No. 95295-7

IN THE SUPREME COURT OF THE STATE OF WASHINGTON

S. MICHEAL KUNATH, *et al.*

Respondents,

v.

CITY OF SEATTLE

Appellant.

OPENING BRIEF OF APPELLANT CITY OF SEATTLE

PAUL J. LAWRENCE, WSBA # 13557
GREGORY J. WONG, WSBA #39329
JAMIE L. LISAGOR, WSBA #39946

PACIFICA LAW GROUP LLP
1191 SECOND AVENUE, SUITE 2000
SEATTLE, WASHINGTON 98101
TELEPHONE: 206-245-1700

ATTORNEYS FOR APPELLANT

KENT MEYER, WSBA #17245

PETER S. HOLMES
SEATTLE CITY ATTORNEY
701 FIFTH AVENUE, SUITE 2050
SEATTLE, WA 98104
TELEPHONE: 206 -615-1960

ATTORNEY FOR APPELLANT

HUGH D. SPITZER WSBA # 5827

5604 16TH AVE NE
SEATTLE, WA 98105-2521
TELEPHONE: 206 -615-1960

ATTORNEY FOR APPELLANT

TABLE OF CONTENTS

TABLE OF AUTHORITIES

WASHINGTON CASES

FEDERAL CASES

OTHER CASES

CONSTITUTIONAL PROVISIONS

WASHINGTON STATUTES

OTHER AUTHORITIES

I. INTRODUCTION

This appeal raises important issues regarding the ability of home rule cities to raise revenue to provide essential public services in a way that does not compound the statewide inequity in tax burdens. The resolution of these issues requires examining the City of Seattle's (the "City's") taxing authority; determining whether an income tax is a property tax, an excise tax, or a *sui generis* tax unto itself; and revisiting unsound and outdated legal authority that wrongly held a progressive personal income tax unconstitutional.

Here, the City properly exercised its broad home rule authority to enact a gross income tax on total personal income. The trial court thus erred in holding a statute that prohibits the enactment of net income taxes barred the City's income tax. Nor does the Washington Constitution prohibit the City's income tax. Cases holding that an income tax is a property tax were wrongly decided, based on flawed reasoning. Indeed, the weight of judicial authority at the time, and today, holds that an income tax is not a property tax. The legislature expressly granted the City broad authority to enact non-property taxes, both in the form of excise taxes under RCW 35A.82.020 and RCW 35.22.280(32), and otherwise for all local purposes in RCW 35A.11.020. The City's income tax falls within its broad statutory authority; the trial court erred in ruling otherwise.

Finally, Respondents' constitutional claims fail because an income tax is not a property tax, and the City had a rational basis for applying the tax only to income above certain thresholds.

The City's income tax should be upheld.

II. ASSIGNMENTS OF ERROR

1. The Ordinance taxes personal "total income" as taxpayers report it to the Internal Revenue Service ("IRS"). The trial court erred in ruling that the City's tax based on the "total income" of individual taxpayers is a "net income" tax prohibited by RCW 36.65.030.

2. The vast majority of courts hold that a tax measured by personal income is an excise tax, not a property tax. Prior Washington case law to the contrary was based on incorrect premises and legal underpinnings that have been overturned. The trial court erred by not applying the proper characterization of the City's income tax and in ruling that the City's income tax is not an excise tax.

3. The legislature has granted the City broad home rule authority to impose taxes, including excise taxes. The trial court erred in ruling that the City's income tax is not an excise tax authorized by RCW 35.22.280(32) and RCW 35A.92.020.

4. RCW 35A.11.020 confers the City with "all powers of taxation for local purposes" within the City's boundaries subject only to

constitutional and statutory constraints. The trial court erred in ruling that the City's income tax is not authorized by this statute.

III. STATEMENT OF THE CASE

Seattle is experiencing unprecedented growth. CP 372. But while some are profiting from this boom, many are falling further behind. *Id*. The City has declared a homelessness state of emergency. CP 372-73. Further, people with low and middle incomes are having an increasingly harder time living in Seattle. CP 372. This stems in part from the exponential growth in housing prices. *Id.* The City also faces growing need for transit, as well as inadequate provision of mental and public health services and gaps in education equity and racial achievement. CP 372-73.

Washington State's tax system—the most regressive in the nation—only exacerbates Seattle's affordability crisis. CP 373, 562-63. Washington is ranked "#1 of the Terrible Ten" in terms of the regressive nature of its state and local taxes. CP 563. As a result, the lowest 20% of income earners in Washington pay 16.8% of their income to taxes, while the top 5% pay 4.6% or less of their income to taxes. *Id.* The current tax scheme results in low- and middle-income residents paying a disproportionate share of their income to support state and local government compared to residents with high incomes. *Id.* Further, the

heavy reliance on property taxes burdens middle-income homeowners, particularly retired people on fixed incomes. The problem is especially acute in Seattle, whose residents pay the most regressive taxes in the state.[1] As a result of these and other pressures, it is growing more difficult for our teachers, police officers, and many other modest wage earners to live in the same city in which they work.

To address these challenges, the City adopted a gross personal income tax that applies to high-income residents in Seattle.[2] SMC 5.65.030.B (the "Ordinance"). The City decided to rely on federal income tax returns to determine the gross personal income attributable to the taxpayer (i.e., the amount of income before any adjustments, deductions or credits), a figure referred to as "total income" by the IRS and the City. SMC 5.65.020.G. The Ordinance defines "total income" as "the amount reported as income before any adjustments, deductions, or credits on a resident taxpayer's United States individual income tax return for the tax year…." *Id.* More specifically, "total income" is the amount "listed as

[1] Gene Balk, *Seattle Times*, "Seattle taxes ranked most unfair in Washington – a state among the harshest on the poor nationwide" (April 13, 2018), *available at* https://www.seattletimes.com/seattle-news/data/seattle-taxes-ranked-most-unfair-in-washington-a-state-among-the-harshest-on-the-poor-nationwide/ (last visited May 21, 2018).

[2] Income taxes are common in our country. In addition to the federal income tax, personal income taxes are imposed in 43 states and corporate income taxes are imposed in 45 states. State of Wash. House of Rep. Office of Program Research, *Summary of Initiative 1098* at 2 (Aug. 12, 2010); *available at* http://leg.wa.gov/House/Committees/OPRGeneral/Documents/2010/1098%20summary.pdf (last visited May 21, 2018).

'total income' on line 22 of Internal Revenue Service Form 1040…." *Id.*[3] Thus, what the IRS considers "total income" attributable to an individual taxpayer is the same as what the City considers "total income" of the same taxpayer.

Individual taxpayers who report more than $250,000 per year in total income and married, filing jointly taxpayers who report more than $500,000 per year in total income, pay an income tax equal to 2.25% of their total income over those thresholds.[4] SMC 5.65.030.B. For example, a married couple that files jointly and reports annual total income of $600,000 would pay an income tax of $2,250 to the City.[5] Taxpayers who report total income less than the threshold amounts pay no income tax to the City.

The City determined that the income tax would generate an estimated $140 million in new revenue annually. CP 402. The City further determined that these additional funds "would have a significant impact on City revenues" and could be used to address the policy priorities described

[3] The Ordinance uses the amount of income the resident taxpayer reports as "total income" to the IRS, regardless of which form is filed. *Id.* The City will use line 22 on Form 1040 in its briefing as it is the most common form filed and the differences in tax forms are not material to the legal issues.

