle the state to collect the maximum amount allowable as the federal credit for state death taxes attributable to California property, that Hoffman v. Connell is contrary to legislative intent, and that the statutory amendment made by AB 2818 "was and continues to be the law."

In Estate of Ridenour v. Commissioner, 36 F.3d 332 (4th Cir. 1994),aff'g, TCM 1993-41, the Fourth Circuit, in affirming the Tax Court, held that under Virginia law, a statement by the General Assembly that the statute at issue was "declaratory of existing law." clearly evidenced the legislative intent that the statute apply retroactively, and therefore, the statute was to be applied retroactively for tax purposes. The Fourth Circuit noted that the General Assembly can only make law and cannot declare what the existing law is. However, the court concluded that, under Virginia law, the legislature has the power to enact retroactive legislation, and generally it is valid if the legislative intent is plainly manifest that the statute is to have a retroactive effect and if the statute does not have the effect of impairing the obligation of a contract and is not

destructive of vested rights. The Fourth Circuit (as well as the Tax Court) concluded that the legislature's statement that the statute is "declaratory of existing law" was sufficient to satisfy the Virginia standard for retroactive application.

The California courts have acknowledged the legislature's power to enact retroactive legislation. See, e.g., Allen v. Franchise Tax Board, 245 P.2d 865, 868(1952) ("There is no provision in the Constitution forbidding retroactive effect of tax measures in proper cases."); Holmes v. McColgan, 17 Cal 2d 426, 431(1941). Generally, "[A] statute is not to be construed so as to have retroactive effect unless the intent that it is to be retroactive clearly appears from the statute itself." Estate of Potter v. Chambers 204 P. 826, 830 (1922).

Initially, we note that Hoffman v. Connell, was decided by an intermediate appellate court and the California Supreme Court has not rendered an opinion on the issue presented in Hoffman. In the absence of a California Supreme Court decision on the issue, it is not certain that AB 2818 did in fact change the law. In any event, we believe that Estate of Ridenour supports the position that the language used by the California Legislature in Section 1(a)-(c) of AB 2818, which is more detailed and explicit than that considered by the court in Estate of Ridenour, can be viewed as clearly expressing the Legislature's intent that the statute apply retroactively to estates of decedents dying prior to September 7, 2000, the date of enactment.

Further, we believe that retroactive application of the statute would be held to be constitutional. As noted above, the California Supreme Court has upheld as constitutional retroactive tax legislation, applying the standards enunciated by the United States Supreme Court. See Allen v. Franchise Tax Board, 245 P.2d 865, 868 (1952). The United States Supreme court has repeatedly upheld retroactive tax legislation provided the legislation is supported by a legitimate legislative purpose furthered by rational means. United States v. Carlton, 512 U.S. 26, 30 (1994), holding that tax legislation that retroactively corrected a perceived mistake in prior legislation was justified by a rational and legitimate legislative purpose. See also, Quarty v. United States, 170 F.3d 961 (9th Cir. 1999). In this case, the legislation is curative in nature, as was the case in Carlton. Further, since the California estate tax is a "pick-up tax" equal to the allowable § 2011 credit, AB 2818 operates to allocate a portion of the total estate tax liability, that would be imposed in all events, to the State of California. Thus, as a practical matter, the statute did not retroactively increase any estate's total estate tax burden.

We recognize that contrary arguments can be made and a taxpayer might challenge the retroactive application of the statute. However, under § 2016, if any tax claimed as a credit under § 2011 is subsequently recovered from the state, then the person receiving the refund must give notice to the Service of the refund. The Service can redetermine the tax due to reflect the reduced credit at any time. This provision will operate to protect the government in the event an estate pays the California estate tax pursuant to AB 2818, and the payment is subsequently refunded. See, Estate of

Weisberger v. Commissioner, 29 T.C. 217 (1957) (holding that under the predecessor to § 2016, the statute of limitations is not a bar to collecting additional federal estate tax resulting from a refund of state estate or inheritance tax.) See also, Rev. Rul. 60-88, 1960-1 C.B. 365.

In summary, for the reasons outlined above, a credit should be allowed under § 2011 for state death tax paid pursuant to AB 2818 with respect to estates of decedents dying prior to September 7, 2000, the date of enactment.

Lane Damazo of our office is familiar with this matter. He can be reached at (202) 622-3090.