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No. 100769-8

SUPREME COURT OF THE STATE OF WASHINGTON

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,

Respondents,

vs.

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

Appellants,

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

Intervenors.

———

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; JOHN MCKENNA, an individual;

WASHINGTON FARM BUREAU; WASHINGTON STATE TREE FRUIT ASSOCIATION; WASHINGTON STATE DAIRY FEDERATION,

Respondents,

vs.

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

Appellants,

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

Intervenors.

RESPONDENTS' ANSWER TO BRIEFS OF AMICI CURIAE

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Respondents Chris Quinn, Craig Leuthold, Suzie Burke, Lewis and Martha Randall, Rick Glenn, Neil Muller, Larry and Margaret King, and Kerry Cox ("the Quinn Respondents") and April Clayton, Kevin Bouchey, Renee Bouchey, Joanna Cable, Rosella Mosby, Burr Mosby, Christopher Senske, Catherine Senske, Matthew Sonderen, John McKenna, Washington Farm Bureau, Washington State Tree Fruit Association, and Washington State Dairy Federation ("the Clayton Respondents") (collectively, "Plaintiffs" or "Respondents") respectfully submit this response to briefs amici curiae submitted in support of Appellants State of Washington, Department of Revenue, and Vikki Smith.

I. INTRODUCTION

The arguments in the amicus briefs supporting the State are heavy on social policy and light on constitutional law. Amici articulate several policy reasons why some may choose to support the capital gains tax and speculate as to its potential effects. But Amici largely sidestep the legal question before the

Court: whether the tax is constitutional under Amendment 14 and this Court's precedents. The answer to that question is a simple no. The capital gains tax is transparently a property tax, and Amici's efforts to portray it as an "excise tax" only highlight the way in which it operates to tax income as property.

Amici's policy preferences are not relevant to the Court's analysis of the constitutional issues. If the Legislature wishes to reform the State's tax system, it must do so by constitutional means. And if the voters of the State wish to change the State's basic tax structure—as they have declined to do on ten occasions by overwhelming margins—they must do so by constitutional amendment. Unless and until the voters do so, this Court should apply its long-settled precedent and affirm the decision below.

II. ARGUMENT

A. Amici's Policy Arguments Are Neither Relevant To The Constitutionality Of The Tax Nor Persuasive.

The amicus briefs submitted by the Equity in Education Coalition and others ("EEC"), Mary Ann Warren et al., and the

Washington State Labor Council ("WSLC") raise several related policy arguments. None is relevant to the constitutionality of ESSB 5096 or persuasive on its own terms. The Court should put aside Amici's policy considerations and hold, on the legal merits, that the capital gains tax violates the state constitution because it is a non-uniform tax on property—income in the form of capital gains—that exceeds permissible rate limitations and is imposed only on select taxpayers within the same classification. *See* Quinn Br. at 14-37.

Amici acknowledge that the bulk of their submissions raise only policy issues. *See* EEC Br. at 2; Warren Br. at 16. In these respects, Amici's "fundamental argument is not a legal one but a disagreement with" the longstanding tax structure of the state. *Quadrant Corp. v. State Growth Mgmt. Hearings Bd.*, 154 Wn.2d 224, 247, 110 P.3d 1132 (2005). But "[i]t is not the function of this court in cases like this to consider the propriety of the tax," or to evaluate "the public policy" the tax may serve. *State ex rel. Namer Inv. Corp. v. Williams*, 73 Wn.2d 1, 7, 435

P.2d 975 (1968). Policy disagreements are simply "not [for] the courts." *State v. Costich*, 152 Wn.2d 463, 479, 98 P.3d 795 (2004). Instead, "judicial decisionmaking is limited to resolving only the issues before the court in any given case," and does not aim to "resolve[] broad public policy questions based on a societal consensus." *Burkhart v. Harrod*, 110 Wn.2d 381, 385, 755 P.2d 759 (1988).[1] This is particularly apt as to social policies like economic inequality and racial equity, however compelling they may be in their own right, that the legislature itself did not consider as a basis to justify the need for the laws under consideration.