[4] The Ordinance takes into account different taxpayer situations, such as trusts and married couples where one spouse is not a Seattle resident. SMC 5.65.020.E, .040. Because these provisions are not material to the Ordinance's overall validity, the City will use the two main filings statuses (individual and married filing jointly) in its briefing.

[5] The couple reports $100,000 in total income over the $500,000 threshold. $100,000 x 2.25% = $2,250.

above. *Id.* The City Budget Office ("CBO") conducted an analysis to determine whether the thresholds of $250,000 and $500,000 would, in general, target high-income households in Seattle. CP 407. The CBO evaluated the reasonableness of the thresholds based on three measures: (1) the distribution of incomes in the City, (2) household expenditure data for the Seattle area, and (3) basic cost-of-living indices. CP 407-09. Based on these measures, the CBO concluded the income thresholds were three to nine times that of what an average household needs to live in Seattle. CP 409 ("Those who would be subject to the tax have incomes in the top three percent of all Seattle households."). The City's tax, as designed, does not tax the wages or income required to live comfortably in the City.

In July 2017, after a series of public meetings, the City Council passed the Ordinance unanimously, and the Mayor signed it into law. CP 371. Respondents filed four separate lawsuits challenging the constitutionality of the Ordinance and the City's authority to impose an income tax. CP 1-5, 1608-15, 1629-52, 1658-98. The lawsuits were consolidated. CP 74-75, 1713-14.

On cross motions for summary judgment, the trial court struck down the Ordinance as invalid. CR 1294. The court ruled that the City lacks statutory authority to impose a local tax on the total income of individual taxpayers. Without analyzing the nature of the City's income

tax, the court ruled that the City's tax is not an excise tax authorized by RCW 35.22.280(32) or RCW 35A.82.020. CP 1306-08. The court stated that the City's "broad authority" to impose excise taxes is limited to levies on businesses for the privilege of doing business within city limits. CP 1308. The court further determined that the City's tax is not authorized by RCW 35A.11.020's grant of "all powers of taxation for local purposes" within constitutional limits. CP 1308-09. The court reasoned that "the general grant of taxing power recited in RCW 35A.11.020, standing alone, confers no specific authority on the City to impose any tax…." CP 1309. The court also determined that the City's tax on total income is a "net income" tax prohibited by RCW 36.65.030. CP 1310-13. The trial court declined to reach Respondents' constitutional claims. CP 1317-18.

The City timely appealed and seeks direct review by this Court.

IV. ARGUMENT

A. This Court liberally construes city tax powers.

Respondents' challenges to the City's income tax hinge on the proper characterization of the tax and the relevant statutory authority that flows from that characterization. The Washington Constitution authorizes the legislature to grant cities the power to levy taxes for local purposes. *See Watson v. City of Seattle*, 189 Wn.2d 149, 166, 401 P.3d 1 (2017). Article VII, § 9 provides that "[f]or all corporate purposes, all municipal

corporations may be vested with authority to assess and collect taxes…." Further, Article XI, § 12 authorizes the legislature to grant municipalities the power to levy taxes for "county, city, town, or other municipal purposes" and provides that only local authorities may "assess and collect taxes for such purposes." Local taxes must serve local purposes, but otherwise these constitutional provisions do not limit the objects or subjects of municipal taxation. *See City of Wenatchee v. Chelan Cnty. Pub. Util. Dist. No. 1*, 181 Wn. App. 326, 337, 325 P.3d 419 (2014). As this Court noted in *Watson*, "these provisions reflect Washington's adoption of what scholars refer to as 'home rule'—shorthand for the presumption of autonomy in local governance." 189 Wn.2d at 166. Home rule "seeks to increase government accountability by limiting state-level interference in local affairs." *Id*. at 167. "In this context, it is appropriate for Washington courts to 'liberally construe[]' legislative grants of power to cities, particularly first class cities." *Id.* (citation omitted). The converse is also true: exceptions to legislative grants of taxing power should be narrowly construed. *See Shoulberg v. Pub. Util. Dist. No. 1*, 169 Wn. App. 173, 179-80, 280 P.3d 491 (2012).

This Court reviews the trial court's summary judgment rulings de novo, performing the same inquiry as the trial court to determine whether the legislature's liberal grants of taxing authority empower the City to

adopt a local tax on total income. *See Am. Legion Post #149 v. Wash. State Dep't of Health*, 164 Wn.2d 570, 584, 192 P.3d 306 (2008). Importantly, "[t]he burden rests upon the party who challenges an ordinance to establish clearly its invalidity." *Winkenwerder v. City of Yakima*, 52 Wn.2d 617, 624, 328 P.2d 873 (1958); *see also Silver Shores Mobile Home Park, Inc. v. City of Everett*, 87 Wn.2d 618, 624, 555 P.2d 993 (1976) ("Every presumption will be in favor of the constitutionality of an ordinance.").

B. The City's tax on total income is not a "net income" tax.

The trial court erroneously ruled that the City's tax on "total income" violates a statute that provides: "A county, city, or city-county shall not levy a tax on net income." RCW 36.65.030. Total income is not net income. RCW 36.65.030 does not apply.

RCW 36.65.030's plain language only prohibits the City from imposing a tax on net income. The limitation to "net income" must be given effect. *See HomeStreet, Inc. v. State, Dep't of Revenue*, 166 Wn.2d 444, 452, 210 P.3d 297 (2009) ("[E]ach word of a statute is to be accorded meaning. Whenever possible, statutes are to be construed so no clause, sentence or word shall be superfluous, void, or insignificant." (quotations omitted)).

Courts may use dictionary definitions to discern the plain meaning of undefined statutory terms. *Id.* at 451. As the trial court noted, Black's Law Dictionary defines the term "net income" as "[i]ncome subject to taxation after allowable deductions and exemptions have been subtracted from gross or total income." CP 1311 (quoting Black's Law Dictionary, Special Deluxe Fifth Edition (1979)). Webster's Third New International Dictionary defines "net income" as "the balance of gross income remaining after deducting related costs and expenses [usually] for a given period and losses allocable to the period." Webster's Third New Int'l Dict. 1520 (1993) ("Webster's"); *see also Audit & Adjustment Co. v. Earl*, 165 Wn. App. 497, 503, 267 P.3d 441 (2011) (relying on Black's and Webster's definitions of "net income" to construe state regulations). Within the federal individual income tax system, personal net income aligns with "taxable income" as determined on line 43 of IRS Form 1040. CP 412. Thus, a city tax on a resident's "taxable income" would violate RCW 36.65.030's prohibition of net income tax.

By limiting RCW 36.65.030's prohibition to "net income" taxes, the legislature implicitly permitted otherwise authorized gross or total income taxes. *See Landmark Dev., Inc. v. City of Roy*, 138 Wn.2d 561, 571, 980 P.2d 1234 (1999) ("Where a statute specifically designates the things or classes of things upon which it operates, an inference arises in

law that all things or classes of things omitted from it were intentionally omitted by the legislature…." (quotation omitted)). In fact, the parties agree that RCW 36.65.030 does not prohibit city taxes on gross business income like the City's B&O tax. *See State ex rel. Stiner v. Yelle*, 174 Wash. 402, 413, 25 P.2d 91 (1933) (upholding gross business income tax). RCW 36.65.030 does not distinguish between business and personal income; thus, a personal income tax on gross income of an individual is also permissible. The question is whether the City acted within its broad discretion in determining how to measure an individual's gross personal income. *See Commonwealth Title Ins. Co. v. City of Tacoma*, 81 Wn.2d 391, 395-96, 502 P.2d 1024 (1972) ("It is inherent in the exercise of the power to tax that a state be free to select the objects or subjects of taxation and to grant exemptions."). The City did so by reference to the closest equivalent to gross personal income in the federal taxation scheme: total income as determined on line 22 of IRS Form 1040.

