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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.

REPLY BRIEF OF APPELLANT STATE OF WASHINGTON

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I. INTRODUCTION

Plaintiffs claim that their challenge to the capital gains excise tax is based on precedent, while the State's defense is based on policy concerns. They have it backwards. Plaintiffs have a policy disagreement with the legislature's enactment of this tax, but precedent requires this Court to uphold it.

This Court has held for decades that a property tax is a tax that falls upon the owner merely because they own property, whereas a tax that applies to the sale, transfer, or use of property is an excise tax. *Morrow v. Henneford*, 182 Wash. 625, 630-31, 47 P.2d 1016 (1935). Plaintiffs admit the capital gains tax applies only when "assets are sold or exchanged for gain." Quinn Br. at 17. The tax is thus an excise.

Plaintiffs' counterarguments fail under this Court's precedent. They say that an excise tax can apply only to purely "voluntary" action, and they posit complex scenarios in which a person could receive capital gains without choosing to sell assets, Quinn Br. at 18-19, but virtually every tax this Court has

deemed an excise sometimes applies where the action triggering the tax is not purely voluntary (e.g., the sales tax applies even where a person makes a purchase solely because of a legal obligation). Plaintiffs also claim that the capital gains tax cannot be an excise because it includes exemptions, but every excise tax contains exemptions (e.g., the sales tax exemption for groceries). Similarly flawed is Plaintiffs' contention that the tax is not actually "on" the sale of capital assets, but on the recognition of capital gains on one's federal tax return. That confuses *what* is taxed with *when* and *how* it gets reported. Many excise taxes can be reported and paid quarterly or annually, rather than at the time of each transaction, but that does not make them property taxes.

In short, Plaintiffs' lead argument fails because the capital gains tax is not a property tax, so it cannot violate sections 1 and 2 of article VII of Washington's Constitution.

Plaintiffs' remaining arguments are equally flawed. Under Washington's Privileges and Immunities Clause,

Plaintiffs claim there is a fundamental right to be exempt from any tax that others need not pay. No court has ever so held. Accepting Plaintiffs' argument would invalidate countless tax exemptions benefitting nonprofits, retirees, and others. Even if such a right existed, the legislature need only have "reasonable grounds" for the distinctions it draws. Such grounds are obvious here, where the tax is aimed at those most able to pay.

Finally, Plaintiffs say the tax violates the Commerce Clause because it might allegedly sometimes apply to transactions unconnected to Washington. That is false, but even if it were true it would provide no basis to invalidate the entire tax. If a taxpayer ever develops evidence of this unlikely scenario happening, they could bring an as-applied challenge.

The bottom line is that precedent refutes all of Plaintiffs' claims. The legislature made the policy choice to enact this tax to fund education and rebalance our State's regressive tax code. Plaintiffs ask this Court to set aside that legislative decision, but this Court overturns legislative policy judgments only if the

challengers prove, beyond reasonable doubt, that the legislature acted unconstitutionally. Plaintiffs come nowhere close to meeting that standard here.

II. ARGUMENT

A. The Capital Gains Tax is an Excise Tax Under this Court's Longstanding Precedent

The capital gains tax is an excise tax, not a property tax, under this Court's cases. A property tax is a tax that "'falls upon the owner merely because he is owner,'" *Morrow*, 182 Wash. at 631 (quoting *Bromley v. McCaughn*, 280 U.S. 124, 137, 50 S. Ct. 46, 74 L. Ed. 226 (1929)), while a tax that applies to the "'exercise of one of the numerous rights of property,'" such as selling property, is an excise tax. *Id.* The capital gains tax does not fall on owners merely because they own property. A person can own extensive stocks, bonds, or other capital assets without owing the tax. Rather, as Plaintiffs concede, this tax applies only when "assets are sold or exchanged for gain." Quinn Br. at 17; RCW 82.87.040(1). The capital gains tax is thus an excise tax.

Plaintiffs agree that *Morrow* sets out the relevant test, Quinn Br. at 14-15, but then largely ignore that test, instead offering various rationales for why the capital gains tax is supposedly not a true excise tax. None carries water.

