IN THE SUPERIOR COURT OF THE STATE OF WASHINGTON
FOR DOUGLAS COUNTY

CHRIS QUINN, *et al*,

Plaintiffs,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE, *et al*,

Defendants.

and

EDMONDS SCHOOL DISTRICT, *et al.*

Intervenors.

APRIL CLAYTON, *et al.*

Plaintiffs,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE, *et al*,

Defendants.

and

EDMONDS SCHOOL DISTRICT, *et al.*

Intervenors.

Case No. 21-2-00075-09

Case No. 21-2-00087-09

PLAINTIFFS' REPLY IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT

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I. INTRODUCTION

ESSB 5096 does not survive constitutional scrutiny under either the United States Constitution or Washington Constitution. The legislation violates the federal Commerce Clause because it impermissibly taxes activities occurring outside the state, imposes a tax that is not fairly apportioned to activities occurring within the state, and discriminates against interstate commerce by exposing gains earned from out-of-state transactions to multiple state taxation. The legislation violates the Washington Constitution because it is a non-uniform tax on property (income) and improperly taxes certain persons while exempting others. To avoid these conclusions, the State must "reimagine" the very nature of the capital gains tax imposed by ESSB 5096 and the governing case law. Each of its arguments in response to Plaintiffs' summary judgment motion fails.

First, the State asks this Court to apply a test for facial challenges that the United States Supreme Court has never applied when analyzing a tax law under the Commerce Clause. The Court has consistently invalidated state tax laws when the "practical operation" of the tax exceeds a state's taxing authority or will discriminate against interstate commerce. The capital gains tax in ESSB 5096 impermissibly does both. It attempts to impose a tax on gains earned outside Washington's borders and subjects the gains to risk of multiple state taxation through lack of apportionment and lack of full credit for taxes paid to other states. The United States Supreme Court has said that such a tax violates the Commerce Clause, and therefore ESSB 5096 must be stricken on its face.

Second, the State recharacterizes ESSB 5096 as an excise tax for some, as-yet unspecified, privilege to engage in transactions anywhere. But examining who, and what, is actually taxed, as Washington law requires, reveals its true character as an income tax. The State has not disputed that the statute imposes an "unavoidable" tax on individuals who are the beneficial recipients of income in the form of capital gains—in other words, the definition of a tax on *property*. As demonstrated by numerous examples involving passive ownership in pass-through business entities like trusts, there is no factual dispute that the capital gains tax is unavoidable because it

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requires no “voluntary” action by the taxpayer. And, unlike excise taxes, the measure of the capital gains tax is the aggregated net gain reported annually on federal income tax returns, not the sales price or other measure of the underlying property in the transaction purportedly being taxed. And despite intimations to the contrary, the State never disputes the doctrine of vertical *stare decisis* that requires this Court to follow binding Supreme Court precedent that income is a form of property, and a tax on income is therefore subject to Article VII’s uniformity requirement and rate limits on property taxes. The State concedes ESSB 5096 does not comply with these property tax limitations in Article VII, assuming they apply. Because ESSB 5096 taxes capital gains as income, it violates the Washington Constitution.

Third, the State ignores that ESSB 5096 exempts some persons accruing capital gains from the tax but imposes it on others for engaging in the same activity without any reasonable ground for making that distinction. This too violates the Washington Constitution under the Privileges and Immunities Clause.

The Legislature attempted to create a work-around to the nearly century-long state prohibition on graduated income taxes. Its creation of a capital gains tax though does not hold up to constitutional scrutiny. Because there is no genuine issue of disputed material fact, Plaintiffs are entitled to judgment as a matter of law. ESSB 5096 must be invalidated.

II. ARGUMENT IN REPLY

A. ESSB 5096 Imposes an Impermissible Tax Under the Commerce Clause of the United States Constitution

ESSB 5096 impermissibly taxes income from activity outside the State’s borders without apportioning the income among all the states in which activity contributed to the gain. Those features of the Act also discriminate against interstate commerce by subjecting it to a risk of multiple taxation. The State tries to save the legislation by ignoring the taxation of income earned outside of Washington; by ignoring that taxation based on when the taxpayer recognizes gain on federal tax forms is independent of any actual transaction (and hence the tax is not based on any privilege to sell long-term capital assets); and by ignoring that Washington cannot tax gains earned

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in another state simply because the other state chooses not to tax those gains. The State is simply wrong.

