Case No. 18-16053

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

JUDITH BADGLEY,

Plaintiff and Appellant,

vs.

UNITED STATES OF AMERICA,

Defendant and Appellee.

APPELLANT JUDITH BADGLEY'S REPLY BRIEF

Appeal from the United States District Court, Northern District of California

Case No. 17-cv-00877-HSG

Honorable Haywood S. Gilliam, Jr., United States District Judge

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I. PRELIMINARY STATEMENT

Appellee's Answering Brief contains numerous arguments. Appellant Judith Badgley's decision to not address any such arguments (which she does not believe are material to this appeal) herein does not constitute a concession of those arguments.

II. ARGUMENT

A. Introduction

Appellee's case is premised on the following:

(1) A retained annuity *should* cause estate inclusion under section 2036(a)(1).

(2) A retained annuity *does* cause estate inclusion under section 2036(a)(1) on either of two separate and independent grounds:

(a) Because it constitutes retained enjoyment of the property; and

(b) Because it constitutes a retained right to the income from the property.

(3) Any doubt as to the foregoing is removed by regulation section 20.2036-1(c)(2) which holds that a retained annuity causes estate inclusion under section 2036(a)(1).

Badgley's case, on the other hand, is premised on the

following:

(1) A right to an annuity is not a way of enjoying the property unless the annuity right is treated as an income right.

(2) An annuity like that retained by the decedent does not constitute a right to income because:

(a) There is an unambiguous difference between the meaning of "income," as used in section 2036(a)(1), and an annuity.

(b) The doctrine of substance over form - a case law doctrine that can be relied upon even though contrary to the words of a statute - does not support ignoring the unambiguous difference between "income" and an annuity where, at the decedent's date of death, the annuity payment could be fully satisfied without using any income.

(3) Insofar as Regulation section 20.2036-1(c)(2) fails to except retained annuities from section 2036(a)(1) inclusion where, at the decedent's date of death, the GRAT principal alone is sufficient to fully satisfy the annuity payment, the Regulation is invalid because it contradicts the plain meaning of the statutory language.

Permeating Appellee’s Brief is the proposition that because all of the property in the GRAT other than the 50% interest in Y&Y

Company was acquired with undistributed income from Y&Y Company, there was never any property in the GRAT with which to pay the annuity other than the Y&Y Company interest and its income. This proposition is false and is referred to herein as the "accumulated income fallacy."

Undistributed income, as the term implies, is income which has not been distributed at the end of a trust's fiscal year and is therefore added to principal. "Accumulated income" is a term of art with no meaning in a trust context; it has meaning only in a corporate context, and means net income that is not distributed as dividends. (Opening Br. at pp. 29-30). Appellee agrees that at the end of each trust year the undistributed income from Y&Y Company became principal, but argues that it nevertheless remained income (Ans. Br. 54).

In support of this novel argument Appellee cites *United States v. O'Malley*, 383 U.S. 627 (1966) and *Horner v. United States*, 485 F.2d 596 (Ct. Cl. 1973). Neither case supports the argument. *O'Malley* does not hold that principal is "accumulated income." It holds that the income referred to in section 2036(a)(1) includes *income* from property acquired with undistributed income and proceeds of sale. *Horner* deals with undistributed income, and

Appellee's reliance on it is an example of Appellee's persistent mislabeling of undistributed income as "accumulated income."

Appellee also contends throughout its Brief that the decedent continued to control Y&Y Company after she transferred her interest in it to the GRAT, without clarifying that any such control was held by her in her capacity as the Trustee of the GRAT. Not only did the decedent's control materially change after the transfer, in that she held such control in a fiduciary capacity, but as Trustee she did not unilaterally make decisions and control the funds distributed from Y & Y Company. She shared such decision-making with her 50% partner Frank Yoder. It is settled law that decedent's retention as Trustee of managerial powers over Y&Y Company was not sufficient to cause inclusion in her gross estate under section 2036(a)(1). See *Reinecke v. Northern Trust Co.*, 278 U.S. 339 (1929) and *Old Colony Trust Co. v. United States*, 423 F.2d 601 (1st Cir. 1970), cited with approval in and followed by the Court in *United States v. Byrum*, 408 U.S. 125, 132-134 (1972); see also *Estate of Trombetta v. Commissioner,* 106 T.C.M. (CCH) 416 (2013) at 423. Appellee's contention on decedent's continued control is referred to herein as the "continued control fallacy."

