

## Jacob Allen

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Weekly Column

# Capital Gains In Wash., Pot In La.: SALT In Review

By [David Brunori](#) · May 7, 2021, 3:51 PM EDT

From Washington's new capital gains tax to Louisiana's move toward legal marijuana, here are my thoughts on noteworthy state and local tax news.

## Sometimes an Income Tax Is Just an Income Tax



David Brunori

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Washington state is a beautiful place. That the state does not tax income makes it all the more so. The absence of an income tax has fueled economic development, particularly in the tech-heavy Seattle area. Beyond the economics, people in Washington have never liked the income tax. Perhaps they like keeping their money in their pockets. Whenever they are asked to allow the tax, they say no. In fact, they have said no 10 times.

Unfortunately, for the people at least, politicians in Washington are determined to tax income. They say they want to make the rich pay their fair share. But I think these politicians just can't stand that some people have more money than others. They also believe they have an inherent right to other people's money. Their latest effort to stick it to the rich comes in the form of a capital gains tax.

That measure, in S.B. 5096, will impose a 7% tax on an individual's Washington capital gains, less a standard deduction of \$250,000. So if you have capital gains as determined by your federal income tax return, you pay the tax. The capital gains tax will not apply to sales of real estate, livestock, retirement accounts like 401(k)s, certain family-owned businesses and agricultural land. So it seems it is aimed at people who own stock and who own businesses.

I obviously think this is a money grab by people who understand neither human nature nor economics. But you may wonder how the state can impose this tax, since the Washington Constitution seems to prohibit income taxation. If you are wondering that, you are as naïve as me. It turns out that proponents of the tax say it's not an income tax. It is an excise tax, like that on cigarettes or marijuana. I am not kidding. Proponents are saying this is a perfectly legal excise tax on the privilege of earning capital gains in Washington.

That is funny. The whole world, including the [Internal Revenue Service](#), every state that has weighed in and the [Congressional Budget Office](#), says a capital gains tax is an income tax. The question is: Will the people or better yet the courts buy this charade?

And the courts are already involved. Before the governor even [signed the bill](#) on May 4, a lawsuit challenged the tax. My understanding is that more suits are coming. That first one was filed on behalf of several residents by Seattle super lawyers Scott Edwards and Callie Castillo of [Lane Powell](#). I love when good firms get into the fight against bad taxes.

## MTC Goes Digital

My friends at the Multistate Tax Commission are stepping into the wild world of state taxation of digital goods. The MTC's uniformity committee has asked its standing subcommittee to [develop a white paper](#) on the topic. You may notice that the MTC has a lot of committees. And I love white papers. They imply gravitas. The [Central Intelligence Agency](#) used to prepare white papers on the threat of a communist global takeover.

I will save the committee a little time. The sales tax should be imposed on the purchase of all digital goods — by consumers. When possible, the sales tax should not be imposed on the purchase of digital goods by businesses. No state should ever impose a gross receipts tax on digital goods, or anything else, for that matter. There. I just wrote part of the white paper.

Seriously, though, folks, I do think the MTC has an important role to play. There is a need for uniformity and consistency with respect to how state and local governments source sales of digital goods. There is a need for clearer definitions of digital goods subject to tax, particularly if we want to exempt business inputs. I have faith that the effort is not aimed at squeezing every dime out of every person who encounters real or perceived digital goods. People should get behind the MTC initiative.

## Speaking of the MTC

I had the honor to speak in a Council on State Taxation income tax webinar recently. I was humbled to be on a panel with Maria Eberle, Jonathan Feldman, Jeremy Abrams and Kate Pascuzzi. They really are among the best tax lawyers in the business. The topic was state transfer pricing; the panelists are the leading experts on the subject.

The North Carolina voluntary disclosure initiative and Indiana's advance pricing agreement program were discussed at length. Some of the presenters said that clients were skittish about entering into a unilateral APA arrangement. They feared that a deal reached in Indiana might not be recognized in, say, Pennsylvania. I personally think the North Carolina and Indiana initiatives are terrific. They potentially save taxpayers a ton of money; transfer pricing audits and litigation are expensive, time-consuming nightmares. These initiatives can also raise money for the states, as most states are not particularly good at transfer pricing.

This is an opportunity for the MTC's newly reconstituted transfer pricing committee. We need more APA programs. But for such programs to succeed, taxpayers need to know that a transfer pricing agreement in State A will not lead to a disaster in State B. Another issue that my fellow panelists brought up is that there is no uniformity when it comes to state transfer pricing. States use a variety of methodologies and approaches.

And there is much confusion about state conformity with Internal Revenue Code [Section 482](#), which addresses transfer pricing. Indeed, after the conference, a veteran transfer pricing lawyer sent me this ditty about states adhering to Section 482:

*Some states say they sometimes do  
Some states say they don't*

*Some states say they always do  
But for my clients they won't*

I've been doing state transfer pricing a long time. I have never seen two states take the same approach. But I believe that there is a principled, right way to determine whether intercompany transactions should lead to tax adjustments. I also believe that there is a fair way to address multistate ramifications of transfer pricing adjustments. The MTC is in the best position to develop that principled approach.

## Good News From Little Rock

Arkansas [has enacted](#) S.B. 484, which ends the administratively adopted "convenience of the employer" test. How unpopular was the test? The bill that ends it passed unanimously in both houses.

The convenience test is a money grab. If you are an employee of a company in Arkansas, you are subject to Arkansas income tax no matter where you live — unless you live out of state because your employer is making you. That is what the Department of Finance and Administration said in a 2020 legal opinion. This is particularly important in a post-pandemic work-remotely world.

Getting rid of the unprincipled convenience test is a good thing, of course. While Delaware, Connecticut, Nebraska and Pennsylvania use the test, it is usually thought of as a New York thing. It is inexplicable everywhere. If I work for a company in Little Rock but can work from New Hampshire, why should Arkansas be able to tax me? It shouldn't.

Unfortunately, the Arkansas Legislature removed a 30-day mobile workforce safe harbor from the bill. I'm not sure why the Legislature declined to heed the advice from the business community on this issue. It can't be about money.

## Feeling Old

I opened my online class recently with my favorite Rolling Stones song, "Rip This Joint." [YouTube](#) it — you will be rockin' in your home office. Of course, most of my students, born in the middle of the Clinton administration, had never heard of this relatively obscure band.

The song is partly about marijuana, with references to rolling joints and getting high. It also has the memorable line "Dick and Pat in ole D.C. / Well they're gonna hold some" pot "for me," with of course a saltier word than "pot." I got blank stares when I explained that Dick and Pat were Mr. and Mrs. Nixon. Apparently mistaking Mr. and Mrs. Nixon for Mr. and Mrs. Fillmore, one of my students asked if "they had pot back then."

In any event, I was looking for a drug song to segue into the fact that Louisiana [may legalize marijuana](#) this session, with H.B. 699. Louisiana is not doing this because, like the Stones, the lawmakers think it would be fun. It's about the money. There will be a wholesale tax, a retail tax and fees for business licenses and permits to grow your own. If the Louisiana measure eventually takes effect, there will be 23 states that have legalized pot or are in the process of legalizing it.

Pot dispensaries are going to be like [Starbucks](#) and [Home Depot](#). Pot will be ubiquitous and banal — hardly the thing of rebellious rockers.

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