1. The Supreme Court's Commerce Clause Analysis Looks to Whether *Any* Application of a Tax Is Unconstitutional.

The State first attempts to save the legislation by claiming that because ESSB 5096 would tax gains arising from transactions occurring exclusively within Washington, the Act cannot be challenged as facially constitutional. The State relies heavily on a principle applicable in other contexts that a facial challenge generally requires plaintiffs to "establish that no set of circumstances exits [sic]" under which the statute could validly apply. *See* State's Opp. at 5–6 (citing *United States v. Salerno*, 481 U.S. 739, 107 S. Ct. 2095, 96 L. Ed. 2d 697 (1987) and *City of Redmond v. Moore*, 151 Wn.2d 664, 669, 91 P.3d 875 (2004)). Yet the State does not cite any case in which *Salerno's* "no set of circumstances" test has been applied in a Commerce Clause challenge to a state tax law, nor are Plaintiffs aware of any such case.[1] Rather, the Supreme Court has consistently applied a "practical" analysis that looks at whether any application of the tax would violate the Commerce Clause. *See, e.g.*, *Comptroller of Treasury of Md. v. Wynne*, 575 U.S. 542, 552, 135 S. Ct. 1787, 191 L. Ed. 2d 813 (2015) (Commerce Clause requires a "practical approach" that looks to the economic impact of the tax); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 616, 101 S. Ct. 2946, 69 L. Ed. 2d 884 (1981) (applying a "consistent and rational method of inquiry focusing on the practical effect of a challenged tax"); *Gwin, White & Prince v. Henneford*, 305 U.S. 434, 439–40, 59 S. Ct. 325, 83 L. Ed. 272 (1939) (looking at tax statute in its "practical operation" to find it discriminated against interstate commerce).

The Supreme Court has not hesitated to find a state tax law invalid under the Commerce

[1] Application of *Salerno* has been called into question by other courts, including in tax challenges. *See, e.g.*, *Gordon v. Holder*, 721 F.3d 638, 654 (D.C. Cir. 2013) (rejecting *Salerno*'s application when a tax statute "erases the boundaries that define a sovereign's jurisdiction"); *Sierra Club v. Bosworth*, 510 F.3d 1016, 1023–24 & n.4 (9th Cir. 2007) (collecting cases in which Supreme Court has not applied *Salerno*, including *Kraft Gen. Foods Inc v. Iowa Dep't of Rev. & Finance*, 505 U.S. 71, 112 S. Ct 2365, 120 L. Ed. 2d 59 (1992), a state tax Commerce Clause challenge); *accord Robinson v. City of Seattle*, 102 Wn. App. 795, 807–08, 10 P.3d 452 (2000) (discussing *Salerno's* application and declining to apply the "no set of circumstances" test in a constitutional challenge to a city tax ordinance under the Washington Constitution).

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Clause without regard to whether there were also scenarios in which imposition of the tax would be constitutionally permissible. For example, in *Gwin*, the fact that Washington's business and occupation ("B&O") tax applied equally to income earned from activities entirely in Washington and those earned both within and outside Washington did not save the tax from being struck down as facially invalid. Notwithstanding that the tax could constitutionally apply to exclusively in-state activity, the Court held the tax scheme discriminated against interstate commerce because of the "risk of a multiple burden to which local commerce is not exposed." *See Gwin*, 305 U.S. at 439. ESSB 5096 suffers from the same constitutional defects.

The State's admission that there are "circumstances where the tax might not constitutionally apply," State's Opp. at 6,[2] dooms the tax. Plaintiffs' briefs presented multiple other "circumstances" in which the tax is structurally unconstitutional. *See* Plaintiffs' MSJ at 7–15; Plaintiffs' Opp. at 22–25. ESSB 5096 fails under well-established Commerce Clause analysis.

