NO. 100769-8

SUPREME COURT OF THE STATE OF WASHINGTON

CHRIS QUINN, et al.,

Respondents,

v.

STATE OF WASHINGTON, et al.,

Appellants,

EDMONDS SCHOOL DISTRICT, et al.,

Intervenors/Appellants.

APRIL CLAYTON, et al.,

Respondents,

v.

STATE OF WASHINGTON, et al.,

Appellants,

EDMONDS SCHOOL DISTRICT, et al.,

Intervenors/Appellants.

BRIEF OF APPELLANT STATE OF WASHINGTON

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I. INTRODUCTION

In 2021, our legislature adopted the most progressive change in Washington tax policy in generations. Senate Bill 5096 created "an excise tax . . . on the sale or exchange of long-term capital assets," like stocks and bonds. Engrossed Substitute Senate Bill 5096, § 5(1) (2021). The tax applies at a seven percent rate, but it exempts the first $250,000 of capital gains a person receives annually, as well as gains from sales involving retirement accounts, real estate, and qualified small businesses. Fewer than one in 1,000 Washingtonians will pay the tax, yet it will produce billions of dollars in revenue to fund the State's paramount duty of educating children.

Opponents of the tax filed this case, incorrectly claiming that the tax: (1) is a property tax prohibited by article VII of Washington's Constitution; (2) violates the state Privileges and Immunities Clause; and (3) violates the dormant Commerce Clause. The trial court ruled for plaintiffs on the first issue and

declined to reach the others. This Court should reverse and reject all of plaintiffs' arguments.

A century of precedent demonstrates that the capital gains tax is an excise tax, not a property tax. Since the 1930s, this Court has consistently held that 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) (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, transfer, or "'use of property . . . , is an excise'" tax, not a property tax. *Id.* at 630 (quoting *Bromley*, 280 U.S. at 136). The capital gains tax does not apply merely because a person owns property—a person can own limitless assets without owing the tax. Rather, it applies only when a person sells, transfers, or uses capital assets and generates taxable gains from that activity. The tax is thus an excise tax under this Court's precedent.

The trial court ignored this well-established precedent and instead held that the capital gains tax is a property tax because it allegedly has certain "hallmarks" of an income tax, rendering it a property tax under this Court's precedent. But every supposed hallmark it cited is present in other taxes this Court has labeled an excise tax and is absent from true property taxes.

Plaintiffs also cannot show that the tax violates the Privileges and Immunities Clause. They claim a fundamental right to receive any tax exemption that any person in Washington receives, but no such right exists. Even if it did, the legislature had reasonable grounds for the exemptions it included in the capital gains tax, satisfying constitutional requirements.

Finally, plaintiffs cannot show that the capital gains tax facially violates the dormant Commerce Clause. The legislature carefully crafted the tax to comply with the Commerce Clause and avoid taxation of the same transaction by Washington and

another state. Plaintiffs speculate that Washington might try to tax transactions with no connection to the state, but even if that were true (it is not), the remedy would be to invalidate that specific tax assessment, not the entire law.

In short, plaintiffs cannot meet their burden of proving this tax unconstitutional, and the Court should uphold the law.

II. ASSIGNMENTS OF ERROR

1. The trial court erred in ruling that the capital gains excise tax is a property tax subject to the limitations imposed by article VII, sections 1 and 2.

2. The trial court erred when it failed to grant summary judgment to the State on plaintiffs' claim that the capital gains tax violates Washington's Privileges and Immunities Clause.

3. The trial court erred when in failed to grant summary judgment to the State on plaintiffs' claim that the capital gains tax facially violates the dormant Commerce Clause.

III. ISSUES PERTAINING TO ASSIGNMENTS OF ERROR

1. Article VII, sections 1 and 2 apply only to property taxes. This Court has long held that a property tax is a tax that falls on the owner merely because they own property. In contrast, any tax imposed on the sale, transfer, or use of property is an excise tax. Given that the capital gains tax does not apply merely because a person owns property, but rather only to the sale, transfer, or use of property resulting in capital gains, did the trial court err when it (a) failed to follow this Court's precedent and instead adopted a "hallmarks" test, and (b) concluded that the capital gains tax is an unconstitutional property tax because it allegedly has certain "hallmarks" of an income tax?

2. Are plaintiffs correct that Washington's Privileges and Immunities Clause creates a fundamental right to receive any tax exemption extended to others?

3. Even if Washington's Privileges and Immunities Clause creates a fundamental right to receive any tax exemption

extended to others, are the exemptions in the capital gains tax reasonable, such that this Court should grant summary judgment to the State on plaintiffs' Privileges and Immunities Clause challenge?

4. Does the capital gains tax facially violate any dormant Commerce Clause requirement established by the U.S. Supreme Court, or should this Court grant summary judgment to the State on plaintiffs' facial dormant Commerce Clause challenge?

IV. STATEMENT OF THE CASE

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

During the 2021 session, the legislature adopted Engrossed Substitute Senate Bill 5096. Laws of 2021, ch. 196, § 5 (codified in RCW 82.87).[1] The law implements a narrowly targeted seven percent excise tax on gains derived from the sale

[1] A copy of the session law is in the clerk's papers at CP Vol. I, p. 327.

or exchange of certain long-term capital assets. As detailed below, the tax exempts the first $250,000 in capital gains a person receives annually, as well as capital gains from retirement accounts and sales of real estate, among other exemptions. Because of the tax's generous deductions and exemptions, less than one in 1,000 Washingtonians will owe the tax in any given year. *See* CP Vol. I, p. 352. The tax took effect on January 1, 2022, and the first payments under the tax will be due in April 2023. RCW 82.87.110(1)(a); CP Vol I, p. 352.

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." RCW 82.87.010. The legislature earmarked the first $500 million collected from the tax each year to the Education Legacy Trust Account to support K-12 education, expand access to higher education, and provide funding for early learning and child care programs. RCW 82.87.030(1)(a).

Revenue above $500 million each year is dedicated to the Common School Construction Account to assist school districts with capital projects, such as building or renovating schools. RCW 82.87.030(1)(b). The Department of Revenue forecasts that the tax will generate approximately $2.5 billion over its first six years for these important education investments. CP Vol. I, p. 354.

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." RCW 82.87.010. Under Washington's current tax code, which relies extensively on retail sales tax imposed on purchasers of everyday goods and services, low-income Washingtonians pay at least six times more in state taxes as a percentage of household income than high-income earners, and middle-income Washingtonians pay two to four times more. *Id*. The tax thus advances the legislature's goals by funding education through an excise tax on those with the greatest ability to pay.

