STATE OF WASHINGTON
DOUGLAS COUNTY SUPERIOR COURT

CHRIS QUINN, an individual; CRAIG LEUTHOLD, an individual; SUZIE BURKE, an individual; LEWIS and MARTHA RANDALL, as individuals and the marital community comprised thereof; RICK GLENN, an individual; NEIL MULLER, an individual; LARRY and MARGARET KING, as individuals and the marital community comprised thereof; and KERRY COX, an individual, Plaintiffs, v. STATE OF WASHINGTON; DEPARTMENT OF REVENUE, an agency of the State of Washington; VIKKI SMITH, in her official capacity as Director of the Department of Revenue, Defendants, EDMONDS SCHOOL DISTRICT, TAMARA GRUBB, ADRIENNE STUART, MARY CURRY, and WASHINGTON EDUCATION ASSOCIATION, Intervenors.	NO. 21-2-00075-09 NO. 21-2-00087-09 DEFENDANTS' MOTION FOR SUMMARY JUDGMENT
APRIL CLAYTON, an individual; KEVIN BOUCHEY, an individual; RENEE BOUCHEY, an individual; JOANNA CABLE, an individual; ROSELLA MOSBY, an individual; BURR MOSBY, an individual; CHRISTOPHER SENSKE, an individual; CATHERINE SENSKE,	

an individual; MATTHEW SONDEREN, an individual; WASHINGTON FARM BUREAU,

Plaintiffs,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE, an agency of the State of Washington; VIKKI SMITH, in her official capacity as Director of the Department of Revenue,

Defendants.

EDMONDS SCHOOL DISTRICT, TAMARA GRUBB, ADRIENNE STUART, MARY CURRY, and WASHINGTON EDUCATION ASSOCIATION,

Intervenors.

TABLE OF CONTENTS

ATTORNEY GENERAL OF WASHINGTON
Revenue and Finance Division
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Olympia, WA 98504-0123
(360) 753-5515

TABLE OF AUTHORITIES

Cases

ATTORNEY GENERAL OF WASHINGTON
Revenue and Finance Division
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Olympia, WA 98504-0123
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Olympia, WA 98504-0123
(360) 753-5515

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PO Box 40123
Olympia, WA 98504-0123
(360) 753-5515

Constitutional Provisions

Statutes

Treatises

Other Authorities

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(360) 753-5515

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Olympia, WA 98504-0123
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I. INTRODUCTION

To prevail in this case, Plaintiffs must prove two things they cannot possibly show under Washington Supreme Court precedent. Either failure is fatal to their case.

First, before Plaintiffs can challenge the capital gains excise tax enacted in Engrossed Substitute Senate Bill (ESSB) 5096, they must show that they have standing to do so. That requires proving that they will suffer an "immediate, concrete and specific" injury from the tax. *Knight v. City of Yelm*, 173 Wn.2d 325, 341, 267 P.3d 973 (2011) (quoting *Suquamish Indian Tribe v. Kitsap Cnty.*, 92 Wn. App. 816, 829, 965 P.2d 636 (1998)). But because of the law's generous deductions and exemptions, only one in one thousand Washingtonians will owe the tax in any given year, and there is no way for Plaintiffs to know currently whether they will be among that small group. Their alleged injury is thus contingent, not immediate or concrete, and they cannot meet their burden of showing standing.

Second, because the capital gains excise tax was duly enacted by our state's elected leaders, a court may only invalidate the tax if Plaintiffs prove that there is no "reasonable doubt that the statute violates the constitution." *Amalgamated Transit Union Local 587 v. State*, 142 Wn.2d 183, 205, 11 P.3d 762 (2000). Plaintiffs cannot come anywhere close.

Plaintiffs' primary claim is that the capital gains excise tax is a property tax subject to Article VII of Washington's Constitution. But a property tax is "a tax which falls upon the owner *merely because he is owner*, regardless of the use or disposition made of his property." *Morrow v. Henneford*, 182 Wash. 625, 631, 47 P.2d 1016 (1935) (emphasis added). By contrast, a tax that applies upon the sale or transfer of property is an excise tax, not a property tax. *Mahler v. Tremper*, 40 Wn.2d 405, 409-10, 243 P.2d 627 (1952). The capital gains excise tax does not apply to anyone "merely because he" owns property, *Morrow*, 182 Wash. at 631; rather, it applies only when a person sells or transfers property. Our Supreme Court has *never* held that a tax like this one that applies upon the sale of property is a property tax. Under binding Washington Supreme Court authority, this is clearly an excise tax.

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7141 Cleanwater Dr. SW
PO Box 40123
Olympia, WA 98504-0123
(360) 753-5515

Plaintiffs' remaining claims are equally meritless. They claim that the tax violates the privileges and immunities clause of Washington's constitution, but the tax implicates no fundamental privilege, and even if it did, the distinctions it draws are eminently reasonable. They claim that the tax invades their privacy, but Washington law has long required taxpayers to keep certain records and make them available to the Department of Revenue, with the records protected from public disclosure by a robust confidentiality statute. This tax is no different and is no invasion of privacy. Finally, Plaintiffs claim that the tax discriminates against interstate commerce, but the claim fails entirely under binding precedent.

In sum, a fair application of Washington Supreme Court precedent can lead to only one result: summary judgment for the State. Plaintiffs lack standing to challenge ESSB 5096, but even if they could, their claims are foreclosed by binding Supreme Court precedent. The State respectfully asks that the Court follow precedent and reject Plaintiffs' claims.

II. STATEMENT OF MATERIAL FACTS

A. The Legislature Enacts the Capital Gains Excise Tax to Advance the State's Paramount Duty to Fund Education and to Make the Tax Code Fairer to Working People

In April 2021, the Washington legislature adopted Engrossed Substitute Senate Bill (ESSB) 5096, which imposes a seven percent tax on the sale of certain long-term capital assets. ESSB 5096, § 5(1).[1]

The Legislature's stated purpose for the tax is two-fold. First, it will advance the "paramount duty of the state" to amply fund educational opportunities for every child by "invest[ing] in the ongoing support of K-12 education and early learning and child care." *Id.*, § 1. Revenue from the capital gains tax is dedicated to the state's Education Legacy Trust Account (ELTA) and the Common School Construction Account. *Id.* § 2. Each year, the first $500 million collected from the tax will be deposited into the ELTA. *Id.* § 2(1)(a). Funds from the ELTA "may be used only for support of the common schools [(i.e., K-12 public schools)], and for

[1] A copy of ESSB 5096 is attached as Appendix A.

ATTORNEY GENERAL OF WASHINGTON
Revenue and Finance Division
7141 Cleanwater Dr. SW
PO Box 40123
Olympia, WA 98504-0123
(360) 753-5515

expanding access to higher education through funding for new enrollments and financial aid, early learning and child care programs, and other educational improvement efforts." *Id.* § 3; RCW 83.100.230. Any revenue from the tax above $500 million each year is dedicated to building or renovating public schools. ESSB 5096 § 2(1)(b). This account assists school districts with capital projects, such as the building or renovation of school buildings. In the first six years, the Department of Revenue forecasts that the law will generate approximately $2.5 billion over the next several years for these important education investments.

Second, the capital gains tax will "mak[e] material progress toward rebalancing the state's tax code," which is the "most regressive in the nation." *Id*. Under Washington's current tax code, which relies extensively on retail sales tax imposed on purchasers of everyday goods and services, middle-income Washingtonians pay two to four times more in state taxes as a percentage of household income than high-income earners, and low-income Washingtonians pay at least six time more. *Id*. The tax thus advances the Legislature's goals by funding education and imposing the tax on those with the greatest ability to pay.

The tax, which takes effect January 1, 2022, applies only to sales or exchanges of long-term capital assets, which the Act defines as capital assets held for more than one year. *Id*., §§ 4(6), 5(1). To achieve its goal of imposing the tax on those with a greater ability to pay, the Legislature provided generous deductions and exemptions. For example, ESSB 5096 exempts "[a]ll real estate transferred by deed, real estate contract, judgment, or other lawful instruments. . . ." *Id*., § 6(1). Assets held in various retirement accounts are exempt. *Id*., § 6(3). And the Act provides for a standard deduction of $250,000 and a qualified family-owned small business deduction. *Id*., §§ 7(1), 8(1). An example illustrates how these exemptions operate. Imagine a Washington taxpayer who in a single year sells a large rental property at a $1 million profit, a small business at a $1 million profit, assets in a retirement account at a $1 million profit, and ordinary stocks held outside a retirement account at a $200,000 profit. Though these transactions would result in over $3 million in capital gains, the taxpayer would owe no Washington capital

ATTORNEY GENERAL OF WASHINGTON
Revenue and Finance Division
7141 Cleanwater Dr. SW
PO Box 40123
Olympia, WA 98504-0123
(360) 753-5515

gains tax because the first three asset categories are exempt and the $250,000 standard deduction exceeds the profit from non-exempt assets.

In light of the generous credits and exemptions in ESSB 5096, the capital gains tax will apply to only a small percentage of Washingtonians in any given year. Although it is currently unknown (and unknowable) exactly who will owe capital gains tax in any given year, the Department of Revenue estimates that approximately 7,000 individuals will owe the tax in the first year. Oline Decl., Ex. 1 at 4. That is less than one in every thousand Washingtonians, which works out to less than five individuals in Douglas County.

The Act requires individuals that owe the tax to file "a return with the department on or before the date the taxpayer's federal income tax return for the taxable year is required to be filed." ESSB 5096, § 12(1)(a). Since the tax does not take effect until January 1, 2022, "the first payments are due on or about April 17, 2023." Oline Decl., Ex. 1 at 4.

To avoid taxing long-term capital gains that are attributable to another state, the Act sets out a detailed allocation process. ESSB 5096, § 11. In general, it allocates to Washington long term capital gains from the sale or exchange of tangible personal property located in Washington and intangible property owned by an individual domiciled in the state. *Id.*, § 11(1). Additionally, the Act provides a credit "equal to the amount of any legally imposed income or excise tax paid by the taxpayer to another taxing jurisdiction on capital gains derived from capital assets within the other taxing jurisdiction . . . ." *Id.*, § 11(2)(a). These provisions will ensure that capital gains are subject to the tax only when there is a constitutional nexus with Washington and no other state is lawfully taxing the same gains.

