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Teachings from Tiki: Tacoma's New Rental Housing Code

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What would you do if you were told that you had to move your home, your family, and all your belongings 20 days from today? How about 60 days from today? How about 120 days?

All of us have had to move, and it's fair to say that moving is a horrendous amount of work, not to mention stressful, and typically costly. If you have children, they may have to transfer schools or school districts, and even if they don't, moving homes undoubtedly has a significant impact on small children. Then there is the administrative inconvenience that accompanies any move: changing addresses, updating employers, schools, banks, billing information, etc. Suffice it to say, we all know the enormous pain and inconvenience that comes with moving.

Nevertheless, most of us reading this article have probably only moved upon our own terms because we wanted to move, not because we were made to. More likely than not, we had already secured a new place to live, and in many cases, a better place to live, before ever considering a move. Moreover, we probably had a financial plan in place to pay for the increase in living costs related to our newer, better place and the resources to physically move all of our stuff. But, what if we didn't?

What if, instead, you were one of the 62 Tiki Apartment residents who learned that the new landlord had issued 20-Day Notices to Vacate to nearly everyone in the apartment complex? What if you were one of the 50+ Tiki tenants who showed up in the Tacoma City Council Chambers on April 24, 2018, pleading for help? What if you didn't have another place to go and you didn't have the money set aside to pay the security deposit for a new apartment or to pay the higher rents that are rampant throughout the metro-Puget Sound area?

Many of our neighbors are facing this very same situation. As much as the growth in the real estate market is a blessing for property owners, it is just as often a curse for those who rent. It is particularly distressing for those who survive on low and fixed incomes.

In Tacoma, about half of the 80,000 households are renters, which is roughly the same percentage of the population renting in Seattle.[1] In April 2018, the *News Tribune* reported that Tacoma rents were increasing at a rate of over 12 percent annually and that "Tacoma's 98402 was listed as having one of the nation's 20 most rapidly gentrifying ZIP code(s)".[2] According to the same article, Tacoma rents grew the fastest in the nation from 2016-2017.[3] In June 2018, Komo News reported that Tacoma had the highest rental rate increases in the Puget Sound Metro Region.[4]

Furthermore, the City of Tacoma's ("City") "Affordable Housing Action Strategy" adopted by the City Council in September 2018 acknowledged that from "1990-2016, Tacoma's median rent increased 39 percent, while the median household income increased by only 20 percent,"[5] illustrating that housing costs are rapidly outpacing income growth. Moreover, rent spikes aside, 40 percent of Tacoma residents (both owners and renters) are already considered "cost burdened,"[6] meaning they spend more than one-third of their income on housing (hence, the existing shortage in affordable housing).

Thus, there's no question that rents have gone up precipitously, and with half of Tacoma residents renting, there's clearly a large number of my neighbors who

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are impacted by the adverse consequences that typically follow a hot rental market. Add in the facts that housing is already too expensive for more than one-third of our residents and that incomes have dramatically lagged behind the increase in housing costs, and you can see that the boom in the rental market has a multiplier effect on the bust for many households in our City.

Taken together, we call this an affordable housing crisis. It is a crisis which has much greater adverse impacts on minority communities, who are disproportionality represented in the renter community, not to mention having to face the present-day disparities resulting from discriminatory practices, such as "red-lining."[7] Extrapolate these factors to every other growing metropolitan area throughout the country and you can see a clear demonstration of the so-called "death" of the middle class in action. While this article will not go into the many good (and sometimes imperfect) works the City and its partners are employing to increase affordable housing in our prefecture, there is no question that the laws that impact the termination of rental tenancies have an extraordinary impact on the stability of housing for tenants.

Because, what is your neighbor going to do when he is told to move out in 20 days, and he can't find a new apartment because he doesn't have the money for the deposit, let alone the new rent? Is he going to live in his car or at the shelter until he finds another place? Many do. In a city where homelessness is on the rise, the last thing we want to do is put more individuals out on the street. But, perhaps the more important question is, what will we do?

Aside from the fact that helping others in need is the right thing to do (See most every spiritual faith that has existed for the past 5,000 years) and the fact that doing this work might actually pay off for us (see the Hindu Proverb: "Help thy brother's boat across, and Lo! Thine own has reached the shore"), it turns out that every community actually performs better when people have stable housing. When we are not facing a housing crisis, we perform better at work, our children perform better at school, we are healthier, and the results are not just increased health and happiness, but we also see economic benefits in the way of increased investments in our communities and a decrease in expensive societal costs, including crime, homelessness, and poor public health. With these benefits in mind, in 2015, when the Tacoma City Council adopted its vision for the next 10 years (Vision 2025), it made sure to make increasing housing security, and by definition reducing housing insecurity, one of its top priorities.

Of course, goals like these are easy to set and incalculably harder to achieve. Increasing housing security for tenants when there are significant market incentives to terminate tenancies and increase rents is not a simple endeavor and most assuredly a precarious one when trying to mitigate or manipulate market realities.

Now, I don't presume to be an expert in the real estate market or economics, but the cause and effect of this crisis seem fairly straightforward: As the demand for rental housing grows, the supply of rental housing shrinks and market rental rates rise. As rents skyrocket regionally amid a shortage in housing, many property owners find themselves in the fortuitous position to not only charge higher rents, but to secure the capital necessary to improve their existing portfolio of rentals, to buy outdated buildings, or to build new buildings, which can now be capitalized as a result of the higher rents, and which will (when complete) command a higher rent. The real estate market is working and the demand for housing is increasing property values and generating the capital needed to invest in housing. Isn't this what we want? Actually, yes, it is.

We want property values to increase. We want higher returns on investments. We want people and corporations to invest more money into our communities. We want old buildings to be refurbished, modernized, and brought up to code and back to life. And we desperately need more housing built.

But what good is a bull market if it comes at the cost of plunging half of our neighbors into housing distress? And what, if anything, should we do to decrease the negative impacts on renters?

Your answer to these questions and others may be informed by your own personal housing and financial situation, your stake in the real estate game, as well as your views on property rights and personal, social, and civic responsibility, and more.

Whatever your experience, and irrespective of your answers to these questions, I would submit to you as a real estate practitioner, and having prosecuted a considerable number of evictions to judgment and defended many tenants facing eviction, that the Residential Landlord Tenant Act ("RLTA") does not adequately protect our most vulnerable rent-paying, law-abiding neighbors in the current market, despite the broad due process and substantive protections afforded by the RLTA.

As a City Council member, it is incumbent upon local policy makers like myself to enact local laws and policies to better protect the people we serve who are facing their own housing crisis (or teetering dangerously close to one). This is particularly true in cities like Tacoma, where the population affected may very well include half of the households we serve.

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In addition, as a lawyer who is passionate about real estate and private property rights, I am cognizant of the balance that must be struck between greater tenant protections and the property rights of owners and landlords. Moreover, if the policies proposed simply result in increased red tape, confusion, and increased costs to landlords, costs which are automatically passed on to tenants, or which in practice actually operate to deter investment in housing in our community, then we have only acted to exacerbate the existing housing crisis. In other words, if we are to achieve our goal of reducing housing insecurity, then we must craft policies that do not ultimately increase tenant costs and/or discourage investment in housing. In a market short on housing (especially affordable housing), we need policies that incentivize those investments and not deter them, and we certainly don't want to raise costs for tenants even more.

All that being said, in a crisis such as this where the status quo is not working, doing nothing is simply not an option and neither is doing something that makes the problem worse. While no good deed may go unpunished, certainly no deed at all warrants one. Thus, acknowledging that housing security is the goal and that we must make changes in how we protect tenants under current market conditions, we must labor to shape the best outcomes through policies that will actually work. Focusing on desired outcomes and testing the application of our policies against our goals, with an open mind and with the courage to make adjustments, are critical to sincerely addressing any problem, especially this one.

So, What Did the City of Tacoma Do?

In April 2018, the Tacoma City Council adopted Ordinance 28559, labeled the "Rental Housing Code," and codified in Tacoma Municipal Code 1.95 (the "Code"). Among other things the Code: (1) allows for rental deposits to be paid in installments; (2) requires 60-day notice prior to any rental increases (unless previously fixed by the lease agreement); (3) requires 60-day notice to vacate for "no cause" lease terminations for every tenancy; (4) requires 120-day notice to vacate for tenant "displacement"; (5) requires tenant relocation assistance for "low income tenants" who are displaced, funded equally by their landlords and the City; and (6) strengthens local enforcement and establishes stiff penalties for violations of the Code. The purpose and intent of the Code is to regulate rental practices such that rental housing can be "equitably undertaken," since housing directly impacts the quality of life for everyone.

As a disclaimer, it's incumbent upon me to disclose that while I am an attorney, I did not draft this Code. Further, my interpretation of the Code does not constitute the City's official interpretation. Thus, while I voted in support of this Code, there are admittedly some provisions I strongly support and others that I remain skeptical will actually result in stronger housing security. This legislation, like most major policies, is the result of considerable dialogue and compromise among Council members and passionate stakeholders with varying interests and divergent views.

This Code was the result of several months of deliberation and public comment, including from those who showed up in great numbers at Council meetings and gathered outside Council chambers demanding greater tenant protections. In April 2018, the need for greater tenant protections became a reality for 62 residents of the Tiki apartments[8] when, following the sale of the building, all 62 residents were suddenly faced with

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notices to vacate, so the new owner could execute plans to renovate the building and raise the rents. For many, Tiki had been their home for years, as there was literally no place left to go at rents they could afford.[9] The Tiki plea for more time and resources to move commanded the City Council's undivided attention, forcing it into emergency session to implore the new owner to provide a reprieve and to prevent this from happening again.

