No. ______

In the

Supreme Court of the United States

CHRIS QUINN; CRAIG LEUTHOLD; SUZIE BURKE; LEWIS RANDALL; RICK GLENN; NEIL MULLER; LARRY and MARGARET KING, as individuals and the marital community comprised thereof; and KERRY COX,

Petitioners,

v.

STATE OF WASHINGTON; DEPARTMENT OF REVENUE; and VIKKI SMITH, Director of the Department of Revenue,

Respondents.

On Petition for Writ of Certiorari to the Supreme Court of Washington

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Upset with what they saw as an unduly regressive tax system, a narrow majority in the Washington legislature recently enacted a 7% long-term capital gains tax that exempts the first $250,000 per year. But the Washington State Constitution mandates that all taxes on "property," which includes income as a matter of state law, must be uniform and capped at 1%, such that residents with higher incomes cannot be made to pay more as a percentage of their income than those who make less. To get around these state-law limits, the new tax operates as an excise tax—i.e., it is "imposed on the sale or exchange of long-term capital assets," not on the income generated by it. RCW 82.87.040(1). Yet while that may have solved a state-law problem, it created a federal-law problem. Seattle is not a hotbed of securities trading, so an excise tax on high-dollar-value transactions would not raise much revenue if it were limited to transactions and property in the state. Not surprisingly, the new excise tax thus reaches far beyond Washington's borders to tax transactions that occur in other states involving property located out of state.

The question presented is:

Whether the Constitution permits a state to tax out-of-state transactions involving only out-of-state property.

PARTIES TO THE PROCEEDING

Petitioners (plaintiffs-appellees below) are Chris Quinn, Craig Leuthold, Suzie Burke, Lewis Randall, Rick Glenn, Neil Muller, Larry & Margaret King, and Kerry Cox.

Respondents (defendant-appellant below) are the state of Washington, the Washington Department of Revenue, and Director of the Department of Revenue Vikki Smith.

STATEMENT OF RELATED PROCEEDINGS

This case is directly related to the following proceedings in the Supreme Court of Washington and the Washington Superior Court:

Quinn v. State, No. 100769-8 (Wash.) (Mar. 24, 2023).

Quinn v. State, Nos. 21-2-00075-09, 21-2-00087-09 (Wash. Sup. Ct.) (Mar. 22, 2022) (order).

Quinn v. State, Nos. 21-2-00075-09, 21-2-00087-09 (Wash. Sup. Ct.) (Mar. 21, 2022) (letter ruling).

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PETITION FOR WRIT OF CERTIORARI

This Court has long held that a state cannot tax transactions that occur outside of its borders just because they involve one of its residents. While states may tax their fair share of the *income* their residents derive from out-of-state transactions, they may not tax the out-of-state transactions themselves. That constraint is a necessary consequence of the federalism principles that the Constitution embodies, which guarantee to each state sovereignty within its own borders.

The tax at issue here defies that bedrock rule. In 2021, Washington imposed a 7% tax on the sale or exchange of certain long-term capital assets above $250,000. Most capital gains taxes are taxes on the income derived from selling capital assets—but not this one. Washington's state constitution caps "property" taxes at 1% and requires them to be uniform. Because Washington defines property to include income, its new tax could pass muster under state law only if it functions as an excise tax—i.e., a tax "levied on an activity" "such as the sale … or manufacture of goods"—rather than as a tax on any income generated by that activity. *Kunath v. City of Seattle*, 444 P.3d 1235, 1241 (Wash. Ct. App. 2019). And that is precisely what the Washington Supreme Court held that Washington's new tax is: Unlike most capital gains taxes, it imposes an excise tax on transactions in capital assets, not a tax on the income that those transactions generate.

While that holding solved Washington's *state*-law problem, it did so only by creating a *federal*-law problem. Washington's excise tax is not limited to in-

state transactions; it applies equally to sales that take place in other states if the seller or beneficiary of the transaction is a Washington resident. It therefore defies the rule under the U.S. Constitution that no state may tax transactions that take place in other states, even if the transactions involve their residents. Washington's Supreme Court nonetheless upheld the tax against federal challenge. That decision conflicts with this Court's cases and the bedrock federalism principles that they embody.

That is reason enough for plenary review, but it is not the only reason. The Washington Supreme Court's expansive view of state power not only defies the Constitution and this Court's cases enforcing it, but squarely conflicts with the law of the Ninth Circuit. In *Sam Francis Foundation v. Christie's, Inc.*, 784 F.3d 1320 (9th Cir. 2015) (en banc), the Ninth Circuit invalidated a California law that required the seller of a work of fine art to pay the artist 5% of the sale price even if the sale took place entirely *in another state* if the seller was a California resident. The court struck the law down on the ground that a state statute that "facially regulate[s] … commercial transaction[s] that 'take[] place wholly outside of the [s]tate's borders'" exceeds the state's power and is therefore unconstitutional. *Id.* at 1323. That holding cannot be reconciled with the Washington Supreme Court's holding in this case. And that conflict between the Ninth Circuit and a state court within it is particularly problematic given that the Tax Injunction Act limits recourse to federal courts in this context.

This Court's intervention is all the more needed given the implications of the decision below. If states

really can impose excise taxes on any out-of-state activities that involve one of their residents, then states could use their tax codes to regulate all manner of out-of-state conduct, taxing activities they disfavor and using their own tax policies to "deprive[] businesses and consumers in other States of whatever competitive advantages they may possess." *Nat'l Pork Producers Council v. Ross*, 143 S.Ct. 1142, 1155 (2023). States have plenty of leeway to tax income that their residents derive elsewhere and to tax the use within their borders of property purchased out of state. But a state cannot reach out and tax activity that takes place wholly outside its borders just because it prefers not to take the revenue-raising paths the Constitution leaves open. The Court should grant certiorari and hold Washington's excise tax on out-of-state transactions unconstitutional.