B. The Legislature Was Justly Concerned with Washington's Regressive Tax System

As set out in ESSB 5096's statement of legislative intent, the Washington tax code has long been the "most regressive in the nation," meaning that, more than in any other state, low and middle-income people in Washington pay a higher share of their income in state and local taxes than wealthy people. ESSB 5096, § 1. Numerous studies support that finding. For instance,

ATTORNEY GENERAL OF WASHINGTON
Revenue and Finance Division
7141 Cleanwater Dr. SW
PO Box 40123
Olympia, WA 98504-0123
(360) 753-5515

the Institute on Taxation and Economic Policy (ITEP) has been modeling the regressivity of state and local tax codes of all 50 states since 1996, and has found that Washington has the "most unfair state and local tax system in the country." Institute on Taxation and Economic Policy, *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States* (6th ed. October 2018) at 127.[2] In its most recent report, from 2018, ITEP concluded that the poorest fifth of households in Washington pay on average 17.8 percent of their incomes in state and local taxes. *Id*. By contrast, the richest one percent of households pay just three percent of their incomes into the state and local tax coffers. *Id*.

These findings are consistent with other studies. For example, a recent presentation on Washington's tax code commissioned by the legislature's bipartisan Tax Structure Work Group found that low-income households earning between $17,000 and $30,000 annually pay 15 percent of their incomes in state and local taxes on average, while the richest households (those earning $208,000 or more annually) pay just 3.4 percent. *See* Tax Structure Work Group presentation (December 2020) at slide 80.[3] Likewise, a 2011 report from the Office of Financial Management found a comparable upside-down relationship between the percentage of income spent on taxes between bottom and top earners in Washington. *See* Office of Financial Management, *The Distribution of Income, Wealth, and Taxes Across Washington Households* (2011) at 44 (showing households earning $15,000 or less annually pay 23.2 percent of their incomes in state and local taxes while households earning $140,000 or more annually had a state and local tax burden of only 5.1 percent).[4]

Why does Washington's tax structure force low and middle income households to pay such a disproportionate share of their income in taxes? The primary reason is that the state has

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[2] Available at https://itep.sfo2.digitaloceanspaces.com/whopays-ITEP-2018.pdf (last visited Dec. 1, 2021).

[3] Available at https://dor.wa.gov/sites/default/files/legacy/Docs/Pubs/Misc/TSWGMeeting2020_1204.pdf (last visited Dec. 1, 2021). The Legislature established the bipartisan TSWG to identify options to make the Washington State tax code more equitable, adequate, stable, and transparent. *See* Tax Structure Work Group, *Overview*, https://taxworkgroup.org/overview (last visited Dec. 1, 2021).

[4] Available at https://ofm.wa.gov/sites/default/files/public/legacy/reports/income_wealth_report.pdf (last visited Dec. 1, 2021).

ATTORNEY GENERAL OF WASHINGTON
Revenue and Finance Division
7141 Cleanwater Dr. SW
PO Box 40123
Olympia, WA 98504-0123
(360) 753-5515

long relied heavily on sales taxes to fund necessary state programs and services. In fiscal year 2020, for example, the state generated 45 percent of its total tax collections from retail sales and use taxes. Oline Decl., Ex. 2 at 2. Although on its face this tax applies equally to all consumers, in practice it disproportionately impacts those with lower incomes because the purchase of everyday items like toiletries and clothing consumes a greater percentage of smaller paychecks.

As these studies show, the legislature understandably was concerned with Washington's regressive tax code. In imposing the capital gains tax on those with the greatest ability to pay, ESSB 5096 is a small but important step toward rebalancing the state's tax code.

III. ARGUMENTS AND AUTHORITY

Plaintiffs lack standing to challenge the capital gains tax, but even if they could show standing, they cannot prove beyond a reasonable doubt that the tax is unconstitutional.

A. Plaintiffs Lack Standing to Challenge the Capital Gains Tax

As a threshold issue, Plaintiffs must first establish that they have standing to challenge ESSB 5096 under the Uniform Declaratory Judgments Act ("UDJA").[5] A party seeking to invoke the UDJA must show that a justiciable controversy exists. *To-Ro Trade Shows v. Collins*, 144 Wn.2d 403, 411, 27 P.3d 1149 (2001). A justiciable controversy has four prerequisites:

> (1) . . . an actual, present and existing dispute, or the mature seeds of one, as distinguished from a possible, dormant, hypothetical, speculative, or moot disagreement, (2) between parties having genuine and opposing interests, (3) which involves interests that must be direct and substantial, rather than potential, theoretical, abstract or academic, and (4) a judicial determination of which will be final and conclusive.

[5] The Court previously analyzed this issue under the permissive standards afforded under CR 12, concluding that when "ruling on a motion for dismissal under CR 12(b)(6), the Court must presume all facts alleged in the plaintiffs' complaint are true and may consider hypothetical facts supporting the plaintiffs' claims." Sept. 10, 2021, letter ruling denying motion to dismiss at 2. But the summary judgment standard requires actual proof. *See Young v. Key Pharmaceuticals, Inc.*, 112 Wn.2d 216, 225, 770 P.2d 182 (1989) (once the moving party has met its initial burden under CR 56, the party that bears the burden of proof at trial must establish the essential elements of its claim and cannot rely on allegations made in its pleadings).

ATTORNEY GENERAL OF WASHINGTON
Revenue and Finance Division
7141 Cleanwater Dr. SW
PO Box 40123
Olympia, WA 98504-0123
(360) 753-5515

Id. (internal quotation and citation omitted). The plaintiff must show that all four elements are satisfied. *Id.*; *see also Grant Cnty. Fire Prot. Dist. No. 5 v. City of Moses Lake*, 150 Wn.2d 791, 802, 83 P.3d 419 (2004) (holding that "the party seeking standing" must establish justiciability).

Courts rigorously adhere to the four-part justiciability test to avoid stepping into the "prohibited area of advisory opinions." *To-Ro Trade Shows*, 144 Wn.2d at 416. Although courts may deliver advisory opinions in rare cases involving issues of overwhelming public importance, they will not do so absent a showing of concrete harm. *Walker v. Munro*, 124 Wn.2d 402, 415, 879 P.2d 920 (1994). An assertion that one's constitutional rights have been violated is not an adequate reason to disregard the four prerequisites for justiciability. *DiNino v. State ex rel. Gorton*, 102 Wn.2d 327, 332, 684 P.2d 1297 (1984).

Additionally, appellate courts have been clear that when plaintiffs seek to base standing on alleged *future* injury, rather than an existing injury, their burden is higher. "If the plaintiff alleges a threatened rather than an existing injury, he or she must also show that the injury will be *immediate, concrete and specific*; a conjectural or hypothetical injury will not confer standing." *Knight v. City of Yelm*, 173 Wn.2d 325, 341, 267 P.3d 973 (2011) (quoting *Suquamish Indian Tribe v. Kitsap Cnty.*, 92 Wn. App. 816, 829, 965 P.2d 636 (1998)) (internal quotation marks omitted, emphasis added). *See also, e.g.*, *Freedom Found. v. Bethel Sch. Dist.*, 14 Wn. App. 2d 75, 86, 469 P.3d 364 (2020), *review denied*, 196 Wn.2d 1033, 478 P.3d 83 (2021) (same); *Thompson v. City of Mercer Island*, 193 Wn. App. 653, 686, 375 P.3d 681 (2016) (same).

Here, Plaintiffs cannot meet their burden to show standing under at least the first and third prongs of the justiciability test. As to the first factor, Plaintiffs' claim that they will owe the tax *if* they realize capital gains in excess of $250,000 in 2022 is entirely speculative. There is no way for Plaintiffs to know currently what taxable capital gains they will incur in 2022 or beyond. Even if Plaintiffs have routinely experienced large capital gains in the past, that does not mean they will in the future. And even if Plaintiffs do experience large gains, they may not owe any tax given ESSB 5096's exemptions for the sale of real estate, retirement assets, and

ATTORNEY GENERAL OF WASHINGTON
Revenue and Finance Division
7141 Cleanwater Dr. SW
PO Box 40123
Olympia, WA 98504-0123
(360) 753-5515

small businesses. Applying this first factor, the Supreme Court has "repeatedly refused to find a justiciable controversy where the event at issue has not yet occurred or remains a matter of speculation[.]" *To-Ro Trade Shows*, 144 Wn.2d at 415–16. That principle controls here and demonstrates that Plaintiffs lack standing.

Plaintiffs also cannot meet their burden of establishing the third justiciability factor, which requires showing "direct and substantial" harm, "rather than potential, theoretical, abstract or academic" injury. *Id.* at 411-12. The Supreme Court has made clear that "direct and substantial" harm cannot be "contingent on . . . intervening event[s]." *Id.* at 413. Here, any alleged harm is contingent on future events, namely, Plaintiffs incurring capital gains in some future year of over $250,000 from the sale of non-exempt assets. Plaintiffs' alleged harms are thus "potential, theoretical, abstract or academic," not direct and substantial.

Plaintiffs' lack of standing is particularly clear given that their claims of standing are based on "a threatened rather than an existing injury." *Knight*, 173 Wn.2d at 341. As such, they must "show that the injury will be *immediate, concrete and specific*; a conjectural or hypothetical injury will not confer standing." *Id.* (emphasis added). Plaintiffs cannot do so. They cannot show that their alleged harm is immediate because they offer no allegations about when they will owe the tax, and no tax will be due until 2023 at the earliest. And the alleged injury is not concrete or specific because Plaintiffs have offered no details about what assets they will sell, when they will sell them, or how they can possibly know what taxable capital gains they will incur. Instead, Plaintiffs simply offer conjecture regarding taxes they may owe at some point in the future.

In short, Plaintiffs fail to establish standing under controlling precedent. The Court should grant summary judgment to Defendants on this issue and dismiss both complaints.

B. Plaintiffs' Constitutional Challenges All Fail as a Matter of Established Law

A party seeking to invalidate a law duly enacted by the legislature must establish "that there is no reasonable doubt that the statute violates the constitution." *Amalgamated Transit Union Local 587 v. State*, 142 Wn.2d 183, 205, 11 P.3d 762 (2000). A facial constitutional

ATTORNEY GENERAL OF WASHINGTON
Revenue and Finance Division
7141 Cleanwater Dr. SW
PO Box 40123
Olympia, WA 98504-0123
(360) 753-5515

challenge fails "if there are any circumstances where the statute can constitutionally be applied." *Lummi Indian Nation v. State*, 170 Wn.2d 247, 258, 241 P.3d 1220 (2010).