In response, on April 26, 2018, the City Council adopted an emergency ordinance requiring 90-day notice for tenant "displacement" (explained below) and affording the City time to craft a more comprehensive tenant protection policy. In addition, the City struck a deal with the new Tiki owner that would give Tiki residents more time and resources to relocate. Meanwhile, grass roots efforts, like the Tiki Tenant Organizing Committee, and other more formal tenant advocacy groups, in addition to the Rental Housing Association of Washington (representing small landlords), sprang into action to help Tiki residents (most of whom faced considerable barriers to securing new housing) find new affordable housing. Ultimately, the joint efforts of the Tacoma Housing Authority, Tacoma Community College (which is located down the street), and the new Tiki owner were able to strike a deal to convert the complex into housing for college students experiencing or at risk of experiencing homelessness.[10]

Although the Tiki story and its "feel-good" ending were highly publicized in the Tacoma *News Tribune*[11] and other news outlets, the plight was not unique. Before the end of the year, at least one more apartment complex full of tenants (the Merkle Hotel) would find itself in the very same position. Thus, the Council was well aware that its response to the Tiki story would prove a bellwether for things to come.

The City's Community Vitality and Safety ("CVS") Committee comprised of four Council members (of which I am not one) spent several public meetings over the next six months listening to hours of intense public debate, from tenants' rights advocates and landlords alike, and considering the vast array of proposals floated by interested constituents. Perhaps the most prominent proposal that did not make the final Code was the proposal for a "Just Cause Eviction Ordinance," although a commitment was made to further study it.[12] After the CVS Committee finished drafting a proposed code, the full Council reconvened to review the draft, making some nominal and substantive revisions throughout, before adopting what would be known as the "Rental Housing Code."

The Code provides:

Distribution of Information and Resources to Tenants.[13] First, the Code imposes new public dissemination requirements on the City and requirements for landlords to timely and adequately distribute information regarding tenants' rights to current and prospective tenants. Such requirements include:

1. The City shall publish a summary of tenants' rights and resources under state, local, and federal law.
2. Landlords shall provide prospective tenants with a copy of the landlord's rental criteria, which shall contain a reference to the City's informational website and shall furnish all prospective tenants with a summary of tenants' rights and resources pursuant to applicable federal, state, and local law (i.e., RLTA 59.18, Unlawful Detainer RCW 59.18, etc.). A Landlord must furnish a hard or electronic copy of this Summary to every prospective tenant upon application for tenancy, or within 30 days after the creation or amendment to the Summary, for every existing tenant, the receipt of which must be acknowledged in writing.

Security Deposit Requirements and Installment Payments.[14] One of the primary objectives when drafting this Code was to address the reality for many tenants who expressed that having the money to pay for a new security deposit, nonrefundable move-in fee, and first and last months' rent (collectively, "Move-in Fees") was a significant barrier to securing new housing when unexpectedly being told to vacate their home. These expenses can be considerable and if unanticipated (as in the event of a speedy tenancy termination) can be cost prohibitive to securing alternative housing. As such, the Code seeks to balance the tenant's need to reduce this significant barrier against the landlord's need for payment, through the following:

1. Written Lease and Checklist Required. Move-In Fees cannot be collected until the lease is executed and the move-in "checklist" provided to the tenant.[15]
2. Move-In Fees paid in Installments. If the total Move-In Fees exceed 25 percent of the first month's rent, then a Tenant may make written request to pay the Move-In Fees in installments.[16]
3. Installment Payments. For fixed term leases of 3 months or more, the tenant must pay the Move-In Fees in 3 consecutive equal monthly installments, beginning at the inception of the tenancy. For month-to-month or 2-month tenancies, the tenant must pay the Move-In Fees in 2 equal payments beginning at the inception of the tenancy.

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4. Failure to Pay Move-In Fees. A failure to pay the Move-In Fees subjects the tenant to a 10-day notice to vacate pursuant to *RCW 59.12.030(4)*. The Code also clarifies that the owners' remedies for damages to the premises are not limited by the amount of the Move-in Fees, including the security deposit.

Reasonable Accommodation.[17] Landlords are required to comply with all reasonable accommodation requests with regard to delivery of a notice to vacate and any other notices required under the Code. Further, this Code provision references a separate City code which establishes a broadly written reasonable accommodation requirement for the rental of dwellings. Of note, interpreting and applying the Fair Housing Act (and other lawful) "reasonable accommodation" requirements can often be daunting given the capacious nature of the applicable laws.

Greater Notice Requirements

1. Notice to Increase Rent.[18] Unless a fixed lease agreement includes agreed-upon rent increases, landlords must provide 60-day notice for any increase in rent, which is double the statewide requirement that requires at least 30-day notice for increases in rent.[19]
2. Notice to Vacate. Probably the most contentious, complex, and impactful section of the Code is the Notice to Vacate provisions, which apply to all leases, including month-to-month and periodic tenancies. The new Notice provisions are as follows.

120-Day Notice to Vacate for Displacement.[20] When tenants are "displaced" a tenant must receive 120-day notice to vacate. Perhaps what makes this provision the most frustrating and challenging for lawyers and landlords alike is that it introduces a new factor, "causation" or "motivation," into the termination of tenancies for no cause. Why is the tenancy being terminated? What are the reasons for termination?

Without the Code, most attorneys (with the exception of the Seattle Bar, which has operated under a "just cause" eviction standard since 1980) have become accustomed to the fairly simple perfunctory steps under state law for terminating month to month tenancies on 20-day notice for any undisclosed legal reason (i.e., excluding eviction based on protected classes). State law provides means for earlier termination for defined reasons such as nonpayment of rent, waste, and nuisance upon 3-day notice, or for violation of the terms of the lease upon 10-day notice, which have been left unaffected by the Code. To be clear, tenants may still face eviction for failure to pay, nuisance or waste, etc., in accordance with the notice provisions set forth in *RCW 59.12.030*. But, up until now a landlord was entitled to terminate a month to month lease upon 20-day notice for any reason or no reason at all; provided, that such termination was not predicated on the basis of race, gender, disability, etc.

The rationale behind the provision is that aside from acknowledging that 20 days is an unreasonable amount of time for any human being to pick up and move their entire life, public policy favors affording more time to make alternative living arrangements to those who are being forced out involuntarily to make way for a new and/or improved facility.. Although the barriers to securing alternative housing are great for anyone, these barriers are nearly insurmountable for tenants who are being displaced from lower rent facilities, who also typically lease on a month-to-month basis.

This 120-day notice provision was very much prompted by the Tiki situation. Following the 20-day notices given in Tiki, Council members were immediately confronted with what should happen to tenants when an owner decides to evict everyone to fix up the building. How much time should a tenant have to find a new place? What is a reasonable amount of time to move, particularly in a tight rental market with high rents? "We need more time to find a new place to live" was the repeated plea the Council heard consistently throughout its rule-making process. Notwithstanding the reasonableness of the request, there was considerable discourse and debate concerning the reasonableness of a 120-day notice requirement. Only time will tell whether it is, in practice, both adequate and reasonable. For even four months after Tiki tenants received their notices to vacate, some were still without another place to go.

The 120-day notice requirement only applies when a tenant is being "displaced." According to the Code, "displacement" or "displaced" means the demolition, substantial rehabilitation, or change of use, requiring existing tenants to vacate the dwelling unit, but shall not include the relocation of a tenant from one dwelling unit to another dwelling unit with the tenant's consent.[21] Thus, on a quick reading, one can easily discern that displacement means having to vacate your dwelling for one of the following three reasons:

1. "Demolition" means the destruction of any dwelling unit. Any "demolition" as provided herein requires displacement of a tenant.[22] If you are being told to leave because your apartment building or unit is being demolished, you are entitled to 120-day notice.
2. "Substantial Rehabilitation" means extensive structural

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repair or extensive remodeling and requires a building, electrical, plumbing, or mechanical permit for the tenant's dwelling unit at issue. Any substantial rehabilitation as provided herein requires displacement of tenant.[23] Practically speaking, the Substantial Rehabilitation scenario is the mode of displacement most likely to cause the most confusion among landlords, since, for example, even replacing a single toilet requires pulling a permit. Nonetheless, if you read the definition closely, you'll see that the rehabilitation must be the cause of the displacement. In other words, is the toilet replacement the reason you have to vacate the premises? If the answer is "no," then the 120-day notice requirement does not apply.

3. "Change of Use" means the conversion of any dwelling unit from a residential use to a nonresidential use, to another type residential use (e.g., a conversion to a retirement home, emergency shelter, transient hotel, or short-term rental as defined in TMC 13.06.700); provided, however, the removal of use restrictions, including those found in assisted housing developments that provide that an owner who must displace a tenant so that the owner or immediate family member can occupy the rental dwelling unit shall not constitute a change of use. Any "change of use" as provided herein constitutes displacement of a tenant.[24] Although surely the most esoteric of the three types of tenant displacement, the idea of the change of use is that if a tenant is being asked to leave so that their dwelling can be re-purposed for a different use, then the tenant should be afforded more time to find another place. Again, the goal is to minimize the impacts associated with a forced relocation compounded by a shortage of affordable housing, making relocation very difficult.