Washington voters have a long history of considering the policy arguments that Amici now advocate, particularly those related to regressivity, in the context of proposed constitutional amendments and popular initiatives to allow an income tax. Yet

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[1] The Superior Court properly explained that it put aside the policy considerations identified by the State and other parties as irrelevant to the legality of the tax. CP Vol. I 866 (citing *Williams*, 73 Wn.2d at 7).

voters have rejected these proposals by large margins over many years. As noted in the Clayton Respondents' brief, the voters on six occasions have declined to adopt proposed constitutional amendments that would have allowed income taxation free from the constitution's uniformity provision. Each time, the proposed amendment was voted down resoundingly. *See* H.R.J. Res. 37 (Wash. 1973) (rejected 77%-23%); H.R.J. Res. 42 (Wash. 1970) (rejected 68%-32%); H.R.J. Res. 4 (Wash. 1942) (rejected 66%-34%); S.J. Res. 5 (Wash. 1938) (rejected 67%-33%); S.J. Res. 7 (Wash. 1936) (rejected 78%-22%); H.R.J. Res. 11 (Wash. 1934) (rejected 57%-43%). And the voters rejected ballot initiatives that would have imposed statewide graduated income taxes on four other occasions, with similarly resounding margins. *See* Initiative 158 (Wash. 1944) (3% tax on gross income) (rejected 70%-30%); Initiative 314 (Wash. 1975) (corporate excise tax measured by income) (rejected 67%-33%); Initiative 435 (Wash. 1982) (corporate franchise tax measured by income) (rejected 66%-34%); Initiative 1098 (Wash. 2010) (personal income tax

rejected 64%-36%). Whether Washington should permit capital gains taxation in light of the pros and cons of such a policy has been and should remain a matter for the voters and is an issue to be resolved through the constitutional amendment process.

Amici's arguments that the tax would fund certain important state programs (EEC Br. at 1; Warren Br. at 16; WLSC Br. at 11), reduce the claimed "regressivity" of the state's tax system (EEC Br. at 16; Warren Br. at 20), or combat social and racial wealth disparities (EEC Br. at 28; WLSC Br. at 7), are therefore not relevant to the Court's constitutional analysis here.

Nor are Amici's policy arguments persuasive on their own terms.

Funding for State Services. Amici claim that the tax is necessary "to ensure critical state programs and services are funded" in the manner they prefer. EEC Br. at 1. And they assert that the tax is needed for "funding for childcare," particularly in rural areas. Warren Br. at 16; *see also* WLSC Br. at 11. Putting aside that the question of how to fund what state programs is "not

[for] the courts," *Costich*, 152 Wn.2d at 479, the state's large budget surplus and forecasted revenue gains from other sources bely the notion that the novel capital gains tax is "necessary" to fund the state programs amici identify. The "total four-year increase in projected revenue since lawmakers adopted the 2021-23 budget is at least $10.538 billion."[2] Any impact the capital gains tax may have is relatively insignificant in the context of total forecasted state revenues, which for 2023-2025 total more than $65.368 billion.[3] Amici's suggestion that the availability of child care services rises and falls with this tax does not withstand scrutiny.

Amici make no legal argument as to why the importance

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[2] Jason Mercier, *$10.5 Billion Increase in Revenue Forecast Since Last March*, Washington Policy Center (Feb. 16, 2022), https://www.washingtonpolicy.org/publications/detail/105-billion-increase-in-revenue-forecast-since-last-march (calculations based on official Washington State Economic and Revenue Forecast Council sources).

[3] *Revenue Review*, Economic and Revenue Forecast Council at 7, 24 (Feb. 16, 2022), https://erfc.wa.gov/sites/default/files/public/documents/ meeting s/rev20220216.pdf.

of funding the state programs they identify can or should override longstanding constitutional limitations on the taxing power. Amici point to the state constitution's provision stating that "[i]t is the paramount duty of the state to make ample provision for the education of all children residing within its borders, without distinction or preference on account of race, color, caste, or sex." WLSC Br. at 11 (quoting Const. art. IX, § 1.). But the constitutional requirement to fund education does not authorize the legislature to disregard other constitutional requirements—including the prohibition on property and income taxes, rooted in Amendment 14. The legislature's obligation is to raise funds and provide for "critical state programs and services" (EEC Br. at 1) without transgressing the constitutional limitations on its legislative powers.

Regressivity. Amici's argument that the tax should be upheld because the existing tax system is "regressive" is

similarly unpersuasive.[4] Whether the existing tax system is desirable or should be changed is a quintessential economic policy matter not appropriate for judicial resolution.[5] *Supra* 3-4.

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[4] In focusing on statistics that families in the lower income brackets pay higher percentages of their income in state and local taxes than those in the higher income brackets, EEC Br. at 17-20, Amici cannot help but expose the truth that the capital gains tax is a tax on income. Moreover, these statistical comparisons are at best incomplete. For example, they entirely exclude the state B&O and estate taxes that are often paid overwhelmingly by wealthier citizens, and even with these exclusions, the same DOR statistics show that the wealthiest 10 percent of households pay 4.5 times the "total taxes" that the second poorest 10 percent pay. See EEC Br. at 20 and n.28 (citing Tax Structure Work Group Meeting (Dec. 4, 2020) at 80, https://dor.wa.gov/sites/default/files/202202/TSWGMeeting2020_1204.pdf).