OPINIONS BELOW

The opinion of the Supreme Court of Washington, 526 P.3d 1, is reproduced at App.1-70. The opinion of the Douglas County Superior Court, 2022 WL 19299167, is reproduced at App.73-77.

JURISDICTION

The Supreme Court of Washington issued its opinion on March 24, 2023. Justice Kagan granted an initial application to extend the certiorari deadline on June 15, 2023, and an additional extension on July 12, 2023, extending the deadline to August 21, 2023. This Court has jurisdiction under 28 U.S.C. §1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Commerce Clause, U.S. Const. art. I, §8, cl. 3, is reproduced at App.95. The relevant provisions of Washington law are reproduced at App.95-121.

STATEMENT OF THE CASE

A. Legal Background

Unlike most states, Washington has no state income tax for either individuals or corporations. Washington instead has traditionally raised revenue through taxes on various in-state *activities*, such as sales taxes, excise taxes, and its unique "business and occupation … tax," a gross-receipts tax on businesses operating in the state. App.3.

Like all state tax regimes, however, Washington's is limited by both state and federal constitutional law. Washington's constitution requires that any tax on property be "uniform upon the same class," Wash. Const. art. VII, §1, and it places a ceiling on aggregate property taxes (they cannot exceed 1% annually), *id.* §2. The key word for these provisions is "property," as not every tax is a tax on property as such. The Washington Supreme Court has long held that income is "property" under Washington law, so income taxes must be uniform as to everyone, regardless of how much they make, to pass state constitutional muster. *Kunath*, 444 P.3d at 1241 (quoting *Culliton v. Chase*, 25 P.2d 81 (Wash. 1933)). But it has also long held that excise taxes—i.e., "levie[s] on an activity," "such as the sale, consumption, or manufacture of goods," rather than on income generated by activity—do not tax "property" within the meaning of Washington law, and thus need not be uniform or capped at 1%. *Id.*

(discussing *Culliton*). Whether a levy is "a tax on income as opposed to an excise" is thus the whole ballgame for purposes of state law. App.89 (quoting *Kunath*, 444 P.3d at 1245).

State law is of course not the only limitation on a state's taxation regime. The federal Constitution also places limits on states' authority to impose taxes—especially when it comes to activities outside their borders. While courts often analyze challenges to tax laws under distinct rubrics given the special role taxes play in the functioning of government, state taxes are not exempt from basic constitutional limits on state power. Nor could they be: "Taxation is regulation just as prohibition is," *Compania Gen. de Tabacos de Filipinas v. Collector of Internal Revenue*, 275 U.S. 87, 96 (1927), and tax laws "impose[] sanctions if prescribed paths of conduct are not followed" no less than other regulations, *Hanover Ins. Co. v. Comm'r*, 65 T.C. 715, 722 (1976). Accordingly, while a state "may subject to taxation" "whatever a state in the exercise of its police power may regulate," *Osborne v. Ozlin*, 29 F.Supp. 71, 81-82 (E.D. Va. 1939), *aff'd*, 310 U.S. 53 (1940), the contrapositive is equally true: The constitutional constraints on what a state may *not* regulate—including those emanating from the horizontal separation of powers—apply equally to taxation.

This Court's cases identify many such limitations, including two that are particularly relevant here. First, states may not tax transactions that take place outside their borders, even if they involve state residents. Indeed, this Court held nearly 80 years ago that Arkansas could not tax "sales made by Tennessee

vendors that are consummated in Tennessee" even though the goods were to be shipped to "Arkansas buyers." *McLeod v. J. E. Dilworth Co.*, 322 U.S. 327, 328 (1944); *see also Memphis Nat'l Gas Co. v. Stone*, 335 U.S. 80, 95 (1948) (it is "beyond the power of the state" to impose a tax when "the taxable event is outside its boundaries").

To be sure, this Court recently "refined [its] Commerce Clause framework." *Mallory v. Norfolk S. Ry. Co.*, 143 S.Ct. 2028, 2053 (2023) (Alito, J., concurring in part and concurring in the judgment). *See generally Ross*, 143 S.Ct. 1142. But the bedrock principle that states may not directly regulate—let alone tax—out-of-state sales remains alive and well. In fact, *Ross* went out of its way to confirm the vitality of the rule that the Constitution constrains the ability of states to "directly regulate[]" "out-of-state transactions" and thereby "'deprive[] businesses and consumers in other States of whatever competitive advantages they may possess.'" *Ross*, 143 S.Ct. at 1155, 1157 n.1 (emphasis omitted) (quoting *Healy v. Beer Inst., Inc.*, 491 U.S. 324, 338-39 (1989)). And it nowhere purported to overrule longstanding tax precedents like *McLeod* and *Memphis National Gas*.

Second, given the federalism concerns that arise with respect to states' sometimes-overlapping taxing powers, even state taxes imposed on activities conducted "*within* the State" must satisfy the so-called *Complete Auto* test, under which a tax will be upheld only if it "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State."

Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 183 (1995) (emphasis added) (quoting *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977)). "The *Complete Auto* test, while responsive to Commerce Clause dictates," "encompasses … due process standards" as well. *Trinova Corp. v. Michigan Dep't of Treasury*, 498 U.S. 358, 373 (1991); *Amerada Hess Corp. v. Dir., Div. of Tax'n, N.J. Dep't of Treasury*, 490 U.S. 66, 79 (1989).

