

Initiative 2109, to repeal the capital gains income tax

By Paul Guppy, Vice President for Research

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Key Findings

1. **Initiative 2109 is a citizens' initiative that would repeal Washington's capital gains income tax.**
2. **In 2021 lawmakers passed SB 5096, imposing a 7% tax on capital gains income of \$250,000 or more.**
3. **The bill was seen as unconstitutional. The state constitution bars an income tax unless it is applied equally at a uniform rate of up to one percent.**
4. **Lawmakers got around this provision by labeling the capital gains income tax as an "excise" tax. The state supreme court, in a split decision that overturned its own past rulings, accepted this wording maneuver.**
5. **A state income tax is highly unpopular. Washington voters have rejected income tax ballot measures ten times, by margins as high as 78%.**
6. **The new income tax resulted in economic losses to the state, by discouraging investment and because some businesses have re-located to no-income-tax states.**
7. **If the legislature takes no action on Initiative 2109 the measure will appear on the November general election ballot, where voters will decide whether Washington should again adopt a policy of having no state income tax.**

Initiative sponsors needed to collect 324,516 valid signatures (8% of the votes cast in the last election for governor) by December 31st to submit the measure for consideration in the 2024 legislative session.

By the end of December Initiative 2109 supporters had collected 454,372 signatures.¹ The signatures were submitted to the Secretary of State's office for verification and certification. On January 23rd the Secretary of State certified the initiative and forwarded it to the legislature for consideration.²

Lawmakers have three choices:³

- They can enact the initiative into law as is (the governor's signature is not required);
- They can take no action, in which case the initiative is forwarded to voters on the November 2024 general election ballot. If voters approve the initiative it becomes law;
- They can pass their own alternative version, in which case both versions, the original and the legislature's, will appear on the November 2024 ballot. Voters will first decide whether either version should become law and, if so, indicate on the same ballot which one should pass.

Introduction

A group of concerned citizens called Let's Go Washington has gathered enough signatures to present a people's initiative to the legislature, Initiative 2109, which would repeal the state's "excise tax" on income of \$250,000 or more from the sale of certain capital assets. Because the state assesses the tax based on income earned from capital gains it functions as an income tax.

- 1 "Let's Go Washington Turns in Over 2.6 Million Signatures of Six Landmark Initiatives," by Let's Go Washington, December 28, 2023, at <https://letsgowashington.com/lets-go-washington-turns-in-over-2-6-million-signatures-for-all-six-landmark-initiatives/>.
- 2 "Secretary Hobbs notifies Legislature of Initiative No. 2109 certification," Washington Secretary of State, January 23, 2024, at <https://www.sos.wa.gov/about-office/news/2024/secretary-hobbs-notifies-legislature-initiative-no-2109-certification>.
- 3 "Initiative and Referenda Handbook – 2024," Washington Secretary of State, accessed 2-8-24, at <https://www.sos.wa.gov/sites/default/files/2022-06/initiative-and-referenda-handbook-2022.pdf>.

Text of Initiative 2109

A graduated income tax is specifically barred under the state constitution's uniformity clause. In defense of this long-standing constitutional principle, income tax opponents filed a legal challenge against SB 5096, the capital gains income tax law passed by the legislature in 2021.

In order to find a way to uphold a graduated income tax on capital gains, seven of the nine judges on the Washington state supreme court overturned decades of their own legal precedents. They labeled the 2021 tax as an "excise tax."⁴ The amount of the tax is derived by imposing a tax of 7% on income of \$250,000 or more earned from capital gains.⁵

Initiative 2109 would repeal the income tax on capital gains passed by the legislature in 2021 and restore the long-standing constitutional policy that Washington does not have a state income tax.⁶

Here is the official ballot title and summary for Initiative 2109.⁷

Ballot Title:

"This measure would repeal an excise tax imposed on the sale or exchange of certain long-term capital assets by individuals who have annual capital gains of over \$250,000. Should this measure be enacted into law?"

Ballot Measure Summary:

"This measure would repeal an excise tax imposed on the sale or exchange of certain long-term assets by individuals who have annual capital gains of over \$250,000."

History of income tax proposals in Washington State

A state income tax is highly unpopular in Washington. Income tax proposals have been defeated by voters ten times. Since adding the broadest definition of property in the country to the state constitution in the 1930s, Washington voters have rejected six constitutional amendments to change this definition and allow a graduated income tax. Voters have turned down a change in the constitution's ban on a graduated state income in 1934 (57% no vote), 1936 (78% no vote), 1938 (67% no vote), 1942 (66% no vote), 1970 (68% no vote) and 1973 (77% no vote).⁸

In addition, Washington residents have voted four times against proposed ballot measures to impose a state income tax: In 1944 (70% no vote), 1975 (67% no vote), 1982 (66% no vote) and 2010 (64% no vote).⁹

Although a graduated income tax is unconstitutional, a uniform income tax of up to one percent is permitted by the state constitution if passed by voters or the legislature, although even a flat state income tax remains highly unpopular. For example, no successful governor candidate in the modern era has campaigned on a promise of imposing a state income tax of any kind, whether a flat tax or a graduated tax.