The tax is designed as an excise tax. RCW 82.87.040(1). That is, it is imposed on the sale or exchange of qualifying long-term capital assets, not on the value of the assets as of a particular date, as would be the case with a property tax. A long-term capital asset is an asset such as stocks, bonds, or valuable artwork held for more than one year.

RCW 82.87.020(6).

The tax applies only to individuals and is measured by the individual's "Washington capital gains." RCW 82.87.040(1). Similar to Washington's estate tax—which starts with a decedent's "federal taxable estate" before making specific additions and subtractions to arrive at the Washington taxable amount—the measure of the capital gains tax is computed by making specific additions and subtractions to an individual's federal net long-term capital gain to arrive at the Washington taxable gain. RCW 82.87.020(1), (13). One significant adjustment is to subtract the amount of all long-term capital gains "from a sale or exchange that is not allocated to

Washington under RCW 82.87.100." RCW 82.87.020(1)(d). Another key adjustment is to subtract the amount of all long-term capital gains that are exempt from the tax. RCW 82.87.020(1)(e). As a result of these adjustments, only non-exempt long-term capital gain transactions with a connection to Washington are taxed.

To avoid taxing capital gain transactions attributable to another state, the legislature established a detailed allocation process in RCW 82.87.100. In general, that provision allocates to Washington long-term capital gains from the sale or exchange of tangible personal property located in Washington and intangible property (like stocks) owned by an individual domiciled in the state. RCW 82.87.100(1)(a), (b). Additionally, the legislature included a credit to prevent the tax from applying 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 . . . ." RCW 82.87.100(2)(a). These provisions are

designed to 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.

To achieve its goal of imposing the tax only on those with the greatest ability to pay, the legislature provided generous deductions and exemptions. For example, an individual's first $250,000 in capital gains each year are exempt from tax. RCW 82.87.060(1). Gains derived from the sale of a qualified family-owned small business are also exempt. RCW 82.87.060(1), 82.87.070(1). In addition, RCW 82.87.050(1) exempts the sale or exchange of "[a]ll real estate transferred by deed . . . or other lawful instruments. . . ." Assets held in various retirement accounts are also exempt from the tax. RCW 82.87.050(3).

An example illustrates how these deductions and exemptions operate in practice to limit the tax to only those with the greatest ability to pay. Imagine a Washington taxpayer who in a single year sells a rental property at a $500,000 gain, a

family-owned small business at a $400,000 gain, assets in a retirement account at a $300,000 gain, and ordinary stocks held outside a retirement account at a $200,000 gain. Though these transactions would result in over $1 million in capital gains, the taxpayer would owe no Washington capital gains tax because the first three asset categories are excluded from the tax and the $250,000 exemption exceeds the gain from non-exempt assets. If the same individual made the same sales but earned a $300,000 gain from the sale of ordinary stocks instead of $200,000, the seven percent tax would apply only to the gain beyond $250,000, for a total tax liability of just $3,500 on a $300,000 gain ($300,000-$250,000=$50,000 * .07=$3,500).

B. The Trial Court Holds That the Capital Gains Tax is an Unconstitutional Property Tax

Three days after the legislature passed the capital gains tax, and even before the Governor signed the law, the Quinn plaintiffs filed suit in Douglas County Superior Court seeking to invalidate the tax in its entirety. CP Vol I, p. 1. The Clayton plaintiffs filed a similar lawsuit soon after. CP Vol. II, p. 1. The

trial court consolidated the two actions, CP Vol. I, p. 107, and granted a motion by the Edmonds School District and other education parties to intervene as defendants. CP Vol. I, p. 136.

Both the Quinn and Clayton plaintiffs asserted that the capital gains tax was unconstitutional on its face. Specifically, they claimed that the tax violates (1) the requirements in article VII, sections 1 and 2 of the Washington Constitution that all taxes on property be uniform and not exceed one percent of the value of the property taxed; (2) the privileges and immunities protections in article I, section 12 of the state Constitution; and (3) the federal Commerce Clause. *See* CP Vol. I, pp. 5-8 (Quinn plaintiffs' causes of action); CP Vol II, pp. 15-16 (Clayton plaintiffs' causes of action).

The parties filed cross motions for summary judgment on the facial constitutionality of the capital gains tax. The trial court granted judgment to plaintiffs on their first theory, concluding that the capital gains tax had too many of what the court deemed "hallmarks of an income tax rather than an excise

tax." CP Vol. I, p. 869. After reciting these alleged "hallmarks," the court concluded that the capital gains tax is "properly characterized as a tax on property" and, as such, "violates the uniformity requirement by imposing a 7% tax on an individual's long-term capital gains exceeding $250,000 but imposing zero tax on capital gains below that $250,000 threshold." *Id*. at 872. Similarly, the court concluded that the tax "violates the [levy] limitation requirement because the 7% tax exceeds the 1% maximum annual property tax rate[.]" *Id*. The court declined to reach plaintiffs' additional arguments. *Id*.

On March 22, 2022, the trial court filed an order granting summary judgment to plaintiffs and denying summary judgment to defendants and Intervenors. CP Vol. I, p. 873. This appeal followed.

V. ARGUMENT

The legislature's authority to adopt tax laws to support public services and fairly distribute tax burdens is one of the most fundamental sovereign powers. *See, e.g.*, *State ex rel. Bd.*

of Comm'rs v. Clausen, 95 Wash. 214, 224, 163 P. 744 (1917). For that reason, this Court has long held that a party challenging the constitutionality of a tax statute bears a heavy burden. As in any case challenging a statute, the "'statute is presumed to be constitutional and the burden is on the party challenging the statute to prove its unconstitutionality beyond a reasonable doubt.'" *Spokane Cnty. v. State*, 196 Wn.2d 79, 84, 469 P.3d 1173 (2020) (quoting *Island Cnty. v. State*, 135 Wn.2d 141, 146, 955 P.2d 377 (1998)). When the statute being challenged is a tax statute, "'a particularly heavy presumption of constitutionality applies.'" *Dot Foods, Inc. v. Dep't of Revenue*, 185 Wn.2d 239, 250, 372 P.3d 747, 750 (2016) (quoting *Ford Motor Co. v. Barrett*, 115 Wn.2d 556, 563, 800 P.2d 367 (1990)).