Plaintiffs' primary argument is that a tax can be an excise only if, in every instance where the tax applies, the person subject to the tax takes "deliberate[], intentional[], or voluntary" action. Quinn Br. at 19. Plaintiffs never dispute that this standard would be met in most applications of the tax (e.g., to the voluntary sale of stocks, bonds, or other assets), but they offer complex scenarios in which a person might recognize capital gains even though they did not personally approve a particular transaction, such as a person "who is the beneficiary of a grantor trust domiciled elsewhere." Quinn Br. at 18.

The fundamental problem with this argument is that practically every tax this Court has endorsed as an excise tax—from the sales tax to the real estate excise tax to the estate tax—applies in some circumstances where the transaction being

taxed would be involuntary under Plaintiffs' theory. Most obviously, death is rarely voluntary, yet the estate tax is an excise tax. *In re Estate of Hambleton*, 181 Wn.2d 802, 832, 335 P.3d 398 (2014). Similarly, the former inheritance tax, predecessor to the estate tax, *see Matter of Estate of Hitchman*, 100 Wn.2d 464, 465, 670 P.2d 655 (1983), was imposed on those receiving the decedent's property and required no voluntary act by the taxpayer, yet this Court deemed it "an excise tax, laid upon the privilege of receiving property by inheritance." *In re Birkeland's Estate*, 56 Wn.2d 441, 443, 353 P.2d 667 (1960). People owe sales tax on purchases even if they make the purchase solely because of a legal obligation, like buying a motorcycle helmet or a legally required pollution control device. And people owe real estate excise tax even if the decision to sell property was made over their objection, such as when they are a minority owner of a building.

As these examples highlight, when this Court describes excise taxes as being "based upon the voluntary action of the

person taxed in performing the act, enjoying the privilege or engaging in the occupation which is the subject of the excise," *Black v. State*, 67 Wn.2d 97, 99, 406 P.2d 761 (1965), it does not mean that the taxpayer necessarily endorses the specific transaction being taxed. To be sure, voluntary action is a common characteristic of excise taxes. But an excise tax does not become a property tax merely because the transaction being taxed might not be entirely voluntary on the taxpayer's part. Such a formalistic standard ignores this Court's prior decisions.

Moreover, this Court's description of an excise tax includes voluntarily "enjoying the privilege" or "engaging in the occupation" that is taxed. To use Plaintiffs' example, a person "who is the beneficiary of a grantor trust domiciled elsewhere," Quinn Br. at 18, has certainly voluntarily enjoyed the privileges that come from being a beneficiary, just as a minority investor in a building has voluntarily enjoyed the privileges of the investment. Taxing that privilege is an excise even if the sale is over the minority owner's objection.

Plaintiffs also claim that the tax "is not imposed *on* the activity of selling or exchanging long-term capital assets," but on "the recognition of capital gains, i.e., income." Quinn Br. at 17. That is untrue and contrary to the plain language of the capital gains tax statute. The tax is "imposed on the sale or exchange of long-term capital assets." RCW 82.87.040(1). Plaintiffs ignore this part of the statute, focusing instead on when and how gain must be reported to the State. *See* Quinn Br. at 24. But, as explained in the State's opening brief, this approach is deeply flawed. Most excise taxes can be reported and paid on a monthly, quarterly, or annual basis, rather than on each transaction, *see, e.g.*, RCW 82.32.045(1)-(3), but that does not convert them into property taxes.

Two examples highlight the real incidence of the capital gains tax and the problems with Plaintiffs' argument. First, if Plaintiffs were right that the real incidence of the tax is the reporting of income on one's federal tax return, that would mean that a person who reported no income on the return (e.g.,

by simply failing to file) would owe no Washington capital gains tax, even if they had massive non-exempt capital gains. That is absurd. Second, the legislature could have created a substantively identical tax where the tax was immediately due and payable on every sale of non-exempt capital assets, with refunds to taxpayers at the end of the year on the taxpayer's first $250,000 in gains. The administrative burden on taxpayers and the Department of Revenue would have been far greater, but the incidence of the tax and the amount owed would be the same. The legislature's choice to use a less burdensome approach does not convert this excise tax into a property tax.