B. Washington's New Excise Tax

Frustrated with the limits on Washington's power to raise revenue and what they saw as an unjustifiably regressive tax system, in 2021 "a narrow one-vote majority in the [Washington] state senate" enacted Engrossed Senate Substitute Bill 5096, "an excise tax … on the sale or exchange of long-term capital assets." App.10; RCW 82.87.040(1); *see* RCW 82.87.020(6) (long-term capital assets are those held for longer than one year); *see also* RCW 82.87.010 (finding that "Washington's tax system today is the most regressive in the nation" and that ESSB 5096 is intended to "mak[e] material progress toward rebalancing the state's tax code"). ESSB 5096 exempts the first $250,000 of long-term capital gains each year, so "if a Washington resident made $260,000 from selling stocks in 2022, [she] would owe the seven percent tax on $10,000 of that amount, or $700." App.12; *see* RCW 82.87.060(1). It also exempts "transactions involving real estate, retirement accounts, agriculture, certain family-owned businesses, and charitable donations." App.12; *see* RCW 82.87.050, .060(4), .070(1). But beyond that, it covers all transactions in covered capital assets.

By its terms, this new tax applies not only to "the sale or exchange of tangible personal property located in-state," but also to the sale or exchange of "tangible personal property located *out-of-state*" if the seller "is a Washington resident" (or spends at least 183 days in the state in a given year). App.12 (emphasis added); *see* RCW 82.87.100(1)(a)-(b). To soften the blow of duplicative taxation that will invariably arise from a tax on transactions completed in other states involving property held in other states, "the statute offers a tax credit 'equal to the amount of any legally imposed income or excise tax paid by the taxpayer to another taxing jurisdiction on capital gains derived from capital assets within the other taxing jurisdiction.'" App.12-13 (quoting RCW 82.87.100(2)(a)). But it makes no effort to apportion any aspect of out-of-state transactions to the states in which they occurred.

Washington is certainly not the first state to enact a capital gains tax, but most other states treat capital gains as taxable income. Washington, by contrast, is the only state to impose such a tax without a personal income-tax regime. Because it is loath to tax income (due to state constitutional constraints), Washington instead characterizes its capital gains tax as an excise tax: The new tax "is imposed *on the sale or exchange* of long-term capital assets." RCW 82.87.040(1) (emphasis added). As the Washington Supreme Court therefore conclusively opined, "[t]he taxable incident is the transaction," not the realization of income in Washington. App.26. And that is how the tax functions: Like a sales tax, where buyers are required to pay a surcharge of X% of the purchase price for qualified transactions, ESSB 5096 requires sellers to

pay a surcharge of 7% on the transaction; it just confines that surcharge to the "gains," rather than to the entirety of the transaction. App.26-27. ESSB 5096 thus taxes *the activity of transferring capital assets*, rather than the gains themselves—even if "the sale or exchange" took place entirely in another state.

Notwithstanding the fact that the tax is expressly characterized as a tax on capital asset transactions rather than on capital gains themselves, the amount of tax owed is nonetheless calculated by reference to a taxpayer's aggregate capital gains. The tax rate is set at 7% of "an individual's Washington capital gains." RCW 82.87.040. The process of determining a taxpayer's "Washington capital gains" begins with identifying the taxpayer's "federal net long-term capital gain" as reported for "federal income tax purposes." RCW 82.87.020(1), (3), (13). The taxpayer must then determine which of these long-term gains are allocated to Washington. Gains from tangible property are allocated to Washington if (1) the property was located in Washington at the time of sale or exchange or (2) the taxpayer was a resident of Washington at the time of the sale or exchange and is not subject to the payment of an income or excise tax on the long-term capital gains by another state. RCW 82.87.100(1)(a). Gains from intangible property are allocated to Washington if the taxpayer was domiciled in Washington at the time of the sale or exchange, regardless of whether those gains are taxed by another jurisdiction and regardless of where the transaction took place. RCW 82.87.100(1)(b).

Although the tax applies only to individuals, not corporations, any capital gains incurred by pass-

through entities (e.g., partnerships, limited liability companies, S corporations, or grantor trusts) are considered to be gains of the entity's "legal or beneficial owner" "to the extent of the individual's ownership interest in the entity." RCW 82.87.040(4). Mere legal or beneficial ownership of the asset and recognition of the gains is sufficient; the individual need not be involved in or even aware of the transaction involving the asset.

The new tax became effective on January 1st, 2022, *see* RCW 82.87.040(1), and the Washington Department of Revenue made its first collections earlier this year. *See* Wash. Dep't of Revenue, *Capital gains tax*, https://rb.gy/j5siq (last visited Aug. 21, 2023). The state estimates that only around 7,000 people will pay the tax, but that it will raise *billions* of dollars. App.13. Indeed, the new tax raised more than $800 million in the first year alone. *See* Claire Withycombe, *WA's new capital gains tax brings in far more than expected*, The Seattle Times (May 26, 2023), bit.ly/45pKYbP; Laura Mahoney, *Washington State Rakes In Revenue From Capital Gains Tax*, Bloomberg Tax (Apr. 27, 2023), bit.ly/3OCE0tc.

C. Proceedings Below

1. Petitioners are a group of individuals who own capital assets that are subject to Washington's new tax. They filed suit in state court challenging ESSB 5096 on three grounds: (1) The tax violates Article VII, Sections 1 and 2 of the Washington Constitution because it is a non-uniform tax on income and because it exceeds the 1% limit on personal property taxes. (2) The tax violates Article 1, Section 12 of the Washington Constitution (the state's Privileges and

Immunities Clause) because it imposes a tax on certain persons while exempting others. And (3) the tax violates the Commerce Clause of the U.S. Constitution because it imposes a tax based on a taxpayer's residence instead of the location of the activity, discriminates against interstate commerce, and is not fairly apportioned.[1]

The parties cross-moved for summary judgment and the trial court granted summary judgment for petitioners. The court noted that the key difference between income and excise taxes is that "excise taxes are levied on an activity." App.87. Moreover, the court explained that in categorizing a tax statute, "the court must look through any labels the state has used to describe the statute … and determine whether it is a 'property tax masquerading as an excise.'" App.89 (quoting *Kunath*, 444 P.3d at 1241). After examining the features of the new capital gains tax, the court concluded that the tax is properly characterized as an income tax—which, given that it is neither uniform nor capped at 1%, meant that it violates the uniformity and rate limitations set by the Washington State Constitution. App.93-94.