The strong presumption of constitutionality applies with greatest force where, as here, a statute is challenged on its face. Claiming that an entire law is facially invalid is the "most difficult" type of constitutional challenge, *United States v.*

Salerno, 481 U.S. 739, 745, 107 S. Ct. 2095, 95 L. Ed. 2d 697 (1987), and "must be rejected if there are any circumstances where the statute can constitutionally be applied." *Wash. State Republican Party v. Pub. Disclosure Comm'n*, 141 Wn.2d 245, 282 n.14, 4 P.3d 808 (2000). Courts do not invalidate an entire law based on a claim that the law might exceed constitutional constraints in some circumstances. A plaintiff claiming such a violation can bring an as-applied challenge, in which the Court invalidates only the unconstitutional application of the law, leaving the rest intact. *See, e.g., Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue*, 483 U.S. 232, 248, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987) (invalidating a business and occupation (B&O) tax exemption on dormant Commerce Clause grounds while leaving the rest of Washington's B&O tax code intact). Given these standards, plaintiffs' facial challenge to the capital

gains tax fails if the tax can be constitutionally applied in any circumstance.[2]

Here, plaintiffs incorrectly contend that the capital gains tax facially violates three constitutional provisions. This Court reviews those claims de novo, performing the same inquiry as the trial court. *Spokane Cnty.*, 196 Wn.2d at 84. Under the holdings described above, this Court should uphold the tax unless plaintiffs can show beyond a reasonable doubt that there is no circumstance in which it can constitutionally be applied.

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[2] The legislature also included a severability clause, mandating that "[i]f 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." Laws of 2021, ch. 196, § 21. "A legislative act is not unconstitutional in its entirety unless invalid provisions are unseverable." *Amalgamated Transit Union Local 587 v. State*, 142 Wn.2d 183, 227, 11 P.3d 762 (2000). Thus, if a taxpayer could muster a successful "as-applied" challenge to a provision within the capital gains tax code, the reviewing court's duty would be to sever and strike only the offending provision if at all possible. *State v. Abrams*, 163 Wn.2d 277, 288-90, 178 P.3d 1021 (2008).

As detailed below, plaintiffs come nowhere close to meeting this burden under any of their three theories.

A. The Trial Court Erred in Holding that the Capital Gains Tax is an Unconstitutional Property Tax

The trial court incorrectly held that the capital gains excise tax violates two provisions in the Washington Constitution that regulate property taxes. This holding is unsupportable because decades of precedent from this Court make clear that the capital gains tax is an excise tax, not a property tax.

Article VII of the state Constitution imposes two restrictions on property taxes that plaintiffs invoke here. Section 1 requires that "[a]ll taxes shall be uniform upon the same class of property," and section 2 limits property tax rates to one percent of the "true and fair value of such property." It is undisputed that these sections apply only to property taxes. *In re Estate of Hambleton*, 181 Wn.2d 802, 832, 335 P.3d 398 (2014). Thus, if the capital gains tax is not a property tax, it

cannot violate these provisions. *See id*.; *Cosro, Inc. v. Liquor Control Bd.*, 107 Wn.2d 754, 761, 733 P.2d 539 (1987).

Over many decades, this Court has articulated a clear test for distinguishing between property taxes and excise taxes. Property taxes are taxes that apply merely because a person owns property, while excise taxes are ones that apply because a person sells, transfers, or uses property. *Morrow*, 182 Wash. at 630-31. The capital gains tax falls squarely on the excise tax side of this line, as detailed in the following sections.

The trial court largely ignored this clear test, instead focusing on whether the capital gains tax taxes part of a person's income. But this was the wrong question under Washington's Constitution and this Court's precedent. Washington's Constitution never mentions taxes on income; it discusses taxes on property. While this Court has previously held that broad-based taxes on personal or corporate income are property taxes covered by article VII, it has also held that many other taxes on transactions that generate income are excise

taxes unregulated by article VII. For example, carpenters, barbers, plumbers, and housepainters earn income by selling their services to consumers. Those sales are subject to sales tax, and their revenue is subject to business and occupation taxes, but this Court has held for decades that these taxes are excise taxes. *See State ex rel. Stiner v. Yelle*, 174 Wash. 402, 407, 25 P.2d 91 (1933) (deeming the 1933 occupation tax an excise tax and explaining that whether a tax "is measured by . . . income in no way affects" whether it is a tax on property for purposes of article VII); *Morrow*, 182 Wash. 625 (deeming sales tax an excise tax). Similarly, a shop owner earns their income from selling goods, yet every sale is subject to sales tax, and their gross revenue is subject to the B&O tax, both excise taxes. Thus, simply saying that a tax applies to part of a person's income does not render it a property tax under this Court's precedent. Rather, the key question is whether a tax applies merely because a person owns property, or rather because there

was some sale, transfer, or use of property. *Morrow*, 182 Wash. at 630-31.

The sections that follow first detail the development of this test, then apply it to the capital gains excise tax, and then refute the trial court's misguided alternative approach.

1. This Court has distinguished excise taxes from property taxes in cases going back to the 1930s

Because sections 1 and 2 of article VII apply only to property taxes, a critical early question faced by this Court was what counted as a tax on "property." The Court answered that question in the 1930s, articulating a principle it has applied ever since. Quoting the U.S. Supreme Court, this Court explained 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*, 182 Wash. at 631 (quoting *Bromley*, 280 U.S. at 137). 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).

This Court has consistently applied this test for decades. For example, in 1933 in *State ex rel. Stiner v. Yelle*, the Court upheld a gross receipts tax imposed on business activity—similar to the current B&O tax—as an excise tax rather than a property tax. Even though the tax was calculated based on the "gross proceeds of sales, or gross income" of a business, 174 Wash. at 404 (quoting Laws of 1933, ch. 191, § 2(2)), the Court concluded it was "an excise tax and not . . . a tax on property," *id.* at 407. The Court emphasized that the tax did not apply merely because a person possessed income, but rather applied to "the privilege of acquiring" income by use of one's property. *Id.*

Similarly, 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 as a valid excise tax. *See id.* at 407. The Court explained that while real estate is property, and annual taxes based on the value of property are classic property taxes, taxing proceeds from *the sale of property* is an excise tax,

even though the proceeds would be income. The Court said: "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." *Id.* at 409. "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.

Most recently, in *Hambleton*, 181 Wn.2d 802, this Court unanimously held that Washington's estate tax—which applies at various rates to the transfer of property occurring at death—is an excise tax, not a property tax. The Court explained that "[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." *Id*. at 832 (quotation marks and citations omitted). Under that standard, the Washington 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." *Id.* (quotation marks and citations omitted). *See also, e.g.*, *Standard Oil Co. v. Graves*, 94 Wash. 291, 306, 162 P. 558 (1917) (oil inspection fee imposed "upon the contingency that the oil is sold" is an excise tax), *rev'd on other grounds*, 249 U.S. 389, 39 S. Ct. 320, 63 L. Ed. 662 (1919); *State ex rel. Hansen v. Salter*, 190 Wash. 703, 70 P.2d 1056 (1937) (upholding tax imposed on privilege of using a private motor vehicle as a true excise tax); *High Tide Seafoods v. State*, 106 Wn.2d 695, 725 P.2d 411 (1986) (holding that a tax on the first possession of fish for commercial purposes was an excise tax, not a property tax); *Sheehan v. Cent. Puget Sound Reg'l Transit Auth.*, 155 Wn.2d 790, 799-800, 123 P.3d 88 (2005) (upholding a local motor vehicle excise tax and Monorail tax as true excise taxes).