Plaintiffs make much of the legislature's decision to use a taxpayer's federal tax reporting as the starting point to calculate Washington capital gains, but the legislature did so for valid reasons having nothing to do with whether the tax is an excise or property tax. By using federal tax amounts and concepts as the starting point, the legislature "avoided having to duplicate congressional effort" in defining terms and setting up a

convenient reporting system. *In re Estate of Bracken*, 175 Wn.2d 549, 583, 290 P.3d 99 (2012) (Madsen, C.J., concurring/dissenting). Providing a convenient method for computing the tax does not change its incidence or make it fall on owners merely because they own property.

The key question under article VII is not the method of reporting taxable gains, but whether the tax applies merely because a person owns property. *Morrow*, 182 Wash. at 630-31. Here, the tax does not apply to every owner of capital assets, but only to those who engage in non-exempt transactions involving assets. That is nothing like a tax on ownership.

Plaintiffs also make the baseless argument that the capital gains tax cannot be an excise because it "does not apply to every sale or transfer of capital assets." Quinn Br. at 17. But virtually every excise tax exempts some transactions or taxpayers. The sales tax generally exempts food, RCW 82.08.0293(1), yet is still an excise tax. The B&O tax exempts a broad range of businesses and transactions, including

businesses earning less than $125,000 annually, RCW 82.04.310 through .4269, and the estate tax excludes estates under $2,193,000. *See* https://dor.wa.gov/sites/default /files/2022-02/EstateTaxExclusionAmount.pdf. Exemptions are a pervasive feature of excise taxes and provide no indication that a tax is an "absolute and unavoidable" demand on property.

Faring no better is Plaintiffs' claim that the capital gains tax cannot be an excise tax because of the way it is measured, which involves a netting of gains and losses and allowing certain deductions and exemptions. Quinn Br. at 22-25. No relevant authority holds that an excise tax must be based on a gross amount or a particular formula, and the measure here is entirely consistent with other excise taxes upheld by this Court. Specifically, this Court unanimously deemed the estate tax an excise in *Hambleton* even though it is based on the value of an estate after various liabilities are subtracted and allows a variety of deductions and exemptions. *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 *Jensen v. Henneford*, 185 Wash. 209, 219, 53 P.2d 607 (1936), Plaintiffs also contend the capital gains tax is a property tax because it is measured by "income that individuals receive" from their ownership of property. Quinn Br. at 21. As the State explained in its opening brief, that theory cannot be squared with this Court's holdings in *State ex rel. Stiner v. Yelle*, 174 Wash. 402, 25 P.2d 91 (1933), and *Supply Laundry Co. v. Jenner*, 178 Wash. 72, 34 P.2d 363 (1934), and its holdings that the sales tax, B&O tax, and real estate excise tax are excise taxes even though they may be measured by income or tied in some way to how the taxpayer earns income. State Br. at 19-20, 37-38. To the extent *Jensen* suggests that a broad-based tax applying to personal income regardless of how it is earned is a tax on property, it does not hold that a tax on the sale, transfer, or use of property is a property tax simply because the transaction generates income.

In summary, the plain language of the capital gains tax and nearly a century of precedent refute Plaintiffs' claim that the capital gains tax is a property tax. The tax is imposed on gains from the *sale* or *exchange* of long-term capital assets, which incontrovertibly is an excise tax under controlling law. This Court should apply its precedent and uphold the tax.

B. No Special Privilege or Immunity Exists to Receive a Tax Exemption Granted to Others

Plaintiffs also fail to show that the capital gains tax violates the state Constitution's Privileges and Immunities Clause. This clause's purpose 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). Plaintiffs never explain how the capital gains tax raises any such concern, but setting that aside, their claim is untenable. To prevail, Plaintiffs must show first that the challenged law grants a "privilege" or "immunity" for purposes of the state Constitution. If they make that showing, they then have to show that the legislature had no

reasonable ground for granting that privilege or immunity. Plaintiffs meet neither requirement.