Consistent with RCW 36.65.030's prohibition on net income taxes, the City reasonably relied on the IRS's calculation of "total income" for purposes of federal personal income taxes as the basis for measuring an individual's gross income. As the City determined, total income is "the amount reported as income **before** any adjustments, deductions, or credits on a resident taxpayer's United States individual tax return…." SMC

5.65.020.G (emphasis added). In particular, total income is the sum total of all personal income received by a taxpayer, including wages, salaries, tips, business income (or losses), etc. *See* CP 411 (Form 1040, ln. 7-22); CP 475-85 (Instructions for Form 1040). Total income does not subtract personal deductions, exemptions, and other reductions, such as moving expenses, health savings accounts, IRAs, and standard or itemized deductions. *See* CP 411-12, 485-95. Total income is therefore an appropriate basis for measuring gross personal income (as opposed to net income, i.e., taxable income "after allowable deductions and exemptions have been subtracted from gross or total income," Black's Law Dictionary, Special Deluxe Fifth Edition (1979)). Indeed, Respondents have never identified any alternative that better reflects a reportable measure of personal gross income.

The City acted within its discretion in using the IRS's calculation of "total income" for purposes of a personal income tax on an individual's gross income. The City's tax does not implicate RCW 36.65.030's prohibition of a tax on net income.

C. An income tax is not a tax on property: *Culliton* and its progeny should be overturned.

Resolution of the remaining claims here depends on the answer to a threshold question: "What is the nature of an income tax?" Whether the

City's income tax need comply with constitutional restrictions on property taxes, and whether the City is authorized to enact the tax, depend on the answer. The trial court entirely skipped this analysis. As explained below, an income tax is not a property tax; it is an excise tax or another kind of non-property tax (i.e., a *sui generis* tax).

1. Stare decisis does not apply if the prior cases were incorrect and harmful or their legal underpinnings have disappeared.

The City acknowledges that this Court previously has held that income is "property" and that an income tax is a "property tax." *See, e.g.*, *Culliton v. Chase*, 174 Wash. 363, 25 P.2d 81 (1933); *Jensen v. Henneford*, 185 Wash. 209, 53 P.2d 607 (1936). But "'stare decisis is neither a straight-jacket nor an immutable rule; it leaves room for courts to balance their respect for precedent against insights gleaned from new developments, and to make informed judgments as to whether earlier decisions retain preclusive force.'" *W.G. Clark Constr. Co. v. Pac. Nw. Reg'l Council of Carpenters*, 180 Wn.2d 54, 66, 322 P.3d 1207 (2014) (quoting *Carpenters Local Union No. 26 v. U.S. Fid. & Guar. Co.*, 215 F.3d 136, 142 (1st Cir. 2000)). As Justice Hale stated: "Rules of law, like governments, should not be changed for light or transient causes; but, when time and events prove the need for a change, changed they must be." *State ex rel. Wash. State Fin. Comm. v. Martin*, 62 Wn.2d 645, 665-66,

384 P.2d 833 (1963) (reversing precedent interpreting state debt limit under Const. art. VIII, §§ 1, 3).

This Court has identified two circumstances in which it will reconsider prior decisions. First, "[a]n opinion can be incorrect when it was announced, or it can become incorrect because the passage of time and the development of legal doctrines undermine its bases." *State v. Abdulle*, 174 Wn.2d 411, 415-16, 275 P.3d 1113 (2012). As this Court has explained: "stare decisis does not compel us to follow a past decision when its rationale no longer withstands careful analysis. When the generalization underpinning a decision is unfounded, we should not continue in blind adherence to its faulty assumption." *Rose v. Anderson Hay & Grain Co.*, 184 Wn.2d 268, 282, 358 P.3d 1139 (2015). Second, this Court will reconsider precedent "when the legal underpinnings of [the] precedent have changed or disappeared altogether." *W.G. Clark Constr. Co.*, 180 Wn.2d at 66 (overturning federal preemption cases due to evolving U.S. Supreme Court precedent and national shift in preemption jurisprudence). Both of these circumstances apply to the prior cases holding income is property and, thus, these cases should be overturned.

2. The Washington Constitution's definition of "property" was added so that stocks, bonds, and other intangible assets in which wealth could be kept no longer evaded taxation.

This Court's case law holding that income is property relies on a faulty conclusion articulated in the 1933, 5-4 ruling striking down an income tax: *Culliton*. At issue in *Culliton* was a statewide, graduated income tax initiative overwhelmingly approved by the people in 1932.[6] The historical and social context leading up to the 1932 income tax initiative is relevant. For the first forty years of Washington's statehood, the state primarily relied on real property taxes to support government services. *Culliton*, 174 Wash. at 385-87 (Blake, J. dissenting). At the time, most people's wealth was kept in real property. *Id.* at 385. This system of taxation worked because "the value of tangible property was great and the cost of government little." *Id.* But economics soon began to shift. Increasingly, "wealth was going into intangibles, into stocks, bonds, securities of various sorts—indicia of property which could easily elude the search of the tax collector." *Id.* At the same time, the cost of government increased greatly and property values began to collapse. *Id.* at 386. This resulted in an onerous tax burden on real estate. *Id.* By 1929, the problem was so acute that the legislature created a commission to

[6] *See* Results of 1932 General Election, Initiative to the People 69, *available at* https://www.sos.wa.gov/elections/results_report.aspx?e=102&c=&c2=&t=&t2=5&p=&p2=&y (last visited May 21, 2018).

investigate the issue and make recommendations. *Id.* at 387.[7]

In 1930, the voters passed Amendment 14 to the Constitution to capture intangible property in the definition of "property" and allow for different rates of taxation between classes of property. Const. art. VII, § 1; *see also State v. Wooster*, 163 Wash. 659, 663-64, 2 P.2d 653 (1931) (evasion of taxation by owners of intangibles (classified as "credits") was one of "the evils sought to be eradicated and abolished" by Amendment 14). In *Wooster*, this Court noted that the effect of the constitutional amendment was that "the Legislature, freed from the former limitations, may now determine what property shall be taxed, the different rates upon which different classes of property shall be taxed, and what property shall pay no tax at all, subject only to the limitations found in the new constitutional provisions." 163 Wash. at 663 (contrasting Amendment 14 to the constitution's prior strict uniformity provision). Amendment 14's main purpose, thus, was to provide a broader ability to tax. As supporters of the ultimately successful constitutional amendment noted in the 1930 Voter's Pamphlet, the measure was based on a simple principle: "Every fair man should be willing to pay towards the cost of government, whether his money is invested in land, merchandise, bonds, or stocks." CP 1031.

[7] *See* CP 619-33 (Report of the Washington Tax Investigation Commission (1930)). The Report Introduction discusses some of the same historical and social context for tax reform as Justice Blake discusses in his *Culliton* dissent.