[5] Amici specifically contend that the tax is beneficial because it places additional tax burden on "urban" communities, to the benefit of rural residents. *See* Warren Br. at 17, 22. Putting aside that it is not the Court's role to pick and choose which political constituencies to favor, Amici's assertion is a gross overgeneralization. The record confirms that many farmers, tree growers, and dairy producers would be subject to the tax based on their non-exempt assets. *See* CP Vol. I 723-33 (Decl. of Washington State Dairy Federation); *id*. at 710-713 (Decl. of Washington Farm Bureau et al.); *id*. at 742-52 (Decl. of Washington State Tree Fruit Association). And several of the individual plaintiffs challenging the proposed tax are or have been farm owners. *See, e.g.*, *id*. at 719-22 (Bouchey Decl.); *id*. at 796-800 (Cable Decl).

The Legislature is, of course, well within its rights to take action to address regressivity in the State's tax code, but it must do so by constitutional means. Amici's argument that the tax should be upheld simply because "it is within the province of the Legislature to move away from th[e] regressive structure" of Washington's tax system therefore misses the mark. Warren Br. at 20. The state constitution defines the province of the legislature and its power to tax. *See Washington State Farm Bureau Fed'n v. Gregoire*, 162 Wn.2d 284, 301, 174 P.3d 1142 (2007). If the legislature wishes to restructure the state's tax system, it must do so in a manner consistent with the state and federal constitutions. And if certain constituents wish to enlarge the tax power of the legislature--*see* EEC Br. at 20-28 citing "grassroots efforts" to advocate for progressive taxation--they must proceed by constitutional amendment.

EEC contends, remarkably, that "the lower court's order striking down the capital gains tax deprives the people of Washington of their respective constitutional authority and right

to democratic self-governance." EEC Br. at 30. This is exactly backwards. It was "democratic self-governance" that produced the state constitutional amendment banning non-uniform taxes on property. Amend. 14 to Const. art. VII, § 1 (1930) (adopted by a 61%-39% popular vote). And it was through "democratic self-governance" that the people repeatedly voted to retain this critical feature of our state constitution, ratifying the Court's longstanding interpretation of the state constitution. *Supra* 5-6. To claim that the lower court's decision applying the state constitution in line with that precedent "deprives the people of their … constitutional authority" wholly inverts the basic structure of the state government, under which the democratically adopted state constitution must take precedence over acts of the state legislature.

Racial Justice. Amici also argue that the tax should be upheld because they believe it will combat wealth imbalances that disproportionately harm communities of color. *See* EEC Br. at 28; WLSC Br. at 7. This again is a policy question beyond the

purview of this Court. Amici note that the "Court in 2020 made a 'commitment to achieving justice by ending racism.'" EEC Br. at 28. But this important and laudable commitment cannot override express, well-settled constitutional limitations on the power to tax.

Amici cite several recent cases in which the Court has appropriately recognized and condemned the role that racism plays in the courts and legal system. *See* ECC Br. at 28-29 (citing *Henderson v. Thompson*, 518 P.3d 1011, 1017 (Wash. 2022) (condemning racial bias in civil jury verdicts); *State v. Zamora*, 199 Wn.2d 698, 721, 512 P.3d 512 (2022) (condemning race-based prosecutorial misconduct); *State v. Sum*, 199 Wn.2d 627, 631, 511 P.3d 92 (2022) (holding that racial dynamics can factor into whether a seizure occurs within the meaning of the state and federal constitutions); and *Martinez-Cuevas v. DeRuyter Bros. Dairy, Inc.*, 196 Wash. 2d 506, 517, 475 P.3d 164, 170 (2020) (noting that states enacted discriminatory laws as a historical matter)). But Amici do not claim that the constitutional

uniformity requirement was a product of racial animus. And they cite no case in which the Court has overruled longstanding precedent simply because some argue that the controlling legal rule may have disparate impacts on minority communities. Nor can they: This Court recently explained that it is not appropriate to disregard *stare decisis* solely because a controlling precedent may create problems relating to "racial bias." *State v. Butler*, No. 100276-9, slip op. at 34 (Wash. Dec. 22, 2022).

