SUPERIOR COURT OF WASHINGTON
FOR DOUGLAS COUNTY

CHRIS QUINN, an individual; CRAIG LEUTHOLD, an individual; SUZIE BURKE, an individual; LEWIS and MARTHA RANDALL, as individuals and the marital community comprised thereof; RICK GLENN, an individual; NEIL MULLER, an individual; LARRY and MARGARET KING, as individuals and the marital community comprised thereof; and KERRY COX, an individual, *Plaintiffs*, v. STATE OF WASHINGTON, DEPARTMENT OF REVENUE, an agency of the State of Washington, VIKKI SMITH, in her official capacity as Director of the Department of Revenue, *Defendants*.	Case No. 21-2-00075-09 Case No. 21-2-00087-09 **PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT**
APRIL CLAYTON, an individual; KEVIN BOUCHEY, an individual; RENEE BOUCHEY, an individual; JOANNA CABLE, an individual; ROSELLA MOSBY, an individual; BURR MOSBY, an individual; CHRISTOPHER SENSKE, an individual; CATHERINE SENSKE, an individual; MATTHEW SONDEREN, an individual; WASHINGTON FARM BUREAU, *Plaintiffs*, v. STATE OF WASHINGTON, DEPARTMENT OF REVENUE, an agency of the State of Washington; VIKKI SMITH, in her official capacity as Director of the Department of Revenue, *Defendants*.	

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I. INTRODUCTION AND RELIEF REQUESTED

Graduated taxes on personal income have been unconstitutional in Washington since the Washington Supreme Court first invalidated a non-uniform income tax in 1933. Since then, Washington courts have reaffirmed this ruling in multiple cases. Since a tax on income was first ruled unconstitutional, Washington voters have rejected proposed taxes on income ten times—including a half dozen proposed constitutional amendments. But in 2021, the Legislature sought once again to tax income, this time in the form of a seven percent tax on capital gains exceeding $250,000. Cognizant of the nearly century-long constitutional prohibition on graduated income taxes, the Legislature has attempted to recharacterize this tax as an excise tax, but that attempt fails. Merely relabeling a tax cannot alter its essential character and cannot save it from constitutional scrutiny in the courts.

Plaintiffs include individuals who will face the tax when they realize capital gains after selling or transferring capital assets, and agricultural associations whose members will likewise be injured by the unconstitutional tax. Plaintiffs bring this action to have the tax declared invalid under the federal and state constitutions. The tax violates the dormant Commerce Clause of the U.S. Constitution, and it violates the Uniformity Clause and the rate limitation on taxes in Article VII of the Washington Constitution and the Privileges and Immunities clause in Article I, Section 12. Summary judgment that the tax is invalid can be decided as a matter of law on the face of the tax statute.

First, the tax violates the dormant Commerce Clause. The Supreme Court articulated a four-part test to assess state tax constitutionality in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 97 S. Ct. 1076, 51 L. Ed. 2d 326 (1977). The tax must (1) apply to an activity with a substantial nexus with the taxing state; (2) be fairly apportioned; (3) not discriminate against interstate commerce, and (4) be fairly related to the services that the state provides. Here, the State purports to impose an excise tax on the sale or transfer of capital gains if the owner or beneficiary

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is an individual residing in Washington, but the tax purports to reach capital gains transactions occurring anywhere. In so doing, the statute impermissibly allocates the tax to Washington based on the taxpayer's location here, instead of where the activity of sale or transfer of the asset occurs. In consequence, the tax fails the second and fourth parts of the *Complete Auto* test because it is not fairly apportioned to activities occurring within the state, and discriminates against interstate commerce. Each of these several failings, standing alone, is sufficient to support a decision that the tax violates the dormant Commerce Clause.

The capital gains tax also violates the Washington Constitution. It is well settled that income is property, and thus, a tax on income must comply with state constitutional restrictions on property taxes. It is equally well settled that it is the province of the courts to decide the nature of a state tax, and the Washington Supreme Court has previously rejected legislative attempts to re-brand an income tax as an excise tax. So too, should this Court. There are numerous factors indicating that this is an income tax and not an excise tax. The foremost is that the tax applies to long-term capital gains identified in federal income tax returns and taxed under federal income tax laws. On the other hand, the State has no legal basis to impose an excise on sales of assets that occur in other jurisdictions, as this tax would do. In consequence, because capital gains are income and income is within the constitutional definition of property, this tax on capital gains violates two separate constitutional restrictions on taxing property. *First*, by subjecting the first $250,000 of capital gains to zero tax but gains above $250,000 to a seven percent rate, the tax violates the Uniformity Clause in Article VII, Section 1, which requires that "[a]ll taxes shall be uniform upon the same class of property." The tax is also non-uniform because it applies to the gains of individuals but not other Washington residents—like corporations—that also sell identical capital assets. *Second*, the seven percent rate exceeds the one percent ceiling in Article VII, Section 2. The Washington Supreme Court's decisions holding income taxes unconstitutional are binding on this Court under principles of vertical *stare decisis*.

Finally, the State's capital gains tax impermissibly taxes certain persons while exempting

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others. This violates the equality guarantees of Article I, Section 12 of the Washington Constitution.

There is no genuine dispute of material fact, and Plaintiffs are entitled to judgment as a matter of law on their constitutional challenges.

II. FACTUAL BACKGROUND

A. Washington's Long-History of Rejecting Taxes on Income

In 1930, Washington's voters adopted Amendment 14 to the Washington Constitution, amending its definition of property to "mean and include everything, whether tangible or intangible, subject to ownership." Const. art. VII, § 1. Two years later, the state's voters passed an initiative levying a graduated state income tax to fund public schools. Jason Mercier, *History of Income Tax Votes in Washington*, Wash. Pol'y Ctr. (Oct. 17, 2016)[1] (hereinafter "History of Income Tax Votes"). But in *Culliton v. Chase*, 174 Wn. 363, 25 P.2d 81 (1933), the Washington Supreme Court invalidated the tax as a non-uniform tax on property under the Washington Constitution. In 1935, the Legislature attempted to sidestep the Washington Constitution's prohibition on graduated income taxes by enacting a tax on "the privilege of receiving income." Laws of 1935, ch. 178, § 2. The Legislature's attempted end run of the Constitution and *Culliton* was invalidated by the Supreme Court. *Jensen v. Henneford*, 185 Wn. 209, 217, 53 P.2d 607 (1936).

From 1930 to the present, Washington voters have rejected six proposed amendments to the Constitution that would have paved the way to graduated taxes on income.[2] Over roughly the same period, Washington voters also rejected four statewide initiatives to codify an income tax by statute.[3] Most recently in 2010, 64% of Washington's voters rejected a measure to levy a tax on

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[1] washingtonpolicy.org/publications/detail/history-of-income-tax-votes-in-washington.

[2] H.R.J. Res. 12 (Wash. 1934); S.J. Res. 7 (Wash. 1936); S.J. Res. 5 (Wash. 1938); H.R.J. Res. 4 (Wash. 1942); H.R.J. Res. 42 (Wash. 1970).