By adding a definition of property that expressly included intangible property ("everything, whether tangible or intangible, subject to ownership") and providing for classification of property, it became "possible to tax bonds and stocks…at moderate rates…." *Id.*[8] Accordingly, "[a]t the time of the 1930 amendment's passage, many of its supporters believed that the new classification authority would allow the state to impose personal and corporate income taxes. Among the strongest supporters of Amendment 14 were groups that favored income taxes.… The [Washington Tax Equalization] Council favored shifting the tax burden from the owners of real property to holders of securities, bonds and other intangible properties that accounted for over 60 percent of the wealth in the state." Don Burrows, *The Economics and Politics of Washington's Taxes From Statehood to 2013* at 131 (2013).[9]

With this understanding, in 1931, the legislature passed a personal, graduated income tax and a business income tax to create revenue streams that did not rely on real estate taxes, but the governor vetoed both measures. *See* Hugh D. Spitzer, *A Washington State Income Tax—Again?*,

[8] *See also id.* (1930 Voter's Pamphlet discussing the unfairness of property taxation where "[s]tocks and bonds…escape altogether under our present system" and noting that "[t]he dog tax brings in more revenue than is received from all of the bonds and stocks owned in the state").

[9] Mr. Burrows is a former Director of the Washington State Department of Revenue and his book contains further historical background.

16 U. Puget Sound L. Rev. 515, 527-28 (1993).[10] In response, the people enacted the personal income tax by initiative in 1932. *See id*; Laws of 1933, ch. 5.[11]

3. The primary case law relied on for the 1933 holding that "income is property" was incorrect and unfounded, and its underpinnings have disappeared.

The *Culliton* court struck down the 1932 income tax initiative as a violation of Amendment 14, reasoning that income is property under Amendment 14's definition of "property"; taxes must be uniform within each class of property; income constitutes a single class of property; and therefore a graduated income tax violates the uniformity requirement. But the *Culliton* court's holding was based in significant part on the following assertion: "It has been definitely decided in this state that an income tax is a property tax, which should set the question at rest here." 174 Wash. at 376. The sole authority the *Culliton* court cited in support of this statement was *Aberdeen Savings & Loan Assoc. v. Chase* ("*Aberdeen*"), 157 Wash. 351, 289 P. 536, *rehearing denied sub nom., Wash. Mutual Savings Bank v. Chase*, 290 P. 697 (1930). But *Aberdeen* includes no such holding. And to the extent *Aberdeen* relied on federal case law for the proposition that

[10] Professor Spitzer's article provides significant historical background and analysis regarding income taxes and related case law in Washington, including more on the background of the events leading up to and intent behind Amendment 14. Professor Spitzer is counsel of record for the City in this case.

[11] For a detailed history of Washington's income tax movement in the late 1920's, culminating in the 1932 initiative campaign, *see* Phil Roberts, *A Penny for the Governor, A Dollar for Uncle Sam: Income Taxation in Washington* 56-99 (2002).

an income tax may be a property tax under the U.S. Constitution, that federal case law has been overruled by the U.S. Supreme Court.

Aberdeen involved a 1929 law that imposed a "tax measured by income upon banks and financial corporations." *Aberdeen*, 157 Wash. at 353. Under the law, savings and loans paid a different corporate income tax from commercial banks and other competitors. *Id.* at 360-61. The law also taxed interest income from federal securities. *Id.* at 369. Respondents brought several claims, including that the law violated the Fourteenth Amendment of the U.S. Constitution and the then-existing uniformity provision in Article VII of the Washington Constitution. *Id.* at 357. The *Aberdeen* court struck down the law. First, *Aberdeen* court held the law violated the Fourteenth Amendment's Equal Protection Clause based almost exclusively on *Quaker City Cab Co. v. Pennsylvania*, 277 U.S. 389, 48 S. Ct. 553, 72 L. Ed. 927 (1928), in which the U.S. Supreme Court held that a tax on certain cab companies but not others conducting the same business, such as natural persons and partnerships, was an arbitrary distinction that violated Equal Protection. *Id.* at 361-64, 373-74. Second, the *Aberdeen* court held that the law's taxation of income from government securities violated federal law. *Id.* at 365-74. But the *Aberdeen* court went no further, stating that its "holding renders unnecessary any discussion of [the] contention that the act…violates the

uniform taxation provisions of the Constitution of the state of Washington, or other provisions thereof." *Id.* at 374. Thus, contrary to *Culliton*, the *Aberdeen* court did **not** rule that income is property for purposes of Article VII of the Washington Constitution.

The state and the legislatively-created Advisory Tax Commission, as *amicus curiae*, petitioned this Court for rehearing in *Aberdeen* and its companion cases. Spitzer, 16 U. Puget Sound L. Rev. at 550-51. They argued that the *Aberdeen* opinion potentially could be misread broadly to decide additional constitutional issues, including the legality of future taxes. *Id.* In denying rehearing, this Court confirmed the limited scope of its holding, stating that the decision "should not be construed as determining any question which was not before the court" and was based solely on "the decisions of the Supreme Court of the United States [(*Quaker City Cab Co.*)]," which treated the tax at issue as attempting "to establish a property and not an excise or corporation franchise tax." *Wash. Mut. Savings Bank v. Chase*, 157 Wash. 351, 392, 290 P. 697 (1930). Thus, to the extent *Aberdeen* treated an income tax as a property tax, it was only applying the U.S. Supreme Court's decision in *Quaker City Cab Co.* for federal Equal Protection Clause purposes.[12]

[12] The same was true in the companion case to *Aberdeen*, *Burr v. Chase*, 157 Wash. 393, 396, 289 P. 551 (1930) ("The opinion of the Supreme Court of the United States in

In 1973, the U.S. Supreme Court expressly overruled *Quaker City Cab Co.*, noting that it was "a relic of a bygone era…." *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356, 365, 93 S. Ct. 1001, 35 L. Ed. 2d 351 (1973). Accordingly, the legal underpinnings of *Aberdeen* and *Culliton* have changed and are no longer valid.

Further, the U.S. Supreme Court, on which the *Aberdeen* court relied, has consistently rejected the characterization of an income tax as a property tax. The U.S. Supreme Court explained as early as 1916 that a prior, influential decision striking down the federal income tax as a "direct" tax on property for federal constitutional apportionment purposes (*Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429, 15 S. Ct. 673, 39 L. Ed. 759 (1895)) did not so hold: "[T]he conclusion reached in the Pollock Case did not in any degree involve holding that income taxes generically and necessarily came within the class of direct taxes on property, but, on the contrary, recognized the fact that taxation on income was in its nature an excise entitled to be enforced as such…." *Brushaber v. Union Pac. R. Co.*, 240 U.S. 1, 16-17, 36 S. Ct. 236, 60 L. Ed. 493 (1916). And the U.S. Supreme Court has explicitly rejected the concept articulated in *Pollock*, and subsequently relied on by this Court in *Jensen*, that a tax on income

---

the case of *Quaker City Cab Co. v. Pennsylvania* [] is even more exactly in point in this case than it was in the case of *Aberdeen Savings & Loan Association*….").

derived from property is inherently the same as a property tax.[13] *Graves v. People of State of New York ex rel. O'Keefe*, 306 U.S. 466, 480, 59 S. Ct. 595, 83 L. Ed. 927 (1939) ("The present [state income] tax applie[s] to salaries at a specified rate. … It is measured by income which becomes the property of the taxpayer when received as compensation for his services; and the tax laid upon the privilege of receiving it is paid from his private funds and not from the funds of the government, either directly or indirectly. The theory, which once won a qualified approval, that a tax on income is legally or economically a tax on its source, is no longer tenable….").[14]

Culliton's incorrect characterization of *Aberdeen*, and implicit acceptance of the U.S. Supreme Court case law on which *Aberdeen* relies, has had a ripple effect throughout Washington jurisprudence. The mistaken concept—that it is well-settled that "income is property"—has been repeated throughout Washington's income tax case law without question. *See, e.g.*, *Jensen*, 185 Wash. at 216-17 (rejecting personal income tax framed as privilege tax and relying on *Culliton* for the premise that "income is property, and that an income tax is a property tax"); *Petroleum Nav. Co. v. Henneford*, 185 Wash. 495, 496-97, 55 P.2d 1056

[13] *See Jensen*, 185 Wash. at 222 (so holding and citing *Pollock*)

[14] *See al*so *South Carolina v. Baker*, 485 U.S. 505, 515-25, 108 S. Ct. 1355, 99 L. Ed. 2d 592 (1988) (confirming that *Pollock* has been overruled in its entirety).