First, the capital gains tax confers no "privilege" or "immunity" under the state Constitution. "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)). Plaintiffs claim a fundamental right to be exempt from taxes that other citizens or corporations are exempt from. Quinn Br. at 33. As pointed out in the State's opening brief, however, this argument is premised on a misreading of dicta in *Grant County Fire Protection District*, where the Court quoted a lengthy passage from *Vance*. *See* App. Br. at 49-52. Both cases mentioned in passing the *federal* 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)

(describing this right); *Nw. Gillnetters Ass'n v. Sandison*, 95 Wn.2d 638, 647, 628 P.2d 800 (1981) (same). Neither case held that Washington residents or businesses have a fundamental right to claim any tax exemption available to other Washingtonians.

Plaintiffs argue that a fundamental right to tax exemptions available to others must exist "by analogy" to federal law, Quinn Br. at 33, but decades of Washington authority disproves this claim. This Court has consistently upheld tax laws applying to some residents or corporations but not others without any suggestion that the tax implicates a privilege or immunity. As noted above, the B&O tax exempts small businesses but not large ones, the sales tax applies to plumbers but not accountants, and the estate tax applies only to large estates. Legions of cases uphold taxes drawing such distinctions. For example, in *Hemphill v. State Tax Commission*, 65 Wn.2d 889, 400 P.2d 297 (1965), this Court upheld the imposition of sales tax on certain recreational

activities such as golf, skiing, and billiards, even though bowling was not taxed. *Id*. at 894. As the Court explained, 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)). *See also, e.g.*, *Supply Laundry*, 178 Wash. at 78 (upholding annual excise tax on wages earned by public employees while exempting wages earned by private employees); *Black v. State*, 67 Wn.2d 97, 100, 406 P.2d 761 (1965) (rejecting claim that imposing sales tax on the lease of a vessel as a floating hotel, but not on land-based hotels, was impermissible).[1]

Plaintiffs attempt to distinguish these prior cases by claiming they involved "citizens seeking *similar* exemptions as that granted to others engaged in *different* activity" (i.e.,

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[1] Applying Plaintiffs' alleged fundamental right exposes its absurdity. If a taxpayer is entitled to receive any tax exemption provided to another taxpayer, then the legislature could not exempt any business from the B&O tax without exempting every other business.

distinguishing between classes), whereas here the legislature is allegedly drawing distinctions within the same class. Quinn Br. at 33-34. That distinction finds no basis in the cases themselves and makes no sense. Many excise tax exemptions are based on a simple financial cutoff, e.g., the estate tax exempting estates valued below $2,193,000, or the B&O tax exempting businesses with revenue below $125,000. The same activity is involved, just in different amounts. The same is true of those who recognize capital gains exceeding $250,000 compared to those with lesser gains.

Because Plaintiffs fail to identify a "constitutional privilege" to receive any tax exemption available to others, their claim fails. *Ass'n of Wash. Spirits & Wine Distribs. v. Liquor Control Bd.*, 182 Wn.2d 342, 363, 340 P.3d 849 (2015). The Court thus need not address "whether the legislature had a 'reasonable ground' for granting the privilege or immunity." *Id.* at 359-60 (citing *Ockletree v. Franciscan Health Sys.*, 179 Wn.2d 769, 776, 317 P.3d 1009 (2014)). But even if the Court

reaches this prong, it should reject Plaintiffs' claim that the legislature lacked reasonable grounds to limit the capital gains tax to individuals.