Because it found the tax unlawful under the Washington State Constitution, the trial court declined to reach petitioners' federal-law arguments.

2. The Washington Supreme Court reversed, holding that the new tax is an excise tax and thus

[1] Because ESSB 5096 allocates the revenue it raises to support Washington's education system, *see* App.11; RCW 82.87.030(1)(a)-(b), 83.100.230, 28A.515.320, education-related parties and a school district successfully intervened as defendants. App.13-14 & n.5.

exempt from the property-tax limits in Article VII of the Washington State Constitution. In reaching that conclusion, the court repeatedly emphasized that "[t]he taxable incident is the transaction," not the gains (i.e., income) derived from the transaction. App.26; *see also, e.g.*, App.32 ("Here the taxable incident is the sale or exchange of qualifying capital assets. The measure is the resulting gain. Consistent with our case law, the incidents of this tax confirm it is an excise."). Because the new tax "specifically targets an activity," the state supreme court held, it is not an income tax. App.26.

The court then proceeded to examine petitioners' remaining claims. After rejecting the claim that ESSB 5096 violated the Privileges and Immunities Clause of the Washington State Constitution, *see* App.37-40, the court turned to the federal Constitution. Applying this Court's *Complete Auto* test, the court held that the tax does not violate the Commerce Clause. App.40-49.[2]

Despite reiterating that "the capital gains tax is levied on capital *transactions*," the court held that ESSB 5096's application to out-of-state transactions involving out-of-state property satisfies the first *Complete Auto* factor because "the taxable incident is the taxpayer's exercise of their power to dispose of capital assets," and "[t]hat power is exercised in the state where the taxpayer is domiciled." App.43. The

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[2] The parties agreed below that "the capital gains tax meets the fourth prong of the *Complete Auto* test" and that "Washington may tax capital gains derived from the sale or exchange of tangible property *within* its borders without violating the dormant commerce clause." App.42 (emphasis added).

court thus concluded that the "taxpayer's in-state domicile provides a sufficient nexus" for Washington to tax activity regardless of where it takes place or where the assets are located. App.44.

The court next concluded that the new excise tax is "fairly apportioned" because it provides a tax credit to guard against double taxation. App.45. The court brushed aside petitioners' concerns that the credit is insufficient because it applies only to capital assets "within" another taxing jurisdiction. In the court's view, the credit "prevents any *real* risk of multiple taxation," App.48 (emphasis added), and to the extent Washington's tax scheme could result in multiple taxation, the plaintiffs should bring an as-applied challenge, App.47.

Finally, the court held that ESSB 5096 does not "discriminate against interstate commerce" for the same reasons that it found the tax to be "fairly apportioned"—i.e., the court found no real risk of multiple taxation, despite the fact that its measure of residency creates the possibility of *double* taxation in certain circumstances. App.48-49. Finding the *Complete Auto* test satisfied, the court upheld Washington ESSB 5096 against federal constitutional challenge and denied petitioners' claims.

REASONS FOR GRANTING THE PETITION

If Washington enacted a law imposing an excise tax on all purchases that Washington residents make at Disneyland, including perishable goods consumed in the park and entrance tickets purchased at the gate, all would agree that the law is unconstitutional. After all, no state may directly regulate transactions wholly outside its borders—and that holds true even if one of

the transacting parties is a resident of the state or the form the regulation takes is a tax. This Court has applied these precepts in an unbroken string of cases dating back nearly a century. These principles and precedents should have compelled the court below to invalidate Washington's new tax on the out-of-state sale of out-of-state assets. Washington has gone to great lengths to make clear that ESSB 5096 is *not* a tax on the income derived from the sale of capital assets. That is understandable given the state-law constraints under which Washington must operate. But if Washington prefers to impose excises instead of income taxes, then it must live with the consequences of that choice. And one of those consequences is that it may not impose excise taxes on transactions that occur entirely outside its borders.

The Washington Supreme Court's decision relieving the state of that consequence cannot stand. Indeed, the court upheld Washington's novel tax without even so much as mentioning the long line of cases in which this Court has invalidated state laws that directly tax or otherwise regulate out-of-state conduct and transactions. That decision not only defies the Constitution and this Court's cases, but creates a split of authority with the federal court of appeals in Washington's home circuit. Worse still, it lays the first stone on a path toward a regulatory regime under which borders are trivialized. After all, if states really could tax all of the out-of-state activity in which their residents engage, then there would be no end to their power to intrude on the sovereign prerogatives of their sister states. This Court's intervention is sorely needed to set states back on the right course and make clear that out-of-state

transactions are not sources of up-for-grabs taxable revenue for the state with the longest arms.

I. The Decision Below Conflicts With Basic Principles Of Constitutional Law And This Court's Cases Enforcing Them.

1. This Court has long held that states may not "impose a tax on a transfer of ownership … where the transfer was made beyond the state limits." *McLeod*, 322 U.S. at 331. It is "beyond the power of the state" to impose a tax when "the taxable event is outside its boundaries." *Memphis Nat'l Gas*, 335 U.S. at 95. That holds true, moreover, even when one of the parties to an out-of-state transaction is a resident of the taxing state and the goods are coming home with the buyer. "More than once this Court has struck down taxes directly imposed on … out-of-state sales," even where "the vendor knew that the goods were destined for use in that State." *Am. Oil Co. v. Neill*, 380 U.S. 451, 457 (1965); *see id.* at 457-58 (citing cases). Indeed, that rule has been held to preclude application of a state tax law even to out-of-state transactions made pursuant to "a sales contract specifically contemplat[ing] … movement of the goods" to the taxing state "before … the transfer of ownership." *Okla. Tax Comm'n*, 514 U.S. at 187.

