

Alert | State & Local Tax (SALT)



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Washington Capital Gains Tax Upheld

On March 24, the Washington Supreme Court in a 7-2 **decision** upheld the 7% capital gains tax enacted in 2021, concluding the tax violated neither the Washington state Constitution nor the U.S. Constitution. The capital gains tax, effective Jan. 1, 2022, was enacted to fund education with the first payment due April 8, 2023. The tax applies to individuals with capital gains of more than \$250,000 and includes the following exemptions:

- transfer of real estate;
- interest in privately held entities to the extent the capital gain or loss was from the sale of real estate;
- certain retirement accounts;
- assets subject to condemnation;
- livestock;
- timber;
- commercial fishing privileges; and
- goodwill from the sale of certain auto dealerships.

The capital gains tax was the subject of two facial challenges, and the Douglas County Superior Court ruled in favor of the plaintiffs, finding the capital gains tax unconstitutional because it is a property tax and the structure (deduction of \$250,000 and 7% rate) violated the Uniformity Clause in Washington's

Constitution. In the case before the Superior Court, certain “Education Parties” intervened to defend the tax, and the intervenors sought Washington Supreme Court direct review, which was granted.

Before the Supreme Court, the plaintiffs argued the capital gains tax violated the Uniformity and Privileges and Immunities Clauses of the Washington Constitution as well as the Dormant Commerce Clause of the U.S. Constitution. In a 50-plus page opinion, the majority concluded the capital gains tax was an excise tax as opposed to a property tax, finding it was not a tax on a capital asset itself but rather the exercise of a right “in and to the property”—namely, the power to sell or transfer capital assets—like an excise.” The majority also concluded the tax did not violate the state’s Privileges and Immunities Clause or the Dormant Commerce Clause. While the intervenors specifically asked the court to consider and overrule Washington’s long-standing precedent, which provides income is property in Washington, the court declined to do so. Here, the majority asserted that issue was not before the court since the capital gains tax was an excise tax.

The dissenting opinion started out very concise and is clear in its position: “‘Capital gains’ are income. In Washington, income is property. A Washington ‘capital gains tax’ is therefore a property tax.”

With this decision, the plaintiffs’ only option appears to be to seek U.S. Supreme Court review, which – considering the state court’s decision is based primarily on an analysis of Washington state law – is unlikely to be granted.

With the April 8, 2023, filing deadline just a few weeks away, taxpayers with Washington capital gains in excess of \$250,000 will need to determine how this tax will impact them.

**Greenberg Traurig is not licensed to practice law in Washington and does not advise on Washington law. Specific questions and Washington legal compliance issues will be referred to lawyers licensed to practice law in Washington.*

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