(1936) (rejecting corporate income tax framed as a privilege tax based on *Aberdeen*, *Culliton*, and *Jensen*); *Power, Inc. v. Huntley*, 39 Wn.2d 191, 195, 235 P.2d 173 (1951) (rejecting corporate net income tax framed as an excise tax based on *Aberdeen*). These cases rely on the incorrect presumption based on *Culliton* and *Aberdeen* that income is property, and reject that an income tax could be anything but a property tax based on that presumption. None of these cases have conducted a substantive analysis of the nature of an income tax. As demonstrated above, because *Culliton's* statement of the law was incorrect and unfounded, and because the bases on which *Aberdeen* was decided have since disappeared, it is time for this Court to revisit the question.

4. *Culliton's* statement that the majority of courts characterized income as property was innacurate and unfounded.

In addition to its mischaracterization of *Aberdeen*, the *Culliton* court, without citation, relied on the conclusory statement that "[t]he overwhelming weight of judicial authority is that 'income' is property and a tax upon income is a tax upon property." 174 Wash. at 374. This was an incorrect statement at the time it was made. Rather, by the 1930s the majority of courts held that an income tax is **not** a property tax. In his exhaustive treatise on state taxation, Professor Wade Newhouse researched every state's income tax laws and cases. Wade J. Newhouse,

Constitutional Uniformity and Equality in State Taxation (1984). Professor Newhouse notes that nationwide the issue of how to characterize an income tax "came to a boil from 1922 through 1936"—the exact timeframe in which *Culliton* and *Jensen* were decided. *Id.* at 2020. Professor Newhouse concludes:

> Overall, for all the bitter controversy of the 1920s and the 1930s, in the end there were only five state courts which actually ruled negatively on income taxes under the uniformity limitations, with that negative position either abandoned or modified in three of them, **leaving only two state courts seemingly standing by their strict uniformity interpretations with respect to income taxes: Washington and Pennsylvania**.
> …
> **A majority of those courts reviewed above have characterized the income tax as a 'nonproperty' tax. Without determining its precise nature in relation to all those other various kinds of taxes which are not property taxes, it was ruled not to be a tax upon property.**

Id. at 2021, 29 (emphasis added). Washington's treatment of an income tax as a property tax was and remains an outlier.

In the modern era, the Illinois Supreme Court dealt with the exact issue presented here. In Illinois, a 1932 case (*Bachrach*) had held that income is property based on *Pollock* and a mistaken claim that the "weight of judicial authority" so held. In 1969, the Illinois Supreme Court reversed that holding, noting that *Pollock* was no longer good law and that: "The court in *Bachrach* also implied that the 'overwhelming weight of judicial

authority' holds that an income tax is a property tax. We have reviewed the many State cases dealing with this question and find the weight of authority to be that an income tax is not a property tax." *Thorpe v. Mahin*, 250 N.E.2d 633, 634-36 (Ill. 1969). Tellingly, *Bachrach's* (now overruled) misstatement of law was part of the briefing before the *Culliton* court. *See* Spitzer, 16 U. Puget Sound L. Rev. at 558 n.282. The *Culliton* court's statement regarding the weight of judicial authority was never accurate. Washington should follow Illinois' lead and correct this error.

5. *Culliton's* conclusion regarding the nature of income based on the definition of "property" was incorrect.

The *Culliton* court also relied on what it characterized as the "peculiarly forceful constitutional definition" of property in the Washington Constitution—"everything, whether tangible or intangible, subject to ownership"—and reasoned that "income is either property…or no one owns it." 174 Wash. at 374. But this is a tautological and conclusory statement. It ignores entirely that the purpose of including the definition of property in Amendment 14 was to allow taxation of stocks, bonds, and other intangible property that had, until that point, evaded taxation. And the Constitution's definition of property as "anything subject to ownership" does not answer the relevant question, it simply raises it: "Is income subject to ownership?"

The nature of income is not that of a static asset subject to ownership that can be kept or sold, such as land (tangible property) or stocks and bonds (intangible property) or other assets that can be purchased with earned or unearned income. Rather, income is better characterized as money in motion, an expectancy that is earned either from time worked or the outcome of a business and is taxed accordingly. Post taxation, that money can be spent or turned into a static asset such as land or stocks. Other courts have adopted this understanding of income in their discussions on the nature of an income tax. The U.S. Supreme Court articulated this concept to distinguish between property and income: "[A taxpayer's] income may be taxed, although he owns no property, and his property may be taxed, although it produces no income. The **two taxes are measured by different standards, the one by the amount of income received over a period of time, the other by the value of the property at a particular date**. Income is taxed but once; the same property may be taxed recurrently." *People of the State of New York ex rel. Cohn v. Graves*, 300 U.S. 308, 314, 57 S. Ct. 466, 81 L. Ed. 666 (1937) (emphasis added); s*ee also Sims v. Ahrens*, 271 S.W. 720, 732 (Ark. 1925) ("because of [income's] **fluctuating and indeterminate nature, during this period and process of its making**, [it] has not yet become an investment or an increment to the permanent wealth or property of the individual who has

to pay the tax") (emphasis added). Here, the City taxes the amount of income earned over the prior year, the period of its making, rather than taxing wealth a person owns on a fixed date.

This concept also finds support in the common meaning of the term income. Webster's defines "income" as "1: a coming in: entrance, influx…2: a gain or recurrent benefit usually measured in money that derives from capital or labor…." Webster's at 1143. One does not own a "coming in" or "gain" until after it is realized as an asset. This contrasts with the pertinent dictionary definition of "property," which is "something owned or possessed…something to which a person or business has a legal title…." *Id.* at 1818.[15]

Moreover, income is not transferable or purchasable in the same way as property. If you own property—whether personal, real estate, stocks, or intellectual property—part of your bundle of rights in that property is the ability to transfer ownership. For example, in your will, you can transfer any of that property to your heirs. But income, *per se*, is not transferrable. You cannot pass it on to your heirs—not the income itself that is, but only the asset that may result from after-tax income. Unlike real property and intangible property like stocks, bonds, and

[15] Contrary to the *Culliton* Court's characterization of Washington's constitutional definition as "peculiarly forceful," 174 Wash. at 374, it appears to mirror this standard dictionary definition closely.

intellectual property, income is not an asset that can be bought and sold.