Tenant Meeting.[25] The Code requires the landlord to provide the required 120-day Notice to Vacate, and the Code further affords tenants the right to request an in-person meeting with the landlord for the purpose of discussing the lease termination. Upon receipt of a written request for the meeting, the landlord must hold such meeting within 20 days at a reasonable time and place. The Code does permit a landlord to hold a single meeting for multiple tenants.

The other consideration at the forefront of policymakers' minds was how to prevent landlords from skirting the requirements under the Code by cloaking a displacement as something else. What if a tenant who has been asked to leave with only 60-day notice later learns that the landlord has since made significant improvements to the dwelling and is now charging a higher rent? Will said tenant be able to assert that the landlord should have provided 120-day notice? How will the courts resolve this "causation" or "motivation" question?

To address these concerns, a section of the Code was added to establish a presumption that if the landlord provides a 60-day notice and then subsequently undertakes one of the three discrete displacement activities, the City will presume that the landlord intended to avoid the 120-day Notice to Terminate requirement.[26] The landlord must overcome this presumption by demonstrating by a preponderance of evidence that the termination was due to proper cause or in the case of substantial rehabilitation, that the tenant left the unit uninhabitable, which necessitated the improvements.[27] If the landlord fails to overcome the presumption, then severe penalties await, with the City reserving unto itself broad discretion to impose penalties. Ultimately, more answers will come only in time, as landlords, tenants, and local policymakers experience the Code in practice.

60-Day Notice to Vacate for Everything but Evictions for Cause.[28] Next, the Code creates a 60-day Notice to Terminate requirement for terminating tenancies without cause (i.e., landlord is terminating for reasons other than failure to pay rent, nuisance, waste, etc.), and which does not constitute a displacement, thus triggering the 120-day notice requirement. Keep in mind, if the landlord is terminating for cause, e.g., failure to pay rent, nuisance, waste, etc., then this 60-day notice requirement does not apply and the landlord may provide Notice to Vacate consistent with the RLTA. For ease of understanding, think of the 60-day notice as the new 20-day notice. Local realtors and landlord associations thought it was a reasonable compromise, and tenant advocacy groups found it satisfactory for the time being, which is how the 60-day notice requirement was arrived at. Only time will tell if the 60-day notice requirement provides a reasonable amount of time to find alternative housing under current market conditions.

Additional Standards/Exemptions for Notice to Vacate. By and large the standards for properly serving a notice to vacate under the City code mirror the RLTA. Exemptions to the 60-day notice requirement include forcause terminations under RCW 50.18 and RCW 59.12, or where safety concerns necessitate repairs when a building is deemed derelict or unfit for habitation under the City's Minimum Building and Structures Code.

Tenant Relocation Assistance.[29] Probably the most verbose and untested section of the Code is the

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section governing Tenant Relocation Assistance.

1. Applicability. Relocation Assistance is only available to "Low Income Tenants," and only in circumstances where the 120-day notice to vacate is required. Accordingly, Relocation Assistance is only available to tenants who are being "displaced" and not in circumstances where the 60-day notice requirement applies, or if the lease is being otherwise terminated for cause. The Relocation Assistance section of the Code begins by reaffirming that the statutory relocation and assistance requirements set forth in state law (*RCW 59.18.085*) continue to apply for condemned dwellings or dwellings that are unlawful to occupy.
2. Eligibility of Tenants. Only tenants who are parties to the rental agreement, reside in the unit, and are deemed "low-income tenants" are eligible for Relocation Assistance. "Low-income tenants" means tenants whose combined total income per dwelling unit is at or below 50 percent of the median income, adjusted for family size, in Pierce County. The median household income in Pierce County is approximately $52,000 for a household of one, which means the same household would have to make less than $26,000 per year to qualify for relocation assistance. Tenants are deemed ineligible for the tenant relocation benefits if they fail to timely submit the Tenant Relocation Packet (see more below) or provide false material information. A decision by the City regarding eligibility for Relocation Assistance is then sent to the landlord and tenant within 14 days after receipt of the application (or after the expiration of the 20-day period following the tenant's initial receipt of the Packet).
3. Appeal. Either party (landlord or tenant) may appeal the tenant relocation eligibility decision to the City's hearing examiner; provided that the appeal is filed within 10 days after the landlord or tenant receives the City's notice of tenant eligibility. The Hearing Examiner's decision may be appealed to the superior court.
4. Exceptions. Tenant Relocation Assistance is not required under the following circumstances:
   - Dwelling is demolished or vacated because the damage is caused by an event beyond the landlord's control (e.g., fires, natural disasters, etc.).
   - Dwelling is vacated or demolished pursuant to the City's Minimum Building Structures Code because of damage within the landlord's control.
   - Dwelling(s) owned or managed by the Tacoma Housing Authority.
   - Dwelling is included within the boundaries of a major educational institution.
   - Relocation assistance is required to be paid under another law.
   - Dwellings functioning as emergency or temporary shelters for homeless persons operated by a nonprofit organization.
5. Tenant Relocation Packet. When a tenant is going to be displaced, the landlord must provide the tenant with the Tenant Relocation Packet ("Packet"), which shall include a relocation assistance form both describing the benefits available and the instructions on how to claim them. The landlord must deliver the Packet to the tenant along with the notice to vacate. Within 20 days of distributing the Packet, the Landlord must submit a list of the names of the tenants who have received the Packet to the City. Twenty days after receiving the Packet, tenants must apply with the City for Relocation Assistance (although the 20-day timeline can be extended for an additional 20 days for good cause).
6. Payment; Who Pays. Tenants eligible for Relocation Assistance shall receive $2,000 per unit, adjusted annually for inflation in accordance with the Consumer Price Index. The Landlord is responsible for paying one-half, and the City for the other half of the monies due. After a tenant is deemed eligible, the tenant must then submit an additional form to request the funds. The City and the landlord must pay their respective portions to the tenant within 21 days following receipt of the request for funds, the latter of which must submit written proof of payment to the City within five days after making the payment. If, however, the City has not appropriated the funds, then both the City and the landlord are relieved of the requirement to pay for relocation. For the 2019-2020 biennium, the City has currently budgeted $200,000 for relocation assistance, which means that absent a budget change, the City is positioned to assist approximately 180 low-income residents over the next two years (offset due to administrative costs).

Compliance and Enforcement.[30]

1. Incorporation into Leases. All leases entered after February 1, 2019, must include a provision incorporating the standards of the Code. Any lease provision that attempts to waive any provision of the Code will be deemed void and unenforceable.

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2. Retaliatory Action. The Code reaffirms and incorporates the prohibitions against retaliation set forth in *RCW 59.18.240* and *RCW 59.18.250*.
3. Affirmative Defenses. A landlord's failure to provide the required 120-day or 60-day Notices or provide the Relocation Assistance Packet, will constitute an affirmative defense for the tenant.
4. Joint and Several Liability. This section authorizes the City to take any action against violators of the Code.
5. Powers of the Director. The Code empowers the Director of the City's Neighborhood and Community Services Department ("Director"), or its delegate, to enforce the Code and promulgate additional rules and regulations, as necessary, and is further authorized to request landlord records (upon notice of five business days) to investigate alleged violations of the Code. Additionally, the Director is required to attempt to settle any alleged violation by agreement.
6. Penalty Process. Upon the Director's determination that a violation has occurred, the City shall issue a Notice of Violation to the offending landlord in accordance with the requirements as further set forth in the Code. Civil penalties that may result from violations of the Code include:

- For failing to distribute the City's Summary on the Tenants' Rights Code, allow a tenant to pay Move-in Fees in installments, or conform to the general notice requirements, landlords are subject to a $500 fine upon an initial violation, and $1,000 fine for each subsequent violation within a three-year period.[31]
- For violations of the notice to vacate requirements, failure to provide relocation assistance, or for retaliatory conduct, landlords are subject to a per diem fine of $250 per day per dwelling unit for the first 10 days, and $500 per day per dwelling unit for each subsequent day thereafter.
- If a tenant has already relocated but did not receive proper notice to vacate, then a penalty of $1,000 per dwelling unit may be imposed.
- The Director may waive or reduce the penalties if the landlord comes into compliance within 10 days of the violation, or if the landlord's failure to comply was due to reasonable cause. A penalty of $1,000 may also be imposed for willful violations.
- Civil penalties are payable to the City and used to help offset the administration costs of the program.
- An aggrieved landlord may seek administrative review by the Director and the Director's decision may be appealed to the Hearing Examiner.

Although the Code is imperfect, and in some ways unsatisfactory for tenant advocates and landlords alike, it constitutes a tremendous step forward in a City that up until eight months ago had no policy for helping rent-paying, law-abiding tenants at risk of facing swift homelessness simply because the market is booming. Having a reasonable time to move and some assistance, particularly when you survive on less than $26,000 per year, seems like a reasonable compromise. However, only time and experience can inform us of what improvements must be made to the Code, and the RLTA more generally, to truly result in greater housing stability.