2. ESSB 5096's Structure Proves Its Invalidity Under the Commerce Clause

The State also mischaracterizes the capital gains as transactional. *See generally* State's Opp. at 6–13. But, as pointed out by Plaintiffs in their opposition brief, it is not. *See* Plaintiffs' Opp. at 13–14. ESSB 5096 imposes an annual tax when an individual recognizes total net capital gains regardless of whether they engage in any voluntary act of selling or exchanging long-term capital assets, or are a party to a sale or legal transfer. The taxpayer need only possess a beneficial interest in the assets and recognize gain on their federal income tax return to be subject to the tax. *See id.* The Act's provisions are facially unconstitutional: they impose tax on 100 percent of the gain earned from sales or exchanges occurring wholly or partly outside Washington based solely on the taxpayer's residency (for gains associated with tangible personal property) or domicile (for

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[2] The State's reliance on the deduction in ESSB 5096 § 7(2) to save such application is a red herring. A deduction for amounts that the State is prohibited from taxing cannot save the statute when the State is prohibited from imposing the tax in the first place. As the Washington Supreme Court has said of the comparable deduction in the B&O tax code, "if a tax were in violation of the due process or commerce clauses, it would also be in violation of [the statutory deduction]." *Nat'l Can Corp. v. Dep't of Revenue*, 109 Wn.2d 878, 880, 749 P.2d 1286 (1988), *overruled on other grounds*, *Digital Equip. Corp. v. Dep't of Revenue*, 129 Wn.2d 177, 916 P.2d 933 (1996) (discussing RCW 82.04.430(6), codified in present as RCW 82.04.4286).

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gains associated with intangible property). *See* Plaintiffs' MSJ at 8-10; Plaintiffs' Opp. at 22–23.

With respect to tangible personal property, the Supreme Court has explicitly held that only the state in which the property was located at the time of sale has constitutional power to tax either the sale or the income from the sale. *See Okla. Tax Comm'n v. Jefferson Lines, Inc*., 514 U.S. 175, 184, 115 S. Ct. 1331, 131 L. Ed. 2d 261 (1995). ESSB 5096 violates this rule by allocating to Washington certain gains on the sale of tangible property "even though the [tangible personal] property was not located in the state at the time of the sale or exchange." *See* ESSB 5096 § 11(a)(i)–(iii). This provision indisputably imposes the tax based on the *residency* of the taxpayer alone, disregarding the constitutionally determinative fact that the *activity* on which the excise tax is purportedly based (i.e., the sale or exchange) may have occurred outside the jurisdictional reach of the State. *See Allied-Signal, Inc. v. Dir., Div. of Tax'n*, 504 U.S. 768, 777, 112 S. Ct. 2251, 119 L. Ed. 2d 533 (1992) ("[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.").

The same constitutional flaw exists with respect to intangible assets. States have authority to impose excise taxes on the sale or transfer of intangible property in cases "where the owner confines his activity to the place of his domicile." *Curry v. McCanless*, 307 U.S. 357, 367, 59 S. Ct. 900, 83 L. Ed. 1339 (1939).[3] But in *Curry*, the Court also explained that the maxim of *mobilia sequuntur personam*[4] is a concept of convenience that must yield to factual reality when the activity involves more than one state:

> [W]hen the taxpayer extends his activities with respect to his intangibles, so as to

[3] All of the cases that the State relies for its arguments with respect to intangibles involve only inheritance taxes. *See, e.g.*, *Greenough v. Tax Assessor of City of Newport*, 331 U.S. 486, 492–93, 67 S. Ct. 1400, 91 L. Ed. 1621 (1947) ("Nothing in these cases leads to the conclusion that a state may not tax intangibles in the hands of a resident trustee of an out-of-state trust."); *Graves v. Elliott*, 307 U.S. 383, 385–86, 59 S. Ct. 913 83 L. Ed. 1356 (1939) (addressing a state's power to tax the relinquishment at death of a power to revoke a trust of intangibles); *In re Eilermann's Estate*, 179 Wash. 15, 16, 35 P.2d 763 (1934) (intangible personal property is only subject to inheritance tax by the state of the owner's domicile).

[4] The maxim means "that it is the identity or association of intangibles with the person of their owner at his domicile which gives jurisdiction to tax." *Curry*, 307 U.S. at 367.

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> avail himself of the protection and benefit of the laws of another state, in such a way as to bring his person or property within the reach of the tax gatherer there, the reason for a single place of taxation no longer obtains, and **the rule is not even a workable substitute** for the reasons which may exist in any particular case to support the constitutional power of each state concerned to tax.

Id. at 367 (emphasis added)[5]; *accord Mobile Oil Corp. v. Comm'r of Taxes of Vermont*, 445 U.S. 425, 444–45, 100 S. Ct. 1223, 63 L. Ed. 2d 510 (1980) (permitting sourcing based on a state's connection to the activity generating the income from intangibles). The Legislature ignored these principles when it allocated income from the sale or exchange of intangible capital assets entirely to Washington based only on the taxpayer's domicile, without regard to whether the capital gains resulted from activity outside the state. *See* ESSB 5096 § 11(1)(b).