[3] Initiative 158 (Wash. 1944); Initiative 314 (Wash. 1975) (corporate excise tax measured by

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"adjusted gross incomes" above $200,000 for individuals and $400,000 for joint filers. See id. From this decades-long string of defeats, former Governor Christine Gregoire observed: "Frankly, I think it's not accepted by the people in this state. Statewide, I do not see an appetite by the people of this state to go to an income tax."[4]

In light of that history, it came as no surprise that when they were asked to express their views on the present capital gains tax in an advisory vote in the November 2, 2021 election, Washington voters once again overwhelmingly rejected this tax, 61 percent to 39 percent, notwithstanding the State's characterization of the tax as an excise tax on sales of capital assets.[5]

B. The Legislature Imposes a Capital Gains Tax on Individuals

In 2021, the Legislature enacted Engrossed Substitute Senate Bill 5096 ("ESSB 5096")[6] to levy a tax on the long-term capital gains of individuals. Beginning January 1, 2022, a seven percent (7%) tax will be imposed on "Washington capital gains" earned from the sale or exchange of long-term capital assets. ESSB 5096 § 4(13) (defining "Washington capital gains" as "adjusted capital gains"); § 5 (imposing the tax). "Long-term capital assets" are those assets defined in the Internal Revenue Code that are subject to the federal capital gain income tax and which have been held more than one year. § 4(2), (6) (defining "Capital asset" and "long-term capital asset."). "Only individuals are subject to payment of the tax." § 5. Capital gains incurred by pass-through entities (e.g. partnerships, limited liability companies, S corporations, or grantor trusts) will be taxed

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income); Initiative 435 (Wash. 1982) (corporate franchise tax measured by income); Initiative 1098 (Wash. 2010).

[4] KIRO Radio, *Washington state has no 'appetite' for income tax*, (Oct. 6, 2017), http://mynorthwest.com/775412/no-appetite-for-state-income-tax/.

[5] The November 2, 2021 advisory vote on the capital gains bill was Advisory Vote No. 37. See https://voter.votewa.gov/genericvoterguide.aspx?e=871&c=99#/measure/5068. The results are tallied at https://results.vote.wa.gov/results/20211102/advisory-vote-no-37.html.

[6] Now codified at RCW 82.87.010 et seq. For ease of reference to the Plaintiffs' Amended Complaints and the record previously established in this case, Plaintiffs cite to the session law as adopted by the Legislature. A copy is attached as Exhibit A to the Mercier Declaration.

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through the entity's "legal or beneficial owner" to the extent of the individual's ownership interest in the entity "as reported for federal income tax purposes." § 5(1), (4). The tax, as structured by the Legislature, will require individuals both inside and outside the State, who incur Washington capital gains to pay the tax.

The starting point for determining an individual's tax liability begins with identifying the taxpayer's "Washington capital gains." This requires ascertaining the individual's "federal net long-term capital gain" reported for "federal income tax purposes" on the taxpayer's federal tax return. § 4(1), (3) This amount is treated as if the alternative minimum tax and the special tax treatment for investments in equal opportunity zones did not exist in the Internal Revenue Code. See § 4(3). A loss carryforward is included in the calculation if it is attributable to Washington. § 5(3) Losses carried back for federal income tax purposes are not included in the calculation of the individual's adjusted capital gain. *Id*.

Next, long-term capital gains that are exempted from Washington's capital gains tax are subtracted from that amount. § 4(a). Long-term capital gains that are exempted from the calculation include gains derived from real estate; certain retirement plans; livestock used primarily in farming or ranching if the gains constitute more than 50 percent of the taxpayer's gross income for that year; timber; depreciable property used in trade or business; commercial fishing privileges; and goodwill in sales of auto dealerships. § 6.

Then, amounts of long-term capital gains that are *not* allocated to Washington under the statute are subtracted. § 4(1)(a). Long-term capital gains derived from *tangible* personal property (e.g., physical capital assets) are allocated to Washington if either (1) the property was located in this state at the time of sale or exchange; or (2) the property was located in Washington at some time during the taxable year, the taxpayer was a resident of Washington at the time of the sale or exchange, and the taxpayer is not otherwise subject to the payment of an income or excise tax on the long-term capital gains by another state. § 11(1)(a). Long-term capital gains derived from *intangible* personal property (e.g., stocks, bonds, goodwill) will be taxed by Washington if the

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taxpayer was domiciled in Washington at the time the sale or exchange occurred. § 11(1)(b). A credit is allowed against the tax equal to the amount of any income or excise tax paid to another taxing jurisdiction but only if the gains are derived from assets "within" the other jurisdiction. § 11(2)(a).

After the initial "Washington capital gains" are calculated, the taxpayer may deduct from the amount (1) a standard deduction of $250,000, or a total of $250,000 for spouses and domestic partners; (2) an adjusted deduction for gains derived from the sale or transfer of certain family-owned small business; and (3) a $100,000 deduction for charitable donations over $250,000 made to certain Washington-based nonprofit organizations. § 7. The sum total of the final "Washington capital gains" is then multiplied by seven percent to determine the ultimate tax liability. § 5.

Individuals owing the tax must report and pay the capital gains tax to Washington on or before the date that their federal annual income tax return must be filed. § 12(1). In addition to filing a Washington return, taxpayers must file a copy of their federal income tax return along with all schedules and supporting documentation for the federal return. §12(2). Failure to comply subjects the taxpayer to civil and criminal penalties. § 15

C. Plaintiffs Filed Suit Challenging the Constitutionality of ESSB 5096

The Clayton Plaintiffs and the Quinn Plaintiffs filed separate lawsuits—since consolidated by this Court—to secure a declaratory judgment that ESSB 5096 is constitutionally void. Plaintiffs are individuals who own capital assets subject to the tax imposed by ESSB 5096. See Clayton Compl. ¶¶ 12–18; Quinn First Am. Compl. ¶¶ 9–10. Those individuals would be subject to the tax if they realized capital gains as provided in ESSB 5096 and would incur a tax liability on capital gains exceeding $250,000. Plaintiffs also include an association, the Washington Farm Bureau, some of whose 46,000 members would be exposed to the capital gains tax.[7] Clayton Compl. ¶ 18.

[7] The Clayton Plaintiffs have moved for leave to file a first amended complaint that would add more plaintiffs, including several other organizations. That motion is pending.

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As detailed below, the capital gains tax violates the Commerce Clause of the U.S. Constitution and Article VII, Sections 1 and 2 of the Washington Constitution. The State has exceeded its authority by taxing activities occurring outside its borders and without apportioning the value to only that earned from activities within the state. And while postured as an "excise tax on the sale or exchange of long-term capital assets," the tax is in reality a tax on property that violates the State Constitution's requirements to impose taxes on property uniformly and at a rate of no more than one percent of the true and fair value.

III. EVIDENCE RELIED ON

Plaintiffs rely on the Declaration of Jason Mercier in Support of Plaintiffs' Motion for Summary Judgment, together with attached exhibits, along with the pleadings and other records on file in this matter.

IV. LEGAL STANDARD

Summary judgment is appropriate when the movant shows there is "no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." CR 56(c).