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2 Debbie Cockrell, *Tacoma's rents keep going up…and up… and up*, The News Tribune, April 6, 2018.
3 *Id.*
4 Komo Staff, Report: *City of Tacoma now has highest rent price hikes in the region*, KOMONews.com, June 28, 2018.
5 City of Tacoma, *Affordable Housing Action Strategy*, September 2018, p. 13.
6 *Id.* at p.17, citing 2016 American Community Survey PUMS 1-Year Estimates.
7 Joint Center for Housing Studies of Harvard University, America's Rental Housing 2017, p. 10. 2017.
8 The Tiki Apartments was an older lower-rent apartment complex located at 1111 S. Highland Avenue in Tacoma.
9 On average, Tiki residents paid $500/month, while the median rental rate in Tacoma hovers around $1,300.
10 Matt Driscoll, *Unique deal means redemption for vilified landlord, housing for TCC students who need help*, The News Tribune, October 10, 2018.
11 Matt Driscoll, *New Tacoma landlord to desperate tenants he's evicting: Moving will be an improvement*, The News Tribune, April 20, 2018; Candace Ruud, *Days before eviction, Tiki residents get an extension as Tacoma passes a Tenants Rights Code*, The News Tribune, April 26, 2018; Matt Driscoll, *Sarah Howe still can't find a place to live. That's why a Tenants' Bill of Rights is needed*, The News Tribune, May 14, 2018; Candace Ruud, *After crisis at the Tiki, Tacoma could see vast new protections for renters*, The News Tribune, July 3, 2018; Matt Driscoll, *Tacoma is finally poised to pass meaningful tenant protections. Activists deserve the credit*, The News Tribune, November 12, 2018.
12 Seattle adopted SMC 22.206.160(C), a No Cause Eviction Ordinance, in 1980. This article does not address Seattle's code.
13 TMC 1.95.030.
14 TMC 1.95.040.
15 Although the Code does not reference the checklist requirements of *RCW 59.18.260*, the Code essentially adopts the requirements to provide a move-in checklist at the commencement of the tenancy.
16 Notably, Tenant Screening Fees are excluded from Move-In Fees and must be separately remitted to landlord.
17 TMC 1.95.050.
18 TMC 1.95.060.
19 *RCW 59.18.140*.
20 TMC 1.95.070.
21 TMC 1.95.020.
22 *Id.*
23 *Id.*
24 *Id.*
25 TMC 1.95.070(D).
26 TMC 1.95.090(B)(1).
27 TMC 1.95.090(B)(2).
27 TMC 1.95.070(C).
29 TMC 1.95.080.
30 TMC 1.95.080.

Severing the Fruit from the Tree: How to Transfer a Partial Interest in a QTIP Trust without Triggering the "Disposition of All Interests" Rule

By Eric Reutter – Lasher Holzapfel Sperry & Ebberson

Overview

Is there a way to avoid the negative tax consequences related to the transfer of a partial income interest in a qualified terminable interest property ("QTIP") trust? This simple question produces an affirmative answer that, when explored, reveals a planning strategy that one respected commentator has labeled "relatively unbelievable."[1] The unbelievable nature of this strategy comes from a fascinating series of private letter rulings ("PLRs") that appear to allow for severing, and then transferring, a QTIP income interest in order to achieve a tax-efficient transfer that would be impossible with an undivided QTIP trust.

To understand the unbelievable nature of this transfer strategy, we must begin with an appreciation of situations in which this transfer strategy might be useful, along with an understanding of the negative tax consequences the strategy seeks to avoid. Since the strategy involves the disposition of an interest in a QTIP trust, we begin with a review of the fundamental nature of QTIP property. This article then (i) illustrates examples in which a surviving spouse may wish to transfer a portion of a QTIP trust,(ii) outlines the "disposition of all interests" rule under Section 2519 of the Internal Revenue Code ("IRC"), and finally (iii) examines a *de facto* exception to the "disposition of all interests" rule.

Understanding the Dual Nature of QTIP Trusts: The Concept of the Fruit and the Tree

A "qualified terminable interest property" trust takes its name from *IRC §2056*, which provides an exception to the general rule that the unlimited marital deduction will not be available for "terminable interest" property (property for which the interest of a surviving spouse will fail after a lapse of time or a contingency).[2] The transfer of "qualified" terminable interest property to a surviving spouse allows for the utilization of the unlimited marital deduction for property with a terminable interest, provided that the deceased spouse's personal representative makes the proper affirmative QTIP election on an estate tax return, and provided that all other statutory requirements are met.[3] In order to qualify for a QTIP election, trust property must meet several requirements, including the rule that the surviving spouse must receive all of the income from the trust assets at least annually.[4]

A QTIP trust consists of two related, but distinct, interests—an income interest and a remainder interest. To understand the income/principal duality, it is helpful to use an analogy often applied to the assignment of income doctrine: the "fruit" and the "tree."[5] The fruit symbolizes the income interest of the trust, and the tree represents the remainder interest (the interest of those individuals or entities that will receive the trust upon the surviving spouse's death). The analogy is meant to convey the notion that the tree (the remainder interest) is separate from, yet intertwined with and connected to, the fruit (the income interest).[6]

The surviving spouse typically does not have the power, at least during life, to make a transfer of the tree (the remainder interest of the trust), since the trust terms provide that the underlying trust assets will pass to other individuals after her death.[7] The surviving spouse, however, is free to transfer her interest in the fruit (the income of the trust) while she is alive, whether that transfer takes the form of a sale, gift, or other disposition.

It is in taking this fruit and tree analogy one step further that we encounter a potential tax trap for the unwary, when it comes to calculating the value of the transferred income interest by the surviving spouse. One might imagine that if a surviving spouse gifts the fruit (her income interest) of the trust, then the value of her gift for tax purposes is simply the present value of that income interest, calculated based upon the surviving spouse's life expectancy using the actuarial tables provided by the Internal Revenue Service ("IRS").

The Internal Revenue Code, however, provides a special rule for transfers of an income interest in a QTIP trust that, when applicable, treats the surviving spouse as having made a deemed gift of the entire remainder interest of the QTIP trust, as well as the transferred income interest.[8] The applicable rule that creates a deemed gift of the remainder interest is often labeled the "disposition of all interests" rule.[9] This rule is the tax trap that the "unbelievable" sever-then-transfer strategy explored by this article seeks to avoid, and understanding its application is paramount to

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understanding the implications of the sever-then-transfer strategy.[10]

When a Surviving Spouse May Wish to Transfer Only a Portion of Her QTIP Interest

Perhaps the most common situation in which a surviving spouse may want to dispose of a portion, but not all, of a QTIP income interest is in the context of estate tax exemption amount planning. Suppose, for example, that a surviving spouse is the beneficiary of a QTIP trust worth 20 million dollars, and that the surviving spouse holds a remaining federal exemption amount of 5 million dollars. In this situation, the surviving spouse may wish to use up the surviving spouse's remaining $5 million exemption amount in order to remove a portion of the QTIP trust from the surviving spouse's estate. The benefit of removing a portion of the QTIP assets from the surviving spouse's estate may be especially significant if the underlying trust assets are anticipated to appreciate in the future, thereby increasing the amount ultimately includible in the surviving spouse's gross estate.[11] A surviving spouse in our example could therefore potentially benefit greatly if the surviving spouse were able to allocate her remaining 5 million dollar exemption amount to a transfer of a partial interest in the QTIP trust income.[12]

Another situation in which a surviving spouse may wish to transfer only a partial interest in a QTIP trust is that of family discord, in which there is a conflict between the remainder beneficiaries and the surviving spouse as income beneficiary. There are many different contexts where a dispute might arise in this situation where two different classes of beneficiaries exist. The remainder beneficiaries may not wish to wait until the surviving spouse passes away to receive their remainder interest in the trust. Alternatively, especially in cases where the trustee of the trust has the power to invade principal for the benefit of the surviving spouse, the remainder beneficiaries may be concerned that the surviving spouse will receive too much trust principal before death and reduce or eliminate their remainder share. This family discord can be especially relevant if the remainder beneficiaries are children from a previous marriage.

To resolve such family discord involved with the administration of a QTIP trust, the remainder beneficiaries and surviving spouse will often come to an agreement, after negotiation or mediation proceedings, to split up the QTIP trust into two new trusts, one trust representing the surviving spouse's income interest, and the other trust representing the remainder interest.[13] Under the terms of a typical dispute resolution agreement, the remainder beneficiaries would receive the remainder interest portion of the trust, while the surviving spouse would keep the remaining trust portion that represents the income interest amount. Conceptually, this method of resolving such a dispute makes sense: assuming that the parties can agree on the value of the two different interests, the division and distribution of the trust would result in the surviving spouse still receiving the income interest, while the remainder beneficiaries accelerate the process of receiving the remainder interest, eliminating the risk of a potential reduction in the trust principal during the surviving spouse's lifetime.

Regardless of the reasons why a spouse might wish to transfer a portion of her QTIP trust, the fact remains that the transfer of any portion of a QTIP trust income interest, whether it be 1 percent or 99 percent of the trust's income interest, triggers the perilous "disposition of all interests" rule under *IRC §2519*.

The Disposition of All Interests Rule

IRC §2519 provides that the "disposition of all or part of a qualifying income interest for life in any property to which [*IRC §2056*] applies shall be treated as a transfer of all interests in such property other than the qualifying income interest."[14] Stated differently, the disposition of all interests rule stands for the concept that if a surviving spouse disposes of even a small fractional interest in the income interest of a QTIP trust, then the surviving spouse is treated as having also made a deemed gift of the entire remainder interest in the QTIP trust.