The Legislature also disregarded the fact that a taxpayer may have no control over sale or exchange of the intangibles at issue, choosing instead to apply the tax based solely on "whether the taxpayer was the legal or beneficial owner" of the assets at the time of sale or exchange. ESSB 5096 § 5(4)(a). The Supreme Court has explicitly rejected the notion that "intangibles—stocks, bonds—in the hands of the holder of the legal title with definite taxable situs at its residence" may be taxed based on the *equitable* owner's domicile. *Safe Deposit & Trust Co. of Baltimore, Md. v. Commonwealth of Virginia*, 280 U.S. 83, 92–93, 50 S. Ct. 59, 74 L. Ed. 180 (1929). Just as in *Curry*, the Court found that "the fiction of *mobilia sequuntur personam*" must yield to the "established fact of *legal* ownership, actual presence and control elsewhere." *Id.* (emphasis added). The State tries to reinstate the "fiction" that the power to tax transactions involving intangible personal property should be based exclusively on domicile, instead of where the activity related to the intangible occurs. *See id.* at 93. It is the State's arguments that are contrary to the controlling authority.[6]

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[5] The State contends *Curry* held that transactions in intangible property are deemed to occur in the state of the owner's domicile. State's Opp. at 8. It created no such black-letter rule. Addressing a Fourteenth Amendment challenge, *Curry* refused to impose a one-size-fits-all rule, explaining "[w]e find it impossible to say that taxation of intangibles can be reduced in every case to the mere mechanical operation of locating at a single place, and there taxing, every legal interest growing out of all the complex legal relationships which may be entered into between persons." *Id.* at 908–09. The Court declined to hold "that the Fourteenth Amendment may be invoked to compel the taxation of intangibles by only a single state by attributing to them a situs within that state." *Id.* at 909 (citation omitted).

[6] For purposes of the B&O tax, Washington allocates gross income in the form of royalties that are earned from

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3. ESSB 5096 Lacks Fair Apportionment.

The fact that ESSB 5096 taxes transactions that occur entirely outside Washington's borders also dooms the Act under *Complete Auto*'s fair apportionment requirement. Income earned from interstate commerce must be "fairly apportioned" to the activities carried on within that state. *See Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 256, 58 S. Ct. 546, 82 L. Ed. 823 (1938). ESSB 5096 contains no method for apportioning gains earned from the sale or exchange of long-term capital assets outside of the state. *See* Plaintiffs' MSJ at 10–15; *see also generally* ESSB 5096 §§ 5, 11. As described previously, this is the same defect that doomed Washington's early B&O tax. *See Gwin*, 305 U.S. at 438–39.

The State repeats its argument that apportionment is not required for income earned from intangible property because such property is "located" based only on the owner's domicile. State's Opp. at 9. But, as just discussed, the State's argument is wrong. *See also Mobil Oil Corp.*, 445 U.S. at 445 ("The Court also has recognized that the reason for a single place of taxation no longer obtains when the taxpayer's activities with respect to the intangible property involve relations with more than one jurisdiction. . . . Moreover, cases upholding allocation to a single situs for property tax purposes have distinguished income tax situations where the apportionment principle prevails.") (internal citations omitted); *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 among different jurisdictions with respect to the processes by which the profits are earned).

The State also argues that apportionment is not required for the sale of tangible property located in Washington. *See* State's Opp. at 9–10. Plaintiffs do not dispute this limited example, Plaintiffs' MSJ at 12, but it is irrelevant because the second sentence of ESSB 5096 § 11(1)(a) unconstitutionally allocates to Washington all the gains earned from sales occurring *outside* the

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intangible assets (e.g., intellectual property such as patents and copyrights) based on where the intangible property will be used—in-state or out-of-state. RCW 82.04.462(3)(b)(i). If the State's interpretation of *Curry* were correct—that only the state of domicile can tax income from intangibles—this provision would be unconstitutional.

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State's borders when another state chooses not to tax. *See* Plaintiffs' MSJ at 12–13. Contrary to the State's contention, whether other states tax activity within their own borders that contributes to the gain is irrelevant to whether Washington may legally tax the whole gain without apportionment. *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 of one state's tax does not turn on how another state has chosen to exercise its taxing authority). ESSB 5096's failure to limit Washington's apportionment to the gains earned only in Washington establishes the constitutional defect.