In any event, whether the proposed tax in fact serves to promote racial justice is at best debatable. The Court should not make assumptions about the preferences of minority voters or rely on generalizations about the proposed tax's possible economic effects, based largely on partisan studies cited by Amici that have not been vetted and proved in the adversarial process in the trial court. Historically, many people of color have supported the constitutional limits on income and property taxation. *See* Clayton Br. at 55. The Tax Structure Work Group (invoked by Amici at EEC Br. 18, 20) reported in 2022 that many

people of color felt an income tax would be less fair than existing options in the state's arsenal, noting that "[p]eople of color have a strong preference for the sales tax relative to their white counterparts."[6] Whether the state's tax system should be transformed as Amici desire should be determined by the voters in an electoral process where individuals' preferences are reliably aggregated, not by the Court when presented with a debatable theory of a policy's possible social impact.

Relocation Effects. Finally, WLSC's postulation that the tax would not encourage Washingtonians and business owners to move out of state cannot remedy the tax's constitutional flaws. *See* WLSC Br. at 22. Even if the Court were inclined to consider this point, Amici's position is both counterintuitive and unsupported. Based on high-level academic studies, Amici assert

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[6] *Tax Structure Work Group (TSWG) Meeting*, Tax Structure Work Group, at 22, 46 (Mar. 30, 2022), https://static1.squarespace.com/static/5fc92c4eb6a6dd36b144ba73/t/624755660e7c38491b7e696a/1648842087942/FINAL+Mar+30+TSWG+Meeting+Slides+v2.pdf.

that most people do not select their state of residence for economic reasons. WLSC Br. at 25. But census data is rife with evidence that people move from high-tax to low-tax states in large numbers.[7] There is no reason to believe Washington voters would not do the same if the state's tax structure—which voters have repeatedly and specifically opted to retain—were transformed.

Moreover, Amici never reckon with the fact that the record here is full of sworn declarations from Washington residents saying that the tax may cause them to sell or close their businesses and relocate out of state. *See, e.g.*, CP Vol. I 702, 716,

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[7] After a decade as a national leader in domestic in-migration, Washington suffered net out-migration to other states of 7,376 from 2020 to 2022. U.S. Census, Annual and Cumulative Estimates of the Components of Resident Population Change for the United States, Regions, States, District of Columbia, and Puerto Rico: April 1, 2020 to July 1, 2022, https://www.census.gov/data/tables/time-series/demo/popest/2020s-state-total.html (showing, *e.g.*, significant net domestic out-migration from California and New York and significant net domestic in-migration to Florida and Texas).

739-40, 798-99. That record evidence is far more reliable than Amici's speculation about what affected individuals might do.

Nor can Amici put the problem aside by suggesting that the tax will affect only the very rich. As explained in the merits briefing, the tax will affect thousands of residents of comparatively modest income who face tax liabilities based on gains from one-time sales of interests in small businesses that fall outside the exemptions in the statute. *See* Clayton Br. at 51.

As for Amici's observation that individuals have "family responsibilities[,] spouses and school-age children that embed them in place," as well as "business that tie them to place," WLSC Br. 26 (citation omitted), that only underscores that physical relocation is just the start of the disruption Plaintiffs and many others would suffer if the tax is upheld. Residents who move out of state will be forced to upend profoundly significant family, community, educational, religious, and cultural relationships—to the detriment of their communities and the whole state. *See, e.g.*, CP Vol. I 716, 739-40, 798-99.

B. The Capital Gains Tax Is A Tax On Property

The true nature of a tax is determined by its subject matter and its incidents, not the name that the Legislature gave the tax. *See*, *e.g.*, *Harbour Village Apartments v. City of Mukilteo*, 139 Wn.2d 604, 607, 989 P.2d 542 (1999). As detailed in the Quinn Respondents' brief (at pp. 13-25), the capital gains tax is a property tax on income. The subject of the tax is capital gain, *i.e.*, net income, recognized by individual on their federal income taxes. *Id.* at 14-22. The incident of the tax, *i.e.*, that to which the tax attaches itself and burdens, is an individual's total, annual receipt of long-term Washington capital gains for the federal taxable year. *Id.* at 23-25.

Several of the Amici, however, parrot the State's arguments that the capital gains tax is somehow an excise tax. *See, e.g.,* Am. Br. of Warren, et al at 23-25; Am. Br. of Professors at 10-12. These amici assert that that the capital gains tax is imposed on the transfer of property, not the resulting income. But the actual application of ESSB 5096 belies this contention. First,

the capital gains tax is not a tax imposed on the sale or transfer of property, as in the case of the sales tax, real estate excise, or estate tax. In each of those instances, the burden of the tax is on sale or transfer itself and paid by parties to the transaction. For example, the retail sales tax is imposed on the selling price of the sale itself. *See* RCW 82.08.020 (sales tax). Likewise, the real estate excise tax is imposed upon each sale of real property and is based on the sale price, not a net gain calculation. RCW 82.45.060. And the estate tax is imposed on the transfer of a decedent's estate. RCW 83.100.040.

