



POLICY BRIEF

Why Washington's capital gains income tax is unconstitutional

By Jason Mercier,
Director, Center for Government Reform

August 2022

Key Findings

1. A comparative study finds Washington's constitution has the broadest definition of property of any state.
2. As a result, for nearly 100 years the state supreme court has ruled that Washingtonians own their income because it is their property.
3. The supreme court has repeatedly ruled a graduated income tax is illegal unless the state constitution is amended first.
4. Voters rejected a constitutional amendment to allow a graduated income tax in 1934, 1936, 1938, 1942, 1970 and 1973, most recently by a 77% "no" vote.
5. Voters rejected income tax ballot initiatives in 1944, 1975, 1982 and 2010, most recently by a 64% "no" vote.
6. Given the legal facts, the state supreme court should reject the latest attempt to circumvent the will of the people as clearly expressed in the constitution and at the ballot box.



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Introduction

In April 2021 the Washington legislature voted to impose a state income tax. The tax applies to “high earners” who receive capital gains income.¹ Governor Inslee signed the bill on May 4, 2021.

Previously, Washington was one of only nine states that did not impose a personal income tax on its citizens.² Once established, history shows that income taxes are expanded to more taxpayers with higher rates until most middle-income and working families have to pay it. This has been the historical experience of every major tax imposed by the state.

The income tax on capital gains is being challenged in court.³ Washington's constitution provides that all taxes shall be applied equally to the same class of property, and that the rate can be no more than one percent. Income tax advocates argue that a person's income is not his property, and that imposing the tax and its high seven percent rate on high earners should be allowed.

The legal question is: Do you own your income?

At the trial court level the Douglas County Superior Court found the answer is “Yes,” and ruled the capital gains income tax unconstitutional.⁴ The case is now on appeal to the state supreme court.

This study presents a comparison of state constitutions, finds Washington has the broadest definition of property of any state, shows how the capital gains income tax is illegal, and lists the several times the people have used democratic means to reject efforts to amend the state constitution and allow a graduated income tax.

Washington has the broadest definition of “property”

Although most state constitutions mention how real, personal, tangible or intangible property should be taxed, the vast majority don't define those terms. Of those state constitutions that define property, Washington's constitution has the broadest definition. This is why our state supreme court has repeatedly ruled that in

1 ESSB 5096, “concerning an excise tax on gains from the sale or exchange of certain capital assets,” introduced by Senator June Robinson (D – Everett), Washington state legislature, passed April 24, 2021, at <https://apps.leg.wa.gov/billsummary/?BillNumber=5096&Year=2021&Initiative=false>. “High-earners” are those with \$250,000 in annual capital gains or more.

2 Nine States With No Income Tax,” by Jim Probasco, Investopedia, July 19, 2022, at <https://www.investopedia.com/financial-edge/0210/7-states-with-no-income-tax.aspx>.

3 The case is Quinn/Clayton et al. v. State of Washington et al.

4 “Notice of Appeal to the Washington Supreme Court,” Douglas County Superior Court, Case No. 21-2-00075-09, March 1, 2022, at <https://www.washingtonpolicy.org/library/docLib/NoticeOfAppeal.pdf>.

order to impose a graduated income tax, the constitution must be amended. In the past Washington voters have overwhelmingly rejected such an amendment six times.⁵

Our broad constitutional definition of property is also why earlier this year, a Governor Jay Inslee-appointed judge ruled that the capital gains income tax is “*declared unconstitutional and invalid and, therefore, is void and inoperable as a matter of law.*”

Here is how Washington’s constitution defines property (emphasis added):

All taxes shall be uniform upon the same class of property within the territorial limits of the authority levying the tax and shall be levied and collected for public purposes only. **The word ‘property’ as used herein shall mean and include everything, whether tangible or intangible, subject to ownership.**⁶

This definition of property wasn’t part of the state’s original constitution but instead was adopted by 61% of the voters in 1930.⁷

For nearly 100 years, the state supreme court has ruled that Washingtonians own their income, meaning it is property. This is why a graduated income tax (non-uniform and at more than 1% of value) requires a constitutional amendment.

Comparison with property definitions in other states

Of those states that do define property in their constitution, no definition is as expansive as Washington. Here are examples:

- Arkansas Constitution – “The General Assembly may classify intangible personal property for assessment at lower percentages of value than other property and may exempt one or more classes of intangible personal property from taxation, or may provide for the taxation of intangible personal property on a basis other than ad valorem.”
- California Constitution – “The Legislature shall enact laws that define earned income. However, earned income does not include any community property interest in the income of a spouse.”
- Colorado Constitution – “The general assembly may levy income taxes, either graduated or proportional, or both graduated and proportional, for the support of the state, or any political subdivision thereof, or for public schools, and may, in the administration of an income tax law, provide for special classified or limited taxation or the exemption of tangible and intangible personal property.”
- Georgia Constitution – “Except as otherwise provided in this subparagraph (b), classes of subjects for taxation of property shall consist of tangible property and one or more classes of intangible personal property including money; provided, however, that any taxation of intangible personal property may be repealed

5 “Income tax ballot measures, 1932 to 2022,” Election Results, Office of the Secretary of State, Washington, accessed August 29, 2022, at <https://www.sos.wa.gov/elections/research/income-tax-ballot-measures.aspx>.