V. ARGUMENT

A. ESSB 5096 Violates the Commerce Clause of the United States

The Supreme Court has long held that Article, I, Section 8, clause 3 ("the Commerce Clause") of the United States Constitution contains a dormant prohibition against certain state taxation involving interstate commerce. *See Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 179–80, 115 S. Ct. 1331, 131 L. Ed. 2d 261 (1995) (analyzing history of the dormant Commerce Clause). To survive Commerce Clause scrutiny, a state tax must meet a four-part test that focuses on the practical effect of the challenged tax. *Complete Auto Transit, Inc.*430 U.S. at 274, 279.The tax must (1) apply to an activity with a substantial nexus with the taxing state; (2) be fairly apportioned; (3) not discriminate against interstate commerce, and (4) be fairly related to the services that the state provides. *Id.* at 279. ESSB 5096 violates this inquiry because the statute impermissibly allocates the tax to Washington based on the taxpayer's location instead of where

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the activity of sale or transfer of the asset occurs, imposes a tax that is not fairly apportioned to activities occurring within the state, and discriminates against interstate commerce.

1. ESSB 5096 Impermissibly Allocates Capital Gains and Losses to Washington Based on Activities Occurring Outside its Borders

The Commerce Clause limits Washington's power to tax to only those activities within its jurisdictional reach. *See Gwin, White & Prince v. Henneford*, 305 U.S. 434, 438–39, 59 S. Ct. 325, 83 L. Ed. 272 (1939). "State taxation, whatever its form, is precluded if it discriminates against interstate commerce or undertakes to lay a privilege tax measured by gross receipts derived from activities in such commerce beyond the territorial limits of the taxing state." *Id.* (citations omitted). This extraterritoriality principle applies whether the tax imposed by the State is a tax on sales, a gross receipts tax on the privilege of engaging in activity, or a tax on income. *See Comptroller of Treasury of Maryland v. Wynne*, 575 U.S. 542, 551–52, 135 S. Ct. 1787, 191 L. Ed. 2d 813 (2015) (Commerce Clause does not "distinguish[]" between taxes on gross receipts or net income); *Jefferson Lines, Inc.*, 514 U.S. at 184 (states may only tax sales or services occurring within its borders); *accord Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 164, 103 S. Ct. 2933, 77 L. Ed. 2d 545 (1983) (states may not tax "value earned outside its borders" without some connection between the activity and the taxing state); *Curry v. McCanless*, 307 U.S. 357, 363–64, 59 S. Ct. 900, 83 L. Ed. 1339 (1939) (jurisdiction to tax tangible personal property is exclusive to the state where the property is physically located). The *Complete Auto* test thus requires that the tax only apply to activities connected to the State and that there be a fair relation between the tax and the activities of the taxpayer in the state. *See Jefferson Lines*, *Inc.*, 514 U.S. at 184, 199.

To determine whether a state tax impermissibly extends beyond the state's territorial limits, a court must ask "whether the tax applies to *an activity* with a substantial nexus with the taxing State." *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2099, 201 L. Ed. 2d 403 (2018) (emphasis added). "Such a nexus is established when the taxpayer . . . 'avails itself of the substantial privilege of carrying on business' [i.e., the taxed activity] in that jurisdiction," *id.* (internal citation omitted), or there is "nexus between [the] tax and transactions with [the] state for which the tax is an

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exaction." *Mobil Oil Corp. v. Comm'r of Taxes of Vermont*, 445 U.S. 425, 437, 100 S. Ct. 1223, 63 L. Ed. 2d 510 (1980). Likewise, the measure of the tax, i.e., what is included in the calculation of the tax, must be reasonably related to the taxpayer's presence or activities in the State. *Jefferson Lines, Inc.*, 514 U.S. at 199. "When the measure of a tax bears no relationship to the taxpayers' presence or activities in a State . . . the State is imposing an undue burden on interstate commerce." *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 629, 101 S. Ct. 2946, 69 L. Ed. 2d 884 (1981). Both inquiries ensure "the taxing power . . . bears fiscal relation to protection, opportunities and benefits given by the state—that is whether the state has given anything for which it can ask return." *MeadWestvaco Corp. ex rel. Mead Corp. v. Ill. Dep't of Rev.*, 553 U.S. 16, 24–25, 128 S. Ct. 1498, 170 L. Ed. 2d 404 (2008) (citation omitted); *accord Allied-Signal, Inc. v. Dir., Div. of Tax'n*, 504 U.S. 768, 777, 112 S. Ct. 2251, 119 L. Ed. 2d 533 (1992) ("The principle that a State may not tax value earned outside its borders rests on the fundamental requirement of both the Due Process and Commerce Clauses that there be 'some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.'") (citation omitted).

ESSB 5096, in this case, overreaches federal constitutional bounds because it allocates gains to Washington that are not derived from activity with nexus to the state or that has a rational relationship to the state. Specifically, Washington imposes a tax "on the sale or exchange of long-term capital assets" measured by an "individual's Washington capital gains." § 5(1). Long-term capital gains are allocated to Washington if:

> (1) earned from sales or exchanges of tangible property located in the state at the time of the sale/exchange (§11(1)(a));
>
> (2) earned from sales or exchanges of tangible property previously located in the state if the taxpayer was a resident at the time of the sale/exchange and the taxpayer is not otherwise subject to the payment of another tax by another jurisdiction (§11(1)(a)(i)-(iii)); and
>
> (3) earned from sales or exchanges of intangible personal property if the taxpayer was domiciled in the state at the time of the sale or exchange. (§ 11(a)(b)).

Thus, for two of these three bases for allocating capital gains to Washington, the State impermissibly derives the tax not based on the location of activity purportedly being taxed—i.e.,

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the sale or exchange of the property—but based solely on the taxpayer's residency or domicile in the State. *Cf. Wayfair, Inc.*, 138 S. Ct. at 2092 ("'It has long been settled' that the sale of goods or services 'has a sufficient nexus *to the State in which the sale is consummated* to be treated as a local transaction taxable *by that State*.'") (emphasis added) (quoting *Jefferson Lines, Inc.*, 514 U.S. at 184).

The State may argue that individuals who reside here avail themselves of the privileges provided by the State, and that alone establishes the requisite nexus for the tax. But this argument would confuse the state's "authority to tax a particular taxpayer" with the requirement that a state must measure and assess the tax consistent with the extraterritoriality limitations required by the Commerce Clause. *See Wynne*, 575 U.S. at 556–57 (rejecting argument that "the Commerce Clause imposes no limit on [a state's] ability to tax the income of its residents, no matter where that income is earned."). It is the "transaction" or "activity" on which the tax is purportedly imposed that drives the nexus inquiry, not the individual taxpayer. *See Allied-Signal, Inc.*, 504 U.S. at 778 ("[W]e have not abandoned the requirement that, in the case of a tax on an activity, there must be a connection to the activity itself, rather than a connection only to the actor the State seeks to tax."); *accord Mobil Oil Corp.*, 445 U.S. at 437. Here, the State purports to tax the "sale or exchange" of certain long-term capital assets simply because the assets' owners are residents of or domiciled in Washington and measures the tax regardless of where the activity occurs. This the State cannot constitutionally do.