Further, as noted above, the 1930 constitutional amendment defining "property" was passed in response to the concern that wealth was escaping taxation by being moved from real property (taxed) to intangible property (not taxed). That concern does not support characterizing income as property, as it is not an asset into which wealth can be transferred. Indeed, such a characterization would be contrary to the intent of the people in passing Amendment 14, which was to **expand** the ability to tax, not limit it. The dictionary definition of "intangible property" is helpful. Webster's defines "intangible property" as: "property having no physical substance apparent to the senses: incorporeal property…often evidenced by documents (as stocks, bonds, notes, judgments, franchises) having no intrinsic value or by rights of action, easements, goodwill, trade secrets." Webster's at 1173. Similarly, Black's defines "intangible property" as: "Property that lacks a physical existence. Examples include stock options and business goodwill." Black's Law Dictionary (10th ed. 2014). Tellingly, income is not listed as an example in either definition. Instead, the definitions reflect property in which wealth can be kept or transferred. Thus, income is not property in the common or constitutional sense.

6. Categorizing income as property is harmful to low- and moderate-income residents and the ability of governments to adequately fund services.

Washington's adherence to the incorrect and unfounded statements in *Culliton* has had a significant negative impact on the state's and Seattle's citizens. As far back as 1932, the people passed an income tax statewide by initiative to address significant harm: "'Existing methods of taxation, primarily based on property holdings, are inadequate, inequitable and economically unsound. Present conditions point the need of a new subject matter for taxation, which should be based on the ability to pay. Earnings for a given period are a fair measure of such ability.'" *Culliton*, 174 Wash. at 372 (quoting initiative). The same is true today. Washington has the most regressive tax structure in the nation, with our low- and moderate-income earners paying a significantly greater share of their income in taxes than high-income households. And Seattle's tax structure is the most regressive of all cities in Washington. Raising new revenue within the existing tax structure harms low- and moderate-income earners and limits the City's ability to meet increasing need for City services. *Culliton* and its progeny have created and exacerbated this harm, and should not be followed.

D. An income tax is best understood as an excise tax, similar to our B&O tax on gross income. An income tax should be upheld as such.

1. Many courts, including this one, understand taxes measured by income to be excise taxes.

Rather than a property tax, an income tax is best understood as one of many types of excise taxes. As noted above, the U.S. Supreme Court has squarely rejected the *Pollock* case, on which much of the "income-is-property" theory relies. And the U.S. Supreme Court has explained how income taxes and property taxes are different: "The incidence of a tax on income differs from that of a tax on property. … The tax on each is predicated upon different governmental benefits; the protection offered to the property in one state does not extend to the receipt and enjoyment of income from it in another." *Cohn*, 300 U.S. at 314. Instead of a property tax, the U.S. Supreme Court observed as far back as 1937 that "[t]he question as to the nature of [an income] tax has come up repeatedly under state constitutions requiring taxes upon property to be equal and uniform, or imposing similar restrictions. Many, perhaps most, courts hold that a net income tax is to be classified as an excise." *Hale v. Iowa State Bd. of Assessment & Review*, 302 U.S. 95, 104-05, 58 S. Ct. 102, 82 L. Ed. 72 (1937) (citing cases); *see also Thorpe*, 250 N.E.2d at 635-36 (discussing *Cohn*, *Hale*, and other authorities that hold an income tax generally is regarded as an excise tax).

Underlying these cases is the concept that an income tax is not a tax on the income itself, but as a fair means to share the cost of providing government benefits among residents. "Domicil itself affords a basis for such taxation. Enjoyment of the privileges of residence in the state and the attendant right to invoke the protection of its laws are inseparable from responsibility for sharing the costs of government…. A tax measured by the net income of residents is an equitable method of distributing the burdens of government among those who are privileged to enjoy its benefits." *Cohn*, 300 U.S. at 313-14.; *see also Reynolds Metal Co. v. Martin*, 107 S.W.2d 251, 258-59 (Ky. 1937) (an income tax is "a contribution exacted from those domiciled or doing business in the state for the purpose of defraying the expenses of government, the contribution being measured by the ability of the taxpayer to pay, which in turn is determined by the extent of his income. He is required to pay this tax because he is domiciled or doing business in the state, and so enjoys the protection of government, the right to earn a living, to receive, keep, and expend, income, and to be safe in his property and pursuit of happiness.").[16] As these cases suggest, such an excise tax is commonly

[16] *See also Hattiesburg Grocery Co. v. Robertson*, 88 So. 4, 5-6 (Miss. 1921) (same); *Kopp v. Baird*, 313 P.2d 319, 321 (Idaho 1957) (same); *Vilas v. Iowa State Bd. of Assessment & Review*, 273 N.W. 338, 340 (Iowa 1937) (same); *Ryan v. Commonwealth*, 193 S.E. 534, 537 (Va. 1937) (same); *Dooley v. City of Detroit*, 121 N.W.2d 724, 730 (Mich. 1963) (same for city income tax).

referred to as a privilege or benefit tax.

This Court has long recognized the validity of a privilege tax measured by gross income. In *State ex rel. Stiner v. Yelle*, 174 Wash. 402, 407, 25 P.2d 91 (1933), this Court held that the B&O tax, as measured by a business's gross proceeds, sales, or income, "does not concern itself with income which has been acquired, but only with the privilege of acquiring, and that the amount of the tax is measured by the amount of income in no way affects the purpose of the act or the principle involved." The Court explained that laws and courts are created by government "for the protection of human rights, the rights of property and to prevent the weak or credulous from becoming the helpless victims of the force or fraud of the strong and the cunning." *Id.* at 406. As a result, "every citizen is now measurably safe in pursuing any gainful occupation with **the expectation that he will be by the state fully protected and made secure in his property investment, and also in his gains therefrom. This is the privilege**, far above mere property, which it is now sought to tax to the end that it may **pay in some part its fair share of the cost to the state of its creation and continuance**." *Id.* at 406-07 (emphasis added). This logic mirrors the above rationale articulated by courts that recognize a personal income tax is a privilege excise tax based on domicile to share the cost of government.

There is no reasonable distinction between a privilege tax on a business based on gross income and a privilege tax on residents based on total income. Much like the state's B&O tax, the City provides protection and infrastructure for residents so they can pursue their livelihoods and lives with peace of mind that the laws of the City will protect them and their property. The City simply asks that residents, like businesses, pay their fair share of the cost of creating and maintaining that protective infrastructure. In *Supply Laundry Co. v. Jenner*, 178 Wash. 72, 78, 34 P.2d 363 (1934), this Court upheld a similar tax. In that case, this Court rejected a challenge to the same B&O tax statute at issue in *Stiner*, affirming that it is a privilege excise tax, not a property tax. In doing so, the Court upheld application of the tax to state employees earning salaries of more than $200 per month. *Id.* at 74, 78. There was no particular business or occupation involved in this application of the tax. Thus, in at least one context this Court already has recognized that taxing income above certain thresholds is a permissible privilege excise tax.

While *Culliton* is incorrect and should be reversed, this Court could avoid addressing *Culliton* and instead simply adopt the reasoning of *Stiner*, *Cohn*, and the other above authority and hold that an income tax is an excise tax regardless of whether income is property. The Court has done so in other contexts in addition to the B&O tax, such as the

inheritance tax. *See In re Fotheringham's Estate,* 183 Wash. 579, 585, 49 P.2d 480 (1935) (the inheritance tax is "not a tax on property, but [] an excise or impost laid upon the privilege of receiving property by inheritance; it is a tax on the right or privilege of succession."). It should also do so here.

2. *Jensen* should be overturned.