When applying the disposition of all interests rule, the IRS interprets the word "disposition" of a qualifying income interest very broadly, to include "circumstances in which the surviving spouse's right to receive the income is relinquished or terminated, by whatever means."[15] As a result, a deemed gift of the remainder interest will occur in a variety of contexts, including sales, gifts, and disclaimers of a QTIP income interest.

This rule is best understood with an example. Suppose a surviving spouse is the lifetime beneficiary of a QTIP trust that has a current fair market value of 10 million dollars. Of the 10 million dollar total value of the QTIP trust, we will further assume that 2 million dollars is the value of the surviving spouse's income interest, and 8 million dollars is the remainder interest value of the trust. If a surviving spouse were to transfer half of her income interest in the trust, worth 1 million dollars, to a third party, *IRC §2519* would treat the surviving spouse as making a gift of the transferred income interest (1 million dollars) *plus* the

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entire value of the remainder interest (8 million dollars) for a total gift of 9 million dollars.

But is this deemed gift of the entire remainder interest in our example the proper policy result? The answer is a point of debate for some commentators. When a surviving spouse transfers the *entire* income interest in a QTIP trust, rather than a partial interest as in our example, the application of *IRC §2519* seems to make sound policy sense. As a general concept, the inclusion of the remainder interest in the value of the transfer of the income interest by the surviving spouse is a balance (or "backstop," as one commentator has labeled it) to the fact that Congress allows for the unlimited marital deduction when a deceased spouse transfers qualified terminable property to a surviving spouse.[16]

The necessity of this "backstop" feature becomes apparent with an understanding of the broader context of qualified terminable interest property. *IRC §2056* grants an unlimited marital deduction to a surviving spouse who receives QTIP property, deferring the estate tax due on the basis that the QTIP property will ultimately by includible in the surviving spouse's estate pursuant to *IRC §2044*.[17] Without the disposition of all interests rule of *IRC §2519*, a surviving spouse could simply contravene the future gross estate inclusion of QTIP property by disposing of the QTIP interest prior to the surviving spouse's death.

While the policy justification of *IRC §2519* may be clear when applied to the transfer of an *entire* interest in a QTIP trust income, commentators often disagree that the Internal Revenue Service's broad interpretation of the disposition of all interests rule is the correct policy result when applied to the disposition of a *partial* interest in a QTIP trust income interest, as in our initial example. Some commentators have argued that in the case of a partial disposition of a QTIP trust income interest, *IRC §2519* should apply only to the extent that the transferred income interest relates to the specific property allocable to the income interest. In other words, some commentators argue that the IRS has too broadly construed the term "property" in *IRC §2519* to include the entire remainder interest value of the trust, rather than the specific property to which the income interest is associated.[18] If this competing philosophy were applied to our initial 10 million dollar QTIP trust, for example, the proper value of the gift would be much closer to 5 million dollars (the deemed gift of the amount of the remainder interest allocable to the income interest, plus the gift of the income interest itself), depending on the facts and circumstances of the underlying trust property and its valuation.

Perhaps the strongest argument levied against the current application of the disposition of all interests rule is the critique that a QTIP remainder interest might be taxed twice, first in the deemed gift made under *IRC §2519*, and second when the remainder interest was included in the surviving spouse's estate under *IRC §2044*. Take, for instance, our example of the surviving spouse who transferred a 1 million dollar income interest in her QTIP trust, and was deemed to also have made a gift of the 8 million dollar remainder under the disposition of all interests rule. Under Section 2044, it would seem that this surviving spouse might be taxed again on this same 8 million dollar remainder interest when she later died. This potential double inclusion might be avoided by the application of other provisions of the tax code, such as *IRC §2001(b)*, but this possibility of double inclusion nonetheless clouds the legislative intent over the current application of the disposition of all interests rule.[19]

Whatever the correct policy interpretation of *IRC §2519*, the IRS has implemented and enforced the broad application of the disposition of all interests rule for several decades now, without any successful challenge by practitioners. What some practitioners may fail to realize, however, is that there is a conspicuous exception to the disposition of all interests rule that, at first glance, seems unbelievable.

The "Unbelievable" *de Facto* Exception to the Disposition of All Interests Rule

As the old adage goes, the IRS giveth, and the IRS taketh away. In this case, the IRS "taketh away" by promulgating Treasury regulations that broadly apply the language of *IRC §2519* to interpret the disposition of all interests rule to trigger a deemed gift of the entire remainder interest of a QTIP trust, whether the surviving spouse transfers 1 percent or 100 percent of her income interest in the trust.[20]

But just as the IRS has broadly applied the disposition of all interests rule, the IRS has, surprisingly, "giveth" as well. In a series of private letter rulings (PLRs) stretching back 20 years, including a PLR issued as recently as August 2018, the IRS has repeatedly permitted taxpayers to avoid the disposition of all interests rule in cases where the taxpayer simply divides a QTIP trust in anticipation of the spouse disposing of some or all of the income interest of the trust.[21] Respected commentator Jeff Pennell called the fact that the IRS blessed this type of severance technique "relatively unbelievable."[22] Other commentators have referred to this sever-then-dispose technique and corresponding private letter rulings

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as a "*de facto*" exception to the disposition of all interests rule of *IRC §2519*.[23]

The relevant private letter rulings share the same general fact pattern: (i) the taxpayers wish to divide a single QTIP trust into two separate trusts, typically "pursuant to state law"; (ii) the divided trusts will retain the general characteristics and terms of the original QTIP trust; and (iii) once the trusts are divided, the surviving spouse will renounce or otherwise dispose of the surviving spouse's interest in one of the two new trusts, while retaining the other new trust. In the PLRs, the IRS has consistently ruled that the transfer or disposition of one of the remaining trusts *will not* result in a transfer or disposition of any part of the other trust.

The following excerpt from PLR 200250033 provides a typical example of the IRS's summary of the sever-then-transfer strategy:

> Pursuant to State law and the representations made herein, Marital Trust A and Marital Trust B will be separate trusts for all purposes from the effective date of the court's order. Therefore, *Taxpayer's renunciation of her entire interest in Marital Trust A will not result in a transfer under section 2519 of any of the assets of Marital Trust B*.[24]

This result—that there will be no deemed transfer of the assets in the second trust—may not seem significant until we apply its effect to an illustration.

Take, for example, the illustration in the previous section, in which the surviving spouse's transfer of a partial QTIP income interest worth 1 million dollars results in a 9 million dollar gift.[25] If instead the surviving spouse were to utilize the sever-then-transfer approach by first dividing the 10 million dollar QTIP trust into two equal portions, and then transferring her income interest in one of the new trusts to a third party, the IRS would first apply *IRC §2511* to treat the surviving spouse as having made a gift of the 1 million dollar income interest in that new trust (the same result as in our initial example). When it comes to valuing the deemed gift of the *remainder* interest, however, the result is drastically different. The IRS would apply *IRC §2519* to treat the surviving spouse as having made a deemed gift of the remainder interest in that new trust, an amount of only 4 million dollars, rather than the remainder interest attributable to the original QTIP trust, an amount of 8 million dollars. Put another way, the surviving spouse using the sever-then-transfer strategy achieves the same underlying transfer as in the initial fact pattern, but with a resulting deemed taxable gift of 4 million dollars less.[26]

The inescapable question that follows is, why has the IRS so consistently blessed a sever-then-transfer strategy that seems to contravene the disposition of all interests rule? The IRS has not provided an answer to this question. PLR 200250033, excerpted above, is typical of the PLRs in the series in which the IRS has accepted the sever-then-transfer strategy, but the IRS has given little in the way of policy analysis for why the taxpayer is able to achieve such a result.

The reasoning behind this *de facto* exception, therefore, is left mostly to speculation. Is it that the IRS has implicitly recognized the harsh application of the Treasury regulations that apply to *IRC §2519*, and therefore adopted the more narrow definition of "property" discussion in Section III, above? Or does the IRS simply not consider the PLRs to be in contravention of the disposition of all interests rule? The fact that the IRS has issued these PLRs consistently over a 20-year period reduces the likelihood of a simple oversight and suggests that perhaps the PLRs do stand for an implicit policy stance in favor of curtailing the harsh application of the disposition of all interests rule.

Regardless of the policy machinations of this *de facto* exception, the result for tax planners is clear. At least according to the non-precedential PLRs in this series, if a taxpayer follows the sever-then-transfer strategy, the disposition of all interests rule will not apply to any of the assets within the retained trust. One important note of caution must be sounded, however, because the sole source of this *de facto* exception is a series of non-precedential private letter rulings, and because the underlying language of *IRC §2519* has historically been subject to competing interpretations. Many commentators recommend, therefore, that before relying on this exception and implementing the sever-then-transfer strategy, practitioners should seek a private letter ruling of their own.[27]

Conclusion

It is here, at the end of our analysis, that the "unbelievable" nature of the sever-then-transfer strategy starts to take form. The unbelievable feature of this strategy lies not so much in its ability to capture tax savings, although tax savings may indeed be an effect of the strategy, but rather in the way that the IRS appears to have used private letter rulings as a tool for creating ways to soften the harsh application of the disposition of all interests rule. It is not often that a government agency promulgates a series of regulations to establish a firm rule (here, the disposition of all interests rule), only to provide a *de facto* exception to the rule in a series of recurring agency determinations (here, two decades of private letter rulings). This *de facto* exception is, therefore, true to its reputation, relatively unbelievable.