This Court has recognized that "the level of scrutiny applied when determining whether a 'reasonable ground' exists in distinguishing between classifications has differed depending on the issues involved." *Grant Cnty. Fire Prot. Dist. No. 5 v. City of Moses Lake*, 145 Wn.2d 702, 731-32, 42 P.3d 394 (2002), *vacated in part on reh'g*, 150 Wn.2d 791, 816, 83 P.3d 419 (2004). The legislature has very broad discretion with respect to tax laws, resulting in deferential review by the courts. *See Texas Co. v. Cohn*, 8 Wn.2d 360, 375, 112 P.2d 522 (1941) ("The legislature has broader discretion and greater power in making classifications for taxation than it has for regulation."). In light of this broad power, courts will not invalidate a tax under article I, section 12 if "'any state of facts can reasonably be conceived that would sustain the classification.'" *Grant Cnty.*, 145 Wn.2d at 732 (quoting *United Parcel Serv., Inc. v.*

Dep't of Revenue, 102 Wn.2d 355, 369, 687 P.2d 186 (1984)). Applying that standard—or even the heightened standard applicable to non-revenue laws—the capital gains tax is constitutional.

As an initial point, Plaintiffs do not argue the legislature acted unreasonably in allowing various exemptions and deductions from the capital gains tax, such as for gains of less than $250,000 annually and gains associated with real estate transfers, retirement accounts, and sales of family-owned small businesses. These provisions, as Plaintiffs implicitly concede, advance legitimate goals, including the legislature's stated purpose to "mak[e] material progress toward rebalancing the state's tax code" to make it less regressive. RCW 82.87.010.

Plaintiffs' sole claim is that the legislature lacked reasonable grounds to impose the capital gains excise tax on individuals but not on corporations or other non-natural persons. Quinn Br. at 36. But they cite no relevant authority for this claim. Indeed, the only case they cite, *Comptroller of*

Treasury of Maryland v. Wynne, 575 U.S. 542, 135 S. Ct. 1787, 191 L. Ed. 2d 813 (2015), did not involve Washington law or privileges and immunities at all, but rather simply noted that the federal dormant Commerce Clause draws no distinction between individuals and corporations. *Id.* at 554. That says nothing about whether tax statutes may distinguish between individuals and corporations. They can and frequently do.

In reality, it is black letter law that Washington and other States have broad leeway in "making classifications and drawing lines which in their judgment produce reasonable systems of taxation." *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356, 359, 93 S. Ct. 1001, 35 L. Ed. 2d 351 (1973). Consistent with this well-established authority, this Court has held that the legislature "has the power to make reasonable and natural classifications for purposes of taxation, and that in the exercise of this power the legislature has very broad discretion in making such classifications." *Hemphill*, 65 Wn.2d at 891. The difference between classes "need not be great," and a 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.” *Cohn*, 8 Wn.2d at 386–87.

The capital gains tax fits easily within this expansive authority. The tax is designed in part to address a concern that Washington’s low and middle income families pay a disproportionate share of their income in taxes as compared to its wealthiest residents. RCW 82.87.010. Imposing a capital gains tax on individuals with gains exceeding $250,000 annually is a reasonable step toward equalizing the tax burden as between individuals. *See Cohn*, 8 Wn.2d at 386–87 (listing “the equalization of the burdens of taxation” as a “lawful taxing policy of the state”).

Despite this precedent, Plaintiffs ask the Court to invalidate the capital gains tax because they disagree with the

legislature's policy goal of "rebalancing the state's tax code" by asking wealthy individuals to contribute more to fund essential education programs that benefit all Washingtonians. The Court should reject Plaintiffs' effort to twist the state Constitution to undo a tax validly enacted by our elected legislative branch.

C. Plaintiffs Fail to Establish Any Violation of the Dormant Commerce Clause

Plaintiffs' final untenable claim is that the capital gains tax exceeds dormant Commerce Clause limits. A state tax satisfies 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. *Wash. Bankers Ass'n v. State*, 198 Wn.2d 418, 429, 495 P.3d 808 (2021) (citing *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 279, 97 S. Ct. 1076, 51 L. Ed. 2d 326 (1977)). Plaintiffs contend that the capital gains tax fails the first three elements, Quinn Br. at 38, but offer only a confused analysis that does not survive scrutiny.