In addition, the State grossly mischaracterizes the credit in ESSB 5096 § 11(2)(a) by asserting that it covers "taxes lawfully paid to another state." State's Opp. at 11. The credit is extended only to "capital gains derived from capital assets within the other taxing jurisdiction," ESSB 5096 § 11(2)(a), but not to circumstances where another state may lawfully impose a tax on the gains. *See* Plaintiffs' MSJ at 14 (giving examples of how this could happen); Plaintiffs' Opp. at 23 (likewise). It is not a "full credit" as the State so blithely asserts. *See* State's Opp. at 11–12. The lack of full credit means that ESSB 5096 does create a "genuine risk of multiple state taxation," State's Opp. at 11, exactly like the state income tax scheme invalidated in *Wynne*. *See* 575 U.S. at 564–69. The State admits there are "circumstances" under ESSB 5096 in which more than one state would impose tax on the same capital gains. State's Opp. at 6; *see also* State's MSJ at 22. This risk of multiple taxation is the exact defect in "internal consistency" for which the *Wynne* Court invalidated Maryland's income tax. 575 U.S. at 564. Moreover, just as in *Wynne*, the constitutionality of Washington's capital gains tax is not dependent on whether *actual* multiple state taxation occurs. The internal consistency test is based on a hypothetical that all states adopt Washington's tax statute, not whether they do so in fact. *Id.* at 562. The possibility that individuals earning capital gains from outside the state *could* bear a higher tax burden than they would bear on gains earned solely within the state means that ESSB 5096 discriminates against interstate commerce and must be invalidated. *See Wynne*, 575 U.S. at 567.

4. ESSB 5096 Discriminates Against Interstate Commerce.

Finally, the State inexplicably claims that the Plaintiffs made no argument that the capital

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gains tax fails the discrimination prong of the *Complete Auto Test*. State's Opp. at 13. But as discussed here and also in Plaintiffs' opening brief at pages 10–15, ESSB 5096 discriminates against interstate commerce by subjecting income earned outside the state to a higher tax burden (via the risk of multiple taxation) than on gains earned solely in the state. As the Supreme Court has explained, this is unconstitutional discrimination:

> among other things, [] a State may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State. ***Nor may a State impose a tax which discriminates against interstate commerce*** either by providing a direct commercial advantage to local business, or ***by subjecting interstate commerce to the burden of multiple taxation***.

Wynne, 575 U.S. at 549–50 (internal citations and quotations omitted) (emphases added); *see also Armco*, 467 U.S. at 644 ("A tax that unfairly apportions income from other States is a form of discrimination against interstate commerce."). The State focuses on only the first example in the discriminatory test—differential treatment of in-state and out-of-state economic interests. *See* State Opp. at 13 (quoting *Wash. Bankers Ass'n v. State*, 198 Wn.2d 418, 430, 495 P.3d 808 (2021)). It ignores that states are also precluded from discriminating by burdening interstate commerce with the risk of multiple taxation through lack of apportionment. *Armco*, 467 U.S. at 644; *Gwin*, 305 U.S. at 438–39. ESSB 5096 fails this constitutional requirement.

B. ESSB 5096 Imposes an Impermissible Property Tax Under the Washington State Constitution

The State calls Plaintiffs' arguments that ESSB 5096 is a tax on income "patently specious," State's Opp. at 17 (quoting *St. Paul & Tacoma Lumber Co. v. State*, 40 Wn.2d 347, 354, 243 P.2d 474 (1952)), yet it is the State that mischaracterizes the very nature of an excise tax in its continuing quest to impose an income tax against the voters' will and the Washington Constitution. This time, relying entirely on the IRS income tax returns that Washington residents must file, the Legislature levies a tax on the same long-term capital gains that are indisputably characterized as "income" under federal law, as ESSB 5096 itself recognizes and calls out. Like the income tax from which it is derived, the capital gains tax is levied annually, not at the time of each transaction. Like income taxes, it is levied not on the value of the property sold in a

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transaction, but on an individual's gains from holding, managing, and growing the asset over a period longer than 12 months. Like an income tax, it is based on an aggregate calculation of an individual's capital gains over the course of a year from all sources, taking into consideration various deductions and exclusions, to arrive at a single annual income figure. And like income, the tax is levied on all long-term capital gains of an individual, regardless where on earth the gains are earned, regardless of whether the gains result from voluntary transactions, and without concern that the state confers no right or privilege to facilitate the underlying transfer that would entitle it to charge an excise.