While the test developed by this Court to distinguish property taxes from excise taxes is quite clear, this Court has acknowledged that *its application* of the test has at times been

"conflicting and bewildering." *Stiner*, 174 Wash. at 406. Two sets of cases decided by the Court exemplify this, though neither calls into question the longstanding test this Court has applied.

First, in two divided *Lochner*-era opinions that never commanded a majority behind one rationale, the Court held that a broad-based 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);[3] *Jensen v. Henneford*, 185 Wash. 209, 212, 53 P.2d 607 (1936).[4] In *Jensen*, a plurality of the Court explained that a tax on a person's entire income is a tax on "ownership, and therefore [on] the property (income) itself." *Jensen*, 185 Wash. at 219. Further, "*the mere right to own and hold property*

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

[4] 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.

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). In 1951, the Court cited these decisions to strike down a broad-based corporate income tax that applied to income "from almost every source," *Power, Inc. v. Huntley*, 39 Wn.2d 191, 235 P.2d 173 (1951), though it also invalidated the law on multiple unrelated grounds, *id.* at 197-204.

While these cases suggest that broad-based taxes that apply to personal or corporate income regardless of how it is earned amount to taxes on property, they do not suggest that a tax on the sale, transfer, or use of property is a property tax simply because the transaction generates income. A contrary reading cannot be squared with this Court's many other cases holding a tax to be an excise tax even though the tax applied to transactions generating income. For example, in *Stiner*, 174 Wash. 402, discussed above, decided the same day as *Culliton* but with a five-justice majority, the Court upheld the 1933

occupation tax as an excise tax even though it was calculated based on the "gross proceeds of sales, or gross income" of a business. *Id.* at 404. And in *Mahler*, 40 Wn.2d at 407, the Court unanimously held that a tax on proceeds from the sale of real property is an excise tax, even though selling property unquestionably generates income.

The second set of seemingly "conflicting and bewildering" cases, *Stiner*, 174 Wash. at 406, involves taxes on the rental of real property. In *Apartment Operators Association of Seattle, Inc. v. Schumacher*, 56 Wn.2d 46, 351 P.2d 124 (1960), the Court struck down a tax on rental income as a property tax. The Court's brief opinion 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.

This Court, however, has never extended this rationale to any other context, instead treating taxes on all other types of

rental 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 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. *See also Wash. Pub. Ports Ass'n v. Dep't of Revenue*, 148 Wn.2d 637, 642, 651, 62 P.3d 462 (2003) (holding that the leasehold excise tax (LET), which is imposed for leasing or using public property, is a "true excise tax," because "[s]imilar to the sales tax at issue in *Black*, under the LET, there must be a rental transaction").

In short, although some decisions addressing whether a tax is a property tax or excise tax are "conflicting and bewildering," *Stiner*, 174 Wash. at 406, the Court has long articulated a clear rule distinguishing between taxes that apply

merely because a person owns property and taxes that apply because a person receives money by selling, transferring, or using property. In applying this rule, the Court has distinguished between broad-based taxes on a person's whole income or on the rental of real estate, and taxes imposed on the sale, transfer, or use of property. *Compare, e.g., Jensen*, 185 Wash. 209 (invalidating net income tax that applied to virtually all types of income), and *Power*, 39 Wn.2d 191 (invalidating broad-based corporate tax on net income "from almost every source"), *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 (*State ex rel. Hansen*), the rental of personal property as an excise (*Black*), and the transfer at death of all forms of property as an excise (*Hambleton*).

2. Under this Court's precedent, the capital gains tax is an excise tax

Applying this Court's longstanding test for distinguishing property taxes from excise taxes, the capital gains tax is an excise tax, not a property tax. No one owes the tax merely because they own property (i.e., capital assets); rather, they owe it only if they sell, transfer, or use property and receive capital gains exceeding $250,000.

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 a levy that falls on the owner "merely because [they are] owner, regardless of the use or disposition made of [their] property." *Morrow*, 182 Wash. at 631; *see also Covell v. City of Seattle*, 127 Wn.2d 874, 890, 905 P.2d 324 (1995) (a true property tax arises merely from the taxpayer's "status as property owner"). In contrast, "[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." *Hambleton*, 181 Wn.2d at 832.

Under the standards articulated by this Court, the capital gains tax is an excise tax, not a property tax. The tax is imposed on the *sale or exchange* of long-term capital assets, not on those assets themselves. RCW 82.87.040(1). Thus, it does not apply to every owner of capital assets merely as a result of ownership, but only to those that sell or transfer those assets. Moreover, unlike a traditional property tax, the capital gains tax is measured only on the amount of gain derived from the sale, not on the value of the assets themselves. For example, if a person purchased $1 million of stock in 2017 and did not sell it until 2025, they would owe no capital gains excise tax at any point until they sold it. When they sold it, the tax due would depend only on the increase in value, so if the value were still $1 million, they would owe nothing. (And because the first $250,000 in gains are exempt, they would owe nothing unless they sold the stock for more than $1,250,000.) This is not a tax

one owes "merely because" they own property. *Morrow*, 182 Wash. at 631. Rather, the capital gains tax is imposed on the exercise of one of the rights to use property, i.e., to sell or transfer ownership. As such, it is substantively indistinguishable from the numerous excise taxes this Court has repeatedly upheld over the past century, going back to the oil inspection fee upheld in 1917 in *Standard Oil*, 94 Wash. at 306, up through the estate tax upheld in 2014 in *Hambleton*, 181 Wn.2d at 832.

If the capital gains tax was an unavoidable tax on the *value* of an individual's capital assets, then it would be more like a property tax. *See High Tide Seafoods*, 106 Wn.2d at 699 (making a comparable observation). But it is not. Accordingly, the capital gains tax is not subject to article VII's uniformity and rate limitations.

3. The trial court's new "hallmarks" test is contrary to precedent and unworkable

The trial court invalidated the capital gains tax because, in its mistaken view, the tax has eight "hallmarks" of an income tax that transform it into a property tax. CP Vol. I, p. 869. But this Court has never adopted such a test, and the trial court's newly invented test is profoundly flawed. Nearly all of the eight hallmarks the trial court identified are found in taxes this Court has long classified as excise taxes. Meanwhile, virtually none of the hallmarks the trial court identified are present in actual *ad valorem* real property taxes, which are the quintessential example of property taxes under article VII. This Court should reject the trial court's unprecedented and illogical approach and instead adhere to its longstanding precedent, under which the capital gains tax is clearly an excise tax.