The *Jensen* court's holding that an income tax is a property tax, not an excise tax, also does not withstand scrutiny and should be overturned. The *Jensen* court attempted to distinguish *Stiner* and *Supply Laundry Co.* by stating that those cases involved a tax on a privilege granted or permitted by the state (engaging in business activities) and a personal income tax does not. *Id*. But, as argued above, the benefits and contributions to government that provided the grounds for upholding the B&O tax on resident businesses in *Stiner* apply equally to resident individuals and couples. And *Supply Laundry Co.* in fact upheld a tax on individuals earning above a certain income threshold.

Further, this Court has recognized that the privilege of benefiting from government structure and protection is a basis for an excise tax on residents. An example of this is the poll (head) tax, the "propriety of the enactment and enforcement of [which] has been recognized ever since, and prior to, the foundation of our government." *Thurston County v.*

Tenino Stone Quarries, 44 Wash. 351, 355, 87 P. 634 (1906). A poll tax is a privilege tax based on residency. In *Tenino Stone Quarries*, this Court upheld a poll tax against an equal protection challenge, explaining in language strikingly similar to *Stiner* and *Cohn* that: "The underlying nature and purpose of a poll tax are disassociated entirely from any consideration of property. The state accords to every inhabitant, regardless of his property possessions, the protection and advantages of its laws and public institutions. By reason of these personal guaranties and benefits, it asks a tribute toward the support of the government from those beneficiaries who are physically qualified to contribute." *Id.* at 356. Poll taxes rooted in this rationale exist today in Washington law. *See* RCW 35.23.371; 35.27.500. That rationale is also the basis for the City's income tax here. The *Jensen* court's (and the trial court's) conclusion that no substantive privilege is present in a privilege tax based on residence is unsupported and should be reversed.

The additional arguments in *Jensen* do not withstand scrutiny. The *Jensen* court stated that "the mere right to own and hold property cannot be made subject of an excise tax, because to tax by reason of ownership of property is to tax the property itself. … The right to receive property (income in this instance) is but a necessary element of ownership, and, without such a right to receive, the ownership is but an empty thing and of

no value whatever." 185 Wash. at 218-19 (citations omitted). This argument is circular, in that it rests on the faulty notion that income is property in the first place—a construct that is wrong, as discussed above.

Further, the cases *Jensen* cites in support of its holding do not stand for the proposition that an income tax is something other than an excise tax. In *McFeely v. Comm'r of Internal Revenue*, 296 U.S. 102, 56 S. Ct. 54, 80 L. Ed. 83 (1935), the U.S. Supreme Court stated that the time one starts to own property is when one acquires it. 296 U.S. at 107. Nothing in the case purported to equate income as property, or even suggest that income is owned as one would own a piece of land. The same is true in the other cited cases—they all involve taxes on real or personal property that were characterized as excises. *See Dawson v. Kentucky Distilleries & Warehouse Co.*, 255 U.S. 288, 293-94, 41 S. Ct. 272, 65 L. Ed. 638 (1921) (tax on ownership of whiskey in bonded warehouses at the time it is removed); *Thompson v. Kreutzer*, 72 So. 891, 891-92 (Miss. 1916) (tax on timber lands); *In re Opinion of the Justices*, 94 N.E. 1043, 1044 (Mass. 1911) (taxes on real estate and personal property). None of the cases relates to income taxes. *Jensen's* holding that an income tax is not an excise tax should not be followed.

3. The City's income tax does not tax the activity of working for salaries or wages, as was the case in *Cary v. City of Bellingham*.

This Court's opinion in *Cary v. City of Bellingham*, 41 Wn.2d 468, 250 P.2d 114 (1952), does not control here. In *Cary*, the City of Bellingham imposed a one-tenth of one-percent excise tax on "the activity of working for salaries or wages" as measured by gross income. *Id.* at 471. This Court examined the putative privilege tax and held that "[t]he right to earn a living by working for wages is not a 'substantive privilege granted or permitted by the state.'" *Id.* at 472 (quoting *Power Inc. v. Huntley*, 39 Wn.2d 191, 53 P.2d 173 (1951)). The *Cary* court also cited distinctions made in *Stiner* and *Supply Laundry* in support, based on statutory exemptions for workers in the laws at issue. *Stiner*, 174 Wash. at 411; *Supply Laundry Co.*, 178 Wash. at 77-78. But as explained in *Stiner*, the concern there was taxing a worker "for the privilege of being employed," which was not consistent with the "spirit of the act" to tax commercial activity. 174 Wash. at 411. Under the then-present conditions of the Great Depression, "when the wage-earner is barely subsisting," this Court found it unlikely an employee would be able to pay the tax, leading to potential double taxation on the business. *Id.* And as this Court explained in *Supply Laundry Co.*, employees simply working for living wages "have no voice in the business itself nor any share in its returns; their compensation is

fixed and they have no independent call upon the state or municipality for the protection of a privately owned business, as that term is ordinarily understood. So far as they are concerned, they are not principals in the business but merely employees, and their pay, whatever it may amount to, is a part of the expense of the business." 178 Wash. at 77-78. Thus, excluding wage-earners from the B&O tax had a reasonable basis. *Id.* Accordingly, *Cary* held that an excise tax could not be based on the privilege of working to earn a living.

Here, in contrast, the City is not taxing the privilege of working to earn a living, the right to be employed, or the right to earn a living wage. Non-residents working in the City are not taxed. Rather, the City is taxing the privilege to residents of benefiting from the City's laws, government and infrastructure as measured by residents' receipt of income over the $250,000/$500,000 threshold. Further, in setting that threshold, the City consciously avoided burdening living-wage earners. Specifically, the City Council found that individuals earning above the $250,000 threshold "tend to have a diversified income base; typically derive income from ownership, managerial, and/or profit-sharing interests in businesses; and are not solely or primarily dependent on wages for their income." CP 374-75. Indeed, the CBO determined that income above the thresholds were "well above a comfortable standard of living" in the City. CP 409. The

CBO continued: "Those subject to the tax have incomes in the top three percent of all Seattle households." *Id.* That is, the majority of payers of the City income tax are not the "wage-earner barely subsisting" or mere employee working to earn a living of concern in *Cary*, *Stiner*, and *Supply Laundry Co*.

4. The City's income tax meets the traditional requirements for an excise tax.

The City's income tax meets the traditional requirements of an excise tax for the same reasons stated above. This Court has held an excise tax must meet two conditions: "First, excise taxes are imposed upon a voluntary act of the taxpayer, which affords the taxpayer the benefits of the occupation, business, or activity that triggers the taxable event. Second, excise taxes are directly imposed based upon the extent to which the taxpayer enjoys the taxable privilege." *Sheehan v. Cent. Puget Sound Reg'l Transit Auth.*, 155 Wn.2d 790, 799-800, 123 P.3d 88 (2005).

As to the first condition, in *Sheehan*, respondents argued that the motor vehicle excise tax was not based upon a voluntary act of the taxpayer because "the only available means of avoiding payment is to relinquish the beneficial use of one's property (i.e., not registering [their vehicles] for use on public roadways)." *Id.* at 800. This Court rejected that argument because there is no requirement that one own a motor vehicle,

and, even if you do own one, there is no requirement to use it on public roadways. *Id.* The same is true here. There is no requirement that one benefit from the City's government structures and protections by living in the City, nor a requirement that one earn income above the $250,000/$500,000 thresholds. This is similar to a business choosing to conduct a certain type of commercial activity and locating in the City. When it does so, it subjects itself to payment of all state and local excise taxes, including B&O taxes based on the classification of business activity. Indeed, several Respondents emphasize the point that they **choose** to live in Seattle to avoid another state's income tax. *See e.g.*, CP 644 at ¶ 3; CP 699 at ¶ 3; CP 747 at ¶ 5. Choosing to live in the City is a voluntary choice especially for high-income earners.