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1 Jeffrey N. Pennell, 843-2d T.M. *Estate Tax Marital Deduction*, at A-113 n.718.

2 *See* IRC §2056(7)(B).

3 *See* IRC §2056(7)(B)(v) ("An election under this paragraph with respect to any property shall be made by the executor on the return of tax imposed by section 2001. Such an election, once made, shall be irrevocable."). *See generally*, IRC §2056(7)(B) for the statutory qualifications of a QTIP trust.

4 IRC §2056(7)(B)(ii)(I). IRC §2056 provides that for a trust to qualify as a QTIP trust: (1) the surviving spouse must have a lifetime right to all of the trust's income, which must be payable to the surviving spouse annually or more often; (2) no person may have a power during the surviving spouse's life to appoint any part of the property to any person other than to the surviving spouse; (3) the property must pass to the trust from the decedent; and (4) the decedent's executor must make an election to treat the trust property as qualified terminable interest property. IRC §2056(b)(7).

5 *See* Lucas v. Earl, 281 U.S. 111, 114–115 (1930).

6 *See id*.

7 Depending on the situation, practitioners will often draft QTIP trusts so that the surviving spouse is permitted to exercise a power of appointment to direct the disposition of the remainder interest of the trust. This power of appointment is effective, however, only on the surviving spouse's death.

8 *See* IRC §2519; *see also*, *Treas. Reg. §25.2519-1(a)*.

9 *See* Jonathan C. Lurie & Andrew Copans, *Post Mortem Estate Planning, Doing it After You're Dead,* Cal. Soc'y of CPAs (Jan. 10, 2018).

10 *See* Jeffrey N. Pennell, 843-2d T.M. *Estate Tax Marital Deduction*, at A-113 n.718.

11 In some cases, the QTIP trust will be drafted so that the surviving spouse has the power to invade trust principal under an ascertainable standard, thereby possibly allowing the surviving spouse to withdraw corpus from the trust and then gift away the withdrawn amount. This withdrawal-and-transfer strategy, however, would be available only if the surviving spouse held the right to invade principal and also if the remainder beneficiaries were not likely to object to large withdrawals from the QTIP trust's principal. Before using such a withdrawal-then-transfer strategy, practitioners should consider, at the very least, obtaining the consent of the remainder beneficiaries for a withdrawal of a significant amount of trust principal in order to utilize the surviving spouse's estate and gift tax exclusion amounts. Additionally, special care should be given to examining the trust document to establish whether such a withdrawal is permissible and whether such a withdrawal would be subject to attack from the IRS as abuse of the surviving spouse's powers under the trust. Moreover, if the terms of the trust and the relationship between the surviving spouse and the beneficiaries are not suitable for a withdraw-then-transfer approach, then a surviving spouse in our example may not be able to utilize her remaining federal exemption amount unless she is able to make a successful gift of a portion of her QTIP trust income interest.

12 The benefit of removing a portion of the QTIP assets in the surviving spouse's estate is amplified in Washington state, which levies an estate tax subject to a 2.193 million dollar exclusion amount (as of 2019) but has no gift tax. A surviving spouse could use the surviving spouse's federal gift tax exclusion amount to make a tax-free transfer of a portion of the QTIP trust, thereby significantly reducing the surviving spouse's Washington taxable estate, in addition to removing the future appreciation of those QTIP trust assets from the surviving spouse's Washington taxable estate.

13 In Washington state, a variety of state law provisions could be used to accomplish such a splitting of the trust. First and foremost, the trust document itself may give the trustee the power to decant the trust as permitted under RCW 11.107. Additionally, the parties involved in the dispute may be able to utilize a Washington Trust and Estates Dispute Resolution Act (TEDRA) proceeding under RCW Ch. 11.96A in order to effectuate this split.

14 IRC §2519(a).

15 Dana R. Irwin, *Removing the Scaffolding: The QTIP Provisions and the Ownership Fiction*, 84 Neb. L. Rev. 571, 591 (2005) (citing H.R. Rep. No. 97-201, pt. 1, at 161).

16 See Charles Rubin, The Tax Results of Settling Trust Litigation Involving QTIP Trusts, Estate Planning Journal (WG&L), Jan. 2009 ("The policy of Code §2519 suggests that such a distribution will trigger a taxable gift under Code §2519. The purpose of Code §2519 is to backstop Code §2044 by assuring that transfer taxes result on the QTIP trust assets if the assets are transferred in a manner that reduces the transfer tax base of the surviving spouse. Such a distribution to remaindermen would do just that.").

17 *See* IRC §2044(a).

18 *See* Jonathan C. Lurie & Andrew Copans, *Post Mortem Estate Planning, Doing it After You're Dead,* Cal. Soc'y of CPAs (Jan. 10, 2018) ("In the 10 years between its issuance of the proposed QTIP regulations and the finalization of the regulations, the IRS changed its mind and concluded that when Congress used the word 'property' in IRC § 2519(a), it actually means 'trust.' Under the IRS's view of IRC § 2519 articulated in the final regulations, if a surviving spouse disposes of an income interest in any one item of property in a QTIP trust, he or she would be deemed to dispose of all the interests of all persons in the QTIP trust. This was not the view taken in the proposed regulations, which consistent with the language of the statute, limited the disposition to all interests in the 'property,' not the 'trust.'").

19 *See* Steve R. Akers, *Estate of Kite v. Commissioner, Rule 155 Order and Decision (Cause NO. 6772-08, Unpublished Opinion October 25, 2013),* CV026 ALI-CLE 951, Apr. 23–25, 2014.

20 *See* *Treas. Reg. §25.2519-1* ("If a donee spouse makes a disposition of all or part of a qualifying income interest for life in any property for which a deduction was allowed under section 2056(b)(7) or section 2523(f) for the transfer creating the qualifying income interest, the donee spouse is treated for purposes of chapters 11 and 12 of subtitle B of the Internal Revenue Code as transferring all interests in property other than the qualifying income interest.").

21 *See* PLRs 201834011, 200438028, 200328015, 200324023, 200250033, 200230017, 200224016, 200223047, 200137022, 200122036, 200122025, 200116006, 200106029, 200044034, 200027001, 199926019.

22 Jeffrey N. Pennell, 843-2d T.M. *Estate Tax Marital Deduction* at A-113 n.718 ("[T]he planning accomplished and the result reached in Private Letter Ruling 199926019 was relatively unbelievable… Most important about these Rulings, by virtue of the severance, is that the spouse was deemed not to have made a transfer that triggered §2519 with respect to the other portion of the QTIP trust, thereby avoiding added gift tax on the transfer and also avoiding further taxation with respect to that portion because, as to it, the spouse did not retain any enjoyment.").

23 *See* Jonathan C. Lurie & Andrew Copans, *Post Mortem Estate Planning, Doing it After You're Dead,* Cal. Soc'y of CPAs (Jan. 10, 2018) ("The large number of private letter rulings issued by the IRS on the IRC § 2519 issue indicates that what may have been relatively unbelievable 10 years ago is now routine. In routinely allowing taxpayers to make these predisposition severances, the IRS has created a de facto exception to the disposition of all interests rule for taxpayers who plan in advance; the 'disposition of all interests' rule therefore applies only to taxpayers who do not separate trusts before making dispositions.").

24 PLR 200250033 (December 13, 2002)(*emphasis added*).

25 *See* §IV, *supra*.

26 Additionally, the IRS has clarified that the transferred split QTIP interest is not subject to estate tax inclusion under IRC §2044. *See* PLR 201834011. ("When Spouse renounces her interest in the property in Trust 1, Spouse will be deemed to have made a transfer of all the property of Trust 1, other than her qualifying income interest therein, under § 2519. Section 2044(b)(2) provides that § 2044(a) does not apply to any property if § 2519 applies to the disposition of part or all of that property prior to Spouse death. Therefore, based on the facts submitted and the representations made, after Spouse renounces her entire interest in the property of Trust 1, the value of the property in Trust 1 deemed to be transferred under § 2519 will not be included in Spouse's gross estate under § 2044(a) because of the application of § 2044(b)(2).").

27 *See* Austin W. Bramwell & Leah Socash, *Preserving Inherited Exclusion Amounts: The New Planning Frontier,* Real Prop., Trust & Est. L.J., vol. 50, no. 1, Spring 2015, at 1, 33 ("The technique of severing a QTIP trust and then triggering Code section 2519 with respect to only one of the resulting trusts has been blessed by several non-precedential private rulings. At this point, some practitioners may be comfortable using the technique without a private ruling. On the other hand, the Code states that if a disposition is made of a qualifying income interest in 'any property' for which QTIP marital deduction was allowed, then the spouse is deemed to have transferred all interests in that property. This language could be interpreted to mean that even if a QTIP trust is divided into separate trusts, a disposition of the income interest in one of the trusts will trigger a deemed transfer under Code section 2519 of the property of both trusts (since both trusts qualified for the marital deduction as QTIP trusts). Thus, cautious practitioners may wish to obtain a private letter ruling before proceeding." (footnotes omitted)).

The Representation of Beneficiary-Fiduciaries in Trust and Estate Litigation

By Hans Juhl – Ryan Swanson & Cleveland PLLC & Gail Mautner — Lane Powell PC

Even prior to obtaining a legal education, many people instinctively recognize conflicts of interest as being a complicating factor in legal representation.