State adoption of a capital gains income tax

The legislature in 2021 redefined a capital gains income tax as an excise tax in a semantic effort to avoid the constitutional prohibition on graduated income taxes. An excise tax is a tax "imposed on certain goods, services and activities," not a tax on realized gains from

4 "Quinn v. State, Case No. 100769-8," Washington State Supreme Court ruling, March 24, 2023, at <https://www.washingtonpolicy.org/library/docLib/100769-8-Opinion.pdf>, and "State supreme court breaks precedent, opens door for state income taxes," by Jason Mercier, Washington Policy Center, March 24, 2023, at <https://www.washingtonpolicy.org/publications/detail/state-supreme-court-breaks-precedent-opens-door-for-state-income-taxes>.

5 "SB 5096, Concerning an excise tax on gains from the sale or exchange of certain capital assets," Washington legislature, introduced January 6, 2021, at <https://app.leg.wa.gov/bills/summary?BillNumber=5096&Year=2021&Initiative=false>.

6 "No sugar coating it – Washington no longer income tax free," by Jason Mercier, Guest Opinion, The Spokesman-Review, April 5, 2023, at <https://www.spokesman.com/stories/2023/apr/05/jason-mercier-no-sugar-coating-it-washington-no-lo/>.

7 "Initiative No. 2109," letter from Jeffery T. Even, Deputy Solicitor General to Steve Hobbs, Washington Secretary of State, May 30, 2023, at https://www2.sos.wa.gov/assets/elections/initiatives/ballottitleletter_3029.pdf.

8 "History of income tax votes in Washington," by Jason Mercier, Washington Policy Center, October 17, 2016, at <https://www.washingtonpolicy.org/publications/detail/history-of-income-tax-votes-in-washington>.

9 Ibid.

selling an investment.¹⁰ By claiming the bill would impose an excise, or transaction tax, lawmakers could argue that they were not taxing income but rather they were taxing a transaction, similar to the state's existing Real Estate Excise Tax (REET) levied on the act of selling a home. The REET, like other excise taxes, is levied on the dollar value of the transaction, not on the amount of profit or income.

This wording change, however, did not accord with long-standing precedents of Washington courts. For nearly 100 years, the state Supreme Court has ruled that Washingtonians own their income, which means income is property. This is why a graduated income tax (non-uniform and taxed at a rate of more than 1%) is unconstitutional in the state.¹¹

In passing SB 5096 lawmakers ignored over a century of tax law that says that capital gains is income and that Washington residents own their income. This maneuver represented a unique and unprecedented word shift. Every other state in the country properly defines capital gains taxes as income taxes, not excise taxes.¹²

At the federal level the Internal Revenue Service, responding to the question about the legal definition of "income" posed by Congressman Dan Newhouse, stated:

*"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. More specifically, capital gains are treated as income under the tax code and taxed as such."*¹³

The constitutionality of the tax was the subject of a lawsuit on this very issue in *Quinn v. State* which was argued before the Washington supreme court. As noted, the court ruled the tax constitutional in a 7-2 split decision.¹⁴ The majority of justices accepted the false argument that, because Washington lawmakers had defined the 2021 capital gains tax bill as imposing an "excise" tax, SB 5096 it was not subject to the uniformity clause of the state constitution.

The dissenting justices, however, offered a much simpler legal answer:

"In Washington, income is property. A Washington 'capital gains tax' is therefore a property tax. The problem is that in Washington, our constitution limits any such property tax to one percent annually. The Washington Legislature nevertheless enacted a new law, [SB 5096], which taxes 'capital gains' at seven percent annually. That's more than one percent."

*"This new 'capital gains' tax therefore constitutes a property tax that violates the Washington Constitution's 'one percent' annual limit on such a 'property' tax."*¹⁵

The benefit of the no-income-tax policy

In addition to being popular, Washington's long-standing no-income-tax policy has brought significant economic benefits to the state. For many decades this fiscal policy had bipartisan support, providing a point of agreement across the political spectrum and forming a united position for Washington in relation to tax policy in other states.

