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## MEMORANDUM

DATE: March 7, 2025

TO: Washington Governor Bob Ferguson, Washington State Department of Revenue, Office of Financial Management

FROM: Andrew Krawczyk, Assistant Attorney General

SUBJECT: **Proposed Tax on Financial Intangible Assets (FIAT) Over \$50 Million.**

### **Brief Description:**

The Legislature is considering a 1% property tax on certain intangible assets worth over \$50 million. It also provides a credit for similar taxes paid to another state.

### **Questions Presented:**

- Whether this tax violates the constitutional uniformity requirement because of the \$50 million threshold? Short Answer: It is difficult to predict the outcome, but it is a realistic possibility for a Court to find that it violates uniformity.
- If the Legislature were to cap the tax (e.g. \$10 million), would that raise additional legal concerns? Short Answer: Yes, it increases the chance FIAT would be found to violate uniformity.
- Are there legal concerns related to the financial assets being taxed twice because of the capital gains tax? Short Answer: No.
- Other legal concerns? Short Answer: a credit for similar taxes paid to another state could also be found to violate uniformity.

### **Legal Analysis:**

It is difficult to say how Washington courts would answer your questions concerning constitutional uniformity of the FIAT and the idea of a \$10 million tax cap. There are unresolved reasonable arguments both for and against the constitutionality of the FIAT. The provisions that pose the greatest risk are the \$50 million threshold exemption and the credit for similar taxes paid to another state.

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By way of background, the Legislature has plenary authority in matters of taxation except as limited by the constitution. *Belas v. Kiga*, 135 Wn.2d 913, 919–20, 959 P.2d 1037 (1998). The primary limitations with respect to property taxes are the uniformity and levy rate restrictions in Article VII, sections 1 and 2 of the state Constitution. The FIAT does not raise any concerns with respect to the levy rate restriction but does pose concerns regarding uniformity.

Initially, the uniformity requirement in Article VII placed stringent limitations on the authority of the state and local governments, barring any property tax that was nonuniform and allowing exemptions from taxation only when set out in the constitutional text. *See e.g., State v. Daniel*, 17 Wash. 111, 117, 49 P. 243 (1897). That changed in 1930 with the ratification of Amendment 14, which broadened the power of the Legislature in two significant ways.

First, it limited the uniformity requirement to property “within the same class.” This means a defined class of taxable property must be assessed on an equal basis and at an equal tax rate. *Belas*, 135 Wn.2d at 923. Thus, the Legislature now had authority to define classes of property and tax different classes at different rates. *State ex rel. Mason Cnty. Logging Co. v. Wiley*, 177 Wash. 65, 70, 31 P.2d 539 (1934). The one caveat is that real property must all be in a single class.

Second, Amendment 14 expressly authorized the Legislature to exempt property from taxation “by general law.” *Belas*, 135 Wn.2d at 929. Thus, an exemption no longer had to be expressly stated in the constitution but could be enacted through the legislative process. Consistent with this change, the Legislature exempted intangible personal property from the property tax. Laws of 1931, ch. 96, § 1. The property tax code now contains numerous additional exemptions. *See* RCW ch. 84.36.

There remains, however, an unanswered question with respect to the Legislature’s power to enact property tax exemptions by general law. Namely, is that power limited to a “full” exemption or can the Legislature enact a partial exemption? As discussed below, there are reasoned arguments on both sides of that debate.

**Does the proposed FIAT violate the Article VII uniformity requirement because of the \$50 million threshold?**

There is no dispute that the Legislature can entirely exempt property from taxation without violating the uniformity requirement. *See generally, State v. Wooster*, 163 Wash. 659, 664–65, 2 P.2d 653 (1931) (affirming constitutionality of total exemption). However, no case law directly addresses whether the Legislature can partially exempt personal property from taxation without a

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constitutional amendment.<sup>1</sup> A partial exemption means that a portion of the exempt unit of property still has some tax levied against; it does not refer to the division of property into smaller taxable units. *See e.g., City of Kennewick v. Benton County*, 131 Wn.2d 768, 775, 935 P.2d 606 (1997) (fully exempting a city's 49 percent ownership interest in a property).

It is also worth noting that when the Legislature has enacted partial exemptions, it has done so only after an amendment to Article VII permitting the exemption. Amendment 47, for example, preceded the Legislature enacting a nonuniform tax preference for low-income retired persons. Wash. Const. art. VII, sec. 10; RCW 84.36.379-389. Another example is the personal property tax preference found in RCW 84.36.110(2), which, in part, allows families to deduct \$15,000 from the taxable value of certain household tangible personal property. This preference was preceded by Amendment 3 (1900) (authorizing the preference); Amendment 81 (1988) (increasing the threshold to \$3,000); and Amendment 98 (2006) (increasing the threshold to \$15,000). Here the \$50 million threshold in the FIAT bill resembles the preference in RCW 84.36.110(2), although the threshold of exempt and taxable value is much larger (\$50 million as opposed to \$15 thousand). In any event, the \$50 million exemption in the FIAT could be considered a partial exemption, and if not preceded by an amendment to Article VII, a court might conclude that it fails the uniformity requirement.