To be sure, this Court held in *South Dakota v. Wayfair, Inc.*, 138 S.Ct. 2080 (2018), that a state can require internet sellers with no physical presence in the state to collect and remit sales tax from transactions involving the state's residents. But that power depends on the transaction being "in-state" in the sense that the buyer orders goods to be shipped from out of state to the taxing state for use there.

Indeed, this Court has long held that states can impose use taxes when goods are "purchased out of State but carried … back for use in State." *Bos. Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 332 (1977). But this Court "ha[s] not abandoned the requirement that, in the case of a tax on an activity, there must be a connection to the activity itself, rather than a connection only to the actor the State seeks to tax." *Allied-Signal, Inc. v. Dir., Div. of Tax'n*, 504 U.S. 768, 778 (1992). In short, while a state may tax its residents' *income* from out-of-state sales, it cannot tax the out-of-state sales themselves. *N.Y. ex rel. Cohn v. Graves*, 300 U.S. 308, 313-14 (1937) (states "may tax net income from operations in interstate commerce, although a tax on the commerce itself is forbidden").

These decisions emanate from bedrock precepts of constitutional law. "The principle that states are territorially bound … permeates the Constitution," Gillian E. Metzger, *Congress, Article IV, and Interstate Relations*, 120 Harv. L. Rev. 1468, 1520 (2007), and is a common thread uniting this Court's interpretation of several constitutional provisions. "[T]his Court has long consulted original and historical understandings of the Constitution's structure and the principles of 'sovereignty and comity' it embraces, … as well [as] a number of the Constitution's express provisions," "[t]o resolve disputes about the reach of one State's power." *Ross*, 143 S.Ct. at 1156. For instance, this Court has held that the Due Process Clause of the Fourteenth Amendment imposes territorial constraints on states' ability to exercise both judicial and regulatory authority. *See Bristol-Myers Squibb Co. v. Super. Ct. of Cal.*, 582 U.S. 255, 261-64 (2017); *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 571 (1996); *Edgar v. MITE*

Corp., 457 U.S. 624, 643 (1982) (plurality op.). The Court has likewise recognized that the Privileges and Immunities Clause "implicates not only the individual's right to nondiscriminatory treatment but also, perhaps more so, the structural balance essential to the concept of federalism." *Austin v. New Hampshire*, 420 U.S. 656, 662 (1975). And, to secure "the autonomy of the individual States within their respective spheres," this Court has held that "the Commerce Clause protects against … the projection of one state regulatory regime into the jurisdiction of another State." *Healy*, 491 U.S. at 336-37; *see also Edgar*, 457 U.S. at 642-43 (plurality op.) (invalidating an Illinois law that "directly regulate[d] transactions which [took] place … wholly outside the State").

To be sure, this Court recently clarified the contours of the *Healy* line of cases, explaining that a state law that directly regulates only *in*-state conduct (such as the in-state sale of goods) is not doomed just because it has significant practical *effects* on conduct out of state. *Ross*, 143 S.Ct. at 1154-57. But while the Court in *Ross* rejected the view that *Healy* and its progeny support "an 'almost *per se*' rule against state laws with 'extraterritorial effects,'" it went out of its way to underscore the vital "role territory and sovereign boundaries play in our federal system." *Id.* at 1156; *see, e.g.*, *id.* at 1157 n.1 (citing *Shelby Cnty. v. Holder*, 570 U.S. 529, 535 (2013), for the proposition that "all States enjoy equal sovereignty"). The bedrock principle that State *A* cannot directly regulate transactions in State *B* thus remains not just alive and well, but a fundamental pillar of our federalist system.

State tax laws are no exception. After all, "[t]axation is regulation just as prohibition is," *Compania Gen. de Tabacos*, 275 U.S. at 96, so it would make no sense to treat a state tax on out-of-state sales any differently from any other state law that directly regulates wholly out-of-state transactions. Just as a state law directly regulating the price term of out-of-state transactions invades the sovereign authority of the jurisdictions in which the sales occur, a state "tax on an [out-of-state] sale … involves an assumption of power by a State which the [Constitution] was meant to end." *McLeod*, 322 U.S. at 330. Indeed, if anything, state efforts to tax out-of-state activities are an even greater affront to sovereignty, as they strike at the core sovereign function of revenue raising.

2. These precedents and principles should have doomed ESSB 5096, as the tax applies to out-of-state sales of "property located out-of-state" simply because the seller "is a Washington resident." App.12; *see* RCW 82.87.100(1)(a)-(b). Yet instead of applying (or even mentioning) that wall of precedent, the Washington Supreme Court upheld ESSB 5096 under the four-part *Complete Auto* balancing test with very little analysis. *See* App.40-49. That arrogation of authority to Olympia cannot be reconciled with this Court's cases or basic principles.

As an initial matter, this Court has never applied *Complete Auto*'s balancing test to a state tax on out-of-state transactions involving only out-of-state property, for the simple reason that such a tax flunks constitutional scrutiny at the threshold: No state has authority to tax transactions completed beyond its borders involving property held beyond its borders. To

be sure, this Court has "often applied, and somewhat refined, … *Complete Auto*'s four-part test." *Okla. Tax Comm'n*, 514 U.S. at 183. But it has never even hinted that a state tax on out-of-state transactions could pass muster under *Complete Auto* just because they involve state residents, let alone held as much. Nor would that make any sense, as *Complete Auto* involved a tax on *in*-state activity, yet nevertheless contemplated that even *in*-state activity may not have a sufficiently "substantial nexus with the taxing State." 430 U.S. at 276, 279. And while "*Complete Auto* abandoned the abstract notion that interstate commerce 'itself' cannot be taxed by the States," *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 30 (1988), it cast no doubt on the principle that State *A* cannot tax transactions in State *B* just because they happen to involve one of State *A*'s residents. Simply put, both before and after *Complete Auto*, a state cannot treat its citizens as extensions of its territory and use that fiction to tax their activities wherever they go.