Before turning to the specific hallmarks the trial court listed, it is important to reiterate one fundamental flaw in the reasoning of both the trial court and plaintiffs. Both reason that if capital gains are "income," then any tax on transactions

generating capital gains must be an income tax. But common sense and precedent refute this argument. Just because a person derives income from a certain type of transaction does not mean that a tax on that transaction is an income tax. For example, as explained above, carpenters, plumbers, and housepainters earn their income by selling their services to consumers, yet every sale they make is subject to sales tax (an excise tax), and their gross revenue is subject to the B&O tax (also an excise tax). The nature of the tax does not change just because the transaction taxed generates income. *See, e.g.*, *State ex rel. Stiner*, 174 Wash. at 407 (deeming the 1933 occupation tax an excise tax and explaining that whether a tax "is measured by . . . income in no way affects" whether it is a tax on property for purposes of article VII, section 1). What plaintiffs are really asking for, and what the trial court granted, is a special rule allowing the wealthy to escape excise taxes on transactions they use to generate income, such as selling stocks and bonds, while ordinary Washingtonians routinely pay excise taxes on

transactions that generate their income. There is no basis in this Court's decisions for such a rule.

Turning to specifics, the first hallmark the trial court listed is that the Washington capital gains tax "relies upon federal IRS income tax returns," CP Vol. I, p. 869, but this theory is doubly flawed. To begin with, real property taxes—the quintessential taxes covered under article VII—do not rely in any way on federal income tax returns, so how can this possibly be a hallmark of taxes covered by article VII? Moreover, this Court has unanimously held that Washington's estate tax is an excise tax, *Hambleton*, 181 Wn.2d at 832, even though it, too, relies on federal tax forms and terminology. *See Estate of Ackerley v. Dep't of Revenue*, 187 Wn.2d 906, 910-11, 389 P.3d 583 (2017) (estate tax is "tied to a large extent to the federal estate tax code" and relies extensively on the "federal statutory scheme").

As with the estate tax, the legislature had valid reasons for using a taxpayer's federal capital gains as a starting point to

calculate Washington capital gains that have nothing to do with whether the tax is a property tax. *See In re Estate of Bracken*, 175 Wn.2d 549, 583, 290 P.3d 99 (2012) (Madsen, C.J., concurring/dissenting). By using federal tax amounts as the starting point to compute the "Washington taxable" amount, the legislature "avoided having to duplicate congressional effort involved in explaining all the possible inclusions, exemptions, and deductions necessary to reach the taxable [amount], and also helped to avoid the complication and confusion that a different set of state rules might create." *Id*. The legislature's rational choice to use federal tax forms did not impact this Court's analysis of Washington's estate tax in *Hambleton*, and has no bearing here. *See Hambleton*, 181 Wn.2d at 832 (holding that the estate tax is an excise tax). *See also, e.g.*, *Trinova Corp. v. Michigan Dep't of Treasury*, 498 U.S. 358, 377, 111 S. Ct. 818, 112 L. Ed. 884 (1991) (recognizing that states can choose to use federal forms or methodologies "as a convenience to taxpayers," but that choice has no constitutional significance).

The second hallmark applied by the trial court is equally irrelevant. The court concluded that the capital gains tax must be a property tax because it levies a tax on gains that the Internal Revenue Service characterizes as "income." CP Vol. I, p. 869. That contention misses the mark for three reasons.

First, *ad valorem* property taxes are not measured by income, so this cannot be a hallmark of property taxes.

Second, as discussed above, this Court has already held that a tax will not be branded a property tax (or an income tax) merely because it is measured by income or tied in some way to how a person earns income. *See State ex rel. Stiner*, 174 Wash. at 407 (that a tax "is measured by . . . income in no way affects" whether it is a tax on property for purposes of article VII, section 1). As a vivid example of this principle, in 1934 this Court upheld an annual occupation tax on *wages* earned by state employees. *Supply Laundry Co. v. Jenner*, 178 Wash. 72, 78, 34 P.2d 363 (1934). Wages are (and were in the 1930s) undeniably characterized as income under the Internal Revenue

Code. *See generally* I.R.C. § 61(a)(1) (compensation for services are gross income). Yet that proved irrelevant in *Supply Laundry* and should be irrelevant here. Simply put, under this Court's precedent, whether an amount derived from the exercise of a privilege or the beneficial use of property is "income" has no bearing on whether the underlying tax is a property tax or excise tax. The trial court's contrary reasoning should be rejected.

The final flaw in this supposed hallmark is that whether a tax is a property tax under Washington's Constitution is purely a question of state law, so federal characterizations do not control. But even if federal law did matter, an income tax is generally considered an *excise tax* under federal law, not a tax on property. *See Brushaber v. Union Pac. R.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"). Thus, to the extent federal decisions inform this question, they support that the capital gains tax is an excise tax.

The next supposed hallmark cited by the trial court is that the capital gains tax is "levied annually (like an income tax), not at the time of each transaction (like an excise tax)." CP Vol. I, p. 870. But many excise taxes can be reported and paid on a monthly, quarterly, or annual basis, rather than at the time of each transaction, including Washington's retail sales, use, B&O, and public utility taxes. RCW 82.32.045(1)-(3). This feature does not dictate in any way whether a tax is an excise tax. For example, the 1933 occupation tax upheld as an excise in *Supply Laundry* was imposed annually. *See* Laws of 1933, ch. 191, § 2(2) ("there is hereby levied and there shall be collected from every person an annual tax or excise for the privilege of engaging in business activity"). Moreover, real property taxes—the quintessential property taxes covered by article VII—may be paid biannually, RCW 84.56.020(3), so the idea that annual payments are a hallmark of property taxes is simply inaccurate. In short, the annual reporting requirement

under the capital gains excise tax does not make it a property tax.

The fourth alleged hallmark the trial court asserted is that the capital gains tax must be a property tax because it is measured by "net capital gain," not the gross value of the property sold. CP Vol. I, p. 870. But that hallmark is again doubly flawed. Under Washington law, property taxes are measured by the *value* of property on a particular date, *see* RCW 84.40.020, not by any gain in value. Thus, computing tax on net gain is not a hallmark of property taxes. Meanwhile, excise taxes often involve some degree of netting, as with the estate tax, which is based on the value of an estate after various debts and liabilities are subtracted. *See generally* WAC 458-57-115(2)(c) (the taxable estate is determined by subtracting allowable "expenses, indebtedness, taxes, losses, charitable transfers, and transfers to a surviving spouse," citing I.R.C. §§ 2051 through 2056A). No relevant authority holds that an excise tax must be measured by a gross amount, and such a

constitutional limitation would be arbitrary. The trial court erred in inventing this hallmark.