B. Appellee's Statement Of The Issues And Relevant Facts Is Erroneous and Misleading

Appellee's statement (Br. 3), that the Treasury Department has determined, by regulation, that a retained annuity "constitutes the retention of the possession or enjoyment of, or the right to the income from, the property for purposes of section 2036" is misleading. Treasury determined, rather, that the Regulation provides "guidance on the portion of a trust property includable in a grantor's gross estate under sections 2036 and 2039 *if the grantor retained* the use of property in the trust or the right to an annuity, unitrust, or other payment from the trust...." See Preamble page 1 under heading "SUPPLEMENTAL INFORMATION" and subheading "Background and Explanation of Provisions," emphasis added. It is important to note that "use of property in the trust" is distinguished from "payment from the trust", i.e., the nouns "use" and "payment" are stated disjunctively, separated by the word "or", indicating that they are alternatives. Appellee also bases its statement on the continued control fallacy.

Finally, the fact that the decedent continued to take depreciation deductions on her personal income tax returns is a red herring because, as Appellee later acknowledges (Br. 65-66), under the

grantor trust rules of the Internal Revenue Code, even though the decedent had no right to the income from Y&Y Company, she was required to report all items of income, deduction, and loss on her personal tax return. Appellee assumes this was a benefit to the decedent, but in later years when the GRAT's share of the net income from Y &Y Company exceeded the annuity payments to her, having to report and pay tax on such undistributed income was a detriment, not a benefit. This is referred to herein as the "tax benefit fallacy."

Again, on page 13 of its Brief, Appellee selectively quotes the wording of Treas. Reg. section 20.2036-1(c)(2)(i), in a way that conveys the (incorrect) impression that the Regulation expressly equates a retained annuity with retained enjoyment of the property as well as with a retained right to the income from the property. Appellee states the Regulation "provides expressly that the retention of an annuity 'constitutes the retention of the possession or enjoyment of, or the right to the income from, the property for purposes of section 2036.'" The unedited wording is: "***the decedent's right to use the property *or* the retained annuity, unitrust, or other interest (whether payable from income and/or principal) constitutes the retention of the possession or enjoyment of, *or* the right to the income from, the

property for purposes of section 2036." *Id.*, emphasis added. The disjunctive syntax is critical to a proper understanding of the Regulation, making clear the distinction between the paired word groups "right to use the property" and "retention of the possession or enjoyment of," and the paired word groups "retained annuity, unitrust, or other interest (whether payable from income and/or principal)" and "the right to the income from." In other words, although the Regulation says a retained annuity is a right to income from the property, the Regulation inherently acknowledges (contrary to Appellee's argument) that a retained annuity is not the retention of "right to use" or retention of "possession or enjoyment" of the property. The Regulation does not equate a retained annuity with retained enjoyment of the property – it does the opposite.

Appellee confirms (Br. 16) that during the public comment period before the Treasury Department issued the Regulation, a commentator recommended that where trust principal alone was sufficient to fully satisfy the annuity payment, the annuity interest should not be treated as a retained right to income within the meaning of section 2036(a)(1). Appellee asserts Treasury rejected this recommendation on the grounds that it was inconsistent with the

language of the statute, the case law interpreting it and the legislative history. That assertion is incorrect. Treasury did not reject the recommendation because it was inconsistent with the language of the statute. Treasury rejected it because of a policy concern. The Preamble to the Regulation states:

> With regard to the commentator's suggestion that section 2036 applies only to the extent that the trust principal alone is insufficient to fully satisfy the annuity payment, the IRS and Treasury Department believe that this would condition the estate tax treatment on the nature and performance of the investments selected by the trustee. The application of section 2036 should not be dependent on either the trustee's exercise of his or her discretion to invest in income or nonincome producing assets, or the actual performance of the trust assets.