A range of elected and business leaders have promoted Washington's policy of not taxing income as important to attracting investment, encouraging business formation, and helping to recruit talented and creative people to come to Washington. Until very recently the state

10 "Excise Taxes," Business taxes, Businesses and Self-Employed, Internal Revenue Service, accessed February 14, 2024, at <https://www.irs.gov/businesses/small-businesses-self-employed/excise-tax>.

11 "Washington's constitution has the broadest definition of property in the country," by Jason Mercier, Washington Policy Center, August 28, 2022, at <https://www.washingtonpolicy.org/publications/detail/washingtons-constitution-has-broadest-definition-of-property-in-the-country>.

12 "Washington versus the world on capital gains income taxes," by Jason Mercier, Blogpost, Washington Policy Center, March 25, 2023 at <https://www.washingtonpolicy.org/publications/detail/washington-versus-the-world-on-capital-gains-income-taxes>.

13 "Letter to Congressman Dan Newhouse," from Paul Axelson, Legislative Affairs Office, Internal Revenue Service, September 25, 2018, at <https://www.washingtonpolicy.org/library/docLib/IRS-Response-Newhouse-Capital-Gains-Tax.pdf>.

14 "*Quinn v. State*, Case No. 100769-8," majority ruling, Washington State Supreme Court, March 24, 2023, at <https://www.washingtonpolicy.org/library/docLib/100769-8-Opinion.pdf>.

15 "*Quinn v. State*, Case No. 100769-8," Gordon McCloud, J. dissenting, "'Capital Gains' are income," Washington State Supreme Court, March 24, 2023, at <https://www.washingtonpolicy.org/library/docLib/100769-8-Opinion.pdf>.

Department of Commerce listed “No income tax” as a primary benefit for re-locating or starting a business in Washington.¹⁶

The enactment of an capital gains income tax in 2021 has since weakened that advantage. Business owners rarely advertise why they have decided to pull out of a particular state. In the case of Washington’s capital gains income tax, however, two notable exceptions stand out.

In March 2023, shortly before the capital gains income tax went in to effect, longtime Washington-based firm Fisher Investments announced it was re-locating its headquarters office from Camas, Washington to Plano, Texas. Texas has no state income tax. The firm employed 1,800 people in Washington and manages some \$197 billion worldwide.¹⁷

Similarly, in October 2023 billionaire Jeff Bezos announced he was relocating his residence from Seattle, Washington to Maimi, Florida. Florida has no state income tax. Six days later Mr. Bezos, in a regulatory filing, indicated he planned to sell 50 million shares of Amazon stock. Based on the 7% rate, the change in residence saved him some \$600 million by avoiding Washington’s capital gains income tax.¹⁸

A partisan majority of the legislature ignored the people’s wishes and passed SB 5096 anyway, in an effort to impose an income tax by re-wording it as an “excise tax.” By this maneuver they sought to avoid the constitutional limitations on property taxes the people had enacted in Washington state. A majority of the state supreme court acceded to this superficial word switch while ignoring the true meaning of the policy as understood by officials in 49 states and the federal government.

As a result, a popular movement emerged in 2023 to qualify a people’s initiative to the legislature that seeks to restore the pre-2021 policy of no state income tax in Washington. Sponsors collected over 100,000 more signatures than they needed. That measure is Initiative 2109. Lawmakers may act on it or forward it to voters on the general election ballot in November. In either case, the outcome will determine whether or not Washington will again adopt a policy of having no state income tax.

Conclusion

The imposition of a capital gains income tax is an example of a policy imposed over the strong objections of a majority of the people of Washington state. Washington voters clearly do not want an income tax imposed at the state or local level, having consistently voted against such a policy ten times, most recently (in 2010) by a margin of nearly two-to-one. The rejected income tax measures included six proposed amendments to the constitution and four proposed laws.

Paul Guppy is the Vice President for Research..

Nothing here should be construed as an attempt to aid or hinder the passage of any legislation before any legislative body.

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16 “‘Choose Washington’ – No income tax,” by Jason Mercier, Washington Policy Center, January 18, 2021, at <https://www.washingtonpolicy.org/publications/detail/choose-washington-no-income-tax>.

17 “Fisher Investments pulls out of Washington in wake of capital gains tax decision,” by Paige Browning and Dyer Oxley, News and Stories/Business, KUOW Radio March 28, 2023 at, <https://www.kuow.org/stories/fisher-investments-pulls-out-of-washington-in-wake-of-capital-gains-tax-decision>.

18 “Jeff Bezos to save \$600M selling stock in Florida, not Washington,” by Spencer Pauley, The Center Square, February 5, 2024, at https://www.thecentersquare.com/washington/article_b854737c-c462-11ee-b459-3b53dda49da0.html.