The fifth hallmark created by the trial court is that the capital gains tax "is based on an *aggregate* calculation of an individual's capital gains over the course of a year from all sources, taking into consideration various deductions and exclusions." CP Vol. I, p. 870. But the same is true of the estate tax (an excise tax), which applies to an aggregate calculation of an estate's value taking into account various deductions and exclusions, including an exclusion of the first $2 million in value. *See* RCW 83.100.020(1)(a). And here again, this alleged hallmark of a property tax is not true of actual property taxes, which are based on the value of each particular piece of property, not any aggregate calculation about an individual's property holdings.

As a sixth hallmark, the trial court stated that the capital gains tax is levied on "all long-term capital gains of an individual, regardless whether those gains were earned within

Washington." CP Vol. I, p. 870. But that statement is untrue. The tax includes a detailed allocation provision that ensures that the tax applies only to sales or transfers of property with a physical or legal situs in the state. RCW 82.87.100(1). The trial court's misunderstanding of the reach of the capital gains tax was an improper reason to characterize the tax as an unconstitutional property tax.

The seventh hallmark applied by the trial court is that the capital gains tax is supposedly "unlike an excise tax" because it contains a deduction for certain charitable donations. CP Vol. I, p. 870; *see also* RCW 82.87.080 (charitable donation deduction). The court, however, offered no authority suggesting that an excise tax cannot include a deduction for charitable giving. Indeed, the estate tax, which this Court unanimously held is an excise tax, includes a deduction for gifts to charities. *See generally* WAC 458-57-115(2)(c) (describing allowable deductions and exclusions in computing the taxable estate, including the deduction for "charitable transfers"); I.R.C.

§ 2055(a)(2) (deduction for charitable transfers). And a wide range of excise taxes include deductions or exemptions designed to favor certain expenditures or conduct, from sales tax exemptions for food to B&O tax exemptions for small businesses. The idea that such deductions and exemptions exist only in property taxes is thus untenable.

Finally, the trial court concluded that the capital gains tax is similar to a property tax because it applies only if the "legal owner of the asset" who makes a sale or transfer is an individual. CP Vol. I, p. 871. But this Court has never mentioned that as a relevant factor in whether a tax is a property tax or an excise tax, and it has nothing to do with whether the tax applies based on the mere ownership of property (a property tax) or on the sale, transfer, or use of property (an excise tax). Indeed, *ad valorem* property taxes apply to property owned by businesses and individuals, so the idea that applying a levy solely to individuals is a hallmark of a property tax makes no sense. Moreover, this Court has consistently upheld excise

taxes that fall on certain persons or entities while exempting others. *E.g.*, *Supply Laundry*, 178 Wash. 72; *Morrow*, 182 Wash. 625; *Black*, 67 Wn.2d 97.

As discussed above, *Supply Laundry* involved an annual excise tax imposed on wages earned by public employees while exempting wages earned by private employees. 178 Wash. at 75, 78. The Court upheld that distinction, explaining that courts should "sustain the classification adopted by the Legislature" unless it is "palpably arbitrary." *Id*. at 76 (quotation marks and citation omitted). The distinguishing features between the classes "need not be great," *id.*, and the legislature's choice to treat public employees less favorably than private employees was rational "because of the fact that private employees are, to a great extent, connected with business activities already taxed, while public employees are not." *Id.* at 78.[5]

[5] The Court in *Supply Laundry* also rejected arguments that the 1933 occupation tax was invalid because it applied to self-employed individuals but not private employees, and because it applied to the business of renting office buildings but

This Court was equally forceful in *Morrow*. There, a restaurant owner argued that the retail sales tax enacted in 1935 was unconstitutional because it taxed prepared food served at restaurants but exempted food "sold by retailers for consumption off premises." 182 Wash. at 633. The Court unanimously rejected the argument, explaining that the legislature has wide latitude in classifying when an excise tax is imposed. *Id*. at 634. "A very wide discretion must be conceded to the legislative power of the State in the classification of trades, callings, businesses, or occupations which may be subjected to special forms of regulation or taxation through an excise or license tax." *Id*. (quoting *Brown-Forman Co. v.*

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not the business of operating hotels or warehouses. *Id*. at 77, 78. In rejecting these arguments, the Court reiterated that "it is not necessary for us to draw fine distinctions between classifications . . . which in some degree may shade into each other or which in some respects may have some common affinity. It is only necessary to determine whether, in the exercise of a broad discretion, the Legislature has abandoned reason and resorted to a wholly arbitrary selection." *Id*. at 78-79.

Kentucky, 217 U.S. 563, 573, 30 S. Ct. 578, 54 L. Ed. 883 (1910)).

Years later, in *Black*, the Court unanimously rejected the claim that imposing the sales tax on the lease of a vessel as a floating hotel but not on land-based hotels was impermissible. 67 Wn.2d at 100. Explaining that "[t]he law in this state is . . . clear in this area," the Court held that classifications in excise taxes are valid so long as they are not "capricious nor arbitrary, and rest[] upon some reasonable consideration of difference or policy." *Id*. (quoting *Allied Stores of Ohio, Inc. v. Bowers*, 358 U.S. 522, 527, 79 S. Ct. 437, 3 L. Ed. 2d 480 (1959)).

As these cases confirm, the legislature acted well within its authority when it imposed a capital gains tax on an individual's sale or transfer of long-term capital assets while excluding from the tax sales or transfers made by non-natural persons. One of the primary purposes of the tax is to address the state's regressive tax code that disproportionately favors wealthy individuals over low- and middle-income individuals.

See RCW 82.87.010 (statement of legislative purpose). Addressing this inequality by requiring wealthy individuals to contribute more for the benefit of all falls squarely within the proper scope of our legislative branch of government. *See Wash. Bankers Ass'n v. State*, 198 Wn.2d 418, 444, 495 P.3d 808 (2021) (upholding tax law that "asked the wealthy few to contribute more to funding essential services and programs to the benefit of all Washingtonians"). And that valid policy choice is not a characteristic or "hallmark" that transforms the capital gains tax into a property tax.

In sum, instead of adopting a flawed "hallmarks" test, the trial court should have followed this Court's precedent. Under the authorities discussed above and applied for over a century, the capital gains tax is an excise tax because it applies to the exercise of a power over property and is not a tax on the mere ownership of property.