Of course, that still leaves states with "wide scope for taxation of those engaged in interstate commerce, extending to the instruments of that commerce, to net income derived from it, and to other forms of taxation not destructive of it." *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434, 441 (1939). In the sale-of-goods context, states can tax sales within their borders and can impose use taxes when goods are "purchased out of State but carried … back for use in State." *Bos. Stock Exch.*, 429 U.S. at 332; *see also Wayfair*, 138 S.Ct. at 2099-100. States can also tax residents' sale of *intangible* property, which has no location, even if the parties designate the locus of the transaction to be elsewhere, to the extent that "the owner of [the]

intangibles confines his activity to the place of his domicile." *Curry v. McCanless*, 307 U.S. 357, 367-69 (1939). Moreover, "there is no constitutional trouble inherent in the imposition of a sales tax in the State of delivery to the customer, even though the State of origin of the thing sold may have assessed a property or severance tax on it." *Okla. Tax Comm'n*, 514 U.S. at 188; *see McGoldrick v. Berwind-White Coal Mining Co.*, 309 U.S. 33, 53 (1940). And states can tax the gross receipts even of an interstate enterprise as long as the tax does not go beyond corporate income attributable to in-state activities. *See Okla. Tax Comm'n*, 514 U.S. at 190; *Gwin*, 305 U.S. at 440.

The problem with ESSB 5096 is that it follows none of those paths. Unlike the state's longstanding business and occupation tax, only individuals are subject to ESSB 5096. Unlike the sort of tax contemplated by *Curry*, ESSB 5096 taxes all capital gains resulting from the sale or transfer of intangible capital assets if the beneficial owner is domiciled in Washington, regardless of whether the owner confined his activity to the place of his domicile. *See* RCW 82.87.100(1)(b). And unlike taxes on in-state activity, Washington's new excise tax applies to out-of-state sales of "tangible personal property *located out-of-state*" whenever the seller "is a Washington resident." App.12 (emphasis added); *see* RCW 82.87.100(1)(a)-(b). Washington is certainly free to favor excise taxes over income taxes. But that policy choice does not free it from the federal-law constraints on excise taxes. And nothing in *Complete Auto* or any other decision of this Court countenances a state effort to impose excise taxes on transactions taking place in another state.

Perhaps seeking to evade the rule that states may not "impose a tax on a transfer of ownership … where the transfer was made beyond the state limits," *McLeod*, 322 U.S. at 331, the Washington Supreme Court tried to reframe ESSB 5096 as a tax on the "taxpayer's exercise of their power to dispose of capital assets." App.43. In other words, the court said that ESSB 5096 is *really* just a use tax that imposes a tax on sellers' "use" of their right to sell their property. That claim is at considerable odds with the court's repeated insistence that ESSB 5096 "is levied on capital *transactions*." App.43. While petitioners contested that view below, they are now bound by it, as is this Court. *See also Alabama v. Shelton*, 535 U.S. 654, 674 (2002) ("We are, of course, bound to accept the interpretation of [the State's] law by the highest court of the State." (alteration in original) (quoting *Hortonville Joint Sch. Dist. No. 1 v. Hortonville Educ. Ass'n*, 426 U.S. 482, 488 (1976))).

In all events, the state court's recharacterization does not pass muster, as ESSB 5096 is not remotely analogous to a use tax. "A use tax is a tax on the enjoyment of that which was purchased." *McLeod*, 322 U.S. at 330. A tax on a "taxpayer's exercise of their power to dispose of capital assets," App.43, plainly does not fit that bill. As the Washington Supreme Court itself elsewhere recognized, that is a tax on a "*transaction*[]" in property, App.43, not a tax on its "use." Washington cannot evade the limits on its power to tax out-of-state transactions by reconceiving of them as taxes on a resident's decision to engage in the transaction.

Moreover, "[t]he jurisdictional basis for use taxes is the use of the property *in the State*." *Mescalero Apache Tribe v. Jones*, 411 U.S. 145, 158 (1973) (emphasis added). Yet ESSB 5096 does not require the property at issue—i.e., the capital assets—to be present, let alone used, in Washington. Nor does it require the resident to be in Washington when she "exercises" her "power to dispose of" her assets. Simply put, ESSB 5096 looks nothing like a use tax. Indeed, to the extent it taxes some "use" of capital assets that are outside its borders, that just underscores the constitutional problem, as it has been the law of the land for more than 80 years that a "state may not tax real property or tangible personal property lying outside her borders." *Great Atl. & Pac. Tea Co. v. Grosjean*, 301 U.S. 412, 424 (1937); *accord, e.g.*, *Norfolk & W. Ry. Co. v. Mo. State Tax Comm'n*, 390 U.S. 317, 325 (1968).

In sum, while states are free to tax their residents' wealth as accumulated from out-of-state activity, they have never been permitted to directly tax out-of-state transactions themselves, even if one of their residents is involved. Washington nonetheless chose to do just that, taxing out-of-state sales of out-of-state property. ESSB 5096 violates the Constitution's horizontal separation of powers and this Court's cases. The decision below upholding it arrogates to Olympia authority that the Constitution withholds.