Preamble, p. 3.

Had Treasury rejected the recommendation on the grounds stated by Appellee, Treasury would have said so instead of engaging in the otherwise idle act of explaining an irrelevant policy concern.

C. Despite Legislative History And Policy Concerns, The Unambiguous Language Of The Statute Controls And Supports Badgley's Position

Appellee's Brief makes the case for why Congress should have expressly included a retained annuity as a string in section 2036(a)(1) and why Congress' failure to do so opens the door to unwarranted tax avoidance. That position may or may not be true; but even if true, it is

not the role of the judiciary to fix statutes which fail in some degree to fulfill their purpose. That is the responsibility of Congress. The government made the same policy-based argument in *United States v. Byrum*, 408 U.S. 125 (1972), *Gitlitz v. Commissioner,* 631 U.S. 206 (2001), and *Wisconsin Central Ltd. v. United States,* 138 S.Ct. 2067 (2018), but did not prevail because in each case the plain wording of the statute did not so provide. The issue in this case is not what section 2036(a)(1) *should* mean, it is what the statute *does* mean. "In determining the meaning of a statute, a court looks first to its language." *R.R. Concrete Crosstie Corp. v. R.R. Ret. Bd.*, 709 F.2d 1404, 1407 (11th Cir. 1983). Legislative history and policy are irrelevant if the unambiguous language of the statute does not conform to such legislative history or satisfy such policy concern. *Byrum, Gitlitz* and *Wisconsin Central Ltd.* all stand for the proposition that what arguably *should be* covered by the statute based on policy goals or legislative history *is not* covered unless the plain language of the statute so provides, whether or not there is a regulation to the contrary. Courts do not typically resort to legislative history when a statute is relatively clear, and "certainly should not do so to undermine the plain meaning of the statutory language." *Harris v. Garner*, 216

F.3d 970, 976 (11th Cir. 2000) (en banc); *see also CBS Inc. v. PrimeTime 24 Joint Venture*, 245 F.3d 1217, 1224 (11th Cir. 2001) ("The 'plain' in 'plain meaning' requires that we look to the actual language used in a statute, not to the circumstances that gave rise to that language."). *See CSX Corporation et al v. United States*, No. 17-12961 (11th Cir. Nov. 21, 2018).

The role of the judiciary is not to fix a deficient statute but to interpret it. As a general rule, when the relevant language is straightforward, a court's interpretive function ceases and it should "enforce [the statute] according to its terms." *United States v. Ron Pair Enters.*, 489 U.S. 235, 241 (1989). Badgley does not believe excluding the decedent's GRAT from her estate is inconsistent with section 2036(a)(1), but even if Congress made a mistake by not including all annuities as a "string," only Congress may fix the mistake.

D. A Retained Annuity Is Not Covered By Section 2036(a)(1)

1. A Retained Annuity is not Retained Enjoyment

Appellee argues, based upon the accumulated income fallacy, that a retained annuity constitutes a way of enjoying the property. Appellee's position is summed up on page 32 of its Brief:

> For Section 2036(a)(1) to apply here, it need only be recognized that decedent's retention of the right to annuity payments funded entirely by the transferred property is a way of enjoying that property. And this is true whether those payments come from the property itself (such as by way of sale of the property or a portion of it) or from income from that property (whether from Y & Y Company's current income or that of a prior year, even if added to principal).

This assertion is not supported by case law. Moreover, if a retained annuity constituted retained enjoyment as Appellee urges (which it does not), then the income/principal mix of the annuity payment would be irrelevant, thus making Treasury's statement in the Preamble of its policy concern superfluous. Appellee's assertion further confirms the inapplicability of an income-based formula to determine the amount includable in the decedent's estate.