Law students are drilled in professional responsibility courses about the importance of avoiding conflicts of interest. Indeed, the rules by which we govern ourselves, the Rules of Professional Conduct, are clear " a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if: (1) the representation of one client will be directly adverse to another client…"[1] Trust and estate litigators often pose a different question. What happens when an individual client has two necessarily conflicted interests? Specifically, what do we do when our client serves in the capacity as a fiduciary, owing the highest of legal obligations to beneficiaries and creditors, but is also a beneficiary in conflict with other beneficiaries, or is a putative creditor or debtor of the estate, whose expectation is that their individual interests will be represented? This situation is not uncommon. A significant number of estates that end up in litigation are served by a fiduciary who was appointed by a family member because such person was a child or sibling who was also a natural beneficiary of the testator or trust settlor's estate plan. Often, family dynamics are not as the testator expected, and the beneficiaries' differing interpretations of the estate plan, or individual documents, are not in harmony. The nominated fiduciary has a duty to defend the estate plan[2] but also has an interest in the estate itself, which would be diminished or enlarged depending on the estate document's interpretation. In this common hypothetical, how does the attorney for the fiduciary properly advise the client?[3]

It is well settled that the attorney representing the fiduciary normally has no duty to the "non-client" beneficiaries. The most oft-cited case for this proposition is *Trask v. Butler.*[4] In *Trask*, the petitioner, attorney Richard Butler, represented Laurel Slaninka as personal representative of her father's estate and as attorney in fact for her mother.[5] In her capacity as personal representative for their father's estate and attorney in fact for their mother, Laurel sued her brother Russell Trask to quiet title to a parcel of property gifted to Russell by their father and a second parcel of property occupied by her mother upon which Russell had constructed a building and driveway. Butler represented Laurel in these actions and in the subsequent sale to a third party of the real property occupied by Laurel and Russell's mother.[6]

After their mother's death, the superior court removed Laurel from her position as personal representative, finding that she had breached her fiduciary duties by attempting to set aside the gift of real property to her brother Russell and selling the property occupied by their mother on disadvantageous terms.[7] Following Laurel's removal and the appointment of an interim personal representative, the sale to the third party was set aside. The interim personal representative then resigned, making way for Russell's appointment as personal representative of both of his and Laurel's parents' estates.[8] Russell threatened to sue Laurel. Laurel received a release from Russell after negotiating away her beneficial interest in the estates, and an assignment of claims she may have had, in her capacity as beneficiary, against Butler.[9] Russell sued Butler on his own behalf, and as assignee of Laurel's potential claims, for malpractice. Butler moved for dismissal on the basis that he had no contractual privity with the estates' beneficiaries. The trial court declined to grant Butler's motion, and Butler's appeal directly to the Supreme Court for discretionary review was accepted.[10]

The Supreme Court, sitting *en banc*, agreed with Butler that he owed no duty to the estates' beneficiaries, applying a "modified multi-factor balancing test" to determine the circumstances under which a non-client could prove a duty owed by an attorney. The court identified the following elements:

1) the extent to which the transaction was intended to benefit the plaintiff;
2) the foreseeability of harm to the plaintiff;
3) the degree of certainty that the plaintiff suffered injury;
4) the closeness of the connection between the defendant's conduct and the injury;
5) the policy of preventing future harm; and
6) the extent to which the profession would be unduly burdened by a finding of liability.

The court concluded that the threshold question was whether the plaintiff was an intended beneficiary of the transaction to which the lawyer's representation pertained.[11] The court distinguished between a lawyer's role in drafting estate planning documents,

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acknowledging that the estate beneficiaries may prove a duty was owed by the drafting attorney,[12] and when the claim was being made against the attorney representing the estate's fiduciary representative. The court found that, in the latter circumstance, the beneficiaries had both recourse against the personal representative for breaches of fiduciary duty resulting from her attorney's advice and the ability to take proactive measures to protect themselves in the course of the estate's administration.[13] The personal representative, the court found, may have recourse in a legal malpractice suit against her attorney, but the beneficiaries would not.[14]

The court further found that public policy weighed against a finding that the personal representative's attorney owed a duty to the beneficiaries, finding that imposing such a duty would detract from the attorney's ethical obligations to his client. The court specifically acknowledged that the divided loyalties between the estate's fiduciary representative and the beneficiaries risked a conflict of interest, particularly where the personal representative's interest "is not harmonious with the interests of the heir." The court found that estate beneficiaries are incidental, rather than intended, beneficiaries of the advice of the personal representative's attorney; that the beneficiaries had a direct cause of action against a malfeasant personal representative; and that, as a policy matter, "the unresolvable conflict of interest an estate attorney encounters in deciding whether to represent the personal representative, the estate, or the estate heirs unduly burdens the legal profession."[15] The court found that Butler was, therefore, entitled to dismissal of Russell's claims.

More recently, Division One of the Court of Appeals considered similar facts in an unpublished decision, *Benjamin v. Singleton*.[16] Relying on *Trask*, the court found that the former personal representative's attorney was not liable to the estate's beneficiaries. The appellate court opined that "[r]equiring [the personal representative's attorney] to act in the best interest of the estate or all its heirs would create the risk of interfering with her duty of undivided loyalty to him. The risk of such interference outweighs the risk of harm to the other beneficiaries."[17]

Though neither the *Trask* nor *Benjamin* courts addressed the situation of an attorney whose personal representative client was also a beneficiary, both decisions implicitly acknowledge the potential conflict of interest inherent in the representation of a client who has a duty to act in the estate's best interests, and an interest in acting in her own best interests, which might be adverse to those of the estate. The question that remains is whether one attorney can represent a client in both capacities while avoiding that conflict of interest. Even if counsel prudently advised their client that counsel's representation was limited to advising the client in her fiduciary role, and the counsel requested a waiver of the potential conflict, it remains unclear if such actions are sufficient to protect the attorney. As a practical matter, the client may not understand the distinction between the attorney's advice given to the client in her capacity as personal representative and advice the attorney would give to the client as a beneficiary. Moreover, if the attorney provides the client with advice, as personal representative, that contradicts the client's personal interests, the client may lose confidence in the attorney's counsel, leading to an interruption of the attorney-client relationship that the *Trask* case intended to protect.

Therefore, in order to avail herself of the protection of *Trask*, the attorney's only solution is a potentially unwieldy one: insisting that the client retain individual counsel to protect her interest as heir or beneficiary. Bifurcation of the representation will benefit both the attorney and client. The attorney will be comforted that the purpose and intent of her advice is not being confused, and the client will have the ability to genuinely demonstrate to hostile co-beneficiaries that she is not using estate resources to fund her individual representation.

This conclusion is also supported by the Rules of Professional Conduct ("RPC"). Both comments 3 and 4 to RPC 1.7 prohibit the attorney from concurrently representing clients with conflicts of interest. Comment 3 requires an attorney to decline the representation of a client when a conflict of interest exists prior to the undertaking of the representation. This is likely to be the case if the attorney is contacted to represent the fiduciary/beneficiary when litigation has already been commenced. Comment 4 requires the attorney to withdraw upon a conflict of interest arising. This addresses a scenario where an attorney representing the personal representative purely in an administrative capacity wishes to continue that representation after litigation ensues, the outcome of which would affect the fiduciary's beneficial interest in the estate. In either case, the commentary to RPC 1.7 would appear to suggest, conclusively, that the attorney is prohibited from representing the fiduciary client's interests personally when those interests are adverse to other duties or interests held by the client.

Bifurcating the client's representation would appear to be a simple and appropriate solution. Practically, however, challenges remain. First, the client is not likely

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to relish the thought of involving additional counsel, paying that counsel personally, and spending more time to assist the additional counsel in the representation. From the attorney's perspective, the idea of being adverse to one's own client feels unnatural and contrary to our ethical obligation to advocate for the best outcome for a client. Imagine the discomfort it would cause the attorney and the client if the litigation engagement required the attorney to cross-examine her client, sitting in her capacity as individual beneficiary.

In spite of these practical challenges, when the adversity exists (or, even when the potential for adversity is apparent or likely), advising the client that he must seek representation in his individual capacity is generally the necessary and appropriate practice. The risk of inadvertently breaching the attorney's ethical responsibilities, or creating the perception of doing so, is simply too great. The courts have extended protection to counsel for the fiduciary from liability to hostile beneficiaries, but it is incumbent upon the estate litigation bar to take advantage of that protection by behaving prudently to avoid actual or perceived conflicts of interest. The only way to fully address the conflict of interest inherent in the representation of a beneficiary-fiduciary is to address the conflict head on, and, where appropriate, to insist that the client have competent representation in both capacities. Despite the practical difficulties, where there is apparent or likely conflict, bifurcating the representation between different counsel is the only effective way to do this.

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1 WA RPC 1.7(a)

2 *See* In re Estate of Black, 116 Wn. App. 476, 490, 66 P.3d 670, 677 (2003), *aff'd on other grounds*, 153 Wn. 2d 152, 102 P.3d 796 (2004),*citing* In re Estate of Jolly, 3 Wn.2d 615, 626–27, 101 P.2d 995 (1940).

3 This article addresses issues of potential or actual conflicts that might result in litigation. Of course, there are any number of circumstances where the fiduciary duties of a personal representative or trustee do not conflict with the individual's personal interests as a beneficiary, or where the interests of all beneficiaries are aligned with each other, such that there is no conflict requiring separate representation for the individual in his or her capacity as a beneficiary. Counsel for a fiduciary evaluating whether separate counsel is necessary for the client's individual interests as beneficiary must examine each situation in its own right and with sensitivity to its own context. No single result of this analysis will always be correct for every situation.