Plaintiffs raise five constitutional claims. None has merit. The Legislature possesses broad authority to impose taxes to fund important governmental services, *Ryan v. State*, 188 Wash. 115, 130-31, 61 P.2d 1276 (1936), including progressive taxes designed to ask more from those with a greater ability to pay. *Wash. Bankers Ass'n v. State*, ___ Wn.2d ___, 495 P.3d 808, 824-25 (2021). The capital gains tax advances legitimate state interests by raising revenue to fund education and rebalancing the state's tax code. Plaintiffs cannot meet their burden to show that ESSB 5096 is unconstitutional.

1. The capital gains tax is an excise tax, not a property tax subject to article VII's uniformity and levy limit requirements

Plaintiffs' primary argument is that the capital gains tax is a tax on income, which they assert is a property tax subject to the Washington Constitution's uniformity and levy limit requirements in article VII, sections 1 and 2. Established law refutes the argument.

Article VII, section 1 provides, "All taxes shall be uniform upon the same class of property within the territorial limits of the authority levying the tax and shall be levied and collected for public purposes only." Article VII, section 2 provides that "the aggregate of all tax levies upon real and personal property by the state and all taxing districts now existing or hereafter created, shall not in any year exceed one percent of the true and fair value of such property in money." Any challenge to a tax based on these sections involves a threshold question: is the tax a property tax? If the answer is no, the analysis ends and these sections do not apply. *In re Estate of Hambleton*, 181 Wn.2d 802, 832, 335 P.3d 398 (2014); *Cosro, Inc. v. Liquor Control Bd.*, 107 Wn.2d 754, 761, 733 P.2d 539 (1987).

In this case, the capital gains excise tax is not a property tax under binding Supreme Court precedent. A property tax is an "absolute and unavoidable" tax levied on the property owner as a consequence of ownership. *Covell v. City of Seattle*, 127 Wn.2d 874, 890-91, 905 P.2d 324

ATTORNEY GENERAL OF WASHINGTON
Revenue and Finance Division
7141 Cleanwater Dr. SW
PO Box 40123
Olympia, WA 98504-0123
(360) 753-5515

(1995), *abrogated on other grounds by Yim v. City of Seattle*, 194 Wn.2d 682, 451 P.3d 694 (2019). The capital gains tax is neither absolute nor unavoidable because it applies only upon the voluntary sale of a long-term capital asset. Consequently, it is not a property tax and Plaintiffs' efforts to invalidate the tax under article VII fail.

a. Article VII's uniformity and levy limit restrictions apply only to property taxes

To understand why Plaintiffs are wrong in claiming that a tax on capital gains from the voluntary sale of assets is unlawful, it is helpful to review the language of article VII and the cases applying it. Article VII regulates taxes on "property"; it imposes no restrictions on other types of taxes. It defines property as "everything, whether tangible or intangible, subject to ownership." Article VII, sec. 1. Thus, a critical early question faced by our Supreme Court was what counted as a tax on "property" under this definition.

Nearly 90 years ago our Supreme Court defined property taxes in a way fatal to Plaintiffs' claims. The Court, citing the U.S. Supreme Court, made clear that a tax on property is "a tax which falls upon the owner *merely because he is owner*, regardless of the use or disposition made of his property.'" *Morrow v. Henneford*, 182 Wash. 625, 631, 47 P.2d 1016 (1935) (quoting *Bromley v. McCaughn*, 280 U.S. 124, 137, 50 S. Ct. 46, 74 L. Ed. 226 (1929)) (emphasis added). By contrast, a tax that applies to the sale or transfer of property, or to another "'particular use of property . . . , is an excise" tax, not a property tax. *Id.* at 630 (quoting *Bromley*, 280 U.S. at 136).

At the same time, in a series of divided opinions that never commanded a majority behind one rationale, the Court held that a tax on personal income is a tax on property, not an excise tax. *See Culliton v. Chase*, 174 Wash. 363, 25 P.2d 81 (1933);[6] *Jensen v. Henneford*, 185 Wash. 209, 212, 53 P.2d 607 (1936).[7] A plurality of the Court explained that, in its view, a tax on income is a tax on "ownership, and therefore [on] the property (income) itself." *Jensen*, 185 Wash. at 219.

[6] The majority in *Culliton* was made up of a 2-member lead opinion authored by Justice Holcomb, a 2-member concurring opinion authored by Justice Mitchell, and a concurring opinion from Justice Steinert.

[7] Four justices joined the plurality opinion in *Jensen*; Justice Millard concurred on *stare decisis* grounds but did not join the lead opinion. 185 Wash. at 225.

ATTORNEY GENERAL OF WASHINGTON
Revenue and Finance Division
7141 Cleanwater Dr. SW
PO Box 40123
Olympia, WA 98504-0123
(360) 753-5515

Further, "*the mere right to own and hold property* cannot be made the subject of an excise tax, because to tax by reason of ownership of property is to tax the property itself." *Id*. at 218 (emphasis added). But these cases did not hold or suggest that a tax on the sale or transfer of property is a tax on the property itself. And contemporaneous and subsequent cases make clear that taxes on the sale or transfer of property are excise taxes, not property taxes.[8]

For example, in *State ex rel. Stiner v. Yelle*, 174 Wash. 402, 25 P.2d 91 (1933), decided the same day as *Culliton* but with a five-Justice majority, the Court upheld a gross receipts tax imposed on businesses—what we now call the "business and occupation tax"—as an excise tax rather than a property tax. Even though the tax was calculated based on businesses' "gross proceeds of sales, or gross income," 174 Wash. at 404 (quoting Laws of 1933, ch. 191, § 2), the Court concluded it was not a tax on property. The Court explained that after income has been acquired, it immediately becomes property and the protections of article VII apply. *Id.* at 407. But the tax at issue, even if measured by a business's gross income, was rather a tax on "the privilege of acquiring" income by making sales or otherwise doing business in the state. *Id.* Accordingly, the tax was "an excise tax and not . . . a tax on property." *Id.*

Two years later, in *Morrow v. Henneford*, the Court held that the retail sales tax is an excise tax, not a property tax, quoting the United States Supreme Court for the proposition that "'a tax imposed upon a particular use of property or the exercise of a single power over property incidental to ownership, is an excise[.]" *Morrow*, 182 Wash. at 630 (quoting *Bromley*, 280 U.S. at 136). Thus, a tax imposed on the exercise of one of the rights of property "'is clearly distinguishable from a tax which falls upon the owner merely because he is owner, regardless of the use or disposition made of his property.'" *Id.* at 631 (quoting *Bromley*, 280 U.S. at 137).

[8] Cases decided before *Culliton* and *Jenson* also held that a tax on the sale or transfer of property is an excise tax. *See, e.g., Standard Oil Co. v. Graves*, 94 Wash. 291, 306, 162 P. 558 (1917), *rev. on other grounds*, 249 U.S. 389, 39 S. Ct. 320, 63 L. Ed. 662 (1919) (oil inspection fee imposed "only upon the contingency that the oil is sold or offered for sale" was an excise tax).

ATTORNEY GENERAL OF WASHINGTON
Revenue and Finance Division
7141 Cleanwater Dr. SW
PO Box 40123
Olympia, WA 98504-0123
(360) 753-5515

Subsequent decisions continued to distinguish between a tax on the mere ownership of property and a tax on selling, transferring, or otherwise exercising a single power over property. Most relevant here, in *Mahler v. Tremper*, 40 Wn.2d 405, 243 P.2d 627 (1952), the Court unanimously upheld the constitutionality of the real estate excise tax, which it deemed an excise tax on the sale of real estate. *See id.* at 407. In *Mahler*, the Court explained that a tax on the sale or transfer of property is an excise tax, not a property tax:

> We are committed to the proposition that a tax upon the sale of property is not a tax upon the subject matter of that sale. A sales tax upon personal property or a sales tax upon real property is a tax upon the act or incidence of transfer. The imposition relates to an exercise of one of several rights in and to property. Imposition is not upon each and every owner merely because he is the owner of the property involved.

Id. at 409-10.

While our Supreme Court has repeatedly held that taxes on the sale of property are excise taxes, it has also held that annual taxes on renting residential property are property taxes. In *Apartment Operators Association of Seattle v. Schumacher*, 56 Wn.2d 46, 351 P.2d 124 (1960), the Court struck down a tax imposed annually on income from renting real property. In a brief opinion, the Court simply stated that under cases such as *Culliton* and *Jensen*, "a tax on rental income is a tax on property, and not an excise tax. Furthermore, a tax upon rents from real estate is a tax upon the real estate itself, and is, thus, a second tax upon real estate." *Id.* at 47. The Court reiterated this principle in *Harbour Village Apartments v. City of Mukilteo*, 139 Wn.2d 604, 989 P.2d 542 (1999), when it struck down an annual flat fee imposed on residential dwelling units offered for rent. The Court reasoned that because each "rental unit is directly taxed . . . regardless of whether it is actually rented, the number of rental transactions associated with the property, or any other factors normally associated with ongoing business activity, including income," the incident of the tax was on "the mere ownership of that subclass of real property defined by its rental use." *Id*. at 607. Importantly, although our Supreme Court in *Apartment Operators* and *Harbour Village* treated annual taxes on renting residential real property as property taxes, it has

ATTORNEY GENERAL OF WASHINGTON
Revenue and Finance Division
7141 Cleanwater Dr. SW
PO Box 40123
Olympia, WA 98504-0123
(360) 753-5515

refused to extend these decisions to any other context, instead treating taxes on all other types of leases or transactions as excise taxes.

For example, in *Black v. State*, 67 Wn.2d 97, 406 P.2d 761 (1965), the Court held that a tax on the lease of a boat (tangible personal property) used as a floating hotel was imposed "on the transaction of leasing tangible personal property. It is not a tax on property." *Id.* at 99. The Court explained that "[t]o the extent that the per curiam opinion in *Apartment Operators* . . . , *may seem* to make statements inconsistent with the above outlined principles, it is hereby deemed not controlling in the instant case." 67 Wn.2d at 100.

Similarly, in *High Tide Seafoods v. State*, 106 Wn.2d 695, 725 P.2d 411 (1986), the Court held that a state tax on the first possession of fish for commercial purposes was an excise tax, not a property tax. The Court explained that "[t]he event causing this food fish tax to be levied is the *transfer* of ownership from the fisherman to the fish purchaser. It is not based just on the ownership of the fish." *Id.* at 700. The tax on commercial use of fish, like the tax on the rental of tangible personal property in *Black*, was imposed on "the voluntary action of the person taxed in performing the act, enjoying the privilege or engaging in the occupation which is the subject of the excise, and the element of absolute and unavoidable demand, as in the case of a property tax, is lacking." *Id*. at 699.