2. ESSB 5096 Lacks Fair Apportionment and Discriminates Against Interstate Commerce

The first and fourth prongs of the Commerce Clause analysis ensure that a state has authority to tax. If multiple states would have that authority, the second and third prongs of the analysis ensure that interstate commerce is protected from state overreach. *See Jefferson Lines, Inc.*, 514 U.S. at 184–85. These prongs thus require that a state tax measured by income earned from interstate commerce be "fairly apportioned" to the activities carried on within the taxing state,

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Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 256, 58 S. Ct. 546, 82 L. Ed. 823 (1938), and not discriminate against interstate commerce. *Wynne*, 575 U.S. at 562. The apportionment requirement "ensure[s] that each State taxes only its fair share of an interstate transaction." *Jefferson Lines, Inc.*, 514 U.S. at 184 (citation omitted). This principle of "fair share" derives from the Commerce Clause's prohibition against multiple taxation: "[W]henever one State's act of overreaching combines with *the possibility* that another State will claim its fair share of the value taxed: the portion of value by which one State exceeded its fair share would be taxed again by a State properly laying claim to it." *Id.* at 184–85 (emphasis added). The anti-discrimination requirement ensures, among other things, that a state does not impose a tax that subjects interstate commerce to the burden of multiple taxation. *See Wynne*, 575 U.S. at 549–50.

To assess ESSB 5096's "threat of malapportionment" the court must ask "whether the tax is 'internally consistent' and, if so, whether it is 'externally consistent' as well." *Jefferson Lines, Inc.*, 514 U.S. at 185 (citation omitted). "Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear." *Id.* This test requires "hypothetically assuming that every state has the same tax structure" to determine whether the state "tax scheme[]" "inherently discriminates against interstate commerce without regard to the tax policies of other states." *Wynne*, 575 U.S. at 562. External consistency, in contrast, looks "to the economic justification for the State's claim upon the value taxed, to discover whether a State's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State." *Jefferson Lines, Inc.*, 514 U.S. at 185. There must be "a rational relationship between the income attributed to the State and intrastate values of the [business being taxed]." *Container Corp. of America*, 463 U.S. at 165–66 (citation omitted). If the income apportioned to the State is "out of all appropriate proportion to business transacted in that State," the tax lacks "fair apportionment." *See id.* at 180–81. ESSB 5096 fails these requirements.

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a. ESSB 5096 Lacks Fair Apportionment Because It Sources the Entirety of the Tax on Activity in Another State

As previously described, ESSB 5096 imposes the tax on three categories of gains that the Legislature has allocated to Washington:

> (1) those earned from sales or exchanges of tangible property located in the state at the time of the sale/exchange;
>
> (2) those earned from sales or exchanges of tangible property previously located in the state if the taxpayer was a resident at the time of the sale/exchange and the taxpayer is not otherwise subject to the payment of another tax on the gains by another jurisdiction; and
>
> (3) those earned from sales or exchanges of intangible personal property if the taxpayer was domiciled in the state at the time of the sale or exchange.

§ 11(1)(a), (b). The first provision sources the income to the location of the property at the time of sale, i.e., Washington, which is consistent with the "long-settled" principle that a sale of tangible goods only has sufficient nexus with the state in which the sale occurs. *See Jefferson Lines, Inc.*, 514 U.S. at 184, 187. The second provision, however, goes further to source income earned from sales occurring outside the State's borders to Washington—if another state with lawful jurisdiction to tax the activity has not exercised its rightful authority to do so.

Setting aside that—as previously shown—Washington lacks authority to tax income earned from activities occurring outside its borders, the second provision also fails to demonstrate external consistency.[8] Washington's alleged economic justification for allocating the gains to itself (i.e., the residency of the taxpayer) cannot overcome the fact that the State is reaching "beyond that portion of value that is fairly attributable to economic activity" within the state. *Jefferson Lines, Inc.*, 514 U.S. at 185. This inherent discrimination occurs because Washington allocates to itself all the gains earned when the property state simply chooses not to impose the tax. *See Armco, Inc. v. Hardesty*, 467 U.S. 638, 644–45 and n.8, 104 S. Ct. 2620, 82 L. Ed. 2d 540 (1984) (validity

[8] The first and second provisions are internally consistent because if every state adopted Washington's capital gains tax structure *all* states would impose the tax on transactions occurring only in-state and *no* state would tax under the second provision.

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of one state's tax does not turn on how another state has chosen to exercise its taxing authority); *accord Mobile Oil Corp.*, 445 U.S. at 444 (constitutionality of state's law does not depend on proof of actual multiple taxation; fact that another state could tax governs the analysis).

b. ESSB 5096 Lacks Consistency Between the Income Earned in Washington and the External Activity Being Taxed

The third provision related to gains earned on sales of intangible personal property likewise suffers from malapportionment. It provides only one method to source the income, i.e., the domicile of the individual taxpayer, and therefore would be internally consistent if adopted by every state in the nation. Nevertheless, the provision runs afoul of the Commerce Clause because does not apportion the tax among the various jurisdictions in which the income was partially earned, subjecting interstate commerce to the risk of multiple taxation. Washington allocates the sale or exchange of intangible capital assets entirely to itself solely based on the property owner's domicile, without regard to whether the actual value of the income from the intangibles was derived outside the state. *Cf. Mobil Oil Corp*. 445 U.S. at 441–42 (dividend income received by corporations operating in interstate commerce may not be taxable if the business activities of the payor have nothing to do with the activities of the recipient); *Wheeling Steel Corp. v. Fox*, 298 U.S. 193, 212, 56 S. Ct. 773, 80 L. Ed. 1143 (1936) (recognizing that tax on net profits from intangible property demands a method of apportionment amongst different jurisdictions with respect to the processes by which the profits are earned). The State is unconstitutionally extending its taxing authority to activities conducted outside its border with no rational relationship between the income on which the state's tax is measured and the activity being taxed.

c. ESSB 5096 Fails to Incorporate Principles of Apportionment

Further, the credit in section 11(2)(a) of ESSB 5096 does not cure these defects. A credit is allowed against Washington's capital gains tax equal to the amount of any legally imposed income or excise tax paid by the taxpayer to another jurisdiction but only "on gains derived from capital assets *within* the other taxing jurisdiction to the extent such gains are included in the

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taxpayer's Washington capital gains." § 11(2)(a) (emphasis added). In short, a credit is allowed but only if the gains were derived from capital assets *within* the other state—for example, the value of goodwill in an out of state business. No other credit is allowed against another state's taxes on the same capital gains sourced to that state by other means, such as where the taxpayer does business. *Cf. Curry*, 307 U.S. at 366–67 (recognizing intangible personal property can be sourced based on taxpayer's activities in state); *First Bank Stock Corp. v. Minnesota*, 301 U.S. 234, 240–41, 57 S. Ct. 677, 81 L. Ed 1061 (1937) (recognizing ownership of shares of corporate stock may be taxed at the localized source of the business).