The Regulation substitutes the word "use" for the word "enjoyment," showing that "enjoyment" contemplates the use of, or right to the income from, a specifically identified asset or group of assets, e.g., a vacation home, an art collection, or a block of closely-held stock. The grantor of a GRAT, who transfers property irrevocably to the Trustee without an express reservation of use or possession, does not have the use of the GRAT assets. Moreover, if (as Appellee argues) a retained annuity constitutes the enjoyment of the transferred property, making the income/principal mix of the

annuity payment irrelevant, there was no reason for Treasury to carefully consider the commentator's recommendation and then reject it on a policy ground. Treasury would not go the trouble of addressing the commentator's recommendation and rejecting it solely on a policy ground if it could dismiss the recommendation because a retained annuity constituted retained enjoyment under the plain language of the statute. The fact that Treasury dismissed the recommendation solely on policy grounds shows that Treasury did not consider a retained annuity to be retained enjoyment.

The Regulation makes it clear that there is a difference between a retained annuity and retained use of the property by (1) repeatedly referring to "retained use" and "retained annuity" disjunctively e.g., "***a grantor's retained use of an asset held in trust ***or*** a retained annuity,...."; "***the right to use such property, ***or*** the right to an annuity...."; "***the decedent's right to use the property ***or*** the retained annuity...." (emphasis added); and (2) prescribing a formula to determine the amount of a GRAT corpus includable under section 2036(a)(1) as if the annuity payments were an income interest, whereas retained enjoyment would require no formula because in cases of retained enjoyment the full amount of corpus is includable

under section 2036(a)(1).

A careful reading of the Regulation, taking note of the disjunctive pairing of word groups, makes clear that the only section 2036(a)(1) string Treasury considered applicable to a retained annuity was the right to income. The Preamble negates enjoyment as a relevant string by rejecting the commentator's recommendation on a policy ground when, if Appellee's position were correct, the recommendation could have been simply dismissed on the ground that the retention of the right to an annuity is a way of enjoying that property.

2. A Retained Annuity is Not Equivalent to a Retained Right to Income

Having catalogued the policy reasons why a retained interest *should* be covered by section 2036(a)(1), Appellee next argues that an annuity interest *is* covered by the statute, leading one to wonder why the extended discussion of policy reasons for inclusion if inclusion is clear under the statute's plain language. The reason appears to be Appellee's misplaced reliance on *Ray v. United States*, 762 F.2d 1361 (9th Cir. 1985), and *Estate of Trombetta v. Commissioner*, *supra*. In *Ray*, the retained interest was not an economically real annuity. The court found that what purported to be a GRAT was in substance a

disguised grantor retained *income* trust (“GRIT”). In the case of a GRIT, the source of the payments to the decedent is irrelevant. But even if the trust in *Ray* were to have been considered a true GRAT, the only source of the payments to the decedent was the income generated by the transferred property, because the trust operated at a breakeven point from its inception until the decedent’s death. Hence, the trust contained no property other than the property transferred to it. In arguing that the facts in this case are comparable to the facts in *Ray,* Appellee relies upon the accumulated income fallacy (Br. 35).

The court in *Estate of Trombetta* found that the decedent retained possession and enjoyment of the property based upon an implied agreement between the decedent and her co-trustees that after she transferred the property to the trust she would continue to have the use of and access to it until her death. *Estate of Trombetta*, 106 T.C.M. (CCH) at 424. Accordingly, the court held that the entire trust corpus was includable in the decedent's estate. What is significant about *Estate of Trombetta* is what it doesn't hold. It doesn't hold that for purposes of section 2036(a)(1) an annuity is, without exception, the same thing as income, nor does it hold that even if an annuity is not the same thing as income, a retained annuity is nevertheless an

economic interest in the transferred property sufficient to cause estate inclusion; for had it so held, it would have applied an income-based formula, such as that specified in the Regulation, to determine what portion of the trust corpus was includable in the decedent's estate.