3. While this Court has never applied the *Complete Auto* balancing test to a state tax on out-of-state transactions involving out-of-state property, ESSB 5096 could not pass that test either, for largely the same reasons. A state tax fails the *Complete Auto*

test if it "applie[s] to an activity" that lacks "a substantial nexus with the taxing State," is not "fairly apportioned" among the several states, discriminates against interstate commerce, or is not "fairly related to the services provided by the State." 430 U.S. at 279. ESSB 5096 flunks that test.[3]

First and foremost, it plainly fails the nexus requirement. Even for transactions far beyond its borders involving property held out of state, Washington imposes its new excise tax on *all* "sale[s] or exchange[s] of tangible personal property" if the taxpayer is a Washington resident and not subject to "another taxing jurisdiction." RCW 82.87.100(1)(a). The same is true for the "sale or exchange" of "intangible personal property … if the taxpayer was domiciled in th[e] state at the time [of] the sale or exchange." RCW 82.87.100(1)(b). The *Complete Auto* test contemplates that states may lack a sufficient nexus even to activities that occur *within* their borders. *A fortiori*, Washington does not have a substantial connection to *out-of-state* transactions of *out-of-state* property just because one of the parties is a Washington resident. Indeed, if that were enough to empower states to enact and apply excise taxes, then each state would become a roving tax authority, free to tax virtually anything its residents do in the rest of the nation.

Nor is ESSB 5096 fairly apportioned, as it taxes activity not fairly attributable to Washington. Simply establishing a domicile in Washington does not

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[3] Petitioners conceded the fourth element below, and do not contest it here. *See supra* n.2.

constitute an "economic justification" allowing the state to tax the sale or transfer of out-of-state assets. *Okla. Tax Comm'n*, 514 U.S. at 185. If it did, then the limits on states' taxing authority would be essentially nil. And even if there were some valid economic justification or rational relationship between Washington and those out-of-state transactions, the state identified no basis here to claim the entirety of such transactions for itself, without apportioning any of their value to the state(s) in which they actually took place. That is particularly problematic, given that most states impose taxes of one kind or another on transactions that occur within their borders—raising the specter of duplicative taxation.

Finally, ESSB 5096 is unduly discriminatory for largely the same reasons. *See Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 171 (1983) ("[T]he anti-discrimination principle has not in practice required much in addition to the requirement of fair apportionment."). To be sure, the tax contains a credit-allocation regime designed to avoid "possible multiple taxation." App.46. But the credit extends only to taxes paid to another state "from capital assets within the other taxing jurisdiction to the extent such capital gains are included in the taxpayer's Washington capital gains." RCW 82.87.100(2)(a). And it is not enough just to have a tax-credit regime, *contra* App.46; the credit must actually function in a way that addresses and eliminates the risk of double-taxation of "products manufactured or the business operations performed in any other State." *Bos. Stock Exch.*, 429 U.S. at 336-37. ESSB 5096 fails that test, subjecting "interstate commerce to the burden of multiple taxation." *Id.* at 549-50 (striking down state income

tax that did not offer residents a full credit against income taxes paid to other states). Accordingly, *Complete Auto* is of no help to the state here.

II. The Decision Below Squarely Conflicts With An En Banc Decision Of The Ninth Circuit.

The decision below defies bedrock constitutional principles and a wall of this Court's precedents. That is reason enough for plenary review. *See Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130, 154 (1982) ("Judicial review of state taxes under the Interstate Commerce Clause is intended to ensure that States do not disrupt or burden interstate commerce[.]"). But it is far from the only reason. Had this issue been litigated in federal instead of state court, it would have come out the other way under the Ninth Circuit's decision in *Sam Francis Foundation v. Christie's, Inc.*

Sam Francis involved a provision of the California Resale Royalty Act under which the seller of "a work of fine art" (or the seller's agent) was required to "pay to the artist" (or the artist's agent) "5 percent of the amount of [the] sale." Cal. Civ. Code §986(a). This requirement applied not only when "the sale takes place in California," but also when the sale took place *in some other state* but "the seller resides in California." *Id.* Various artists and their representatives brought suits against Sotheby's, Christie's, and eBay, respectively, each alleging that the auction house failed to comply with the Act's requirements when acting as an agent of sellers of fine art. *Sam Francis*, 784 F.3d at 1322. The district court held that the provision violated the Commerce Clause as applied to out-of-state transactions, and an en banc panel of the Ninth Circuit agreed.

The reasoning and result of that decision are squarely at odds with the decision below. Just like ESSB 5096, the California law at issue in *Sam Francis* "facially regulate[d] … commercial transaction[s] that 'take[] place wholly outside of [California's] borders.'" *Id.* at 1323 (quoting *Healy*, 491 U.S. at 336). And that was enough for the en banc court to conclude that "it violates the dormant Commerce Clause." *Id.* Here, by contrast, the Washington Supreme Court upheld Washington's tax on wholly out-of-state transactions even though it expressly and repeatedly held that ESSB 5096 is an excise tax on transactions, *not* a tax on the income generated thereby. App.2, 19. Those two decisions cannot be reconciled.

To be sure, the California law "require[d] the seller or the seller's agent to pay a royalty *to the artist*, a private party, not to the government," and thus did "not impose a tax" in the traditional sense. 784 F.3d at 1324. The Ninth Circuit declined to apply "cases that concerned the validity of state-imposed *taxes*, such as … *Complete Auto*," for that reason. *Id.* But the same "principles" that underlie the prohibition on direct state *regulation* of out-of-state sales "also animate the Court's Commerce Clause precedents addressing the validity of state taxes." *Wayfair*, 138 S.Ct. at 2091. And while those principles leave states with considerable leeway to generate tax revenue *based on* their residents' out-of-state activities, *see supra* p.15-16, they foreclose efforts to tax the out-of-state activities directly.