6 “Washington State Constitution,” as amended, at <https://www.washingtonpolicy.org/library/docLib/NoticeOfAppeal.pdf>.

7 “Constitutional Amendment to Article VII, Section 1 – 4,” as proposed by House Joint Resolution 13, General Election, November 1930, Election Results, Office of the Secretary of State, Washington, at https://www.sos.wa.gov/elections/results_report.aspx?e=103&c=&c2=&t=&t2=&p=&p2=&y=

by general law without approval in a referendum effective for all taxable years beginning on or after January 1, 1996.”

- Illinois Constitution – “(a) The General Assembly by law may classify personal property for purposes of taxation by valuation, abolish such taxes on any or all classes and authorize the levy of taxes in lieu of the taxation of personal property by valuation. (b) Any ad valorem personal property tax abolished on or before the effective date of this Constitution shall not be reinstated. (c) On or before January 1, 1979, the General Assembly by law shall abolish all ad valorem personal property taxes and concurrently therewith and thereafter shall replace all revenue lost by units of local government and school districts as a result of the abolition of ad valorem personal property taxes subsequent to January 2, 1971. Such revenue shall be replaced by imposing statewide taxes, other than ad valorem taxes on real estate, solely on those classes relieved of the burden of paying ad valorem personal property taxes because of the abolition of such taxes subsequent to January 2, 1971. If any taxes imposed for such replacement purposes are taxes on or measured by income, such replacement taxes shall not be considered for purposes of the limitations of one tax and the ratio of 8 to 5 set forth in Section 3(a) of this Article.”
- Kentucky Constitution – “All property, whether owned by natural persons or corporations, shall be taxed in proportion to its value, unless exempted by this Constitution; and all corporate property shall pay the same rate of taxation paid by individual property. Nothing in this Constitution shall be construed to prevent the General Assembly from providing for taxation based on income, licenses or franchises.”
- Maine Constitution – “The Legislature shall have power to levy a tax upon intangible personal property at such rate as it deems wise and equitable without regard to the rate applied to other classes of property.”
- Missouri Constitution – “All taxable property shall be classified for tax purposes as follows: class 1, real property; class 2, tangible personal property; class 3, intangible personal property. The general assembly, by general law, may provide for further classification within classes 2 and 3, based solely on the nature and characteristics of the property, and not on the nature, residence or business of the owner, or the amount owned. Nothing in this section shall prevent the taxing of franchises, privileges or incomes, or the levying of excise or motor vehicle license taxes, or any other taxes of the same or different types.”
- Nebraska Constitution – “(1) Taxes shall be levied by valuation uniformly and proportionately upon all real property and franchises as defined by the Legislature except as otherwise provided in or permitted by this Constitution; (2) tangible personal property, as defined by the Legislature, not exempted by this Constitution or by legislation, shall all be taxed at depreciated cost using the same depreciation method with reasonable class lives, as determined by the Legislature, or shall all be taxed by valuation uniformly and proportionately... Taxes uniform as to class of property or the ownership or use thereof may be levied by valuation or otherwise upon classes of intangible property as the Legislature may determine, and such intangible property held in trust or otherwise for the purpose of funding pension, profit-sharing, or other employee

benefit plans as defined by the Legislature may be declared exempt from taxation. Taxes other than property taxes may be authorized by law... When an income tax is adopted by the Legislature, the Legislature may adopt an income tax law based upon the laws of the United States.”

