

Tax Base

Proposed Washington Capital Gains Tax Faces Battle in Republican-Controlled Senate

By [Paul Shukovsky](#)

March 2 - A centerpiece of Washington Gov. Jay Inslee's (D) proposal to raise revenue and improve what he says is the nation's most regressive tax system faces a skeptical reception from the Republican majority in the Senate.

H.B. 1484 and companion legislation S.B. 5699 would impose a 7 percent tax on capital gains to earnings above \$25,000 for individuals and \$50,000 for joint filers beginning Jan. 1, 2016. The tax is structured such that it would apply to “only a tiny fraction of the state's taxpayers,” according to an Inslee position paper. The proposal exempts retirement accounts, homes, farms and forestry.

Inslee is seeking to address income inequality, structural problems with the tax system and a big budget shortfall in part by enacting the capital gains tax, which would generate an estimated \$798 million in revenue in the second half of the 2015-2017 biennium.

Under the headline “Improving Washington's Unfair and Outdated Tax System,” the position paper cites an Institute on Taxation & Economic Policy study declaring that “our poorest residents are paying six times as much of their income in taxes as do the wealthiest.” In a state without an income tax, revenue as a share of the personal income has fallen almost 30 percent over the past 25 years, the position paper says.

'A Rollercoaster Revenue Source.'

Andrew Nicholas of the Washington State Budget & Policy Center--a politically progressive research organization--calls the Inslee proposal “a really bold step towards bringing Washington's 1930's-era tax system more in line with the modern economy. We rely on an outdated system of sales and use tax predominantly.”

“The problem is that the tax covers things like soap and toothpaste, over-the-counter drugs and household necessities which tend to take up a much larger portion of a lower and middle-income family budget than that of someone at the very top of the income scale. By imposing any tax at all on capital gains, you are almost by default taxing those at the very top of the income scale.”

Nicholas said the tax will apply to 1.7 percent of the people in the state who file income tax returns and “probably less than one percent” if you apply it to all the people in the state.

Jason Mercier of the conservative, free-market Washington Policy Center told Bloomberg BNA in a March 2 telephone call that “A capital gains tax is basically a rollercoaster revenue source; you have

deep swings either way.” Mercier said he finds it “very concerning” that none of the revenue under the governor's proposal would go into a reserve account or rainy day fund.

Skimming the 'Volatility Cat.'

Nicholas agrees that a portion of the capital gains revenue should go to a reserve fund, but he says that is no reason not to enact the bills into law. “There are lots of ways to skin the volatility cat. There is a dependable portion of capital gains every year. It's in the hundreds of millions of dollars. You can budget on the dependable part.”

Mercier also contends the capital gains proposal “arguably” violates the Washington State Constitution. “Under 80 years of Supreme Court precedent, income has been defined as property. Under the constitution, all property has to be taxed uniformly,” with a one-percent cap on property. “That's why we are one of nine states without an income tax because our court has held that a graduated income tax is unconstitutional.” And none of the nine states has a capital gains tax, Mercier said.

The fiscal note prepared by Inslee's Office of Financial Management for the bills assumes up to five Superior Court challenges to the constitutionality of the capital gains tax.

“I don't see any way capital gains passes the Legislature,” said Mercier, who predicted it won't even pass the Democrat-controlled House. “If this becomes policy in the State of Washington, it will happen at the ballot box as an initiative.”

'It Wildly Fluctuates.'

Sen. Andy Hill (R), chairman of the Ways and Means Committee, told Bloomberg BNA in a March 2 telephone interview that S.B. 5699 has not moved in committee. “We're waiting to see what comes out of the House.”

“First of all, it's not clear that we need a big massive new tax,” Hill said. “We're not in dire straits.” And even if the revenue is needed, Hill asserts a capital gains tax is a deeply problematic approach.

“It's one of the most volatile revenue sources out there,” Hill said. “It wildly fluctuates and we need to write budgets that are sustainable. You can't write a budget on something that varies by 50 or 60 percent from year to year.”

Asked about the use of a capital gains tax to address the regressive nature of Washington's sales-tax heavy system, Hill said: “All state tax systems are regressive. That's completely overshadowed by an incredibly progressive federal tax system. Overall our tax system in the United States is pretty progressive.”

Inslee Open to Compromise.

Gov. Inslee's Communications Director David Postman told Bloomberg BNA March 2: “We don't disagree that there is some volatility to it. Our budget plan is designed to have large reserves that would allow us to smooth out any volatility. But there are other mechanisms to do that and we are

not opposed to those and we would be happy to talk to lawmakers about other ways. I don't think that should stop consideration of capital gains.”

“I think some people who don't want anything done throw up the volatility question,” Postman said. “And we won't be able to satisfy those people.” But the electorate is in favor of it, he said, citing December polling data that showed 57 percent of register voters support the capital gains tax proposal.

Postman said that while there will undoubtedly be arguments over the constitutionality of the capital gains tax, “We are confident that the way it's designed, it's not an income tax. This is an excise tax just on investment earnings.”

Washington lawmakers have a history of reaching last minute budget compromises, sometimes in special session. Said Postman: “This is going to be part of the discussion until the Legislature leaves town. You never know until the very end.”

To view the IETP study, go to <http://www.itep.org/whopays/>.

To view the capital gains bills, go to the Internet at <http://app.leg.wa.gov/DLR/billsummary/default.aspx?Bill=1484&year=2015>

By Paul Shukovsky

To contact the reporter on this story: Paul Shukovsky in Seattle at pshukovsky@bna.com

To contact the editor responsible for this story: Steven Roll at sroll@bna.com

Copyright 2015, The Bureau of National Affairs, Inc.