



# This Week in State Tax (TWIST)

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WASHINGTON



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## Washington State: Capital Gains Excise Tax Does not Violate State Constitution

The Washington State Supreme Court recently reversed a lower court ruling and in doing so upheld the constitutionality of the state's capital gains tax. Enacted in 2021, the capital gains tax is imposed at a rate of 7 percent on an individual's Washington allocated capital gains after a standard deduction of \$250,000 for both individuals and joint filers. The enactment of the tax was controversial, and several plaintiffs filed suit to invalidate the tax on three grounds. First, they argued that the tax was a property tax on income that violated the uniformity and levy limitation requirements for property taxes set forth in the state Constitution. The state, on the other hand, argued that the capital gains tax was an excise tax not subject to the uniformity and levy restrictions. The plaintiffs also alleged that the tax violated the Washington State privileges and immunities clause and the federal dormant commerce clause. After a trial court judge concluded that the capital gains tax was a property tax on income that violated the uniformity clause, the state appealed directly to the state's highest court.

On appeal, the court noted that the central question it must answer was whether the capital gains tax constituted a property tax. The answer to this question was governed by a "steady line of cases," including *Culliton v. Chase* in which the Washington State Supreme Court invalidated a graduated income tax on the grounds that streams of income fell within the definition of property and were therefore protected by the uniformity clause. On appeal, the court held that *Culliton* did not apply. Relying on the state's long history of distinguishing between property taxes—those levied on owners of property merely because they are owners—and excise taxes—those imposed upon the exercise of rights in and to property, such as its lease or sale, the court noted that the state had long permitted taxes *measured* by income so long as they were not imposed *on* income. Because the capital gains tax is imposed on the sale of assets, rather than on their ownership, the court determined that the tax was properly characterized as an excise tax, even though it was measured by taxpayer's gains from those assets.

The court next rejected the privileges and immunities clause challenge on the grounds that there was no fundamental right under the state constitution to be exempt from taxes from which other Washingtonians are exempt. Regardless, the legislature's classification choice (e.g., the \$250,000 exemption) was reasonable. The capital gains tax, in the Court's view, complied with the four-part test from *Complete Auto Transit v. Brady*, meaning there was no dormant commerce clause violation.

A two-justice dissent argued that the tax was a graduated income tax prohibited by *Culliton* because it is a tax on the recognition of income from a capital transaction (rather than on the transaction itself) and is imposed on net (rather than gross) income. Although the capital gains tax return due date is extended if a taxpayer's federal income tax return is extended, there are no extensions for making payments. The first payment is due on April 18, 2023, and the Department's online system is open to make tax payments. Please contact [Michele Baisler](#) with questions on *Quinn, et al. v. Washington*.



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