A few years later, in *Washington Public Ports Association v. Department of Revenue*, 148 Wn.2d 637, 62 P.3d 462 (2003), the Court upheld the leasehold excise tax (LET) as a valid excise tax. The LET is imposed for "the act or privilege of occupying or using publicly owned real or personal property through a leasehold interest." *Id.* at 642 (quoting RCW 82.29A.030(1)). "Similar to the sales tax at issue in *Black*, under the LET, there must be a rental transaction. In other words, there needs to be an occupancy or use of publicly owned real or personal property through a leasehold interest before the tax is due." *Id*. at 651. Because the tax required a voluntary act by the lessee, it qualified as a "true excise tax." *Id*. at 652.

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The Court continued to follow and apply *Black* in *Sheehan v. Central Puget Sound Regional Transit Authority*, 155 Wn.2d 790, 123 P.3d 88 (2005). *Sheehan* involved a motor vehicle excise tax (MVET) and a "Monorail" tax that were measured by the value of motor vehicles owned by residents of the taxing districts. *See id.* at 794-95. Rejecting the assertion that article VII applied to the taxes, the Court described the "two conditions" that distinguish excise taxes from property taxes:

> We have previously noted that excise taxes require two conditions: First, excise taxes are imposed upon a voluntary act of the taxpayer, which affords the taxpayer the benefits of the occupation, business, or activity that triggers the taxable event. Second, excise taxes are directly imposed based upon the extent to which the taxpayer enjoys the taxable privilege. *See Harbour Vill. Apartments v. City of Mukilteo*, 139 Wn.2d 604, 611, 989 P.2d 542 (1999) (Talmadge, J., dissenting) (summarizing *Black v. State*, 67 Wn.2d 97, 99, 406 P.2d 761 (1965)). . . .

Id. at 799-800. Regarding these conditions, the Court first explained that the vehicle taxes at issue "satisfy the requirement that excise taxes must be voluntary. There is no inherent requirement that residents of the taxing districts own or continue to own a motor vehicle." *Id*. at 800. Likewise, the vehicle taxes satisfied the second condition because there was a sufficient relationship between the privileges being taxed (use of a motor vehicle on public roadways) and the method of taxation (annual tax measured by the value of the motor vehicle being used). *Id*. at 801. Consequently, the taxes were valid excise taxes.

More recently, in *In re Estate of Hambleton*, 181 Wn.2d 802, 832, 335 P.3d 398 (2014), the Court held Washington's estate tax—which applies at various rates to the transfer of property occurring at death—is an excise tax not subject to article VII, section 1's uniformity requirement. The Court explained:

> A tax is an "excise" or "transfer" tax if the government is taxing a particular use or enjoyment of property or the shifting from one to another of any power or privilege incidental to the ownership or enjoyment of property. An estate tax is an excise tax because the tax is not levied on the property of which an estate is composed. Rather it is imposed upon the shifting of economic benefits and the privilege of transmitting or receiving such benefits.

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Id. (quotations and citations omitted). Specifically, an estate tax "is an excise tax upon the happening of an event, namely, death, where the death brings about certain described changes in legal relationships affecting property." *Id*. at 832-33 (quotation omitted).

Although the above decisions applying article VII may at first seem "conflicting and bewildering," *Stiner*, 174 Wash. at 406, a coherent legal principle has emerged. The Court has consistently distinguished between annually imposed income taxes, including taxes on real property rental income (which qualify as property taxes for purposes of article VII), and taxes imposed on the sale or transfer of property (which do not). *Compare, e.g., Jensen*, 185 Wash. 209 (invalidating annual net income tax) and *Power, Inc. v. Huntley*, 39 Wn.2d 191, 235 P.2d 173 (1951) (invalidating annual corporate tax on net income) *with Morrow*, 182 Wash. 625 (upholding retail sales tax) and *Mahler*, 40 Wn.2d 405 (upholding real estate excise tax). These cases show that the state may tax the sale of real property as an excise (*Mahler*), the sale of personal property as an excise (*Morrow*), the use of real property as an excise (*Washington Public Ports Association*), the use of personal property as an excise (*Vancouver Oil Co. v. Henneford*, 183 Wash. 317, 49 P.2d 14 (1935)), the rental of personal property as an excise (*Black*), and the transfer at death of all forms of property as an excise (*Hambleton*).

b. The capital gains tax is an excise tax, not a property tax

Washington courts look beyond how a tax is labeled to determine its true nature based on how it operates in practice. *Wash. Pub. Ports Ass'n*, 148 Wn.2d at 650. The true nature of a property tax is an "absolute and unavoidable demand against property or the ownership of property" that arises merely from the taxpayer's "status as property owner[.]" *Covell*, 127 Wn.2d at 890. In contrast, under the line of Supreme Court cases discussed above, an excise tax "is based upon the voluntary action of the person taxed in performing the act, enjoying the privilege or engaging in the occupation which is the subject of the excise, and the element of absolute and unavoidable demand, as in the case of a property tax, is lacking." *Black*, 67 Wn.2d at 99 (quoting

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1 Cooley, *Taxation* § 46, at 132 (4th ed. 1924)); *see also High Tide Seafoods*, 106 Wn.2d at 699; *Covell*, 127 Wn.2d at 889; *Wash. Pub. Ports Ass'n*, 148 Wn.2d at 651-52.

Under the above standard, the recently enacted capital gains tax is an excise tax not subject to article VII. The tax is imposed on the *voluntary sale or exchange* of long-term capital assets, not on those assets themselves. ESSB 5096, § 5(1). Thus, it does not apply to every owner of capital assets, but only to those that elect to sell or transfer those assets and then only on the amount of gain, not on the value of the assets themselves. In short, the capital gains tax is imposed on the beneficial use of property as distinguished from a tax on property itself. As such, it is not materially different from the numerous excise taxes upheld by our Supreme Court. If the capital gains tax was an annual tax on the value of the capital asset, then it might be more like a property tax, such as the real property taxes every homeowner pays. But it is not. Accordingly, this Court should hold it is an excise tax.

Plaintiffs may argue that because the federal government and some other states treat capital gains taxes as a type of income tax under their tax codes, the same must be true in Washington. That argument fails on two levels.

First, whether the capital gains excise tax is a property tax under Washington's Constitution is a question of Washington law controlled by the Washington Supreme Court decisions discussed above, not by the vagaries of tax laws imposed by other jurisdictions. Under controlling Washington law, a tax on the voluntary sale of certain capital assets is an excise tax.

Second, even if federal law or the law of other states were relevant, the overwhelming consensus is that income taxes are excise taxes, not property taxes. *See, e.g.*, *Brushaber v. Union Pac. R. Co.*, 240 U.S. 1, 17, 36 S. Ct. 236, 60 L. Ed. 493 (1916) (recognizing that an income tax is "in its nature an excise entitled to be enforced as such"); Hugh D. Spitzer, *A Washington State Income Tax—Again?*, 16 Univ. Puget Sound Law Rev. 515, 557-58 (1993) (explaining that virtually every state that has "directly addressed the income-as-property issue" has ruled that an

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income tax is not a tax on property). Thus, if the laws of other jurisdictions controlled, a capital gains tax would not be a property tax even if it were classified as an "income tax."

In sum, to determine whether the capital gains tax is an excise tax, Washington courts must follow Washington law. Under the authorities discussed above, the capital gains tax is an excise tax not subject to article VII, sections 1 and 2. Even if this Court looks to authority from other jurisdictions, the capital gains tax would not be a property tax. Plaintiffs' claims to the contrary are legally groundless and should be rejected.

2. Plaintiffs' remaining constitutional arguments fail

Plaintiffs allege three additional constitutional violations. First, they argue that the capital gains tax violates article I, section 12's privileges and immunities clause because it imposes a tax "on certain Washington citizens while exempting other Washington citizens and all Washington corporations." Quinn Am. Comp., ¶ 42. Second, they argue that the tax violates article I, section 7's protection for private affairs because it requires those who owe the tax to disclose "their federal income tax returns, schedules, and supporting documentation." *Id.* at ¶ 47. Third, they argue that the tax violates the federal Constitution's Commerce Clause. *Id*. at ¶ 52; Clayton Comp., ¶ 76. Each claim is without merit.

a. ESSB 5096 does not violate the Privileges & Immunities Clause

Plaintiffs first claim that ESSB 5096 violates article I, section 12 by imposing a capital gains tax on certain citizens while exempting others. Article I, section 12 provides that "[n]o law shall be passed granting to any citizen, class of citizens, or corporation other than municipal, privileges or immunities which upon the same terms shall not equally belong to all citizens, or corporations." The purpose of this provision is "to limit the sort of favoritism [towards special interests] that ran rampant during the territorial period." *Martinez-Cuevas v. DeRuyter Bros. Dairy, Inc.*, 196 Wn.2d 506, 514, 475 P.3d 164 (2020).

The clause is interpreted and applied consistently with the federal equal protection clause in some circumstances, but the analysis diverges when the challenged law "implicates a

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'privilege or immunity' as defined in our early cases distinguishing the fundamental rights of state citizenship." *Id*. at 518-19 (citation omitted); *Schroeder v. Weighall*, 179 Wn.2d 566, 572, 316 P.3d 482 (2014). In such situations, courts use a two-step analysis. *Martinez-Cuevas*, 196 Wn.2d at 519. First, the court asks whether a challenged law grants a "privilege" or "immunity" for purposes of the state constitution. If the answer is yes, the court asks whether there is a "reasonable ground" for granting that privilege or immunity. *Id*.; *see also Ockletree v. Franciscan Health Sys.*, 179 Wn.2d 769, 776, 317 P.3d 1009 (2014).