The lack of full credit by Washington for other states' taxes on the same activity creates a risk that the gains earned from the sales of long-term assets will be taxed by multiple states, and thus impermissibly burdens interstate commerce. *Cf. Wynne*, 575 U.S. at 545 (striking down part of state income tax that did not offer residents a full credit against income taxes paid to other states); *Gwin*, 305 U.S. at 339–40 (striking down Washington privilege tax derived from gross receipts incurred from sales in interstate commerce and without apportionment). For example, consider a hypothetical situation in which Washington allocates for itself capital gains from the sale or exchange of intangible personal property because the taxpayer was domiciled in Washington at the time of sale. If the taxpayer was also a California resident during a portion of that same year, the taxpayer runs the risk under Washington's structure of being taxed on the entirety of the income from the sale twice—once by Washington by virtue of the taxpayer's domicile and once by California by virtue of the taxpayer's residency, without any apportionment between the two.[9]

[9] ESSB 5096 does not define domicile, but the term generally means "a man's legal relation to a place" after selecting the place as his "home." *E.g.*, *Ex Parte Mullins*, 26 Wn.2d 419, 444, 174 P.2d 790 (1946). For purposes of its income tax (which capital gains are included in), California defines resident as any individual who is (1) in California for other than a temporary or transitory purpose; or (2) domiciled in California, but who is outside California for a temporary or transitory purpose. Cal. Rev. & Tax Code § 17014. Thus, a person can be both domiciled in Washington at the time of sale and also a resident of California for purposes of the tax. *Accord* ESSB 5096 § 4(10)(a) (defining "resident")

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While a full credit provision for capital gain taxes paid to another state "could remedy [some of] the infirmity in" ESSB 5096's internal consistency, *see Wynne*, 575 U.S. at 568, it would not alleviate the problem with external consistency. As previously stated, external consistency requires that gross receipts taxes or taxes on income "be apportioned to reflect the location of the various interstate activities by which [the amount] was earned." *Jefferson Lines, Inc.*, 514 U.S. at 190. The Legislature has failed to incorporate principles of apportionment in ESSB 5096 so that the capital gains tax is constitutionally imposed only on that portion of income reasonably attributed to the taxpayer's in-state activities garnering the sale. ESSB 5096 tries to allocate taxable gains derived from the sale of certain capital assets to Washington solely because the taxpayer resides or is domiciled within the State. But the act of simply living in the State does not bear a rational relationship to the amounts earned from the long-term ownership and eventual sale/transfer of those assets. And, even if some link were identified, there would still be no basis for Washington to allocate to itself —as it does in ESSB 5096—*all* of the gains earned without any apportionment for the value earned in other jurisdictions. By doing so, the gains apportioned to Washington are "out of all appropriate proportion" to the activities conducted here. *See Container Corp. of America*, 463 U.S. at 180–81.

* * * *

In sum, ESSB 5096 violates the dormant Commerce Clause because the capital gains tax imposed impermissibly allocates the tax to Washington based on the taxpayer's location instead of where the activity of sale or transfer of the asset occurs, imposes a tax that is not fairly apportioned to activities occurring within the state, and discriminates against interstate commerce.

B. ESSB 5096 Imposes an Impermissible Tax on Income Under the Washington Constitution

These three propositions are legally indisputable. First, capital gains are income. Second, income is property. Third, a tax on property that is either non-uniform, or at a rate exceeding one percent, violates Article VII, Section 1 of the Washington Constitution. Applying these three principles, this court should rule as a matter of law that ESSB 5096 levies a non-uniform tax at a

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rate exceeding one percent on personal income and is unconstitutional.

1. Capital Gains are Income and Income is Property Under the Washington Constitution

Amendment 14 to the Washington Constitution substantially broadened the definition of "property" for purposes of Article VII, related to taxes. It states that "[t]he word 'property' as used herein shall mean and include everything, whether tangible or intangible, subject to ownership." Income is within the definition of "property." *See, e.g.*, *Culliton*, 174 Wn. at 374; *Jensen*, 185 Wn. at 219–20; *Huntley*, 39 Wn.2d at 194–97.[10] As the Court explained in *Culliton*:

> It would certainly defy the ingenuity of the most profound lexicographer to formulate a more comprehensive definition of 'property.' It is 'everything, whether tangible or intangible, subject to ownership.' Income is either property under our Fourteenth Amendment, or no one owns it. If that is true, anyone can use our incomes who has the power to seize or obtain them by foul means. There being no other classifications in our Constitution but real and personal property and intangible property, incomes necessarily fall within the category of intangible property. No more positive, precise, and compelling language could have been used than was used in those words of our Fourteenth Amendment. It needs no technical construction to tell what those words mean. The overwhelming weight of judicial authority is that 'income' is property and a tax upon income is a tax upon property.

174 Wn. at 374. There is no question that capital gains are income, and income is property subject to the constitutional limitations on state taxing authority discussed below

2. A Tax on Capital Gains Is a Tax on Income, Not an Excise Tax.

The Legislature states (and Defendants aver in their Answer), that ESSB 5096 imposes an excise tax on the sale or exchange of long-term capital assets, not a tax on income. This Court must disregard the Legislature's description for two reasons: *First*, the capital gains tax in ESSB 5096 cannot be a legitimate excise tax because the State of Washington lacks jurisdiction to impose an excise tax on sales of long-term capital assets that do not occur within Washington. By its terms,

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[10] In a different context, the Washington Supreme Court recently held that a security deposit—which is a contractual entitlement to receive money upon the occurrence of future events—is "personal property" of the tenant and subject to the three-year statute of limitations for recovery of personal property. *See Silver v. Rudeen Mgmt. Co., Inc.*, 197 Wn.2d 535, 549, 484 P.3d 1251 (2021).

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ESSB 5096 attempts to reach gains on sales that occur beyond its borders; indeed, so long as the taxpayer is a resident or is domiciled in the state, it purports to levy a tax on some capital gains from sales that may occur anywhere in the world. As previously discussed, Washington has no authority to impose tax on activities outside its borders. *Second*, and more fundamentally, ESSB 5096 does not in fact tax the privilege of engaging in transactional activity but simply levies a tax on the same aggregate net income from capital gains that an individual reports to the IRS for federal income tax purposes. The federal government and every other state in the country classify a tax on capital gains as income, and no other state imposes an *excise* tax on capital asset sales at all, much less an excise tax on capital asset sales regardless where they occur in the world. The Legislature's attempt to evade constitutional scrutiny by misclassifying an income tax as an excise tax is without legal support, legal precedent, or grounding in reality.

a. Binding Washington Case Law Requires This Court to Reject the Legislature's "Excise Tax" Label

This is not the first time the Washington Legislature sought to evade the constitutional prohibition on graduated income taxes by misclassifying them as an excise tax. Following Washington voters' adoption of Amendment 14 to the Constitution, the Supreme Court held in *Culliton* that income falls squarely within the constitutional definition of property ("everything, whether tangible or intangible, subject to ownership"), and therefore, a tax on income is a property tax subject to the uniformity clause, not an excise tax. 174 Wn. at 375–76. In 1935, the Legislature tried to evade *Culliton*'s prohibition on graduated income taxes by purporting to levy a tax on "the *privilege* of receiving income therein while enjoying the protection of [Washington] laws." Laws of 1935 ch. 178, § 2. The Legislature's attempt to end run *Culliton* fell flat. In a decision that remains binding law today, the Court held:

> It is true that the Legislature has so labeled the 1935 act. But the legislative body cannot change the real nature and purpose of an act by giving it a different title or by declaring its nature and purpose to be otherwise. . . . *The Legislature may declare its intended purpose in an act, but it is for the courts to declare the nature and effect of the act. The character of a tax is determined by its incidents, not by its name.*

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Jensen, 185 Wn. at 217 (emphasis added and citations omitted). The Court specifically rejected the Legislature's assertion that it was taxing "the *privilege* of receiving income," observing:

> an examination of the various provisions of the act shows clearly that the Legislature was concerned with the property (income) upon which the amount of the tax was to be levied, not with the mere privilege of the individual to receive the income. When a tax is, in truth, levied for the exercise of a substantive privilege granted or permitted by the state, the tax may be considered as an excise tax and sustained as such.