Concerning *Ray* and *Estate of Trombetta*, Jonathan G. Blattmachr, cited several times in Appellee's Brief as an authority on GRATS, says:

> ***given the structure of the *Trombetta* opinion, as well as the structure of the *Ray* opinion itself, it would seem that both courts contemplate that an estate can defeat a finding of a retained section 2036(a)(1) string if *either* it satisfies the *Fidelity-Philadelphia* criteria *or* there is no relationship between the annuity amount and the anticipated income.

Gans and Blattmachr, *Private Annuities and Installment Sales: Trombetta and section 2036*, Journal of Taxation 227 (May 2014) at 235. In this case, both conditions were met. The *Fidelity-Philadelphia* criteria were satisfied (*see infra,* pages 25-26) and there was no relationship between the annuity amount and the anticipated income.

In discussing *Ray*, Appellee surmises that had the annuity payments therein not been designed to equal the trust's annual income, but designed to be less than the trust's income, "[t]here is no reason to think that such a modification would have changed this

Court's analysis" (Br. 36). Gans and Blattmachr would disagree.

E. The Regulation Does Not Hold That A Retained Annuity Constitutes The Retention Of Possession Or Enjoyment Of The Property

While Badgley agrees with Appellee that the Regulation plainly states a retained annuity constitutes the retention of the right to the income from the property (Br. 28), (which Badgley maintains is overly broad and thus invalid), Badgley does not agree that the Regulation states that a retained annuity constitutes the retention of possession or enjoyment of the property. Quite the opposite, the language of the Regulation makes clear that a retained annuity does not constitute retained possession or enjoyment.

Appellee's characterization of Bagley's interpretation of section 2036(a)(1) as "crabbed reading" (Br. 31) and argument that the statute must be read as a whole and in the context of the statutory scheme of which it is a part is reminiscent of what the Internal Revenue Service surely argued in *Byrum*, *Gitlitz* and *Wisconsin Central Ltd.*

Badgley agrees that the right to income from property is a type of enjoyment of property, so that a grantor who has the right to the income from the property has the enjoyment of the property; but this simply circles back to the only real issue in this case: whether a

retained annuity constitutes a retained right to income.

In the absence of an expressly reserved right to use or possess the property, it is not possible for the grantor of a GRAT to enjoy the property within the meaning of section 2036(a)1) unless he or she has a right to the income therefrom.

Badgley further agrees with Appellee that when Treasury issued regulation section 20.2036-1(c)(2)(i), it carefully considered and rejected the argument Badgley makes here (Br. 39). However, Treasury did not reject the argument as being inconsistent with the language of section 2036(a)(1), its legislative history, and the case law interpreting it, as maintained by Appellee. Instead, Treasury rejected it on the policy ground noted by Appellee (Br. 40).

Badgley maintains (which Appellee misconstrues) that Treasury's acknowledgement that a retained annuity interest is not a form of possession or enjoyment of trust property is necessarily inferred from the fact that Treasury, in the Preamble, addressed the policy concern associated with conditioning the estate tax treatment on the nature and performance of the investments selected by the trustee, which discussion would be completely irrelevant if estate inclusion were based upon retained possession or enjoyment.

F. The Regulation Is Invalid Insofar As It Holds That Retained Annuities, Without Exception, Constitute Retained Rights to Income

Appellee argues the Regulation is entitled to *Chevron* deference because the failure of section 2036(a)(1) to expressly include a retained annuity as a string requiring estate inclusion means the statute is "arguably" silent or ambiguous with respect to the specific issue (Br. 37). *Chevron* deference does not apply to "arguably" silent or ambiguous statutes; it applies where there is a clear and obvious gap or ambiguity in the statute. There is none here. Even if policy objectives suggest that the coverage of section 2036(a)(1) is not as broad as it ideally should be, that does not mean the statute is silent within the meaning of *Chevron*, thereby empowering Treasury to legislate by regulation. Nor is there any ambiguity in section 2036(a)(1).