Plaintiffs cannot get past the first hurdle here. Not every legislative classification implicates a privilege or immunity under article I, section 12. Rather, "privileges" or "immunities" are only "those fundamental rights which belong to the citizens of [Washington] by reason of such citizenship." *Grant Cnty. Fire Prot. Dist. No. 5*, 150 Wn.2d at 813 (quoting *State v. Vance*, 29 Wash. 435, 458, 70 P. 34 (1902)). These include the right to carry on business within the state; the right to acquire and hold property and to "protect and defend the same in the law;" the rights to usual remedies to collect debts and enforce other personal rights; and the right to be exempt from taxes or burdens "which citizens of some other state are exempt from." *Id*. The Supreme Court has declined to broadly construe "privileges and immunities" because doing so would require the Court to "second-guess the distinctions drawn by the legislature for policy reasons nearly every time it enacts a statute." *Ockletree*, 179 Wn.2d at 779.

In their Complaints, Plaintiffs fail to allege any fundamental right of state citizenship implicated by ESSB 5096. Moreover, even assuming the capital gains tax implicates a privilege or immunity, Plaintiffs' article I, section 12 challenge falls short because reasonable grounds exist for the distinctions drawn in ESSB 5096. The "reasonable grounds" test comprises two prongs: (1) whether the law applies equally to all persons within a designated class, and (2) whether there is a reasonable ground for distinguishing between those who fall within the class and those who do not. *Ockletree*, 179 Wn.2d at 783. Here, ESSB 5096 requires all taxpayers within certain parameters to pay capital gains tax (gains over $250,000 on sale/exchange of

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nonexempt assets), and exempts all taxpayers who meet specific exemption criteria (real estate, retirement assets, small businesses, gains under $250,000). The first prong is thus met.

The second prong is also met here. States have broad leeway in "making classifications and drawing lines which in their judgment produce reasonable systems of taxation." *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356, 359, 93 S. Ct. 1001, 35 L. Ed. 2d 351 (1973). "Indeed, in taxation, even more than in other fields, legislatures possess the greatest freedom in classification." *General Motors Corp. v. Tracy*, 519 U.S. 278, 311, 117 S. Ct. 811, 136 L. Ed. 2d 761 (1997) (internal quotations and citation omitted); *accord City of Seattle v. Rogers Clothing for Men, Inc.*, 114 Wn.2d 213, 234, 787 P.2d 39 (1990) ("Legislative bodies have extensive authority to make classifications for purposes of legislation and even broader discretion in making classifications for taxation than it has for regulation."). Consistent with this deferential approach, Washington courts will uphold a legislative classification under article I, section 12 unless there are no reasonable grounds "for distinguishing between those who fall within the class and those who do not." *Grant Cnty. Fire Prot. Dist. No. 5 v. City of Moses Lake*, 145 Wn.2d 702, 731, 42 P.3d 394 (2002), *vacated in part by Grant Cnty Fire Prot. Dist. No. 5 (Grant Cnty II)*, 150 Wn.2d at 816. In matters involving taxation, the legislature's broad discretion to make classifications is given considerable deference. *Id.* at 732; *see also id.* at 738 (Madsen, J., concurring/dissenting). Thus, "a revenue statute will not be invalidated under article I, section 12 if 'any state of facts can reasonably be conceived that would sustain the classification.'" *Id.* at 732 (quoting *United Parcel Serv. v. Dep't of Revenue*, 102 Wn.2d 355, 369, 687 P.2d 186 (1984)).

Under this deferential standard, the legislature had reasonable grounds for imposing the capital gains tax on those with more than $250,000 in gain from the sale or exchange of nonexempt assets. The purpose of the tax is to raise revenue and address Washington's regressive tax code. ESSB 5096, § 1. Drawing distinctions so as to impose the tax on those with a greater ability to pay is a reasonable approach to these goals. *See generally Wash. Bankers*, 495 P.3d at

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822 (upholding tax law that "asked the wealthy few to contribute more to funding essential services and programs to the benefit of all Washingtonians").

In sum, to the extent the capital gains tax implicates a "privilege" or "immunity" under article I, section 12 (which it does not), Plaintiffs cannot show the legislature lacked reasonable grounds in determining who would be subject to the tax. Consequently, ESSB 5096 does not violate article I, section 12.

b. ESSB 5096 does not violate article I, section 7

Plaintiffs next claim that ESSB 5096 violates privacy rights granted under article I, section 7 in requiring that taxpayers owing capital gains tax file their federal tax returns and other supporting documentation with the Department of Revenue. Article I, section 7 provides that "[n]o person shall be disturbed in his private affairs, or his home invaded, without authority of law." Const. art. I, § 7. The provision is "grounded in a broad right to privacy and protects citizens from governmental intrusion into their private affairs without the authority of law." *State v. Hinton*, 179 Wn.2d 862, 868, 319 P.3d 9, 12 (2014) (internal quotation marks and citations omitted). The party asserting a protected privacy right must show both that his or her "private affairs" were disturbed and that the disturbance was not justified by authority of law. *State v. Chase*, 1 Wn. App. 2d 799, 803-04, 407 P.3d 1178 (2017).

ESSB 5096 does not violate article I, section 7. State law already requires taxpayers to maintain tax records, including copies of federal income tax returns, and subjects those records to "examination at any time by the department of revenue." RCW 82.32.070. Indeed, "records related to the collection of taxes have historically been available to the Department [of Revenue] for audit." *Chase*, 1 Wn. App. 2d at 807; *see also id.* ("since 1935, taxpayers have been on notice that their financial records could be subject to random audit at the Department [of Revenue]'s discretion" (citing RCW 82.32.070)). Moreover, federal courts have long recognized that the federal Constitution does not relieve taxpayers from their obligation to file income tax returns. *See*, *e.g.*, *U.S. v. Sullivan*, 274 U.S. 259, 47 S. Ct. 607, 71 L. Ed. 1037 (1927) (bootlegger had

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no Fifth Amendment protection against filing income tax returns); *U.S. v. Campbell*, 619 F.2d 765, 767 (8th Cir. 1980) (tax protestor had no Fifth Amendment protection against filing income tax returns). Accordingly, there is no recognized privacy interest in concealing tax returns from the taxing authority.

The information at issue here (federal tax returns) has already been provided to the federal government, and will be protected from public disclosure by a robust confidentiality statute. *See* RCW 82.32.330. The Department of Revenue may use the information only for enforcement and collection of taxes. Plaintiffs' contention that providing federal income tax returns to the Department violates privacy rights granted under article I, section 7 is meritless.

c. ESSB 5096 does not violate the Commerce Clause

The Commerce Clause vests in Congress the authority "[t]o regulate commerce . . . among the several states." U.S. Const. art. I, § 8, cl. 3. "Implicit in this affirmative grant of power is the negative or 'dormant' aspect of the clause: states intrude on this federal power when they enact laws that unduly burden interstate commerce." *Wash. Bankers*, 495 P.3d at 813 (citing *State v. Heckel*, 143 Wn.2d 824, 832, 24 P.3d 404 (2001)). A state tax is consistent with the dormant Commerce Clause if it (1) applies to an activity with a substantial nexus with the taxing state, (2) is fairly apportioned, (3) does not impermissibly discriminate against interstate commerce, and (4) is fairly related to services provided by the state. *Id*. at 814 (citing *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 279, 97 S. Ct. 1076, 51 L. Ed. 2d 326 (1977)).

Plaintiffs do not challenge *Complete Auto*'s first prong ("nexus"). Instead, they claim that the tax violates the last three *Complete Auto* factors, i.e., is not fairly apportioned, discriminates against interstate commerce, and is not fairly related to services provided by the state. *See* Clayton Comp. at 16 (¶ 76). As discussed below, Plaintiffs are wrong.

Under the second *Complete Auto* factor, the capital gains tax is fairly apportioned. The "central purpose" of the fair apportionment requirement "is to ensure that each State taxes only its fair share of an interstate transaction." *Goldberg v. Sweet*, 488 U.S. 252, 260-61, 109 S. Ct.

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582, 102 L. Ed. 2d 607 (1989). Consistent with that purpose, the Constitution "imposes no single [apportionment] formula on the States." *Id*. at 261 (citations omitted). Instead, the Court evaluates a state's apportionment method "by examining whether it is internally and externally consistent." *Id*.

Internal consistency requires a tax to be structured so that if every state imposed it, no multiple taxation would result. *Id*. In contrast, the external consistency test evaluates the "economic justification for the State's claim upon the value taxed." *Okla. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 185, 115 S. Ct. 1331, 131 L. Ed. 2d 261 (1995). The capital gains tax meets both requirements.

First, if every other state imposed an identical tax, there would be no risk of multiple taxation. This is so because ESSB 5096 allocates gains from the sale of tangible personal property to the state where the property is located, and allocates gains from the sale of intangible personal property to the state where the owner is domiciled. ESSB 5096, § 11(1). Thus, absent highly unusual circumstances where tangible personal property straddles state lines, or the owner of intangible property maintains a domicile in more than one state, there is no risk of multiple taxation. And even if a particular taxpayer could demonstrate multiple taxation, the Act allows a targeted tax credit to remedy this situation. *Id*. at § 11(2). In short, the Legislature carefully crafted the capital gains tax to ensure internal consistency.

Second, a rational relationship exists between the gain allocated to the state and the activity that generated the tax liability. With respect to the sale of tangible personal property, the state where the sale is made has "economic justification" to tax the gain derived from the sale. *Cf.*, *Jefferson Lines*, 514 U.S. at 184 ("It has long been settled that a sale of tangible goods has a sufficient nexus to the State in which the sale is consummated to be treated as a local transaction taxable by that State."). And as to the sale of intangible property, there can be no rational dispute that the state where the owner resides has economic justification to tax the gain. *Cf., Wheeling*

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Steel Corp. v. Fox, 298 U.S. 193, 209, 56 S. Ct. 773, 80 L. Ed. 1143 (1936) Thus, the tax is externally consistent, and *Complete Auto*'s fair apportionment requirement is met.

Plaintiffs' claims as to *Complete Auto*'s third prong ("discrimination") also fail. Our Supreme Court recently addressed this prong in a case involving a surtax on large banks. *See Wash. Bankers, supra*. The Court explained that "discrimination" under *Complete Auto* means "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Wash. Bankers*, 495 P.3d at 814 (quoting *Filo Foods, LLC v. City of SeaTac*, 183 Wn.2d 770, 809, 357 P.3d 1040 (2015)). A state tax "may be discriminatory on its face, in purpose, or by having the effect of unduly burdening interstate commerce." *Id*. A law is facially discriminatory only if it "textually identifies out-of-state persons or entities and grants them unfavorable treatment." *Id*. at 815 (quoting *Filo Foods*, 183 Wn.2d at 809).