- Nevada Constitution – “The Legislature shall provide by law for a uniform and equal rate of assessment and taxation, and shall prescribe such regulations as shall secure a just valuation for taxation of all property, real, personal and possessory, except mines and mining claims, which shall be assessed and taxed only as provided in Section 5 of this Article... No income tax shall be levied upon the wages or personal income of natural persons. Notwithstanding the foregoing provision, and except as otherwise provided in subsection 1 of this Section, taxes may be levied upon the income or revenue of any business in whatever form it may be conducted for profit in the State.”
- New York Constitution – “Notwithstanding the foregoing or any other provision of this constitution, the legislature, in any law imposing a tax or taxes on, in respect to or measured by income, may define the income on, in respect to or by which such tax or taxes are imposed or measured, by reference to any provision of the laws of the United States as the same may be or become effective at any time or from time to time, and may prescribe exceptions or modifications to any such provision...Intangible personal property shall not be taxed ad valorem nor shall any excise tax be levied solely because of the ownership or possession thereof, except that the income therefrom may be taken into consideration in computing any excise tax measured by income generally. Undistributed profits shall not be taxed.”
- North Carolina Constitution – “The proceeds of all lands that have been or hereafter may be granted by the United States to this State, and not otherwise appropriated by this State or the United States; all moneys, stocks, bonds, and other property belonging to the State for purposes of public education”
- South Carolina Constitution – “The General Assembly may define the classes of property and values for property tax purposes of the classes of property set forth in Section 1 of this article and establish administrative procedures for property owners to qualify for a particular classification.”
- South Dakota Constitution – “Classification of property for taxation-- Income. To the end that the burden of taxation may be equitable upon all property, and in order that no property which is made subject to taxation shall escape, the Legislature is empowered to divide all property including moneys and credits as well as physical property into classes and to determine what class or classes of property shall be subject to taxation and what property, if any, shall not be subject to taxation. Taxes shall be uniform on all property of the same class, and shall be levied and collected for public purposes only. Taxes may be imposed upon any and all property including privileges, franchises and licenses to do business in the state. Gross earnings and net incomes may be considered in taxing any and all property, and the valuation of property for taxation purposes shall never exceed the actual value thereof. The Legislature is empowered to impose taxes upon incomes and occupations, and taxes upon

incomes may be graduated and progressive and reasonable exemptions may be provided.”

- Tennessee Constitution – “The Legislature shall have power to classify intangible personal property into subclassifications and to establish a ratio of assessment to value in each class or subclass, and shall provide fair and equitable methods of apportionment of the value of same to this state for purposes of taxation... Notwithstanding the authority to tax privileges or any other authority set forth in this Constitution, the Legislature shall not levy, authorize or otherwise permit any state or local tax upon payroll or earned personal income or any state or local tax measured by payroll or earned personal income”
- Texas Constitution – “The Legislature may provide for the taxation of intangible property and may also impose occupation taxes, both upon natural persons and upon corporations, other than municipal, doing any business in this State. The Legislature may also tax incomes of corporations other than municipal...The legislature may not impose a tax on the net incomes of individuals, including an individual’s share of partnership and unincorporated association income.”
- Utah Constitution – “The Legislature may by statute determine the manner and extent of taxing or exempting intangible property, except that any property tax on intangible property may not exceed .005 of its fair market value. If any intangible property is taxed under the property tax, the income from that property may not also be taxed...In a statute imposing an income tax, the Legislature may: (a) define the amount on which the tax is imposed by reference to a provision of the laws of the United States as from time to time amended; and (b) modify or provide exemptions to a provision referred to in Subsection (2)(a).”
- Virginia Constitution - “The General Assembly may define and classify taxable subjects. Except as to classes of property herein expressly segregated for either State or local taxation, the General Assembly may segregate the several classes of property so as to specify and determine upon what subjects State taxes, and upon what subjects local taxes, may be levied... Intangible personal property, or any class or classes thereof, as may be exempted in whole or in part by general law.”
- West Virginia Constitution – “No one species of property from which a tax may be collected shall be taxed higher than any other species of property of equal value; except that the aggregate of taxes assessed in any one year upon personal property employed exclusively in agriculture, including horticulture and grazing, products of agriculture as above defined, including livestock, while owned by the producer, and money, notes, bonds, bills and accounts receivable, stocks and other similar intangible personal property shall not exceed fifty cents on each one hundred dollars of value thereon and upon all property owned... The Legislature shall have authority to tax privileges, franchises, and incomes of persons and corporations and to classify and graduate the tax on all incomes according to the amount thereof and to exempt from taxation incomes below a minimum to be fixed from time to time, and such revenues as may be derived from such tax may be appropriated as the Legislature may provide.”

Examples of states that have passed income tax constitutional amendments

Unlike in Washington, lawmakers in other states have successfully received voter approval for income tax constitutional amendments. Here are a few examples:

- Illinois (Adopted 1970): “A tax on or measured by income shall be at a non-graduated rate. At any one time there may be no more than one such tax imposed by the State for State purposes on individuals and one such tax so imposed on corporations. In any such tax imposed upon corporations the rate shall not exceed the rate imposed on individuals by more than a ratio of 8 to 5.”
- Massachusetts (Adopted 1916): “Full power and authority are hereby given and granted to the general court to impose and levy a tax on income in the manner hereinafter provided. Such tax may be at different rates upon income derived from different classes of property, but shall be levied at a uniform rate throughout the commonwealth upon incomes derived from the same class of property. The general court may tax income not derived from property at a lower rate than income derived from property, and may grant reasonable exemptions and abatements. Any class of property the income from which is taxed under the provisions of this article may be exempted from the imposition and levying of proportional and reasonable assessments, rates and taxes as at present authorized by the constitution. This article shall not be construed to limit the power of the general court to impose and levy reasonable duties and excises.”
- Nebraska (Adopted 1966): “When an income tax is adopted by the Legislature, the Legislature may adopt an income tax law based upon the laws of the United States.”
- New Jersey (Adopted 1976): “No tax shall be levied on personal incomes of individuals, estates and trusts of this State unless the entire net receipts therefrom shall be received into the treasury, placed in a perpetual fund designated the Property Tax Relief Fund and be annually appropriated, pursuant to formulas established from time to time by the Legislature, to the several counties, municipalities and school districts of this State exclusively for the purpose of reducing or offsetting property taxes.”

