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The Tumultuous Journey of the Washington State Capital Gains Tax Continues

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I have reported in several prior blog posts the significant events impacting the newly enacted Washington state capital gains tax. The turbulent ride of this legislation continues!

The Colorful Journey

The colorful journey of the Washington capital gains tax started with Senate Bill 5096 ("SB 5096"). The bill was originally introduced to the Washington State Senate on January 6, 2021. It was passed by the Senate on March 6, 2021, after a hearing in the Senate Committee on Ways and Means, three readings and some floor amendments. The bill's passage margin in the Senate was narrow, receiving 25 affirmative votes and 24 negative votes.

SB 5096 continued its journey to the Washington State House of Representatives, where the bill was introduced on March 9, 2021. After three readings and two separate votes, as well as some amendments, the bill was passed in the House on April 21, 2021. As was the case in the Senate, its passage margin in the House was narrow, receiving 52 affirmative votes and 46 negative votes.

SB 5096, as amended by the House, was referred back to the Senate for consideration on April 22, 2021. The Senate, however, quickly refused to consider the House's amendments.

A Conference Committee was convened to break the deadlock between the House and the Senate. The Conference Committee was comprised of Senators June Robinson (D), Jamie Pederson (D) and Lynda Wilson (R), and Representatives Noel Frame (D), Ed Orcutt (R) and Pat Sullivan (D).

On April 23, 2021, the committee promptly issued a report ("Conference Report") with its recommendations/compromises. The following day, the Conference Report was adopted in the House by a narrow margin, receiving 52 affirmative votes and 44 negative votes (with two representatives excused). On April 25, 2021, the Senate voted in favor of SB 5096, as amended by the Conference Report, with the same voter results it originally had on the bill (i.e., 25 affirmative votes and 24 negative votes).

SB 5096 was delivered to Governor Jay Inslee for signature on April 26, 2021. Before he could sign the bill into law, however, on April 28, 2021, opponents to the legislation filed a

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lawsuit in the Superior Court of Washington for Douglas County, challenging the new tax regime as a tax on income - a violation of the state constitution.

Almost a week after the judicial challenge was instituted, on May 4, 2021, Governor Inslee signed SB 5096. The law, at that point in time, was set to go into effect on January 1, 2022, but for the judicial challenge.

On February 4, 2022, Judge Brian C. Huber of the Superior Court of Washington for Douglas County heard oral arguments in the case. On March 1, 2022, Judge Huber rendered his opinion, striking down the tax as unconstitutional. The court ultimately concluded:

[SB] 5096 violates the uniformity and limitation requirements of article VII, sections 1 and 2 of the Washington State Constitution. It violates the uniformity requirement by imposing a 7% tax on an individual's long-term capital gains exceeding $250,000 but imposing zero tax on capital gains below that $250,000 threshold. It violates the limitation requirement because the 7% tax exceeds the 1% maximum annual property tax rate of 1%.

The capital gains tax did not remain dormant very long. On March 25, 2022, Washington Attorney general, Robert W. Ferguson, filed a notice of appeal, asking the Washington Supreme Court to review the matter (bypassing the Court of Appeals).

The Washington Supreme Court accepted the state's appeal. The case was briefed by the parties, and oral arguments occurred on January 26, 2023.

Before oral arguments even occurred, by motion dated November 3, 2022, the Washington State Attorney General asked the Washington Supreme Court to allow the Washington Department of Revenue to implement and collect the capital gains tax struck down as unconstitutional by the Douglas County Superior Court, pending the high court's ultimate ruling on the matter.

In a brief order of the Washington Supreme Court, on November 30, 2022, Chief Justice Steven Charles Gonzalez delivered the court's ruling that the lower court order was stayed pending the ultimate resolution of the matter. He stated that the decision was unanimous among the court's justices. Accordingly, taxpayers subject to the Washington capital gains tax would be required to report and pay the tax for taxable year 2022 by April 17, 2023.

On March 24, 2023, the Washington Supreme Court rendered its decision on the tax. In a 7-2 opinion, the Court overturned the Douglas County Superior Court decision that had ruled the state capital gains tax enacted by the legislature in 2021 violates the Washington State Constitution. So, the tax was given a new life.

The opponents of the tax sought to have the case reviewed by the U.S. Supreme Court. In January 2024, however, the high court denied the opponents writ of certiorari. So, at that point, it appeared the Washington capital gains tax was here to stay.

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A New Twist in the Journey

Opponents of the capital gains tax, after losing in the courts, decided to take the matter to the voters. They have proposed a ballot measure that, among other things, would repeal the tax. That sounds fair and reasonable - allow the voters of Washington in November 2024 to decide whether the Washington state capital gains tax shall live or die. Unfortunately, the matter is not that simple.

The State of Washington election officials plan to include in the materials that go to voters a disclosure of the revenue impact the passage of the ballot measure would have on the state's revenue - a drop of roughly $1 billion per year. Proponents of the ballot measure have filed a lawsuit in the Superior Court of Washington for Thurston County to block the inclusion of the revenue impact in the voter packets. A hearing in the case is scheduled for tomorrow, June 7, 2024.

It will be interesting to learn how the court rules on this latest twist in the journey of the Washington capital gains tax. Despite its ruling, it appears the voters will ultimately get to determine the fate of the tax in November. Stay tuned for more news about the Washington capital gains tax!

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