Supreme Court Stays Order Invalidating Capital Gains Tax

By: Howard M. Goodfriend

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The Supreme Court recently granted the State of Washington's motion to stay pending appeal the Douglas County Superior Court's ruling invalidating the ESSB 5690—the Legislature's 7% tax on capital gains in excess of $250,000[1]. As enacted and signed into law in 2021, the tax applies to transactions occurring on or after January 1, 2022.[2] By staying enforcement of the superior court's order, the Supreme Court allowed the Department of Revenue to promulgate rules and create tax forms and instructions to taxpayers while the Supreme Court considers the constitutionality of the capital gains tax after hearing argument in its winter 2023 term. If the Court has not yet decided the case, the State will begin collecting the tax on April 18, 2023.

The capital gains tax's specific provisions and exemptions are beyond the scope of this article, as are the arguments for and against its validity under the state and federal constitutions. The Supreme Court's stay order, however, provides an opportunity to review the standards used by appellate courts for staying enforcement of a trial court's injunction or other equitable order pending appellate review.

A trial court's final judgment is generally enforceable within two weeks after it has been entered, even if a party appeals the judgment. Under RAP 7.2(c), the trial court may enforce its judgment unless the decision has been stayed, and "[a]ny person may take action premised on the validity of a trial court judgment or decision" until its enforcement is stayed pending appeal.

Unlike a monetary judgment, which may be stayed as a matter of right upon the posting of supersedeas in the form of cash or a surety bond, an injunction, decision affecting property, or other equitable order may be stayed pending appeal only at the discretion of the appellate court. RAP 8.1(b). The order enjoining the State from collecting the capital gains tax is an equitable order that may be stayed under RAP 8.1(b)(3).

The appellate court also has the authority to enter any orders, before or after the acceptance of review or in an original action under Title 16 of the Rules of Appellate Procedure, to issue such orders as necessary to "insure effective and equitable review." RAP 8.3. This includes the authority to grant injunctive or other relief. RAP 8.3.

These provisions grant "the appellate court . . . discretion before or after acceptance of review, to stay enforcement of the trial court decision upon such terms as are just." The appellate court considers (1) "whether the moving party can demonstrate that debatable issues are presented on appeal," and (2) compares "the injury that would be suffered by the moving party if a stay were not imposed with the injury that would be suffered by the nonmoving party if a stay were imposed." RAP 8.1(b)(3).

The party seeking a stay need not demonstrate ultimate success on the merits, but only that the issue is debatable. *Kennett v. Levine,* 49 Wn.2d 605, 607, 304 P.2d 682 (1956). But the existence of a "debatable issue" alone is not sufficient to justify a stay, particularly when the practical effect of a stay would be to reverse or postpone the effect of a time-sensitive trial court decision.

A stay is more likely to be granted where enforcement of the trial court's order will deprive the appellant of the fruits of a successful appeal. In *Shamley v. City of Olympia*, 47 Wn.2d 124, 127, 286 P.2d 702 (1955), for instance, the Court stayed an order requiring

sale of timber pending an appeal because in the absence of a stay, the trees, which the appellants sought to protect, would be destroyed and the appeal would become moot.

While there are no clear guidelines as to whether an appeal presents "debatable issues" to justify a stay under RAP 8.1(b)(3), in practice the courts use a sliding scale to evaluate the merits of an appeal against the need for a stay in deciding whether to suspend enforcement of a trial court decision.[3] In *Shamley*, the court stated that when the question presented is one of first impression to the Court, a debatable issue is presented by the appeal. 47 Wn.2d at 127. As the harm flowing from the denial of a stay increases, the Court will likely require less certainty of prevailing on a "debatable" issue on appeal.

A party seeking a stay from the appellate court under RAP 8.1(b)(3) or RAP 8.3 should file a motion in the appellate court and, if necessary, seek emergency consideration by an appellate court commissioner. A party seeking a stay of enforcement should do so promptly, as a trial court may find a party in contempt for failing to comply with its order.[4]

A stay by the appellate court will ordinarily be conditioned on the furnishing of a bond, cash, or other security. RAP 8.1(b)(3); 8.3. But that is not always the case, particularly where the party seeking a stay can convince the Court that there will be no meaningful harm imposed by the stay order.[5]

The capital gains tax case illustrates how these principles may be applied. The Douglas County Superior Court declared ESSB 5096 "unconstitutional and invalid and, therefore . . . void and inoperable as a matter of law."[6] That order prevented the State from collecting the tax, but also created uncertainty whether the State could prepare implementing the tax—for instance, by promulgating rules, or creating forms and an on-line system to assist taxpayers.

Without having to hold that the State would likely prevail, in granting a stay, the Supreme Court clearly believed the constitutionality of the capital gains tax presented debatable issues on appeal. And the State demonstrated that it would face significant financial injury if it was prevented pending appeal from taking the steps necessary to collect a tax authorized by the legislature to fund state programs in April 2023.

Further, while the challengers had a financial interest in not paying an unlawful tax, they could not show irreparable injury were the State permitted to collect the tax while an appeal was pending. The State would be required to refund any taxes collected, with interest, should the Supreme Court ultimately agree with the trial court that the tax was invalid, thus obviating any financial injury to affected taxpayers.

Given the substantial public interest at stake, it is likely that the Court will issue a merits decision before the State begins collecting the tax on April 18, 2023. While there is clearly a risk that the State's implementation would be for naught were the Court to hold the tax invalid, that is a risk the State was willing to accept.

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[1] https://bit.ly/3hfmA9H

[2] RCW 82.87.040(1), .110.

[3] *Boeing Co. v. Sierracin Corp.*, 43 Wn. App. 288, 716 P.2d 956 (1986), *rev'd in part on other grounds*, 108 Wn.2d 38, 738 P.2d 665 (1987).

[4] *See Cronin v. Cent. Valley Sch. Dist.*, 12 Wn. App.2d 123, 131, 456 P.3d 857, *rev. denied*, 195 Wn.2d 1031 (2020) (trial court had discretion to find party in contempt for failing to comply with its order even though party's motion to stay enforcement of that order was pending).

[5] If the appellate court does order a bond to secure the respondent's losses pending appeal, it may remand the case to the superior court for the limited purpose of setting the amount of the bond. *See* RAP 7.2(h); *see, e.g., Boeing Co.*, 43 Wn. App. at 292.

[6] https://bit.ly/3uGDqBo