The State agrees that the legal test for a property tax is whether it is an "'absolute and unavoidable' tax levied on the property owner as a consequence of ownership." *See* State's MSJ at 9 (citations omitted). But the State goes astray because it applies this test to the wrong "property." *Id.* at 10–11. The State mischaracterizes ESSB 5096 as a "tax on the sale or transfer of property," and argues that such taxes are excise taxes. *Id.* at 11. But as Plaintiffs have explained at length, ESSB 5096 is *not* a tax on "the sale or transfer" of capital assets. *See* Plaintiffs' MSJ at 16–22; Plaintiffs' Opp. at 11–17. Instead, ESSB 5096 levies a tax on receipt, and thus ownership, of capital gains. *See Jensen v. Henneford*, 185 Wash. 209, 219, 53 P.2d 607 (1936) ("The right to receive" is an incident of property ownership). Because the State's legal premise is false, the State's argument that ESSB 5096 levies an excise tax rather than a property tax must be rejected.

Plaintiffs previously explained why ESSB 5096 meets the test Washington courts have stated for a property tax, an "absolute and unavoidable" tax. *See* Plaintiffs' Opp. at 13–17. To dodge that test, the State argues without providing a foundation or basis, that the tax "applies only upon *voluntary* sales of long-term capital assets." State's Opp. at 15 (emphasis added). That is plainly false. Plaintiffs have identified numerous scenarios where the sale or transfer of a capital asset would occur without any voluntary act by the taxpayer, and thus be unavoidable. Plaintiffs' Opp. at 14. In many scenarios, the taxpayer would be powerless to prevent the sale or transfer (e.g., minority shareholder, non-managing member of LLC, trust beneficiary). Because ESSB 5096 requires no voluntary act by the taxpayer it is an "unavoidable" property tax.

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Moreover, if the legal owner of the asset who transfers title or ownership is not an individual, then the legal owner is not liable for the tax on the transaction, unlike every other excise tax identified by the State. *See* Plaintiffs' Opp. at 13–14 (examples in which legal owner is pass-through entity such as "partnership, limited liability company, S corporation, or grantor trust"). And unlike excise taxes relied on by the State, no tax accrues in connection with the transaction itself. Instead, an individual taxpayer becomes personally liable for the tax *annually* based on a complex set of calculations, deductions, and exclusions, all derived from annual federal *income* tax reporting.[7] Even the State admits the fundamental distinction between "annually imposed income taxes," State's MSJ at 15, and excise taxes imposed and reported in connection with specific transactions.

The State's effort to re-imagine an annual tax on aggregate capital gains earned anywhere in the world and derived from federal income tax returns to be an "excise tax" is simply not credible. *See Kunath*, 10 Wn. App. 2d at 215 ("scheme [that] hewed closely to federal corporate income tax law" held to be an unconstitutional property tax). And except to contest Mr. Mercier's testimony, the State never disputes that the federal government, and every state that taxes capital gains,[8] all define gains as income. Although his declaration is admissible,[9] the Court is not required

[7] In response to Plaintiffs' arguments about annual calculations of capital gains involving deductions and exemptions, the State argues it "is inherent in the exercise of the power to tax that a state be free to select the objects or subjects of taxation and to grant exemptions." State's Opp. at 21. But the Legislature's authority here is constrained by the Article VII uniformity clause, which ESSB 5096 violates. *See Kunath v. City of Seattle*, 10 Wn. App. 2d 205, 221, 444 P.3d 1235 (2019) ("breadth of the taxing authority from this statute, however, is not so great as to overwhelm article VII, section 1 of our constitution"). Moreover, even though permissible, the State's choices about "who is being taxed, what is being taxed, and how the tax is measured" determine its incidence and whether it is a tax on income or not. *Id.* at 221–22 (citation omitted).

[8] Plaintiffs believe the Court should follow the uniform law of every state that capital gains are income. The State retorts that other states allow graduated income taxes. This argument is inane—those states have different constitutions, but here, *stare decisis* mandates that income taxes obey constitutional limitations on property taxes.