Id. at 218. (emphasis added and citations omitted). But no state-conferred privilege was at issue in *Jensen*. As the Court explained, "the mere right to own and hold property cannot be made the subject of an excise tax, because to tax by reason of ownership of property is to tax the property itself." *Id.* The Court flatly rejected the State's contention that the "right to receive property (income in this instance)" is distinct and subject to an excise, holding instead that "[t]he right to receive property (income in this instance) is but a necessary element of ownership." *Id.* As a result, it also unambiguously rejected the State's excise tax characterization:

> The right to receive, the reception, and the right to hold are progressive incidents of ownership and indispensable thereto. To tax any one of these elements is to tax their sum total, namely, ownership, and therefore the property (income) itself. Despite its change of designation, we are convinced that the 1935 act imposes a tax on net income, and is therefore a property tax.

Id. at 219.

After *Jensen*, the Legislature again attempted an income tax end run in 1951 by enacting a purported corporate excise tax "for the privilege of exercising [a] corporate franchise in this state or for the privilege of doing business in this state." *Power, Inc. v. Huntley*, 39 Wn.2d 191, 193, 235 P.2d 173 (1951). That four percent tax, measured on "net income," was equally ill-fated. Relying on *Jensen*, the Supreme Court held "that the tax is a mere property tax 'masquerading as an excise.'" *Id.* at 196. Of particular significance here, the Court explained:

> It is *geared throughout to the Federal income tax legislation*…. It has no reference to income from the various business activities on which the business and occupation tax, a true excise tax, is based, but taxes almost any income from almost every source. After studying this act in its entirety, we conclude that the tax is levied

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> because the corporation has net income, not because it does any business in this state or exercises its corporate franchise.

Id. at 196–97 (emphasis added). The same red flags that led the Court to unmask an unconstitutional income tax in *Huntley* are found in ESSB 5096.

First, ESSB 5096 is expressly "geared" to federal income taxes. There is no serious argument that the *federal* tax on gains on sale of a capital asset ("capital gains") is not an income tax. *See*, *e.g.*, 26 U.S.C. § 1221 (capital asset defined). ESSB 5096 tethers its definition of capital assets to Subtitle A of the Internal Revenue Code governing *income* taxes. *See* ESSB 5096 § 4(2) ("'Capital asset' has the same meaning as provided by Title 26 U.S.C. Sec. 1221"); *see also* § 4(3) ("'Federal net long-term capital gain' means the net long-term capital gain reportable for federal income tax purposes").

Second, as in *Jensen* and *Huntley*, the incidence of the tax is an individual's receipt of income from "the sale or exchange of long-term capital assets," not specific sales transactions. A true excise tax on sales only taxes sales occurring wholly in the state because, as discussed in the Commerce Clause section above, sales are deemed to occur in only one location. This principle gives that single state exclusive jurisdiction to tax the sale. *Jefferson Lines, Inc.*, 514 U.S. at 184. But the capital gains tax here reaches gains from capital asset transactions occurring throughout the world so long as the capital assets sold or transferred are here, or the taxpayer resides or is domiciled in Washington. In consequence, the tax plainly cannot be keyed to specific transactions, particularly transactions involving capital assets outside Washington, but are instead keyed to "the calculation of an individual's federal net long-term capital gain" over the course of a year. ESSB 5096 § 5(3). It is measured as a percentage of the aggregate gain on sale. *Id.* at §§ 4(1), 5. In other words, it is a tax on net income.

This interpretation is consistent with federal law and the laws of every other state. As the nonpartisan legislative staff explained in the final bill report for ESSB 5096:

> Under the federal tax code, individuals and corporations pay income tax on the net total of all their capital gains just as they do on other sorts of income. For

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> individuals, the amount of federal CGT depends on both the tax bracket of the individual and the amount of time the capital asset was held before being sold….
>
> In addition to the federal tax, capital gains are often subject to state income taxes. Most states do not have separate capital gains tax rates. Instead, most states tax capital gains as ordinary income subject to the state's income tax rates.

Final Bill Report, ESSB 5096, C 196 L 21 at 1 (Wash. 2021).[11] And as the Internal Revenue Service made clear when responding to a request for clarification by Congressman Dan Newhouse of Washington:

> This is in response to your inquiry regarding the tax treatment of capital gains. You ask whether tax on capital gains is considered an excise tax or an income tax? It is an income tax.

Mercier Decl., Ex. D. Moreover, if this were a true excise tax on transactions, the state would have no legitimate interest in compelling taxpayers to produce the entirety of their federal income tax returns, along with all schedules and supporting materials, unrelated to the capital asset sales being taxed.

If there were any doubt, looking to the views of other jurisdictions dispels it. Every state revenue department in the country describes capital gains as income. And "those that tax capital gains do so via their income tax codes. No state taxes capital gains as an excise tax." *See* Mercier Decl. ¶ 4 & Ex. B. Washington courts look to the views of other state and federal courts in determining the nature of a challenged tax, *see, e.g.*, *Morrow v. Henneford*, 182 Wn. 625, 27–30, 47 P.2d 1016 (1935), and doing so here confirms that ESSB 5096 enacts a tax on income.

b. ESSB 5096 Bears Hallmarks of an Income Tax, Not an Excise Tax

There are other telltale signs that RCW 82.87.040 is not the excise tax on transaction it purports to be. In Washington, excise taxes on transactions are typically levied on the sale of specified goods or services like cigarettes, gasoline, or alcohol; only on sales transactions occurring wholly *within* the state; and are measured based on *gross value or volume*. *See, e.g.*,

[11] lawfilesext.leg.wa.gov/biennium/2021-22/Pdf/Bill%20Reports/Senate/5096-S.E%20SBR%20FBR%2021.pdf?q=20211206111918.

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RCW 82.08.150 (liquor); RCW 82.24.020 (cigarettes); *see generally* RCW 82.08 (retail sales taxes).[12] None of those features is present here.

Also, like an income tax, ESSB 5096 allows deductions for certain charitable donations, none of which has any relation to the underlying sales of assets but are prominent features of an income tax. *See* ESSB 5096 § 9. Indeed, even the State Department of Revenue , in assessing ESSB 5096, concluded that the deduction for charitable donations—"is a common feature of income taxes" that "may increase the chance that the courts will determine that the Washington capital gains tax is an income tax." Wash. Dep't of Revenue, *Enrolled Bill Analysis & Agency Recommendation* at 5–6 (as of April 30, 2021) (commenting that "the charitable deduction is not the only provision in the bill that opponents of the capital gains tax can point to in support of their argument that the capital gains tax is an income tax"), attached as Exhibit C to Mercier Decl.

Besides its tether to federal income taxes and obvious characteristics of an income tax, there are other, less obvious ways in which ESSB 5096 betrays that it is not truly an excise based on transactions in capital assets. "Only individuals are subject to payment of the tax," ESSB 5096 § 5, although other persons (i.e., corporations, partnerships, LLCs, etc.) obviously engage in identical capital asset transactions.[13] If this were truly a tax based on the authority of the State with

[12] A signature feature of an income tax is that it applies to income or gains from any geographic source, unlike an excise tax such as the Washington Business and Occupations ("B&O") tax that is closely tied to the state-conferred *privilege* of conducting business within the state, and is measured based on gross revenue or income earned only within the state. *See, e.g.*, *Lakehaven Water & Sewer Dist. v. City of Federal Way*, 195 Wn.2d 742, 748–49, 466 P.3d 213 (2020) (city excise tax on gross income of utilities providing water and sewer services); *Watson v. City of Seattle*, 189 Wn.2d 149, 168–69, 401 P.3d 1 (2017) (B&O excise tax on gross revenues).