ESSB 5096's plain text does not grant unfavorable treatment to out-of-state persons, and, therefore, the law is not facially discriminatory. Moreover, Plaintiffs have not alleged what discriminatory effect the new capital gains tax will have (once it goes into effect) or how it conceivably has a discriminatory purpose. Courts are not required to address every argument thrown into the "constitutional sea." Absent real evidence of a discriminatory effect or purpose, the Court should summarily reject Plaintiffs' discrimination claim. *See Wash. Bankers,* 495 P.3d at 819 ("discrimination requires more than mere assertion that it exists").

The capital gains excise tax also meets the fourth *Complete Auto* factor asking whether the tax is fairly related to the "presence and activities of the taxpayer within the State." *Goldberg*, 488 U.S. at 266. The purpose of this test "is to ensure that a State's tax burden is not placed upon persons who do not benefit from services provided by the State." *Id*. at 266-67 (citing *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 627, 101 S. Ct. 2946, 69 L. Ed. 2d 884 (1981)). In applying this test, courts evaluate the "wide range of benefits provided to the taxpayer, not just the precise activity connected to the interstate activity at issue." *Id.* at 267.

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Such benefits include "police and fire protection, the use of public roads and mass transit, and the other advantages of civilized society." *Id*.

Plaintiffs cannot seriously argue that individuals who will eventually owe the capital gains tax receive none of the "wide range of benefits" offered by the state. Among other public benefits, they have access to public schools and colleges, the state court system (as this case demonstrates), state highways and parks, and the protection of state and local police, fire, and public health services. The tax meets the fourth *Complete Auto* prong.

Finally, Plaintiffs raise what appears to be a new factor: that the dormant Commerce Clause somehow prohibits states from "allocat[ing] taxable gain" from the sale of intangible personal property to the state based on "residency instead of the location of the sale." Clayton Comp. at 16 (¶ 76). Defendants are not aware of any authority requiring states to allocate gains from the sale of property in a particular manner. *See generally Wheeling Steel*, 298 U.S. at 209 (recognizing that one permissible way to determine the location of intangibles is to "treat [the intangible property] as localized at the owner's domicile for purposes of taxation"); *Greenough v. Tax Assessors of City of Newport*, 311 U.S. 486, 492, 67 S. Ct. 1400, 91 L. Ed. 1621 (1947) (state may impose tax on resident taxpayer's intangible property). So long as the four *Complete Auto* factors are met—which they are here—there is no basis to require that gains be "allocated" based on where a sale occurs.

IV. CONCLUSION

Plaintiffs lack standing under the UDJA to challenge the capital gains excise tax. Additionally, each of their constitutional arguments fail as a matter of law. The Court should therefore grant Defendants' Motion for Summary Judgment and dismiss Plaintiffs' Complaints.

DATED this 6th day of December, 2021.

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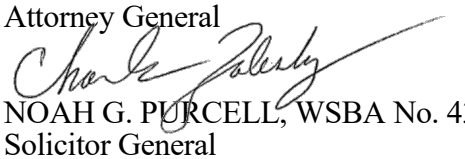

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I certify under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 6th day of December, 2021, at Olympia, WA.

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APPENDIX A

CERTIFICATION OF ENROLLMENT

ENGROSSED SUBSTITUTE SENATE BILL 5096

Chapter 196, Laws of 2021

67th Legislature
2021 Regular Session

CAPITAL GAINS TAX

EFFECTIVE DATE: July 25, 2021

Passed by the Senate April 25, 2021
Yeas 25 Nays 24

DENNY HECK

President of the Senate

Passed by the House April 24, 2021
Yeas 52 Nays 44

LAURIE JINKINS

Speaker of the House of Representatives

Approved May 4, 2021 2:58 PM

JAY INSLEE

Governor of the State of Washington

CERTIFICATE

I, Brad Hendrickson, Secretary of the Senate of the State of Washington, do hereby certify that the attached is **ENGROSSED SUBSTITUTE SENATE BILL 5096** as passed by the Senate and the House of Representatives on the dates hereon set forth.

BRAD HENDRICKSON

Secretary

FILED

May 5, 2021

Secretary of State
State of Washington

ENGROSSED SUBSTITUTE SENATE BILL 5096

AS RECOMMENDED BY THE CONFERENCE COMMITTEE

Passed Legislature - 2021 Regular Session

State of Washington 67th Legislature 2021 Regular Session

By Senate Ways & Means (originally sponsored by Senators Robinson, Hunt, Nguyen, and Wilson, C.; by request of Office of Financial Management)

READ FIRST TIME 02/18/21.

AN ACT Relating to investing in Washington families and creating a more progressive tax system in Washington by enacting an excise tax on the sale or exchange of certain capital assets; amending RCW 83.100.230; adding a new section to chapter 82.04 RCW; adding a new chapter to Title 82 RCW; creating new sections; and prescribing penalties.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

NEW SECTION. **Sec. 1.** INTENT. The legislature finds that it is the paramount duty of the state to amply provide every child in the state with an education, creating the opportunity for the child to succeed in school and thrive in life. The legislature further finds that high quality early learning and child care is critical to a child's success in school and life, as it supports the development of the child's social-emotional, physical, cognitive, and language skills. Therefore, the legislature will invest in the ongoing support of K-12 education and early learning and child care by dedicating revenues from this act to the education legacy trust account and the common school construction account.

The legislature further recognizes that a tax system that is fair, balanced, and works for everyone is essential to help all Washingtonians grow and thrive. But Washington's tax system today is

the most regressive in the nation because it asks those making the least to pay the most as a percentage of their income. Middle-income families in Washington pay two to four times more in taxes, as a percentage of household income, as compared to top earners in the state. Low-income Washingtonians pay at least six times more than do our wealthiest residents.

To help meet the state's paramount duty, the legislature intends to levy a seven percent tax on the voluntary sale or exchange of stocks, bonds, and other capital assets where the profit is in excess of $250,000 annually to fund K-12 education, early learning, and child care, and advance our paramount duty to amply provide an education to every child in the state. The legislature recognizes that levying this tax will have the additional effect of making material progress toward rebalancing the state's tax code.

The legislature further intends to exempt certain assets from the tax including, but not limited to, qualified family-owned small businesses, all residential and other real property, and retirement accounts.

NEW SECTION. **Sec. 2.** DISTRIBUTION OF REVENUES. (1) All taxes, interest, and penalties collected under this chapter shall be distributed as follows:

(a) The first $500,000,000 collected each fiscal year shall be deposited into the education legacy trust account created in RCW 83.100.230; and

(b) Any remainder collected each fiscal year shall be deposited into the common school construction account.

(2) The amounts specified under subsection (1)(a) of this section shall be adjusted annually as provided under section 17 of this act.

Sec. 3. RCW 83.100.230 and 2019 c 415 s 990 are each amended to read as follows:

The education legacy trust account is created in the state treasury. Money in the account may be spent only after appropriation. Expenditures from the account may be used only for support of the common schools, and for expanding access to higher education through funding for new enrollments and financial aid, early learning and child care programs, and other educational improvement efforts. ((~~During the 2015-2017, 2017-2019, and 2019-2021 fiscal biennia appropriations from the account may be made for support of early~~

~~learning programs. It is the intent of the legislature that this policy will be continued in subsequent fiscal biennia.~~))

NEW SECTION. **Sec. 4.** DEFINITIONS. The definitions in this section apply throughout this chapter unless the context clearly requires otherwise.

(1) "Adjusted capital gain" means federal net long-term capital gain:

(a) Plus any amount of long-term capital loss from a sale or exchange that is exempt from the tax imposed in this chapter, to the extent such loss was included in calculating federal net long-term capital gain;

(b) Plus any amount of long-term capital loss from a sale or exchange that is not allocated to Washington under section 11 of this act, to the extent such loss was included in calculating federal net long-term capital gain;

(c) Plus any amount of loss carryforward from a sale or exchange that is not allocated to Washington under section 11 of this act, to the extent such loss was included in calculating federal net long-term capital gain;

(d) Less any amount of long-term capital gain from a sale or exchange that is not allocated to Washington under section 11 of this act, to the extent such gain was included in calculating federal net long-term capital gain; and

(e) Less any amount of long-term capital gain from a sale or exchange that is exempt from the tax imposed in this chapter, to the extent such gain was included in calculating federal net long-term capital gain.

(2) "Capital asset" has the same meaning as provided by Title 26 U.S.C. Sec. 1221 of the internal revenue code and also includes any other property if the sale or exchange of the property results in a gain that is treated as a long-term capital gain under Title 26 U.S.C. Sec. 1231 or any other provision of the internal revenue code.

(3) "Federal net long-term capital gain" means the net long-term capital gain reportable for federal income tax purposes determined as if Title 26 U.S.C. Secs. 55 through 59, 1400Z-1, and 1400Z-2 of the internal revenue code did not exist.

(4) "Individual" means a natural person.

(5) "Internal revenue code" means the United States internal revenue code of 1986, as amended, as of the effective date of this

section, or such subsequent date as the department may provide by rule consistent with the purpose of this chapter.

(6) "Long-term capital asset" means a capital asset that is held for more than one year.

(7) "Long-term capital gain" means gain from the sale or exchange of a long-term capital asset.

(8) "Long-term capital loss" means a loss from the sale or exchange of a long-term capital asset.

(9) "Real estate" means land and fixtures affixed to land. "Real estate" also includes used mobile homes, used park model trailers, used floating homes, and improvements constructed upon leased land.

(10)(a) "Resident" means an individual:

(i) Who is domiciled in this state during the taxable year, unless the individual (A) maintained no permanent place of abode in this state during the entire taxable year, (B) maintained a permanent place of abode outside of this state during the entire taxable year, and (C) spent in the aggregate not more than 30 days of the taxable year in this state; or

(ii) Who is not domiciled in this state during the taxable year, but maintained a place of abode and was physically present in this state for more than 183 days during the taxable year.

(b) For purposes of this subsection, "day" means a calendar day or any portion of a calendar day.

(c) An individual who is a resident under (a) of this subsection is a resident for that portion of a taxable year in which the individual was domiciled in this state or maintained a place of abode in this state.

(11) "Taxable year" means the taxpayer's taxable year as determined under the internal revenue code.

(12) "Taxpayer" means an individual subject to tax under this chapter.

(13) "Washington capital gains" means an individual's adjusted capital gain, as modified in section 7 of this act, for each return filed under this chapter.