As an initial matter, Plaintiffs misstate the applicable legal standard. Although Plaintiffs have offered no evidence that any taxpayer or transaction has been taxed in violation of the Commerce Clause, and rely instead on hypothetical circumstances where the capital gains tax allegedly might exceed Commerce Clause limits, Quinn Br. at 41, they ask this Court to facially invalidate the entire tax. No case supports that approach. None of the cases Plaintiffs cite resulted in the Supreme Court invalidating an entire state tax, as Plaintiffs request here. *See* Resp. Br. at 42-44 (citing *Wynne*, 575 U.S. 542, *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 101 S. Ct. 2946, 69 L. Ed. 2d 884 (1981), and *Gwin, White & Prince v. Henneford*, 305 U.S. 434, 59 S. Ct. 325, 83 L. Ed. 272 (1939)).

For example, *Gwin* involved a challenge to Washington's B&O tax as applied to a Washington-based "marketing agent" that engaged in business "in other states and foreign countries." *Gwin*, 305 U.S. at 435-36. The Court found the B&O tax as

applied discriminated against interstate commerce. *Id*. at 440. The Court did not, however, invalidate the *entire* B&O tax regime or hold that it could not be applied to other taxpayers. Instead, the Court held only that the tax could not be applied in a manner that discriminated against interstate commerce, a flaw that the legislature quickly remedied a few months after the *Gwin* decision. Laws of 1939, ch. 225, § 4.

Gwin's narrow holding and fact-bound approach are not outliers. The Supreme Court does not wield its powers under the Commerce Clause to facially invalidate entire state tax regimes, as Plaintiffs seek here. Rather, in a successful as-applied Commerce Clause challenge, the Supreme Court invalidates only the unconstitutional application of the state tax, leaving the rest intact. *See, e.g., Wynne*, 575 U.S. at 545 (invalidating only one "feature" of Maryland's personal income tax scheme, while leaving the remainder intact); *Tyler Pipe Indus., Inc. v. Dep't of Revenue*, 483 U.S. 232, 248, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987) (invalidating a specific tax

exemption while leaving the rest of Washington's B&O tax intact).

Here, Plaintiffs' challenge is "not in the context" of the capital gains tax as applied to any of them, and they have offered no evidence of an individual or transaction that has been taxed in an unconstitutional manner. Instead, they bring a facial challenge to the entire enactment, which can succeed only by "'establish[ing] that no set of circumstances exists under which the Act would be valid.'" *Wash. State Grange v. Wash. State Republican Party*, 552 U.S. 442, 449, 128 S. Ct. 1184, 170 L. Ed. 2d 151 (2008) (quoting *U.S. v. Salerno*, 481 U.S. 739, 745, 107 S. Ct. 2095, 95 L. Ed. 2d 697 (1987)). In determining whether an enactment is facially invalid, courts are "careful not to go beyond the statute's facial requirements and speculate about 'hypothetical' or 'imaginary' cases." *Id*. at 449-50 (citing *U.S. v. Raines*, 362 U.S. 17, 22, 80 S. Ct. 519, 4 L. Ed. 2d 524 (1960)).

There are several important reasons why courts exercise restraint when considering a facial constitutional challenge, including that such challenges "threaten to short circuit the democratic process" by "frustrat[ing] the intent of the elected representatives of the people." *Id*. at 450-51 (internal quotation marks and citation omitted). Plaintiffs suggest that these reasons do not apply when a law is challenged under the dormant Commerce Clause, but offer no relevant authority supporting their claim.

In any case, whether or not this Court applies the "no set of circumstances" test, Plaintiffs' Commerce Clause challenge fails under established precedent.

1. Washington has nexus to tax capital assets that are physically or legally located in the state

Plaintiffs first claim that the capital gains tax lacks a nexus to Washington because certain asset sales that could be included in the Washington tax allegedly "occur[] outside its borders." Quinn Br. at 45. Plaintiffs rightly concede that Washington has nexus to tax all sales of *tangible* property

located in Washington. Quinn Br. at 49 (citing *Okla. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S 175, 184, 115 S. Ct. 1311, 131 L. Ed. 2d 261 (1995)). But they misstate controlling law establishing when a state has sufficient nexus to tax intangibles.