Washington voters have rejected an income tax constitutional amendment six times

After adding the broadest constitutional definition of property in the country in 1930, Washington voters have since rejected constitutional amendments to change this definition and allow a graduated income tax.

Voters rejected the proposal in 1934 (57% no), 1936 (78% no), 1938 (67% no), 1942 (66% no), 1970 (68% no) and 1973 (77% no). Washington voters have also rejected

multiple income tax ballot initiatives in 1944 (70% no), 1975 (67% no), 1982 (66% no) and 2010 (64% no).⁸

Previous attempts by the legislature to circumvent the fact the voters have rejected income tax constitutional amendments have been overturned by the court. In fact, the state supreme court in 1960 reminded income tax advocates that in order to impose a graduated income tax in Washington, the constitution must be amended. From the 1960 state supreme court decision:

“The argument is again pressed upon us that these cases were wrongly decided. The court is unwilling, however, to recede from the position announced in its repeated decisions.

“Among other things, the attorney general urges that the result should now be different because the state is confronted with a financial crisis. If so, the constitution may be amended by vote of the people. Such a constitutional amendment was rejected by popular vote in 1934.”⁹

Income tax advocates want to use the courts to impose an income tax

Despite this clear and consistent message from the courts and voters, some income tax advocates now hope to use the capital gains income tax as a way to change the definition of property by judicial fiat and allow the imposition of a graduated income tax without a constitutional amendment.

Consider the following 2018 e-mail from Sen. Jamie Pedersen:

“But the more important benefit of passing a capital gains tax is on the legal side, from my perspective. The other side will challenge it as an unconstitutional property tax. This will give the Supreme Court the opportunity to revisit its bad decisions from 1934 and 1951 that income is property and will make it possible, if we succeed, to enact a progressive income tax with a simple majority vote.”¹⁰

Joining this strategy of ignoring the voters and hoping the courts will now allow a graduated income tax without a constitutional amendment is the powerful Washington Education Association (WEA).

The WEA on June 30 filed a legal brief with the state supreme court in the capital gains income tax case asking the justices to change their prior rulings and now declare that income isn't property (meaning Washington residents do not own their incomes).¹¹

8 “Income tax ballot measures, 1932 to 2022,” Election Results, Office of the Secretary of State, Washington, accessed August 29, 2022, at <https://www.sos.wa.gov/elections/research/income-tax-ballot-measures.aspx>.

9 “Apartment Operators of Seattle Association v. Schumacher et al,” Washington Supreme Court, En Banc, 56 Wn.2d 46, 351 P2d 124, April 14, 1960, at https://scholar.google.com/scholar_case?case=3297928517238259484&q=Apt.+Operators+Ass%27n+of+Seattle,+Inc.+v.+Schumacher&hl=en&as_sdt=6,48&as_vis=1#p48.

10 Sen. Jamie Pedersen, Dick Nelson, e-mail exchange per public records disclosure, April 30, 2018, at <https://www.washingtonpolicy.org/library/docLib/capgainsemails.pdf>.

11 Intervenors legal brief, In the Supreme Court of the State of Washington, No. 100769-8, filed by Washington Education Association (WEA), April 30, 2022, at <https://www.washingtonpolicy.org/library/docLib/WEAincometax.pdf>.

Conclusion

The proper way to impose a graduated income tax in Washington is with a constitutional amendment. Claiming an income tax is instead an “excise tax” to set up litigation in hopes the state supreme court will now say that we don’t own our income is disingenuous at best and highly contemptible of voters and the norms of governing.

Washingtonians made it crystal clear in 1930 that property “shall mean and include everything, whether tangible or intangible, subject to ownership.” Voters have since rejected six constitutional amendments to change that definition. It is past time for income tax advocates to play by the rules the self-governing voters of the state have adopted in our democracy.

The legal case is clear. The constitution provides that people living in Washington own their income, and that it cannot be taken by the unconstitutional income tax the legislature recently passed. It is time for the state supreme court to reject yet again an attempt to circumvent the will of the people clearly expressed in the constitution and at the ballot box.

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