NEW SECTION. **Sec. 5.** TAX IMPOSED. (1) Beginning January 1, 2022, an excise tax is imposed on the sale or exchange of long-term capital assets. Only individuals are subject to payment of the tax, which equals seven percent multiplied by an individual's Washington capital gains.

(2) The tax levied in subsection (1) of this section is necessary for the support of the state government and its existing public institutions.

(3) If an individual's Washington capital gains are less than zero for a taxable year, no tax is due under this section and no such amount is allowed as a carryover for use in the calculation of that individual's adjusted capital gain, as defined in section 4(1) of this act, for any taxable year. To the extent that a loss carryforward is included in the calculation of an individual's federal net long-term capital gain and that loss carryforward is directly attributable to losses from sales or exchanges allocated to this state under section 11 of this act, the loss carryforward is included in the calculation of that individual's adjusted capital gain for the purposes of this chapter. An individual may not include any losses carried back for federal income tax purposes in the calculation of that individual's adjusted capital gain for any taxable year.

(4)(a) The tax imposed in this section applies to the sale or exchange of long-term capital assets owned by the taxpayer, whether the taxpayer was the legal or beneficial owner of such assets at the time of the sale or exchange. The tax applies when the Washington capital gains are recognized by the taxpayer in accordance with this chapter.

(b) For purposes of this chapter:

(i) An individual is considered to be a beneficial owner of long-term capital assets held by an entity that is a pass-through or disregarded entity for federal tax purposes, such as a partnership, limited liability company, S corporation, or grantor trust, to the extent of the individual's ownership interest in the entity as reported for federal income tax purposes.

(ii) A nongrantor trust is deemed to be a grantor trust if the trust does not qualify as a grantor trust for federal tax purposes, and the grantor's transfer of assets to the trust is treated as an incomplete gift under Title 26 U.S.C. Sec. 2511 of the internal revenue code and its accompanying regulations. A grantor of such trust is considered the beneficial owner of the capital assets of the trust for purposes of the tax imposed in this section and must include any long-term capital gain or loss from the sale or exchange of a capital asset by the trust in the calculation of that

individual's adjusted capital gain, if such gain or loss is allocated to this state under section 11 of this act.

NEW SECTION. **Sec. 6.** EXEMPTIONS. This chapter does not apply to the sale or exchange of:

(1) All real estate transferred by deed, real estate contract, judgment, or other lawful instruments that transfer title to real property and are filed as a public record with the counties where real property is located;

(2)(a) An interest in a privately held entity only to the extent that any long-term capital gain or loss from such sale or exchange is directly attributable to the real estate owned directly by such entity.

(b)(i) Except as provided in (b)(ii) and (iii) of this subsection, the value of the exemption under this subsection is equal to the fair market value of the real estate owned directly by the entity less its basis, at the time that the sale or exchange of the individual's interest occurs, multiplied by the percentage of the ownership interest in the entity which is sold or exchanged by the individual.

(ii) If a sale or exchange of an interest in an entity results in an amount directly attributable to real property and that is considered as an amount realized from the sale or exchange of property other than a capital asset under Title 26 U.S.C. Sec. 751 of the internal revenue code, such amount must not be considered in the calculation of an individual's exemption amount under (b)(i) of this subsection (2).

(iii) Real estate not owned directly by the entity in which an individual is selling or exchanging the individual's interest must not be considered in the calculation of an individual's exemption amount under (b)(i) of this subsection (2).

(c) Fair market value of real estate may be established by a fair market appraisal of the real estate or an allocation of assets by the seller and the buyer made under Title 26 U.S.C. Sec. 1060 of the internal revenue code, as amended. However, the department is not bound by the parties' agreement as to the allocation of assets, allocation of consideration, or fair market value, if such allocations or fair market value do not reflect the fair market value of the real estate. The assessed value of the real estate for property tax purposes may be used to determine the fair market value

of the real estate, if the assessed value is current as of the date of the sale or exchange of the ownership interest in the entity owning the real estate and the department determines that this method is reasonable under the circumstances.

(d) The value of the exemption under this subsection (2) may not exceed the individual's long-term capital gain or loss from the sale or exchange of an interest in an entity for which the individual is claiming this exemption;

(3) Assets held under a retirement savings account under Title 26 U.S.C. Sec. 401(k) of the internal revenue code, a tax-sheltered annuity or custodial account described in Title 26 U.S.C. Sec. 403(b) of the internal revenue code, a deferred compensation plan under Title 26 U.S.C. Sec. 457(b) of the internal revenue code, an individual retirement account or individual retirement annuity described in Title 26 U.S.C. Sec. 408 of the internal revenue code, a Roth individual retirement account described in Title 26 U.S.C. Sec. 408A of the internal revenue code, an employee defined contribution program, an employee defined benefit plan, or a similar retirement savings vehicle;

(4) Assets pursuant to, or under imminent threat of, condemnation proceedings by the United States, the state or any of its political subdivisions, or a municipal corporation;

(5) Cattle, horses, or breeding livestock if for the taxable year of the sale or exchange, more than 50 percent of the taxpayer's gross income for the taxable year, including from the sale or exchange of capital assets, is from farming or ranching;

(6) Property depreciable under Title 26 U.S.C. Sec. 167(a)(1) of the internal revenue code, or that qualifies for expensing under Title 26 U.S.C. Sec. 179 of the internal revenue code;

(7) Timber, timberland, or the receipt of Washington capital gains as dividends and distributions from real estate investment trusts derived from gains from the sale or exchange of timber and timberland. "Timber" means forest trees, standing or down, on privately or publicly owned land, and includes Christmas trees and short-rotation hardwoods. The sale or exchange of timber includes the cutting or disposal of timber qualifying for capital gains treatment under Title 26 U.S.C. Sec. 631(a) or (b) of the internal revenue code;

(8)(a) Commercial fishing privileges.

(b) For the purposes of this subsection (8), "commercial fishing privilege" means a right, held by a seafood harvester or processor, to participate in a limited access fishery. "Commercial fishing privilege" includes and is limited to:

(i) In the case of federally managed fisheries, quota and access to fisheries assigned pursuant to individual fishing quota programs, limited entry and catch share programs, cooperative fishing management agreements, or similar arrangements; and

(ii) In the case of state-managed fisheries, quota and access to fisheries assigned under fishery permits, limited entry and catch share programs, or similar arrangements; and

(9) Goodwill received from the sale of an auto dealership licensed under chapter 46.70 RCW whose activities are subject to chapter 46.96 RCW.

NEW SECTION. **Sec. 7.** DEDUCTIONS. In computing tax for a taxable year, a taxpayer may deduct from his or her Washington capital gains:

(1) A standard deduction of $250,000 per individual, or in the case of spouses or domestic partners, their combined standard deduction is limited to $250,000, regardless of whether they file joint or separate returns. The amount of the standard deduction shall be adjusted pursuant to section 17 of this act;

(2) Amounts that the state is prohibited from taxing under the Constitution of this state or the Constitution or laws of the United States;

(3) The amount of adjusted capital gain derived from the sale or transfer of the taxpayer's interest in a qualified family-owned small business pursuant to section 8 of this act; and

(4) Charitable donations deductible under section 9 of this act.

NEW SECTION. **Sec. 8.** QUALIFIED FAMILY-OWNED SMALL BUSINESS DEDUCTION. (1) In computing tax under this chapter for a taxable year, a taxpayer may deduct from his or her Washington capital gains the amount of adjusted capital gain derived in the taxable year from the sale of substantially all of the fair market value of the assets of, or the transfer of substantially all of the taxpayer's interest in, a qualified family-owned small business, to the extent that such adjusted capital gain would otherwise be included in the taxpayer's Washington capital gains.

(2) For purposes of this section, the following definitions apply:

(a) "Assets" means real property and personal property, including tangible personal property and intangible property.

(b) "Family" means the same as "member of the family" in RCW 83.100.046.

(c)(i) "Materially participated" means an individual was involved in the operation of a business on a basis that is regular, continuous, and substantial.

(ii) The term "materially participated" must be interpreted consistently with the applicable treasury regulations for Title 26 U.S.C. Sec. 469 of the internal revenue code, to the extent that such interpretation does not conflict with any provision of this section.

(d) "Qualified family-owned small business" means a business:

(i) In which the taxpayer held a qualifying interest for at least five years immediately preceding the sale or transfer described in subsection (1) of this section;

(ii) In which either the taxpayer or members of the taxpayer's family, or both, materially participated in operating the business for at least five of the 10 years immediately preceding the sale or transfer described in subsection (1) of this section, unless such sale or transfer was to a qualified heir; and

(iii) That had worldwide gross revenue of $10,000,000 or less in the 12-month period immediately preceding the sale or transfer described in subsection (1) of this section. The worldwide gross revenue amount under this subsection (2)(d)(iii) shall be adjusted annually as provided in section 17 of this act.

(e) "Qualified heir" means a member of the taxpayer's family.

(f) "Qualifying interest" means:

(i) An interest as a proprietor in a business carried on as a sole proprietorship; or

(ii) An interest in a business if at least:

(A) Fifty percent of the business is owned, directly or indirectly, by any combination of the taxpayer or members of the taxpayer's family, or both;

(B) Thirty percent of the business is owned, directly or indirectly, by any combination of the taxpayer or members of the taxpayer's family, or both, and at least:

(I) Seventy percent of the business is owned, directly or indirectly, by members of two families; or

(II) Ninety percent of the business is owned, directly or indirectly, by members of three families.

(g) "Substantially all" means at least 90 percent.

NEW SECTION. **Sec. 9.** ADDITIONAL DEDUCTION FOR CHARITABLE DONATIONS. (1) In computing tax under this chapter for a taxable year, a taxpayer may deduct from his or her Washington capital gains the amount donated by the taxpayer to one or more qualified organizations during the same taxable year in excess of the minimum qualifying charitable donation amount. For the purposes of this section, the minimum qualifying charitable donation amount equals $250,000. The minimum qualifying charitable donation amount under this subsection (1) shall be adjusted pursuant to section 17 of this act.

(2) The deduction authorized under subsection (1) of this section may not exceed $100,000 for the taxable year. The maximum amount of the available deduction under this subsection (2) shall be adjusted pursuant to section 17 of this act.

(3) The deduction authorized under subsection (1) of this section may not be carried forward or backward to another tax reporting period.

(4) For the purposes of this section, the following definitions apply:

(a) "Nonprofit organization" means an organization exempt from tax under Title 26 U.S.C. Sec. 501(c)(3) of the internal revenue code.