Appellee argues (Br. 38) that the Regulation is a legislative regulation issued pursuant to the general authorization set forth in section 7805, citing *Mayo Found. for Med. Educ. & Research v. United States*, 562 U.S. 44 (2011). *Mayo* was concerned with the meaning of the word "student", which it found to be ambiguous absent any definition in the Code, thus satisfying step one of the

Chevron test. In this case the word "income " is not ambiguous; it is defined by the Code to have the meaning given it by California law. (Opening Brief, pp. 36-37). The term "income" may be broad, but it is not vague; and its plain meaning vitiates any need for the court to rely on legislative or regulatory history.

It is true, as Appellee states (Br. 38 n.7), that *Chevron* deference is not limited to regulations promulgated where Congress overtly left the statute ambiguous by telling the agency to write the rule (for example, the consolidated return regulations). *Chevron* deference can apply to any regulation required to fill a gap in the Code that is large enough to infer Congress intended Treasury to fill it, as with the FICA statute in *Mayo* (when the issue was whether a medical student-employee was a student or an employee within the meaning of the statute). Therefore, "general authority" regulations written under section 7805 can be due *Chevron* deference. This does not mean, however, that all of the hundreds of regulations written under section 7805 are due *Chevron* deference; some remain merely interpretive. Only the words of the statute can determine whether Congress intended the agency to have discretion to write the law, and those words do not include a general regulation grant, as in section

7805, because that would make all tax regulations legislative. The courts believe they can construe the statute just as well as the Treasury, and they retain that power. But if the gap is great enough, which can be called an ambiguity in the statute, the regulation promulgated by the agency is entitled to deference.

Treasury appears to believe any regulation adopted after a process of notice and comment is automatically entitled to deference. This is not so. That approach would make Treasury the master of its own deference determinations and take it away from the courts. Rather, the courts are the ultimate arbiter of whether the statutory gap is great enough to impute a Congressional intent that the agency should write the rule. The plurality opinion in *United States v. Home Concrete & Supply, LLC,* 566 U.S. 478 (2012), made the *Mayo* holding clear: if a court can figure out what the statute means, there is no gap and no *Chevron* deference.

This Court addressed the issue of deference in *Altera Corp. v. Commissioner*, Case: 16-70496 (9th Cir. 7/24/2018), opinion withdrawn 8/7/2018, stating:

> Ultimately, questions of deference boil down to whether 'it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in

> the exercise of that authority.' *United States v. Mead Corp*., 533 U.S. 218, 226-27 (2001).

But even conceding, for purposes of argument, that *Chevron* step one were satisfied, the Regulation fails to satisfy step two. Insofar as it equates an annuity with income without exception, it is not a reasonable interpretation of section 2036(a)(1). It does not elucidate the statute but instead attempts to rewrite it.

Chevron deference may be short-lived with the appointment of Justice Brett Kavanaugh to the Supreme Court. As predicted by Lee A. Sheppard in the July 16, 2018 issue of Tax Notes:

> With Kavanaugh and Justice Neil Gorsuch on the Court, the bottom line is that it is open season on tax regulations that stretch IRS authority. The *Chevron* doctrine will be killed off by this Court.

Id. at 280.

G. Badgley's Interpretation Of Section 2036(a)(1) Has Not Been Rejected By Case Law

Appellee implies (Br. 41) that under the authority of *Church's Estate*, property transferred to a trust that was intended to, and did, postpone until the settlor's death the right of the settlor's relatives to possess and enjoy the property would always be subject to estate inclusion under section 2036(a)(1). This is simply not so. Merely postponing possession and enjoyment of property irrevocably

transferred to a trust until the death of the settlor is not sufficient to cause inclusion in the settlor's estate under section 2036(a)(1). Consider property transferred by a father, irrevocably and without reservations, to a trust for the benefit of his son, which trust provides that income shall be accumulated and added to principal during the father's lifetime and upon his death the trust property will be distributed to the son. There is no basis whatsoever for inclusion in father's gross estate under section 2036(a)(1) or any other Code section.