[9] The State's motion to strike the Declaration of Jason Mercier, State's Opp. at 18 n.4, should be denied. Mr. Mercier testifies as an expert on tax policy. Mercier Decl. ¶ 2. His opinions on taxing capital gains are based on a state-by-state survey he conducted. *See id.* ¶¶ 1, 4–5. The survey results are "'of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject.'" *See State v. Mohamed*, 186 Wn.2d 235, 242, 375 P.3d 1068 (2016) (quoting ER 703). His general opinion is admissible even if the underlying correspondence is not. Additionally, Exhibit C to the Mercier declaration is a report on ESSB 5096 prepared by the Washington Department of Revenue that is an admission of a party-opponent. ER 801(d)(2).

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to rely just on Mr. Mercier's 50-state survey and expert opinion establishing that states uniformly treat capital gains as income because statutory law in each state confirms his statement and obviously controls.[10]

Comparing the capital gains tax with the real property excise tax is instructive, State's Opp. at 15, but the State mistakes the lesson taught by *Mahler v. Tremper*, 40 Wn.2d 405, 243 P.2d 627 (1952). Most significantly, *Mahler* approved an excise tax on the privilege, conferred by the State, of transferring legal title and ownership to real property in Washington, and measured based on the sales price of the property. Unlike the real estate excise tax, ESSB 5096 does *not* apply "upon the act or incidence of transfer," but, like a property tax, is imposed upon the owner "merely because he is the owner of the property involved." *Id.* at 410. Moreover, unlike the real estate excise tax, ESSB 5096 does not tax the value of the underlying real property asset—what it taxes are the *gains* an individual beneficial owner *realizes* when capital asset(s) she has owned for longer than 12 months were sold or exchanged over the course of a year, without regard to Washington's role or the taxpayer's role in the eventual transfer. In other words, ESSB 5096 taxes *income*, not a State-privileged transfer of property.

The Washington Supreme Court has rejected similar efforts to recharacterize income taxes as excise taxes. *See* Plaintiffs' MSJ at 17–20 (discussing cases). An excise tax may be levied on "a substantive privilege granted or permitted by the state," *Jensen*, 185 Wash. at 218, and every

[10] *See, e.g.*, Ala. Code §§ 40-18-6.1 & 40-18-8.1 (addressing treatment of capital gains within income tax code); Ariz. Rev. Stat. § 43-1022 (income tax subtraction for capital gains); Ark. Code § 26-51-706 (capital gains taxed under income tax code); Col. Rev. Stat. § 39-22-518 (income tax modification for net capital gains); Cal. Rev. & Tax Code § 18151 (income tax code applying federal tax provisions on capital gains and losses); Conn. Gen. Stat. § 12-506 (taxing capital gains as income); Hawaii Rev. Stat. § 235-51(e)–(f) (taxing capital gains as income); Idaho Code § 63-3022H (allowing deduction for capital gains from state income tax); 35 Ill. Comp. Stat. 5/203(a)(2) (income tax modification for capital gains); Ind. Code § 6-3-2-2 (addressing capital gains within income tax code); Iowa Admin. Code § 40.38 (income tax deduction for net capital gains); Kan. Stat. § 79-3276 (addressing capital gains in income tax code); La. Rev. Stat. § 47:293 (addressing capital gains in income tax code); Mich. Comp. Laws § 206.112 (addressing allocation of capital gains within income tax code); Mont. Code Ann. §§ 15-30-2301 & 15-30-3704 (addressing capital gains in income tax code); N.D. Cent. Code § 57-38-30.3 (addressing capital gains in income tax code); Ohio Rev. Code § 5747.01(34) (addressing treatment of capital gains in income tax code); Or. Rev. Stat. §§ 314.635 & 316.737 (allocating capital gains and losses for taxes based on income); R.I. Gen. Laws § 44-30-2.6(b) (imposing income tax on capital gains); Utah Code § 59-10-1022 (granting tax credit for capital gains against state income tax).

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excise tax case that the State cites shares this element. *See* Plaintiffs' Opp. at 16 (discussing cases). The State fails to identify any "substantive privilege" that Washington confers as to sales or transfers of capital assets that occur outside the state. Because Washington lacks power to regulate or tax these out-of-state transactions, ESSB 5096 cannot be the excise tax it purports, which means the only privilege it may tax is the privilege of receiving income. But a tax on an individual's "privilege of receiving income" is merely a tax on income. *Jensen*, 185 Wash. at 217–18.[11]

The State claims that *stare decisis* "supports the State, not Plaintiffs," because *Culliton* and *Jensen* "both involved unavoidable taxes on the receipt of income during the taxable year, not taxes on the voluntary sale of property." State's Opp. at 22. The only difference between the Act and the invalidated excise tax on the "privilege of receiving income" in *Jensen*, 185 Wash. at 218, or the invalidated "corporation excise tax" "for the privilege of exercising its corporate franchise in this state" in *Power, Inc. v. Huntley*, 39 Wash.2d 191, 193, 235 P.2d 173 (1951), is that ESSB 5096 imposes the tax on "the privilege of receiving" just one type of annual income: capital gains.