Even if partial exemptions are not permitted without constitutional amendment, proponents of the FIAT could argue that the \$50 million threshold can be interpreted and applied as a total exemption. The FIAT provides that the exemption is "up to" \$50 million, which is applied by exempting only whole assets up to the maximum allowed,<sup>2</sup> instead of a tax deduction which reduces \$50 million from the total value of taxable assets and causing partial taxation.

It is difficult to reliably forecast how Washington courts would ultimately resolve these uniformity issues. If challenged, the FIAT will be presumed constitutional and proponents have some good arguments for defending it, however, the presence of this exemption creates a realistic possibility FIAT will be found to violate the requirements of Article VII section 1.

**If the Legislature were to cap the tax (e.g. \$10 million), would that raise additional legal concerns?**

Yes, this likely depends in part on how the cap is written, but generally a cap on total tax liability would increase the chance of the FIAT violating Article VII, section 1. In addition to the partial

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<sup>1</sup> The issue of a partial exemption has come up in at least one case, but the Court resolved the dispute on different grounds. *Belas*, 135 Wn.2d at 935, 942 (value averaging formula was not enacted as an exemption from taxation, value averaging formula results in nonuniform taxes).

<sup>2</sup> For example, a person with two assets, each indivisible and valued at \$30 million, would only be able to claim the exemption on one whole \$30 million asset. Allowing the second \$30 million asset to be exempt would cause the claimed asset to exceed the "up to" threshold by effectively reducing the tax liability of the second asset to \$10 million.

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exemption issues discussed above, a property tax preference that comes into operation after tax liability is imposed likely violates uniformity. *See Cameron*, 90 Wash. at 414–15 (finding that the method of applying the \$300 personal property deduction after the property tax ratio was applied was unconstitutional). However, *Cameron* was decided before Amendment 14, so the answer to this question is now uncertain. Additionally, this proposal starts to resemble “tax bracketing,” and it is unclear to what extent that is permitted using the discretion to create different classes of personal property and exemptions after Amendment 14.

**Are there legal concerns related to the financial assets being taxed twice because of the capital gains tax?**

There is no legal bar against imposing the FIAT on assets that, when sold, may also be subject to the capital gains tax. The two taxes have entirely different incidents. The capital gains tax is an excise tax imposed on a transaction - the sale or exchange of qualifying capital assets. RCW 82.82.040; *see Quinn v. State*, 1 Wn.3d 453, 478-83, 526 P.3d 1 (2023) (discussing the taxable incident). The FIAT, by contrast, is an annual tax on the value of taxable asset owned by Washington residents. Section 3. The fact that the state imposes an excise tax on the sale of property, and a property tax on the value of that same property prior to sale, raises no legal concerns.

**Other legal concerns.**

Section (7) provides a credit “equal to the amount of any similar tax legally imposed on, and paid by, the person to another state for the same tax year.” This provision was enacted to address commerce clause concerns of multiple state taxation. It is unclear, at this point, if it would ever apply because a state would need to pass a similar scheme, a taxpayer would need an asset subject to both taxes, and the taxpayer would have to be entitled to take the credit against their Washington liability; however, if it did apply it reduces the ultimate tax paid on a Washington taxable asset and thus results in nonuniform taxation. Accordingly, it poses the same concerns and uncertainties identified above for the \$50 million threshold as well as the additional concern of coming into operation after tax liability is imposed.

While there would still be some litigation uncertainty because of the novel issues the FIAT presents, an easier to defend approach to achieve the policy goals in sections (6) subsection (1) and (7) would be to make them complete exemptions. For example, the Supreme Court describes three classes of exemptions, including an exemption which “is defined by some characteristic of the property owner (i.e., low-income, retired or disabled).” *Belas*, 135 Wn.2d at 931. Accordingly, the Legislature could completely exempt the property of a person who had less than \$50,000,000 in taxable assets. The property of a person who had more than \$50 million in taxable assets would pay the tax on all taxable assets unless a different exemption applies.

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This memo is based on the latest versions of the FIAT presented to us. Any changes to the FIAT should be carefully reviewed by our office to ensure no additional problems with the constitutional requirements don't emerge. This is not an official opinion of the Attorney General's Office and is intended only as general guidance.

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