Badgley agrees with Appellee's abstract of *Estate of McNichol*, especially the court's conclusion that "[h]e who receives the rent in fact enjoys the property" (Br. 45-46). Rent is a form of income, and as previously stated, Badgley agrees that having a right to income from transferred property is a way of enjoying the property within the meaning of section 2036(a)(1). But *Estate of McNichol* is of no help to Appellee unless a retained right to an annuity is the same as a retained right to income. It is not.

Badgley agrees with Appellee's point in footnote 9 (Br. 46) that Badgley's statement "*there can be no enjoyment of property without either possession or income*" is not precisely correct. Based upon

Estate of McNichol, the statement should be "*there can be no enjoyment of property without either possession or **a right to** income*." Also in footnote 9 of its Brief, Appellee bases its rejection of Badgley's interpretation of *Estate of McNichol* on the accumulated income fallacy.

H. Appellee's Attempt To Distinguish The Cases Relied Upon By Badgley Falls Short

Badgley agrees with Appellee's statement (Br. 47) that the words "possession or enjoyment" must be interpreted in a commonsense manner so long as, by "commonsense manner," Appellee means in accordance with their ordinary meaning. The ordinary meaning of "possession" is not in question; and, as stated in *Church's Estate* and *Estate of McNichol*, the right to income is a form of enjoyment. But once again Appellee erroneously equates a right to an annuity with a right to income. Moreover, Appellee proffers an out-of-the-ordinary meaning of "enjoyment," i.e., the availability of property to fund an annuity payment.

In *Byrum*, the IRS argued that by retaining voting rights the decedent retained enjoyment of the transferred stock within the meaning of section 2036(a)(1). In its attempt to distinguish *Byrum*, Appellee fails to note that one basis upon which the Court rejected the

IRS' argument was that retaining control over management-type decisions does not constitute retaining enjoyment of the transferred property:

> At the outset we observe that this Court has never held that trust property must be included in a settlor's gross estate solely because the settlor retained the power to manage trust assets.

Byrum, 408 U.S. at 132-33.

Appellee maintains, however, that the Court's rejection was based on the ground that the decedent's control of the stock was constrained by his fiduciary duty to the minority stockholders. To the extent the holding in *Byrum* was based on the finding that the decedent was a fiduciary, Appellee's apparent approval of the holding stands in stark contrast to its persistent repetition of the continuing control fallacy, which refuses to distinguish between having control in a fiduciary capacity and having it in an individual capacity. And Appellee again rests its enjoyment argument on the accumulated income fallacy.

Appellee's attempt to distinguish *Fidelity-Philadelphia Trust* fails because it is based on the continuing control fallacy as well as the accumulated income fallacy. Appellee's contention that "Footnote 8 of *Fidelity-Philadelphia Trust* is simply inapplicable here" (Br. 52)

is also contradicted by Gans and Blattmachr (Gans and Blattmachr, *Private Annuities and Installment sales: Trombetta and Section 2036*, Journal of Taxation (May 2014) at 227) who, in discussing private annuities and installment sales, state:

> The applicability of the *Fidelity-Philadelphia* principle in the context of a sale to a trust as opposed to an individual has not been questioned. The *Trombetta* court unhesitatingly assumed its pertinence. See also *Ray*, 762 F. 2d 1361, 56 AFTR2d 85-6406?(CA -9, 1985*); Estate of Becklenberg*, 273 F.2d 297, 5 AFTR2d 1821 (CA -7 1959)

and further:

> Hence, it seems that, by reason of *Fidelity-Philadelphia*, if the trust has adequate additional property, no estate tax inclusion should occur on account of an annuity or installment obligation owed to the decedent.

Gans and Blattmachr, *supra*, footnote 26, 232-33.

Regarding Appellee's contention that the promise of annuity payments " was plainly not 'a personal obligation of the transferee'" (Br. 53) Gans and Blattmachr state:

> The obligation can be viewed as the personal obligation of the trust in the sense that it can be paid from the trust's other assets.