[13] The tax code generally applies to any "person" meaning interchangeably "any individual, receiver, administrator, executor, assignee, trustee in bankruptcy, trust, estate, firm, copartnership, joint venture, club, company, joint stock company, business trust, municipal corporation, political subdivision of the state of Washington, corporation, limited liability company, association, society, or any group of individuals acting as a unit, whether mutual, cooperative, fraternal, nonprofit, or otherwise and the United States or any instrumentality thereof." RCW 82.04.020 (excise tax purposes); *see also* RCW 83.100.020(9) (estate and transfer tax; same); RCW 84.04.075 (property taxes; same).

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respect to transactions (like Washington's excise tax on transfers of real estate), it would presumably be agnostic and indifferent as to the categories of persons—individuals, trusts, union pension funds, corporations, limited partnerships and LLCs—that were party to the transaction and subject to paying the tax. Distinguishing between "natural persons" and other persons is a common feature of most income tax regimes (e.g., individual vs. corporate tax).

It also applies to individuals who are the "beneficial owner of such assets at the time of the sale or exchange," when the legal owner of the assets may be another entity at the time of the transaction, and only "when the Washington capital gains are recognized by the taxpayer," not necessarily as of the date of the transaction. ESSB 5096 § 5(4)(a). Here again, there is no reason for the State to spare a legal owner of the capital asset from liability for a transaction tax, but it is typical to make these distinctions for purposes of income taxes.

In short: the Legislature's *ipse dixit* that "an excise tax is imposed on the sale or exchange of long-term capital assets" is insufficient under *Jensen* and *Huntley* to overcome the inescapable conclusion that ESSB 5096 levies an income tax.

3. As a Tax on Property, ESSB 5096 Violates Article VII of the Washington Constitution

Capital gains are income and fall within the Washington Constitution's broad definition of "property." That determination has critical constitutional consequences. Because capital gains fall within the definition of "property," ESSB 5096 must comply with the Washington Constitution, Article VII, Sections 1 & 2, governing taxes on property. It does not. *First*, ESSB 5096 violates the Uniformity Clause in Section 1 by imposing a non-uniform rate of seven percent on Washington Capital Gains in excess of $250,000, but imposing zero tax on capital gains below that $250,000 threshold. *Second*, ESSB 5096 violates Section 2 because the seven percent tax rate exceeds the maximum annual property tax rate of one percent.

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a. ESSB 5096 Taxes Property in Violation of the Uniformity Clause in Article VII, Section 1

The Uniformity Clause, Article VII, Section 1, requires that "[a]ll taxes shall be *uniform* upon the same class of *property* within the territorial limits of the authority levying the tax …. The word '*property'* as used herein shall mean and include everything, whether tangible or intangible, subject to ownership." (Emphasis added). "'[N]et income.' . . . under the Fourteenth Amendment, constitutes one class of property." *Jensen*, 185 Wn. at 222–23. In ESSB 5096, "adjusted capital gains" and "Washington capital gains" are defined so that they constitute a single class of property. ESSB 5096 § 4(1) & (13). If net income is a single class of property, it follows that net income in the form of gains from the sale of long-term capital assets is one class of property, and any tax on such gains must satisfy principles of uniformity.

ESSB 5096 must comply with the Uniformity Clause but it does not. The capital gains tax is non-uniform in at least two ways. *First*, the State will tax the capital gains of individuals but not other residents, such as corporations, that sell or exchange capital assets. This is non-uniform taxation. *See Huntley*, 39 Wn.2d at 195 ("If the four per cent tax on corporate net incomes is a tax on property, it violates the principle of uniformity in that it levies no tax on the incomes of individuals and copartnerships which may be in competition with corporations required to pay the tax.") (citing authorities).

Second, taxpayers will pay a seven percent tax on their "Washington capital gains" ESSB 5096 §5. But after a standard deduction, the first $250,000 of Washington capital gains are subject to zero tax. ESSB 5096 § 7. Additional deductions for qualifying sales of small businesses and charitable deductions are also allowed. *Id.* As a result, ESSB 5096 imposes a graduated, non-uniform tax on a single class of capital gains. *See Culliton*, 174 Wn. at 382 ("The constitutional amendment speaks of the same class of property. One who pays a tax on a $2,000 taxable income pays a tax on precisely the same class of property as one who pays a tax on a $1,000 taxable income, and to tax the one at a progressively higher rate than the other positively violates the other

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clause of the amendment, that all taxes shall be uniform upon the same class of property.”).

The Washington Supreme Court has consistently held that graduated taxes on income violate the Uniformity Clause. *See, e.g.*, *Culliton*, 174 Wn. at 377–79; *Jensen*, 185 Wn. at 219–20; *Huntley*, 39 Wn.2d at 194–97 (“It is no longer subject to question in this court that income is property”). As a graduated, non-uniform tax on capital gains as property, binding precedent requires that this court also decide that ESSB 5096 violates the Uniformity Clause.

b. ESSB 5096 Taxes Property in Violation of the One Percent Rate Limitation in Article VII, Section 2

As a tax on property, ESSB 5096 must also comply with Article VII, Section 2, which places a ceiling on the aggregate taxes that can be imposed on property. Section 2 restricts the aggregate of all tax levies on property to a rate of one percent annually without a supermajority vote of the people. Seven percent is obviously more than one percent, so ESSB 5096 also violates the Washington Constitution by levying a tax that exceeds the maximum rate permitted under Section 2.

4. Supreme Court Decisions Invalidating Income Taxes Bind this Court Under Principles of Vertical *Stare Decisis*

We expect the State to ask this court to decline to follow *Culliton*, *Jensen*, and *Huntley*, but a decision by the Washington Supreme Court “is binding on all lower courts in the state.” *1000 Va. Ltd. P’ship v. Vertecs Corp.*, 158 Wn.2d 566, 578, 146 P.3d 423 (2006); *see also State v. Gore*, 101 Wn.2d 481, 487, 681 P.2d 227 (1984). “[T]rial and appellate courts in Washington must follow decisions handed down by our Supreme Court and the United States Supreme Court. Adherence is mandatory, regardless of the merits of the higher court's decision.” *Matter of Arnold*, 198 Wn. App. 842, 846, 396 P.3d 275 (2017). In *Gore*, the Washington Supreme Court reversed the Court of Appeals’ choice to follow non-binding federal decisional law that it preferred:

> In failing to follow directly controlling authority of this court, the Court of Appeals erred. … Further, once this court has decided an issue of state law, that interpretation is binding on all lower courts until it is overruled by *this court.* … The Court of Appeals was therefore without authority to adopt [non-binding United

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> States Supreme Court authority] based on what it perceived to be the preferable policy.