Indeed, there is no practical difference between a tax and some other kind of regulatory exaction on an out-of-state transaction. If the proceeds of ESSB 5096

were directed to a fund controlled by the parents of schoolchildren instead of a fund controlled by the state that sends all the money it receives out to schools, it would remain every bit as much of a direct regulation of the individuals being compelled by state law to hand over money. In fact, the proceeds raised by the law in *Sam Francis* could even "wind up … in a special fund of the State's coffers," but that did not change the fact that the state statute "directly regulate[d]" private conduct "for a transaction that occurs wholly outside the State." 784 F.3d at 1324. The same is true here, yet the decision below reached exactly the opposite result.

In short, the decision below creates a split of authority between a state court of last resort and the federal court of appeals in which the state sits. It does so, moreover, in a context where litigants have only limited recourse to the federal courts by virtue of the Tax Injunction Act. *See* 28 U.S.C. §1341 ("The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State."). That makes it all the more important for this Court to step in and vindicate the constitutional rights of Washingtonians.

III. The Question Presented Is Exceptionally Important, And This Is A Good Vehicle To Resolve It.

The decision below opens a pandora's box of dangerous practical implications on a national scale. If Washington can tax out-of-state transactions based merely on the domicile of the transactor, then any state can tax its residents' transactions anywhere and

everywhere, regardless of the regime that governs where the transaction occurs or the property involved is held. *See C & A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 406 (1994) (O'Connor, J., concurring in the judgment) (state law "must be evaluated not only by considering the consequences of the statute itself, but also by considering … what effect would arise if not one, but many or every, [jurisdiction] adopted similar legislation" (alteration in original) (quoting *Healy*, 491 U.S. at 336)). Utah could impose a roaming excise tax that applies anytime one of its residents purchases or sells alcohol anywhere. California could do the same for firearms. Or Alabama could impose a tax on abortions obtained by its residents out of state. And the logic of the decision below does not stop at excise taxes. If personal nexus suffices, then states could impose property taxes even for goods that never come home. None of that can be reconciled with this Court's cases or bedrock principles of federal constitutional law.

This Court has long held that, while Washington is of course free to maintain an untraditional tax system, the state cannot use its innovations to evade the limits on state constitutional authority. *See, e.g.*, *Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue*, 483 U.S. 232 (1987) (invalidating wholesale component of Washington's B&O tax); *Gwin*, 305 U.S. at 439-40 (invalidating Washington gross receipts tax that, "though nominally local, … discriminate[d] against interstate commerce" in "its practical operation"). The core problem with those taxes of yore was the discrimination against interstate commerce and risk of multiple taxation. ESSB 5096 raises that concern too—but the problem with it and the regime

the decision below threatens to unleash is not limited to the specter of duplicative taxation.

It is more fundamental. While the allocation of power in our federal system is most often articulated in terms of "the prerogatives and responsibilities of the States and the National Government vis-à-vis one another," *Bond v. United States*, 564 U.S. 211, 221 (2011), the federal-state divide is not federalism's only axis. "The Constitution allocates sovereign power between governments along two dimensions: a vertical plane that establishes a hierarchy and boundaries between federal and state authority, and a horizontal plane that attempts to coordinate fifty coequal states that must peaceably coexist." Allan Erbsen, *Horizontal Federalism*, 93 Minn. L. Rev. 493, 494 (2008). The Framers "intended that the States retain many essential attributes of sovereignty," and the "sovereignty of each State, in turn, implie[s] a limitation on the sovereignty of all of its sister States." *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 293 (1980). That limitation takes many forms, but one is paramount: Because "each State has a sovereignty that is not subject to unlawful intrusion by other States," *J. McIntyre Mach., Ltd. v. Nicastro*, 564 U.S. 873, 884 (2011) (plurality opinion), "[n]o State can legislate except with reference to its own jurisdiction," *Gore*, 517 U.S. at 571 (quoting *Bonaparte v. Appeal Tax Ct. of Balt.*, 104 U.S. 592, 594 (1881)).

This territorial constraint "is, in part, an end in itself," as it "ensure[s] that States function as political entities in their own right." *Bond*, 564 U.S. at 221. Indeed, "any attempt directly to assert extraterritorial jurisdiction over persons or property would offend

sister States and exceed the inherent limits of the State's power." *Shaffer v. Heitner*, 433 U.S. 186, 197 (1977). But that limitation "is more than an exercise in setting the boundary between different institutions of government for their own integrity." *Bond*, 564 U.S. at 221. It also "secures to citizens the liberties that derive from the diffusion of sovereign power." *New York v. United States*, 505 U.S. 144, 181 (1992). In freeing legislators in Olympia from Washington's territorial constraints, the decision below not only impinges on sister states' sovereignty, but undermines the very liberties our Constitution exists to secure.

On top of that, the decision upholding ESSB 5096 creates immediate and severe hardship on taxpayers. In just its first year, the tax is expected to generate around *$850 million* in revenue. *See* Claire Withycombe, *WA's new capital gains tax brings in far more than expected, supra*. And there is no reason to think that future years will be materially different. An unconstitutional exaction that unlawfully deprives taxpayers of nearly a billion dollars annually should not be permitted to stand.

Finally, this is an excellent vehicle through which to clarify that states may not impose excise taxes on transactions that occur in different states. That issue was raised at every stage below, fully briefed by the parties, and decided by the state's highest court. The Washington Supreme Court's resolution of that issue directly conflicts with the law of the Ninth Circuit. But petitioners likely could not raise their challenges to ESSB 5096 in federal court in light of the Tax Injunction Act. States should not be able to enact unconstitutional laws and then insulate those laws

from federal review. The only recourse petitioners and others in their shoes have is this Court's intervention. This Court should grant review to resolve this question of national importance, and answer it in the negative.

CONCLUSION

For the foregoing reasons, this Court should grant the petition for certiorari.

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