B. The Court Should Grant Summary Judgment to the State on Plaintiffs' Privileges and Immunities Claim

Plaintiffs have also claimed that the capital gains tax violates article I, section 12 of the Washington Constitution by taxing individuals with capital gains above $250,000 while exempting corporations and "other Washington citizens." CP Vol. I, p. 6; *see also* CP Vol. I, p. 440-41 (arguing that tax exemptions must apply to all to satisfy the Privileges and Immunities Clause). The claim is baseless.

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).

In applying this clause, this Court applies a two-step analysis, first asking whether a challenged law grants a

"privilege" or "immunity" for purposes of the state Constitution. If it does not, the challenge fails. In the second step, if the challenged law does grant a recognized privilege or immunity, the law will be upheld if there is a "reasonable ground" for granting that privilege or immunity. *Martinez-Cuevas*, 196 Wn.2d at 519. Plaintiffs' claim fails at both steps of the analysis.

First, plaintiffs can identify no "privilege" or "immunity" protected under article I, section 12. It is well settled that "[n]ot every benefit constitutes a 'privilege' or 'immunity' for purposes of the independent article I, section 12 analysis." *Schroeder v. Weighall*, 179 Wn.2d 566, 573, 316 P.3d 482 (2014). 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 v. City of Moses Lake*, 150 Wn.2d 791, 813, 83 P.3d 419 (2004) (quoting *State v. Vance*, 29 Wash. 435, 458, 70 P. 34 (1902)).

There is no fundamental right of state citizenship to be exempt from a state tax merely because the legislature has enacted exemptions available to other Washingtonians. To the contrary, this Court consistently upholds tax laws that apply only to some citizens or corporations without any suggestion that the tax implicates a privilege or immunity. *See, e.g., Supply Laundry,* 178 Wash. at 78; *Morrow*, 182 Wash. at 634; *Black*, 67 Wn.2d at 100.

Plaintiffs' argument to the contrary is based on a misreading of *Grant County Fire Protection District v. Moses Lake*, where the Court quoted a lengthy passage from *State v. Vance*. *Vance* involved a murder conviction and whether the process used to empanel the jury violated the state Privileges and Immunities Clause. 29 Wash. at 457-58. In listing examples of "fundamental rights" recognized under the federal Privileges and Immunities Clause, the Court in *Vance* included the right "to be exempt, in property or persons, from taxes or burdens which the property or persons of citizens *of some other state* are

exempt from." *Id*. at 458 (quoted in *Grant Cnty.*, 150 Wn.2d at 813) (emphasis added).

The statement was dicta, as it had no bearing on the issues in *Vance*, but more importantly, the privilege the Court mentioned in passing is the right of *nonresidents* to enter the state and compete for business on equal footing with residents. *See generally Shaffer v. Carter*, 252 U.S. 37, 56, 40 S. Ct. 221, 64 L. Ed. 445 (1920)) (federal Privileges and Immunities Clause protects the right of a citizen of any state to "remove to and carry on business in another without being subjected in property or person to taxes more onerous than the citizens of the latter state are subjected to"). The federal Privileges and Immunities Clause does not grant residents of a state a fundamental right to every tax exemption available to other residents of the same state, and this Court did not create such a right under the state Privileges and Immunities Clause when it decided *Vance*. *See Peterson v. Dep't of Revenue*, 9 Wn. App. 2d 220, 234, 443 P.3d 818 (2019) (rejecting reliance on *Grant*

County because there was no allegation that disparate treatment was the result of "citizenship in another state"), *aff'd on other grounds*, 195 Wn.2d 513 (2020). Because Plaintiffs identify no fundamental right of state citizenship implicated by the capital gains tax, their article I, section 12 challenge fails at the first step.

Even if the Court were to accept plaintiffs' misreading of *Grant County*, their claim would still fail at the second step of the analysis. The capital gains tax applies alike to "all persons within a designated class," individuals with non-exempt taxable capital gains exceeding the $250,000 annual threshold, and the legislature had a reasonable ground for distinguishing between those who fall within this class and those who do not: to addresses a genuine concern that Washington's low and middle-income families pay a disproportionate share of their incomes in taxes as compared to its wealthiest residents. Imposing a tax on individuals whose sales of capital assets result in gains over a quarter million dollars annually is a small

but reasonable step toward equalizing the tax burdens between individuals. Because the tax reasonably advances a legitimate public policy, it does not violate article I, section 12.

This Court has consistently affirmed and upheld the legislature's broad "power to make reasonable and natural classifications for purposes of taxation." *Hemphill v. State Tax Comm'n*, 65 Wn.2d 889, 891, 400 P.2d 297 (1965). In exercising that authority, the "'legislature is not bound to tax every member of a class or none.'" *Id.* at 893 (quoting *Carmichael v. S. Coal & Coke Co*., 301 U.S. 495, 509, 57 S. Ct. 868, 81 L. Ed. 1245 (1937)). The difference between classes "need not be great" and a particular tax classification is permissible "if it is reasonably related to some lawful taxing policy of the state, such as greater ease or economy in the administration or collection of a tax, the selection of a fruitful source of revenue with the exemption of sources less promising, or the equalization of the burdens of taxation." *Texas Co. v. Cohn*, 8 Wn.2d 360, 386-87, 112 P.2d 522 (1941).

Under this principle, this Court has repeatedly rejected arguments that excise taxes applicable to some groups but not others violate the Constitution. *See, e.g.*, *United Parcel Serv., Inc. v. Dep't of Revenue*, 102 Wn.2d 355, 367-69, 687 P.2d 186 (1984); *Black*, 67 Wn.2d at 100-01; *Hemphill*, 65 Wn.2d at 891-94; *Armstrong v. State*, 61 Wn.2d 116, 119-22, 377 P.2d 409 (1962).

Disregarding this precedent, plaintiffs seek to invalidate the capital gains tax because they disagree with the legislature's policy of rebalancing the state's tax code by asking wealthy individuals to contribute more to funding essential education programs that benefit all Washingtonians. This Court should reject plaintiffs' effort to substitute their personal interests for the policy adopted by our elected legislative branch.

C. The Court Should Grant Summary Judgment to the State on Plaintiffs' Commerce Clause Claim

The final issue raised by plaintiffs is their untenable claim that the capital gains tax facially violates the dormant Commerce Clause. CP Vol. I, p. 7; CP Vol. I, p. 421. This

claim is supported by no evidence or relevant authority, and because this is a facial challenge, plaintiffs' claim "must be rejected if there are any circumstances where the statute can constitutionally be applied." *Wash. State Republican Party*, 141 Wn.2d at 282 n.14.

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)). Under Supreme Court precedent, 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)). The capital gains tax easily meets all four requirements.