The capital gains tax, however, is not imposed on every sale or exchange of long-term capital assets, as in these excise taxes. Transfers by legal and beneficial owners that are entities are not taxed. And because it is imposed on *beneficial* owners, the tax is also not necessarily imposed on the person or entity—the *legal owner*--engaging as a party to a transaction, also contrary to these other valid excises.

For example, the amici make perfectly clear that the

principal target of this tax are gains from sales of stocks and bonds, but individuals residing in Washington typically have only a *beneficial* interest in these assets, the *legal* title of which is held by an organization known as DTC (Cede & Company) in arrangements with participant registered securities brokers.[8] Unlike real estate, for example, Washington grants no privileges and has no jurisdiction to levy excises in connection with these transfers of interests in stocks and bonds.

The State and amici also try to analogize to the estate tax—arguing that such taxes are triggered by an involuntary action,

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[8] "The largest 'legal' owner of most public companies' shares is 'DTC', the world's largest securities depository.… DTC is owned by its 'participants,' which are the member organizations of the various national stock exchanges (*e.g.*, State Street Bank, Morgan Stanley, Goldman Sachs & Co.).…When one participant's client sells shares in a particular company, that participant's DTC account is debited and the purchasing participant's account is credited by the same amount.… It is important to understand that DTC legally owned those shares both before and after the transaction—it merely shifted them from one account to another." Practical Guide to SEC Prox. and Compensation Rules § 11.02[B] (Amy L. Goodman et al. eds, 6th ed. 2021).

death. *See* Am. Br. Warrant at 25; Am. Br. Prof. at 7-8. They ignore that the estate tax is imposed because the decedent voluntarily chose to transfer their wealth to another at the time of their death and that the estate tax is imposed against the estate for that privilege, not against the person or entity receiving the income. *See* RCW 83.100 et seq. Here, however, the capital gains tax is imposed merely because an individual recognizes receipt of capital gains on their federal income tax returns. *See* Quinn Br. at 17.

Second, the capital gains tax is a direct tax on the value of property acquired—and that property is income received by an individual over a course of a given year from capital gains. This makes the capital gains tax more like the property tax upon rental income invalidated in *Apartment Operators Assoc. of Seattle*, 56 Wn.2d 46, 351 P.2d 124 (1950), than the Amici Professors would acknowledge. *See* Am. Br. Prof. at 10. Moreover, in making their arguments, Amici fail to acknowledge that the capital gains tax is imposed because an individual has acquired certain income,

not because they exercised any privilege of sale or transfer granted by the State. *See State ex. rel. Stiner v. Yelle*, 174 Wash. 402, 407, 25 P.2d 91 (1933) (distinguishing the former as a property tax and the latter subject to excise); *accord Jensen v. Henneford*, 185 Wash. 209, 219, 53 P.2d 607 (1936) (holding that the right to receive income cannot be the subject to an excise tax).

Third, the State and Amici argue that the fact that the capital gains tax is tied to income is of no moment because excise taxes may be calculated based on a measure of a taxpayer's gross income. They ignore, however, that the measure of these taxes like the B&O tax, is the privilege being taxed, *i.e.*, the value of the business conducted within Washington's sovereign jurisdiction as measured by in-state gross income. *See City of Seattle v. Paschen Contractors, Inc.*, 111 Wn.2d 54, 57, 758 P.2d 975 (1998).

Unlike the B&O tax, the measure of the capital gains tax is not based on the value of the activity or privilege engaged in

by the taxpayer with the state. Instead, the capital gains tax is measured by the net total of an individual's capital gains recognized in the given year after specific adjustments, deductions. and credits are applied. The capital gains tax is imposed on the value of the individual's net income, meaning it is a property tax on income under this Court's precedents.

III. CONCLUSION

The decision below should be affirmed.

This document contains 3,859 words, excluding the parts of the document exempted from the word count by RAP 18.17.

RESPECTFULLY SUBMITTED this 5th day of January, 2023.

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CERTIFICATE OF SERVICE

I hereby certify that I caused the foregoing Brief to be served on counsel for all other parties in this matter via this Court's e-filing platform.

Dated January 5, 2023.

s/Robert M. McKenna
Robert M. McKenna
Attorney for Clayton Respondents

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