Gans and Blattmachr, *supra*, 232-33.

Appellee's contention that "here the obligation to make the annuity payments to decedent was chargeable to the transferred property" rests on the accumulated income fallacy. The cash and

securities in the GRAT constituted additional property, not income. Therefore, according to Gans and Blattmachr, the first of the *Fidelity-Philadelphia Trust* conditions was satisfied:

> The [annuity] obligation is not chargeable solely to the transferred property but to the [additional property] as well . . . .

Gans and Blattmachr, *supra*, 232.

Appellee agrees that when the undistributed income from Y&Y Company was invested at the end of the year it became principal. However, Appellee contends that it did not thereby cease to be income, thus continuing to perpetuate the accumulated income fallacy (Br. 54). Appellee's argument, based upon *Ray,* that there was no additional property falls short because *Ray* involved a disguised GRIT where the presence or absence of additional property is irrelevant; and in any case there was no additional property in the *Ray* trust from which the payments could be made.

I. Appellee's Recital of Legislative And Regulatory History Is Not Only Irrelevant, It Is Inaccurate

Appellee's extended recital of legislative and regulatory history, summed up by its statement (Br. 60) "The truth is that the Treasury expressly provided that retained annuities trigger inclusion when the statute was first enacted and for years after," is contradicted by

Blattmachr, Gans, and Zeydel who state, regarding the proposed regulations:

> Despite the wide popularity that GRATs have enjoyed, Treasury and the IRS did not- until now- issue any published guidance on the estate tax treatment of these trusts.

See Blattmachr, Gans, and Zeydel, *Treatment of GRATs under the Section 2036 Proposed Regulations – Questions Remain*, 107 Journal of Taxation 143 (September 2007) at 146.

J. The Regulation's Formula Is Arbitrary When Applied To A Fixed Term GRAT

Regarding the Regulation's formula, Appellee quibbles when it states that Badgley's statement the formula is flawed does not amount to a statement that it is arbitrary (Br. 61). Regardless, the formula is, in fact, arbitrary. Moreover, instead of explaining why the formula is not arbitrary if applied to a short term GRAT which contemplates the amortization of principal as the primary source for the annuity payment, Appellee implies that a different formula might apply to that kind of GRAT.

K. Decedent's Continued Control Of The Y&Y Company Interest In Her Capacity As The Trustee Of The GRAT Is Irrelevant, And She Obtained No Tax Benefit

Appellee's final argument (Br. 61-67) repeats and rests upon the continued control fallacy and the tax benefit fallacy. Appellee

provides a quotation from *Church's Estate* (Br. 63) with which Badgley agrees, and the test expressed in the quotation was satisfied in this case: the decedent made a bona fide transfer of the Y&Y Company interest to the GRAT in which she absolutely, unequivocally, irrevocably, and without possible reservation parted with all of her title, possession, enjoyment of the transferred interest.

Regarding the continued control fallacy, the court in *Estate of Trombetta* stated:

> However, the decedent's retention of the right to exercise managerial power over the transferred property does not in and of itself result in inclusion under section 2036(a). *Byrum*, 408 U.S. at 132-134.

Estate of Trombetta, 106 T.C.M. (CCH) at 423.

III. CONCLUSION

The judgment of the District Court should be reversed and the District Court ordered to enter a new judgment granting Badgley's Motion for Summary Judgment and denying Appellee's Cross-Motion for Summary Judgment.

Dated: December 5, 2018 Respectfully submitted,

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Certificate of Compliance

Pursuant to 9th Circuit Rule 32-1(e)

Case Number 18-16053

I certify that this brief complies with the length limits permitted by Ninth Circuit Rule 32-1. The brief is 5,747 words, excluding portions exempted by Fed. R. App. P. 32(f), if applicable. The brief's type size and type face comply with Fed. R. App. P. 32(a)(5) and (6).

Signature of Attorney: /S/ PAUL FREDERIC MARX

Date: December 5, 2018

Certificate of Service

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on December 5, 2018.

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