Under controlling precedent, Washington has nexus to tax sales of intangible property by persons domiciled in the state. *Curry v. McCanless*, 307 U.S. 357, 366, 59 S. Ct. 900, 83 L. Ed. 1339 (1939); *Graves v. Elliott*, 307 U.S. 383, 386, 59 S. Ct. 913, 83 L. Ed. 1356 (1939); *In re Estate of Grady*, 79 Wn.2d 41, 43, 483 P.2d 114 (1971). To the extent Plaintiffs claim Washington could lose its constitutional nexus to tax intangible property if some other state has the right to tax the same transaction, Quinn Br. at 50-53, courts have thoroughly debunked that theory. For example, the Supreme Court in *State Tax Commission of Utah v. Aldrich*, 316 U.S. 174, 62 S. Ct. 1008, 86 L. Ed. 1358 (1942), held that both New York and Utah had nexus to tax the transfer of stock in a Utah

corporation occurring at the death of a New York resident, and there was no logical reason to impose a constitutional restriction on which state could assert its taxing jurisdiction with respect to the property. *Id*. at 179-80.

This Court, citing *Aldrich*, has held that "[t]here is no constitutional rule of immunity from taxation of intangibles by more than one state," and "[t]axation of the property by another jurisdiction is not decisive of the domiciliary state's power to impose a tax." *In re Plasterer's Estate*, 49 Wn.2d 339, 343, 301 P.2d 539 (1956). Thus, *Aldrich* and *Plasterer's Estate* put to rest Plaintiffs' contention that if one state has nexus over intangibles as a result of some in-state activity "related to the intangible," the state of the owner's domicile necessarily lacks nexus. *See* Resp. Br. at 53. That is simply not the law.[2]

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[2] Plaintiffs rely on *Safe Deposit & Trust Co. of Baltimore, Md. v. Virginia*, 280 U.S. 83, 50 S. Ct. 59, 74 L. Ed. 180 (1929), in claiming intangible property cannot be taxed based on the equitable owner's domicile. Quinn Br. at 53. But the Supreme Court has expressly limited the reach of *Safe Deposit & Trust* and other Lochner-era cases to circumstances

That leaves only Plaintiffs' hypothetical claim that the capital gains tax might be applied to certain sales of tangible property occurring after a Washington-resident owner removes it from the state. Plaintiffs offer no evidence that the State has attempted to tax such a transaction, and if it ever did, a taxpayer could raise an as-applied challenge claiming a lack of nexus as to that transaction. The theoretical possibility that the State might seek to tax such a transaction provides no basis to invalidate the entire capital gains tax.

2. The capital gains tax is fairly apportioned

Plaintiffs next argue that the capital gains tax is not fairly apportioned. Quinn Br. at 53. Again, controlling precedent defeats their argument.

The central purpose of the apportionment requirement "is to ensure that each State taxes only its fair share of an interstate

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where there is no recognized basis for a state to exercise its taxing jurisdiction. *Guaranty Trust Co. of New York v. Virginia*, 305 U.S. 19, 22 n.1, 59 S. Ct. 1, 83 L. Ed. 16 (1938). That is not the case here.

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 Constitution "imposes no single [apportionment] formula on the States." *Id*. at 261 (citations omitted). With respect to excise taxes, states typically apply allocation rules to determine where the taxable transaction occurs and tax credits to eliminate the risk of multiple state taxation, which is exactly the approach the legislature utilized for apportioning the capital gains tax. *See* RCW 82.87.100(1) (allocation rules); .100(2) (tax credit). This Court has previously rejected arguments like those Plaintiffs offer here that an excise tax statute must include a statutory *formula* to divide the tax base, calling the argument "[m]eritless" and contrary to settled law. *W.R. Grace & Co. v. Dep't of Revenue*, 137 Wn.2d 580, 596, 973 P.2d 1011 (1999). Excise taxes typically *do not* employ such formulas.

Amounts derived from the sale or transfer of property located in Washington are "inherently apportioned" to the state without the need for any further division. *Chicago Bridge &*

Iron Co. v. Dep't of Revenue, 98 Wn.2d 814, 830, 659 P.2d 463 (1983). This rule applies to tangible and intangible property, and is no longer subject to debate, as the Supreme Court has "consistently approved taxation of sales without any division of the tax base among different States." *Jefferson Lines*, 514 U.S. at 186.