(b) "Qualified organization" means a nonprofit organization, or any other organization, that is:

(i) Eligible to receive a charitable deduction as defined in Title 26 U.S.C. Sec. 170(c) of the internal revenue code; and

(ii) Principally directed or managed within the state of Washington.

NEW SECTION. **Sec. 10.** OTHER TAXES. The tax imposed under this chapter is in addition to any other taxes imposed by the state or any of its political subdivisions, or a municipal corporation, with respect to the same sale or exchange, including the taxes imposed in, or under the authority of, chapter 82.04, 82.08, 82.12, 82.14, 82.45, or 82.46 RCW.

NEW SECTION. **Sec. 11.** ALLOCATION OF GAINS AND LOSSES. (1) For purposes of the tax imposed under this chapter, long-term capital gains and losses are allocated to Washington as follows:

(a) Long-term capital gains or losses from the sale or exchange of tangible personal property are allocated to this state if the property was located in this state at the time of the sale or exchange. Long-term capital gains or losses from the sale or exchange of tangible personal property are also allocated to this state even though the property was not located in this state at the time of the sale or exchange if:

(i) The property was located in the state at any time during the taxable year in which the sale or exchange occurred or the immediately preceding taxable year;

(ii) The taxpayer was a resident at the time the sale or exchange occurred; and

(iii) The taxpayer is not subject to the payment of an income or excise tax legally imposed on the long-term capital gains or losses by another taxing jurisdiction.

(b) Long-term capital gains or losses derived from intangible personal property are allocated to this state if the taxpayer was domiciled in this state at the time the sale or exchange occurred.

(2)(a) A credit is allowed against the tax imposed in section 5 of this act equal to the amount of any legally imposed income or excise tax paid by the taxpayer to another taxing jurisdiction on capital gains derived from capital assets within the other taxing jurisdiction to the extent such capital gains are included in the taxpayer's Washington capital gains. The amount of credit under this subsection may not exceed the total amount of tax due under this chapter, and there is no carryback or carryforward of any unused credits.

(b) As used in this section, "taxing jurisdiction" means a state of the United States other than the state of Washington, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, or any foreign country or political subdivision of a foreign country.

NEW SECTION. **Sec. 12.** FILING OF RETURNS. (1)(a) Except as otherwise provided in this section or RCW 82.32.080, taxpayers owing tax under this chapter must file, on forms prescribed by the department, a return with the department on or before the date the

taxpayer's federal income tax return for the taxable year is required to be filed.

(b)(i) Except as provided in (b)(ii) of this subsection (1), returns and all supporting documents must be filed electronically using the department's online tax filing service or other method of electronic reporting as the department may authorize.

(ii) The department may waive the electronic filing requirement in this subsection for good cause as provided in RCW 82.32.080.

(2) In addition to the Washington return required to be filed under subsection (1) of this section, taxpayers owing tax under this chapter must file with the department on or before the date the federal return is required to be filed a copy of the federal income tax return along with all schedules and supporting documentation.

(3) Each taxpayer required to file a return under this section must, without assessment, notice, or demand, pay any tax due thereon to the department on or before the date fixed for the filing of the return, regardless of any filing extension. The tax must be paid by electronic funds transfer as defined in RCW 82.32.085 or by other forms of electronic payment as may be authorized by the department. The department may waive the electronic payment requirement for good cause as provided in RCW 82.32.080. If any tax due under this chapter is not paid by the due date, interest and penalties as provided in chapter 82.32 RCW apply to the deficiency.

(4)(a) In addition to the Washington return required to be filed under subsection (1) of this section, an individual claiming an exemption under section 6(2) of this act must file documentation substantiating the following:

(i) The fair market value and basis of the real estate held directly by the entity in which the interest was sold or exchanged;

(ii) The percentage of the ownership interest sold or exchanged in the entity owning real estate; and

(iii) The methodology, if any, established by the entity in which the interest was sold or exchanged, for allocating gains or losses to the owners, partners, or shareholders of the entity from the sale of real estate.

(b) The department may by rule prescribe additional filing requirements to substantiate an individual's claim for an exemption under section 6(2) of this act. Prior to adopting any rule under this subsection (4)(b), the department must allow for an opportunity for

participation by interested parties in the rule-making process in accordance with the administrative procedure act, chapter 34.05 RCW.

(5) If a taxpayer has obtained an extension of time for filing the federal income tax return for the taxable year, the taxpayer is entitled to the same extension of time for filing the return required under this section if the taxpayer provides the department, before the due date provided in subsection (1) of this section, the extension confirmation number or other evidence satisfactory to the department confirming the federal extension. An extension under this subsection for the filing of a return under this chapter is not an extension of time to pay the tax due under this chapter.

(6)(a) If any return due under subsection (1) of this section, along with a copy of the federal income tax return, is not filed with the department by the due date or any extension granted by the department, the department must assess a penalty in the amount of five percent of the tax due for the taxable year covered by the return for each month or portion of a month that the return remains unfiled. The total penalty assessed under this subsection may not exceed 25 percent of the tax due for the taxable year covered by the delinquent return. The penalty under this subsection is in addition to any penalties assessed for the late payment of any tax due on the return.

(b) The department must waive or cancel the penalty imposed under this subsection if:

(i) The department is persuaded that the taxpayer's failure to file the return by the due date was due to circumstances beyond the taxpayer's control; or

(ii) The taxpayer has not been delinquent in filing any return due under this section during the preceding five calendar years.

NEW SECTION. **Sec. 13.** JOINT FILERS. (1) If the federal income tax liabilities of both spouses are determined on a joint federal return for the taxable year, they must file a joint return under this chapter.

(2) Except as otherwise provided in this subsection, if the federal income tax liability of either spouse is determined on a separate federal return for the taxable year, they must file separate returns under this chapter. State registered domestic partners may file a joint return under this chapter even if they filed separate federal returns for the taxable year.

(3) The liability for tax due under this chapter of each spouse or state registered domestic partner is joint and several, unless:

(a) The spouse is relieved of liability for federal tax purposes as provided under Title 26 U.S.C. Sec. 6015 of the internal revenue code; or

(b) The department determines that the domestic partner qualifies for relief as provided by rule of the department. Such rule, to the extent possible without being inconsistent with this chapter, must follow Title 26 U.S.C. Sec. 6015.

NEW SECTION. **Sec. 14.** ADMINISTRATION OF TAXES. Except as otherwise provided by law and to the extent not inconsistent with the provisions of this chapter, chapter 82.32 RCW applies to the administration of taxes imposed under this chapter.

NEW SECTION. **Sec. 15.** CRIMINAL ACTIONS. (1) Any taxpayer who knowingly attempts to evade payment of the tax imposed under this chapter is guilty of a class C felony as provided in chapter 9A.20 RCW.

(2) Any taxpayer who knowingly fails to pay tax, make returns, keep records, or supply information, as required under this title, is guilty of a gross misdemeanor as provided in chapter 9A.20 RCW.

NEW SECTION. **Sec. 16.** A new section is added to chapter 82.04 RCW to read as follows:

BUSINESS AND OCCUPATION TAX CREDIT. (1) To avoid taxing the same sale or exchange under both the business and occupation tax and capital gains tax, a credit is allowed against taxes due under this chapter on a sale or exchange that is also subject to the tax imposed under section 5 of this act. The credit is equal to the amount of tax imposed under this chapter on such sale or exchange.

(2) The credit may be used against any tax due under this chapter.

(3) The credit under this section is earned in regards to a sale or exchange, and may be claimed against taxes due under this chapter, for the tax reporting period in which the sale or exchange occurred. The credit claimed for a tax reporting period may not exceed the tax otherwise due under this chapter for that tax reporting period. Unused credit may not be carried forward or backward to another tax

reporting period. No refunds may be granted for unused credit under this section.

(4) The department must apply the credit first to taxes deposited into the general fund. If any remaining credit reduces the amount of taxes deposited into the workforce education investment account established in RCW 43.79.195, the department must notify the state treasurer of such amounts monthly, and the state treasurer must transfer those amounts from the general fund to the workforce education investment account.

NEW SECTION. **Sec. 17.** ANNUAL ADJUSTMENTS. (1) Beginning December 2023 and each December thereafter, the department must adjust the applicable amounts by multiplying the current applicable amounts by one plus the percentage by which the most current consumer price index available on December 1st of the current year exceeds the consumer price index for the prior 12-month period, and rounding the result to the nearest $1,000. If an adjustment under this subsection (1) would reduce the applicable amounts, the department must not adjust the applicable amounts for use in the following year. The department must publish the adjusted applicable amounts on its public website by December 31st. The adjusted applicable amounts calculated under this subsection (1) take effect for taxes due and distributions made, as the case may be, in the following calendar year.

(2) For purposes of this section, the following definitions apply:

(a) "Applicable amounts" means:

(i) The distribution amount to the education legacy trust account as provided in section 2(1)(a) of this act;

(ii) The standard deduction amount in sections 4(13) and 7(1) of this act;

(iii) The worldwide gross revenue amount under section 8 of this act; and

(iv) The minimum qualifying charitable donation amount and maximum charitable donation amount under section 9 of this act.

(b) "Consumer price index" means the consumer price index for all urban consumers, all items, for the Seattle area as calculated by the United States bureau of labor statistics or its successor agency.

(c) "Seattle area" means the geographic area sample that includes Seattle and surrounding areas.

NEW SECTION. **Sec. 18.** The provisions of RCW 82.32.805 and 82.32.808 do not apply to this act.

NEW SECTION. **Sec. 19.** Sections 1, 2, 4 through 15, and 17 of this act constitute a new chapter in Title 82 RCW.

NEW SECTION. **Sec. 20.** (1) If a court of competent jurisdiction, in a final judgment not subject to appeal, adjudges section 5 of this act unconstitutional, or otherwise invalid, in its entirety, section 16 of this act is null and void in its entirety. Any credits previously claimed under section 16 of this act must be repaid within 30 days of the department of revenue's notice to the taxpayer of the amount due.

(2) If the taxpayer fails to repay the credit by the due date, interest and penalties as provided in chapter 82.32 RCW apply to the deficiency.

NEW SECTION. **Sec. 21.** If any provision of this act or its application to any person or circumstance is held invalid, the remainder of the act or the application of the provision to other persons or circumstances is not affected.

Passed by the Senate April 25, 2021.
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Approved by the Governor May 4, 2021.
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