The State closes its defense of ESSB 5096 with false analogies and specious comparisons, including (i) an irrelevant apples-to-oranges comparison to Washington's use of federal estate tax forms for its estate tax, (ii) reliance on the Legislature's power "to make classifications for purposes of regulatory laws," which is not contested but is obviously subject to constitutional limitations, and (iii) asserting the Legislature faces "no constitutional problem" when it selectively taxes some activities while exempting others. *See* State's Opp. at 20–21. Although the Legislature may possess such power, its selections as to who and what is taxed dictate the *kind* of tax levied.

C. ESSB 5096 Imposes an Impermissible Tax on Some Persons While Exempting Others in Violation of the State Privileges and Immunities Clause

The State's arguments that ESSB 5096 does not violate the Privileges and Immunities Clause fail for the same reasons they fail in its own motion for summary judgment. *See* Plaintiffs'

[11] The State's simplistic retort that business owners pay B&O tax on "income" barely merits response. State's Opp. at 16–17 (citing *State ex rel. Stiner v. Yelle*, 174 Wash. 402, 25 P.2d 91 (1933)). The State has the power to impose a tax for the *privilege* of conducting business *within* Washington *measured* by the extent of the business conducted, i.e., gross revenues. The State lacks power to tax individuals' *receipt* of capital gains because it confers no such privilege.

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Opp. at 20–21. First, as discussed in Plaintiffs' briefs, ESSB 5096 implicates "a fundamental right" that belongs to all citizens of the State—the right to be exempt from taxes from which other citizens or corporations are exempt. *See Grant Cty. Fire Prot. Dist. No. 5 v. City of Moses Lake*, 150 Wn.2d 791, 812-13, 83 P.3d 419 (2004); Plaintiffs' MSJ at 25–26; Plaintiffs' Opp. at 20–21. The State tries to argue that no such right exists because the state tax code is replete with provisions that are applicable to some Washington residents but not others. *See* State's Opp. at 24–25. But the State confuses application of the tax based on participation in the activity (such as transfer of assets at death, engaging in particular business, or selling real estate) with application of the tax based on the identity of the person. In each of the State's cited examples, the Legislature has imposed the tax on all "persons" whose activity is subjected to tax. *See, e.g.*, RCW 82.04 (B&O tax); RCW 82.29A (leasehold excise); RCW 83.100 (estate tax). It has not subjected some persons to tax but excluded others who engage in the same activity. In contrast, ESSB 5096 purports to tax the "activity" of selling or exchanging long-term capital assets for gain, but requires only individuals to pay the tax. ESSB 5096 § 5. It exempts non-natural persons from paying the tax even when they engage in the same activity as natural persons and thus are in the same class. ESSB 5096 plainly implicates the fundamental right of natural persons to be exempt from a tax from which other Washington taxpayers, such as corporations, are exempt.

Second, the State's hypothetical reasons for why the Legislature would create this distinction are not supported by the text of ESSB 5096. *See* State's Opp. at 26. The Washington Supreme Court has said that it "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." *Schroeder v. Weighall*, 179 Wn.2d 566, 574, 316 P.3d 482 (2014) (internal citations omitted). The State focuses on the legislative distinction of imposing the tax only on the state's "wealthiest residents" and exempting those whose gains are less than $250,000. State's Opp. at 26. This speaks only to a policy concern over income disparities among individuals; it says nothing about why the Legislature would impose the tax only on individuals as opposed to imposing the tax on any person owning capital assets that sells those assets for gain. This

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distinction does not in fact support the Legislature's stated purpose for imposing the tax, and thus unconstitutionally places the tax burden only on a select subset within the relevant class of taxpayers in violation of Article I, Section 12.

III. 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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CERTIFICATE OF SERVICE

I hereby certify under penalty of perjury of the laws of the State of Washington that on the date listed below, I caused to be served a copy of the foregoing document on the following persons in the manner indicated:

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DATED this 21st day of January, 2022.

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