4 123 Wn. 2d 835, 872 P.2d 1080 (1994). *See also* WA RPC 1.7 fn 40 ("Under Washington case law, in estate administration matters the client is the personal representative of the estate.").

5 Trask, 123 Wn. 2d at 837.

6 *Id*. at 838.

7 *Id*.

8 *Id*. at 839.

9 *Id*.

10 *Id*.

11 *Id*. at 843.

12 *See e.g.,* Stangland v. Brock, 109 Wn. 2d 675, 680, 747P.2d 464 (1987).

13 *Compare* In re Guardianship of Karan, 110 Wn. App. 76, 86, 38 P.2d 396 (2002), where the Court of Appeals applied the *Trask* factors and found a duty on the part of counsel for the guardian towards the incapacitated person who was at the heart of the reason for the guardianship ("The *Trask* court based its decision in part on the premise that a beneficiary can take an active role in estate matters by retaining an attorney or communicating with the personal representative. [Citation omitted.] But a three-year-old cannot do this.")

14 *Id*. at 844.

15 *Id*. at 845.

16 Benjamin v. Singleton, No. 77684-3-I, 2019 WL 350709 (Wash. Ct. App. Jan. 28, 2019).

17 *Id*.

Practice Tip
Tools for Redevelopment of Contaminated Properties

By Michael Dunning – Perkins Coie LLP[1]

Redeveloping property contaminated by our industrial past — known as "brownfield development" — is complex, expensive, and risky. But, with some changes to Washington's cleanup law, there are tools for developers to pay for cleanups and reduce risk. New, groundbreaking projects show these tools can provide significant benefits to developers. This practice tip briefly describes contaminated site liability and how these tools can address that liability.

Background: The Model Toxics Control Act and Contaminated Site Liability

The Model Toxics Control Act, RCW 70.105D ("MTCA") is Washington's superfund-type law. Passed by citizen initiative in 1988 and implemented by the Department of Ecology ("Ecology"), MTCA makes certain entities that are connected to contaminated sites jointly, strictly, and severally liable for the costs of addressing legacy contamination. These entities include current owners of contaminated properties and current operators of businesses on such properties or the former owners or operators of such properties if the release of the contamination occurred during their period of ownership or operation.[2] Under MTCA, liability is not limited to the owner's property, but to "sites," which are "any…area where a hazardous substance has… come to be located."[3] For current owners and operators, liability is not based on fault; simply owning the contaminated property will subject the current owner or operator to strict, joint, and several liability. Thus, developers contemplating purchasing and developing contaminated properties face broad liability and potentially significant cleanup costs.[4]

Managing Risk and Accessing Cleanup Grant Funding

In 2013, the Legislature passed SB 5296, which amended MTCA and for the first time provided a pathway for developers to access public funds for cleanup costs if the developer meets three key, mandatory criteria.[5] First, the contaminated property must be located within a "Redevelopment Opportunity Zone" ("ROZ"). A ROZ is an area designated by the local government that encompasses the redevelopment project. The local government designates the ROZ through a resolution and ensures the project's use is consistent with local land use and that the property owners in the ROZ consent to the designation. Second, the developer, Ecology, and the Attorney General's office must enter into a Prospective Purchaser Consent Decree ("PPCD"). A PPCD is, at its core, a regulatory contract between the state and the developer completed *prior* to the developer taking ownership of the contaminated property that settles the developer's MTCA liability. Third, Ecology's Director determines that the redevelopment project provides a "substantial public benefit" that is in addition to the cleanup. Entering into a PPCD and providing public funds are discretionary decisions with Ecology and the Attorney General's office. In deciding whether to enter into a PPCD with a developer, these agencies carefully consider the cleanup and other public benefits of the proposed project.

Seattle's First Use of the Cleanup Grant Funding: The Maddux Project

While the cleanup grant funding criteria are challenging to meet, recent contaminated site redevelopment projects show that they can be met and developers can access public grant funding for cleanup.

The Maddux project is a brownfield redevelopment by the Mt. Baker Housing Association ("MBHA"), a non-profit affordable housing developer based in south Seattle.[6] Once completed, the Maddux will provide approximately 150 new affordable housing units and affordable commercial space just blocks from the Mount Baker light rail station. As those of us who live in Seattle know, affordable housing is one of the city's most pressing needs and important public policy issues. The Maddux project will clean up legacy contamination on five parcels and the surrounding area from dry cleaning and gas station operations. MBHA entered into a PPCD with Ecology and the Attorney General's office that resolves MBHA's liability under MTCA in exchange for MBHA's cleanup of the site and provides for public grant funding. In 2017, for the first time, the City of Seattle passed a resolution that designated a ROZ for the project area. And, because the Maddux project provides for new affordable, transit-oriented housing, Ecology determined the project provided a "substantial public benefit." To date, Ecology has provided $1 million in cleanup grant funding to MBHA and the legislature has appropriated additional funding for the Maddux

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project that should fully cover all cleanup costs incurred by MBHA.

MTCA liability can make brownfield redevelopment projects risky and expensive. However, as shown by the Maddux project, amendments to the Act provide tools to address that risk and provide cleanup funds for projects that provide significant public benefits.

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1 Mike practices environmental law and serves as environmental counsel for the Mt. Baker Housing Association and other affordable housing and market developers. https://www.perkinscoie.com/en/professionals/michael-dunning.html. This article is for informational purposes only and does not contain or convey legal advice. The information herein should not be used or relied upon without first consulting a lawyer.

2 RCW 70.105D.040.

3 RCW 70.105D.020(8).

4 Liable parties may seek to recover cleanup costs from other liable parties under MTCA. RCW 70.105D.080. Cost recovery among liable parties generally tracks fault or responsibility for the release of the contamination. In addition, there are some defenses to MTCA liability, but these are narrow and are often unavailable. RCW 70.105D.040(3); RCW 70.105D.020(22)(b). Discussion of private allocation under MTCA and its defenses are beyond the scope of this article.

5 RCW 70.105D.070(3)(q). Public grant funds for cleanup cost have long been available to local governments. *See* RCW 70.105D.070(4).

6 MT. BAKER HOUSING, http://mtbakerhousing.org/. In addition, a second project, Grand Street Commons, has recently been started under this model. The Grand Street Commons project is a joint venture between MBHA and Lake Union Partners, a Seattle-based market developer.

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Recent Developments

Real Property

By Russel R. Robertson – Schwabe Williamson & Wyatt, PC

Bellevue Square, LLC v. Whole Foods Market Pacific Northwest, Inc., 432 P.3d 426 (Wash. Ct. App. 2018)

This Washington Court of Appeals opinion involved the closing by Whole Foods of its Whole Foods 365 store in Bellevue Square and appeal of injunctive relief ordering Whole Foods to reopen the store pursuant to a continuous operations covenant.

Bellevue Square, as landlord, and Whole Foods, as tenant, executed a lease in July 2015 for a term of 20 years with optional extensions. The lease contained an operating covenant that required Whole Foods "to conduct and carry on" its business "without interruption" for the first 10 years of the lease. The Whole Foods store opened in September 2016, but a little more than a year later Whole Foods closed the store, sold its inventory, and offered its employees jobs at other stores.

Bellevue Square filed suit against Whole Foods and also filed a motion for preliminary injunction to compel Whole Foods to reopen the Bellevue Square location pursuant to the continuous operations covenant. The trial court granted the motion, finding that Bellevue Square established a clear legal right to a preliminary injunction and specific performance of the operating covenant within the lease. The Court of Appeals reversed and remanded.

The court noted that a party seeking a preliminary injunction must show (1) a clear legal or equitable right, (2) a well-grounded fear of immediate invasion of that right, and (3) the acts complained of either result in or will result in actual and substantial injury.[1] Whether Bellevue Square had a clear and equitable right to specific performance was governed by the language of the lease, reviewed de novo.

In reviewing the specific lease provisions, the court found that the language granting Bellevue Square the right to obtain injunctive relief was, by its terms, only applicable to protect the landlord from "further defaults" after Bellevue Square elected to allow the lease to continue and to recover rent, damages, and other payments as they became due following Whole Foods's default. Such language did not extend to the operating covenant, which separately provided for very specific remedies for breach that were inapplicable in the event that Whole Foods completely vacated or abandoned the property. Furthermore, the court found that the remedy limitations set forth in the lease, notably a duty to mitigate and a disclaimer on consequential damages, were inconsistent with the trial court's conclusion that Bellevue Square was entitled to compel Whole Foods to continue operating. Accordingly, Bellevue Square was not entitled to specific performance and the lower court erred in finding a clear legal right to specific performance and an injunction. The court further noted that the lower court incorrectly found that indirect harms were difficult to quantify and that no remedy at law existed to compensate Bellevue Square, noting that Bellevue Square waived its right to recover any indirect or consequential damages and had an adequate, complete, and speedy remedy for the direct harm caused by Whole Foods.

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1 Bellevue Square, LLC v. Whole Foods Market Pacific Northwest, Inc., 432 P.3d 426, 429, *citing*Tyler Pipe Indus., Inc. v. Dept't of Revenue, 96 Wn.3d 785, 792, 638 P.2d 1213 (1982).

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