Regardless, the tax is fairly apportioned because Washington provides a credit for taxes lawfully paid to another state. RCW 82.87.100(2)(a). Even if a taxpayer could show the hypothetical possibility that two states might tax the same sale, "the credit provision … operates to avoid actual multiple taxation." *Goldberg*, 488 U.S. at 264. Providing such a credit is an accepted method of avoiding dormant Commerce Clause concerns. *D.H. Holmes Co., Ltd. v. McNamara*, 486 U.S. 24, 31, 108, S. Ct. 1619, 100 L. Ed. 2d 21 (1988). Plaintiffs cite no case in which a court has invalidated a state tax imposed on the sale of property by a person domiciled in the state where, as

here, the tax includes a credit mechanism ensuring that only one state will tax the sale.

Plaintiffs theorize there may be some hypothetical circumstance where the tax credit in RCW 82.87.100(2)(a) might not apply to sales of tangible property, causing an individual with "multiple residencies" to owe tax to both Washington and another state (California in their example). Quinn Br. at 57. They argue this would violate the "internal consistency" test, Quinn Br. at 58, which, as explained in the State's opening brief, analyzes whether a state tax, if imposed by every other state, would result in multiple taxation. App. Br. at 59. But in truth, in Plaintiffs' hypothetical situation where a taxpayer is a resident of both Washington and California and recognizes gain from the sale of tangible property "within" only one of those states, there is no inconsistency because, in that circumstance, the state where the property was located when sold would impose its capital gains tax and the other state would grant the credit. Thus, for example, if a resident of both

Washington and California sold artwork that was removed from Washington and sold in California, Washington would grant the credit, leaving California to tax the sale. If the circumstances were reversed, California would grant the credit and Washington would tax the sale. That is exactly how the credit statute is written, and exactly the way it is intended to work.

As to external consistency, Plaintiffs challenge Washington's allocation of all gains from the sale of capital assets to itself based on the taxpayer's domicile. But Plaintiffs do not generally dispute that domicile is a proper basis for taxation; rather, they claim that in some circumstances a taxpayer's activities in other states might entitle those states to tax a portion of the transaction. This possibility is accounted for not only in the tax's credit provision as noted above, but also in its deduction for amounts the State is prohibited from taxing under the federal constitution. RCW 82.87.060(2). Any claim that the State is taxing more than its fair share as to a particular taxpayer should be brought as an as-applied challenge.

Plaintiffs' flawed arguments do not create or establish a genuine risk of multiple state taxation. Consequently, their fair apportionment claim fails. *See Goldberg*, 488 U.S. at 263-64 ("limited possibility of multiple taxation … is not sufficient to invalidate" a state's tax).

3. Plaintiffs' "discrimination" argument is a repeat of their incorrect fair apportionment argument

Plaintiffs offer no cogent argument that the capital gains tax discriminates against interstate commerce. Instead, they merely incorporate their "fair apportionment" argument. Quinn Br. at 62-63. As discussed above and in the State's opening brief, the capital gains tax is inherently apportioned, meets both the internal and external consistency tests, and provides a tax credit eliminating the risk of multiple state taxation. Thus, it does not discriminate against interstate commerce.

III. CONCLUSION

This Court is careful not to lightly overturn the legislature's enactments. Here, Plaintiffs cannot meet their burden of proving beyond a reasonable doubt that the

legislature violated the constitution. Under longstanding precedent, the capital gains tax is an excise tax and complies with the Privileges and Immunities Clause and dormant Commerce Clause. The Court should uphold the tax.

This document contains 5,992 words, excluding the parts of the document exempted from the word count by RAP 18.17.

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RESPECTFULLY SUBMITTED this 7th day of October, 2022.

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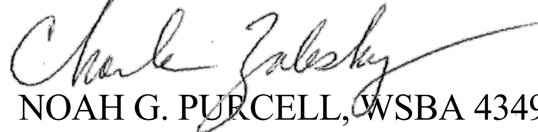

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