101 Wn.2d at 487 (emphasis added).

Because *stare decisis* protects reliance interests, it has particular force when property rights are threatened. *See State Oil Co. v. Khan*, 522 U.S. 3, 20, 118 S. Ct. 275, 139 L. Ed. 2d 199 (1997) (concerns of *stare decisis* are "at their acme" in cases involving contract and property rights); *State ex rel. Egbert v. Gifford*, 151 Wn. 43, 45 (1929) (applying *stare decisis* to rule that certain intangibles were not taxable "property" before amendment of Const. art. VII, § 1).[14]

The rulings in *Culliton*, *Jensen*, and *Huntley* have been followed by Washington courts consistently and without exception.[15] Bound by vertical *stare decisis,* this court must declare that the ESSB 5096 tax on capital gains violates Article VII of the Washington State Constitution.

C. ESSB 5096 Impermissibly Taxes Certain Persons While Exempting Others in Violation of Article I, Section 12 of the Washington Constitution

Article I, Section 12 of the Washington Constitution provides that "No law shall be passed granting any citizen, class of citizens, or corporation other than municipal, privileges or immunities

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[14] Rejecting stare decisis would undermine the personal reliance interests of Washington residents. Many people have moved to Washington from other places, or remained in Washington, secure in the understanding that neither the State would not levy tax on their income unless the legally mandated political procedures for amending the Washington Constitution were honored. If stare decisis were overturned, some citizens would find it necessary to cease being Washington residents—particularly residents of more modest income who have built and saved their entire lives to store their wealth in a personal business or a single asset (e.g., farmers) that will generate large state tax liabilities with a single, one-time asset sale, avoidable only by changing the state of residence.

[15] *See, e.g.*, *Kunath v. City of Seattle*, 10 Wn. App. 2d 205, 444 P.3d 1235 (2019)*; Dean v. Lehman*, 143 Wn.2d 12, 25, 18 P.3d 523 (2001) (citing *Jensen* for rule that income is property); *Harbour Vill. Apartments v. City of Mukilteo*, 139 Wn.2d 604, 608, 989 P.2d 542 (1999) (relying on *Jensen* to hold a tax on rental income is a tax on property that violates constitutional prohibition against nonuniform taxation of real property); *Apartment Operators Ass'n of Seattle, Inc. v. Schumacher,* 56 Wn.2d 46, 47, 351 P.2d 124 (1960) (relying on *Jensen* and holding that question whether tax on rent is property tax "is foreclosed by prior decisions of this court"); *Petrol. Nav. Co. v. Henneford*, 185 Wn. 495, 496–7, 55 P.2d 1056 (1936) (following *Aberdeen*, *Culliton*, and *Jensen* to hold that annual tax, measured by net income is a tax on property).

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which upon the same terms shall not equally belong to all citizens, or corporations." Const. art. I, § 12. This provision, which is more protective than the federal equal protection clause, "protects . . . against laws serving the interest of special classes of citizens to the detriment of the interests of all citizens." *Grant Cnty. Fire Prot. Dist. No. 5 v. City of Moses Lake*, 150 Wn.2d 791, 806–07, 83 P.3d 419 (2004). Courts subject legislation implicating Article I, Section 12 to a two-part test. *Schroeder v. Weighall*, 179 Wn.2d 566, 572–73, 316 P.3d 482 (2014). First, the Court must ask whether the law grants a "privilege" or "immunity" within the meaning of the constitution. *Id.* If the answer is yes, then the Court must ask whether there is a "reasonable ground" for granting that privilege or immunity. *Id.*

In the case of ESSB 5096, the answer to the first question of whether the statute implicates a "fundamental right[] of state citizenship" is an easy yes. *See Schroeder*, 179 Wn.2d at 573. As long-recognized by our State Supreme Court, a "privilege" within the meaning of article I, section 12 includes "the right to be exempt, in property or persons, from taxes or burdens which the property or persons" of others in the state are "exempt from." *See State v. Vance*, 29 Wash. 435, 458, 70 P. 34 (1902); *see also Grant Cnty. Fire Prot. Dist. No. 5*, 150 Wn.2d at 812–13 (collecting cases recognizing same). ESSB 5096 imposes a capital gains tax on any sale or exchange of long-term capital assets. § 5(1). The tax thus generally applies to any person[16] who owns long-term capital assets and engages in the sale or exchange of those assets. The same provision also specifies that "[o]nly individuals are subject to payment of the tax," meaning that any non-natural persona that also earns capital gains is not subject to payment of the tax. *Id.* ESSB 5096 on its face subjects only certain persons owning and selling capital assets to the tax, while exempting any other person

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[16] The tax code generally applies to any "person" meaning interchangeably "any individual, receiver, administrator, executor, assignee, trustee in bankruptcy, trust, estate, firm, copartnership, joint venture, club, company, joint stock company, business trust, municipal corporation, political subdivision of the state of Washington, corporation, limited liability company, association, society, or any group of individuals acting as a unit, whether mutual, cooperative, fraternal, nonprofit, or otherwise and the United States or any instrumentality thereof." RCW 82.04.020 (excise tax purposes); *see also* RCW 83.100.020(9) (estate and transfer tax; same); RCW 84.04.075 (property taxes; same).

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with the exact same circumstances from the tax.

The second question when applied to state taxes asks whether there is a "reasonable ground" for the legislature to have taxed one class and exempted other classes from the same tax. *Schroeder*, 179 Wn.2d at 573; *cf. Texas Co. v. Cohn*, 8 Wn.2d 360, 376, 112 P.2d 522 (1941) (applying federal equal protection analysis to tax law).[17] "Under the reasonable ground test a court will not hypothesize facts to justify a legislative distinction. . . Rather, the court will scrutinize the legislative distinction to determine whether it *in fact* serves the legislature's stated goal." *Id.* at 574 (internal citations omitted). The Legislature's stated purpose for imposing the tax in ESSB 5096 purportedly is to "rebalance" the state's tax code so that its "wealthiest residents" pay more taxes on their share of income than those residents at the bottom of the income spectrum. ESSB 5096 § 1. This stated purpose, however, speaks only to the difference in levying the tax on individuals whose "profit is in excess of $250,000," *id.*, it says nothing of a legislative basis for imposing the tax only on individuals as opposed to imposing the tax on any person owning the capital assets and selling those assets for gain.[18] And there is no discernable basis for the State to treat individuals incurring capital gains discriminatively from other "persons" incurring capital gains, when the purported reason is to raise revenue, except for the Legislature to reach individual *income*. *Cf. Wynne*, 575 U.S. at 554 (disparate treatment of corporate and personal income cannot be justified based on the state services enjoyed by two groups of taxpayers). This arbitrary distinction does not in fact support the Legislature's stated purpose, and thus unconstitutionally burdens the tax against only a select set within the relevant class of taxpayers in violation of Article I, Section 12

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[17] The Washington Supreme Court has since held that Article I, Section 12 provides greater constitutional protections than equal protection. *Grant Cty. Fire Protection Dist. No.* 5, 150 Wn.2d at 806–07. The test applied in *Texas Co*, which looked to "any conceivable basis" to uphold the classification, therefore no longer applies.

[18] Such a distinction, of course, also violates Article VII, Section 1's uniformity provision for property taxes.

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VI. CONCLUSION

For these reasons, Plaintiffs ask the Court to grant their motion for summary judgment and declare ESSB 5096 constitutionally invalid on its face.

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