First, although plaintiffs claim that Washington lacks sufficient "nexus" to tax capital gains derived from the sale of tangible and intangible property, this claim is incorrect. Washington undeniably has nexus to tax sales of tangible property located in the state, such as a valuable artwork or coin collection. *See Okla. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 184, 115 S. Ct. 1331, 131 L. Ed. 2d 261 (1995) ("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."). Additionally, it is settled law that Washington has nexus to tax the sale or transfer of intangible property (such as stocks and bonds) owned by persons domiciled in the state. *Curry v. McCanless*, 307 U.S. 357, 366, 59 S. Ct. 900, 83 L. Ed. 1339 (1939); *In re Estate of Grady*, 79 Wn.2d 41, 43, 483 P.2d 114

(1971). As the United States Supreme Court explained more than eighty years ago, the power to sell or dispose of intangible property "is the appropriate subject of taxation at the place of the domicile of the owner of the power." *Graves v. Elliott*, 307 U.S. 383, 386, 59 S. Ct. 913, 83 L. Ed. 1356 (1939).

Washington thus has jurisdiction to tax the sale or exchange of property that has a physical or legal situs in the state. Consistent with this jurisdictional principle, the capital gains tax expressly excludes from its reach the sale of property that is appropriately allocated to another state or conclusively located in another state under established constitutional law. RCW 82.87.020(1)(d); *see also* RCW 82.87.060(2) (deduction allowed for amounts the state is constitutionally prohibited from taxing). In short, there is "'nexus' aplenty here." *D.H. Holmes Co. Ltd. v. McNamara*, 486 U.S. 24, 33, 108 S. Ct. 1619, 100 L. Ed. 2d 21 (1988).

In the trial court, plaintiffs posited various hypothetical situations in which Washington might attempt to tax a

transaction that would also be taxed by another state or that lacked sufficient nexus with Washington. But even if one of those unlikely hypotheticals came to pass, the appropriate remedy would be for the individual subject to the allegedly unconstitutional tax levy to bring an as-applied challenge, not to facially invalidate the entire tax. A facial challenge fails if there are any circumstances where the statute can constitutionally apply, *Wash. State Republican Party*, 141 Wn.2d at 282 n.14, and here plaintiffs do not seriously argue that every application of the tax will violate the dormant Commerce Clause.

Plaintiffs also alleged that the capital gains tax is not "fairly apportioned," but again they are wrong. 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. 582, 102 L. Ed. 2d 607 (1989). Consistent with that purpose, the dormant Commerce Clause "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*. External consistency evaluates the "economic justification for the State's claim upon the value taxed." *Jefferson Lines*, 514 U.S. at 185. The capital gains tax easily meets both requirements.

As to internal consistency, if every other state imposed an identical tax, there would be no risk of multiple taxation. This is so because the legislature included a detailed allocation provision that allocates gains from sales of tangible personal property to the state where the property is located, and allocates gains from sales of intangible personal property to the state where the owner is domiciled. RCW 82.87.100(1). Thus, there is no genuine risk of multiple taxation. And even if a taxpayer

could demonstrate the hypothetical possibility that two states might tax the same sale, the tax credit provision in RCW 82.87.100(2) eliminates any chance of multiple taxation. In short, the legislature carefully crafted the capital gains tax to ensure internal consistency.

As to external consistency, 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. *Jefferson Lines*, 514 U.S. at 184. And as to the sale of intangible property, it is well-established that the state where the owner resides has economic justification to tax the gain. *Graves*, 307 U.S. at 386. Thus, the tax is externally consistent, and the fair apportionment requirement is met.

Plaintiffs' claims of discrimination also fail. This Court recently addressed the discrimination prong in *Washington Bankers*, 198 Wn.2d 418. The Court explained that

"discrimination" in the dormant Commerce Clause context means "'differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.'" *Wash. Bankers*, 198 Wn.2d at 430 (quoting *Filo Foods, LLC v. City of SeaTac*, 183 Wn.2d 770, 809, 357 P.3d 1040 (2015), quoting *United Haulers Ass'n, Inc. v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330, 338, 127 S. Ct. 1786, 167 L. Ed. 2d 655 (2007)). A state tax "may be discriminatory on its face, in purpose, or by having the effect of unduly burdening interstate commerce." *Id*. at 429. A law is facially discriminatory only if it "textually identifies out-of-state persons or entities and grants them unfavorable treatment." *Id*. at 431 (quoting *Filo Foods*, 183 Wn.2d at 809).

Under its plain text, the capital gains tax does not grant unfavorable treatment to out-of-state persons, so the law is not facially discriminatory. And because plaintiffs presented no evidence of a discriminatory effect or purpose, the Court should summarily reject their discrimination claim. *See Wash.*

Bankers, 198 Wn.2d at 439 ("discrimination requires more than mere assertion that it exists").

The capital gains tax also meets the fourth 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. 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 owe the capital gains tax receive none of the "wide range of benefits" offered by Washington. 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 easily meets the fourth prong.

Because the capital gains tax satisfies all four Commerce Clause requirements, plaintiffs' dormant Commerce Clause claim fails as a matter of law, and this Court should grant summary judgment to the State on this claim.

VI. CONCLUSION

In enacting the capital gains excise tax, the legislature took an important step to provide greater funding for education and make our tax code fairer. To override that legislative judgment, plaintiffs must convince this Court beyond a reasonable doubt that the tax is unconstitutional. They cannot do so under any of their theories.

The capital gains tax is an excise tax under this Court's established precedent. The tax's exemptions do not implicate any fundamental right of state citizenship, but even if they did,

there are reasonable grounds to support them. And finally, the tax is entirely consistent with Supreme Court cases applying the dormant Commerce Clause. Plaintiffs unquestionably cannot show that every application of the tax will be unconstitutional, as they must to prevail in this facial challenge. Consequently, the Court should reverse the trial court and grant summary judgment to the State on all issues raised in plaintiffs' facial challenge.

This document contains 11,141 words, excluding the parts of the document exempted from the word count by RAP 18.17.

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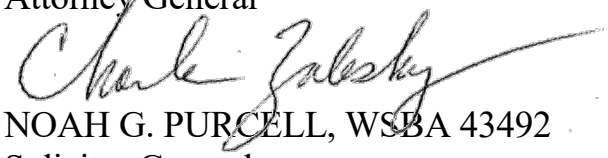
RESPECTFULLY SUBMITTED this 30th day of June, 2022.

ROBERT W. FERGUSON
Attorney General



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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 30th day of June, 2022, at Olympia, WA.

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June 30, 2022 - 4:19 PM

Transmittal Information

Filed with Court:	Supreme Court
Appellate Court Case Number:	100,769-8
Appellate Court Case Title:	Chris Quinn et al. v. State of Washington et al.
Superior Court Case Number:	21-2-00075-8

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