As to the second condition, while an excise tax must be imposed based upon the extent to which the taxpayer enjoys the taxable privilege, the Washington Constitution does not require a precise fit. *Sheehan*, 155 Wn.2d at 801. Here, a modest percentage of income over the $250,000/$500,000 thresholds approximates the extent to which residents enjoy the benefit of taking advantage of the City's protections without taxing residents' right to earn a living.

The elements of a valid excise tax are met here. The tax is on the benefit of taking advantage of the City's protections by being a Seattle

resident (the incident), imposed on personal total income above the thresholds (the measure), at a rate of 2.25% for any amount over the threshold (the rate).

E. The City's income tax is within its excise tax authority.

Properly understood as an excise tax, a total personal income tax is within the City's legislatively granted taxing authority. The legislature has authorized the City to levy excise taxes under two statutes: RCW 35A.82.020 and RCW 35.22.280(32).[17] First, as a first class city, the City possesses the same excise tax authority granted to code cities to "impose excises for regulation or revenue in regard to all places and kinds of business, production, commerce, entertainment, exhibition, and upon all occupations, trades and professions **and any other lawful activity**…." RCW 35A.82.020 (emphasis added); *see also* RCW 35.22.570 (granting first class cities all powers conferred on other cities). This broad taxing power is liberally construed in favor of the city imposing the tax. RCW 35A.01.010; *see also City of Wenatchee*, 181 Wn. App. at 337.

Second, RCW 35.22.280 enumerates "broad legislative powers" delegated to first class cities, including Seattle. *Watson*, 189 Wn.2d at 167; *see also* RCW 35.22.900 (ch. 35.22 RCW "shall be liberally construed"). In relevant part, this statute authorizes the City to "grant licenses for any

[17] The City is also empowered to levy excise taxes under RCW 35A.11.020's comprehensive grant of tax authority, as explained in Section V.G, *infra*.

lawful purpose, and to fix by ordinance the amount to be paid therefor…." RCW 35.22.280(32). As this Court has explained, the licensing power granted to first class cities is dual: cities have the right to impose license taxes either for the lawful purpose of regulation or for the lawful purpose of raising revenue. *Watson*, 189 Wn.2d at 167-68. When the power is exercised for revenue purposes, licensing is "merely the method provided for raising the revenues." *Id.* at 168 (quotation omitted).

Both RCW 35A.82.020 and RCW 35.22.280(32) grant the City the power to impose a tax that fairly shares the cost of government among residents as measured by residents' total personal income. The Ordinance imposes "excises for…revenue …upon [the] lawful activity" of residency within Seattle. *See* RCW 35A.82.020; SMC 5.65.030.B. Likewise, the Ordinance imposes an excise for the "lawful purpose" of raising revenue for critical City objectives. *See* SMC 5.65.010.A. The trial court erroneously ruled that the income tax cannot be within the City's excise tax authority because that authority is limited to taxes on businesses. CP 1308. Such a limitation, however, is contrary to the plain language of the statutes that grant authority to tax for any "lawful activity" or "lawful purpose." Accordingly, the City's income tax falls within its broad excise tax authority.

The trial court further misconstrued the City's authority to impose

an excise tax as only applicable to activities for which a revocable license issues. CP 1308. This misunderstands that the City's statutory authority here is under its power to license for revenue. Licenses can be either regulatory under the police power or for purposes of raising revenue under the taxing power. *See Pac. Tel. & Tel. Co. v. City of Seattle*, 172 Wash. 649, 654-55, 21 P.2d 721 (1933); *see also Arborwood v. City of Kennewick*, 151 Wn.2d 359, 365-66, 89 P.3d 217 (2004) (police power and taxing power derive from different parts of the Constitution). An activity need not be one that requires a regulatory license in order to be subject to an excise tax. Washington courts traditionally have characterized the "license" for revenue as proof of payment of the City's required charge for enjoying the privilege within its jurisdiction. The license is "an incident to the power to raise revenues. The license is the means, not the end. It is the method provided for raising the revenues. The penalty provided is merely a mode of enforcing payment, and the license is only a receipt for the tax." *Pac. Tel. & Tel. Co.*, 172 Wash. at 654-55. The trial court's reference to *Margola Assocs. v. City of Seattle*, 121 Wn.2d 625, 854 P.2d 23 (1993), is incorrect for this reason. That case involved a claimed regulatory fee, not a license tax, and this Court remanded the question whether it was a fee or tax and, if a tax, the validity of the measure. *Id.* at 634, 642. This Court should hold that the City's

income tax falls within its excise tax authority.

F. An income tax also could be appropriately characterized as *sui generis*.

Some states' courts do not classify income taxes as either an excise tax or a property tax; instead, they treat income taxes as a unique category. One court said: "In many ways such a tax is *sui generis*. It imposes a tax on the net income or revenue which passes into or through a man's hands within a prescribed period, a large share of which never finds permanent investment." *Reed v. Bjornson*, 253 N.W. 102, 105 (Minn. 1934); *see also* Spitzer, 16 U. Puget Sound L. Rev. at 559-61; Robert C. Brown, *The Nature of the Income Tax*, 17 Minn. L. Rev. 127, 143-45 (1933) (analyzing income tax cases and arguing that income taxes are *sui generis*).

This is an alternative and reasonable characterization that Washington courts could adopt. Indeed, this Court recently recognized this concept when it noted that local "taxation must fall into one of three categories: property, income, or excise taxes." *Watson*, 189 Wn.2d at 167 (quoting Washington State Department of Revenue Tax Reference Manual). Incomes taxes can be considered their own category apart from property and excise taxes.

G. The City's income tax, whether characterized as an excise tax or *sui generis,* falls within RCW 35A.11.020's grant of "all powers" of taxation.

Whether understood as an excise tax or *sui generis*, the City has authority to impose its income tax under RCW 35A.11.020, which confers "all powers of taxation for local purposes" within the City's territorial limits subject only to constitutional and statutory constraints. RCW 35A.11.020's sweeping grant of tax authority reflects the legislature's decision to implement by legislation the "home rule" principle for certain cities including Seattle.

The home rule principle presumes "autonomy in local governance," namely, that a city may exercise powers that do not violate a constitutional provision, legislative enactment, or the city's charter. *Watson*, 189 Wn.2d at 166.[18] By pushing power to the local level and reducing interference by the legislature and other state agencies, home rule increases government accountability, which is "particularly important with respect to local taxation authority." *Id.* Home rule arose in opposition to Dillon's rule, which asserts that a local government exercises no powers except as expressly granted by law, or incidental to powers expressly granted. *See* Spitzer, 38 Seattle U. L. Rev. at 813-24 (summarizing history

[18] *Citing* Hugh Spitzer, *"Home Rule" vs. "Dillon's Rule" for Washington Cities*, 38 Seattle U. L. Rev. 809, 809 (2015); *Citizens for Financially Responsible Gov't v. City of Spokane*, 99 Wn.2d 339, 343, 662 P.2d 845 (1983).

of Dillon's Rule and home rule).

Home rule gained traction in Washington in the early to mid-twentieth century. *See Id.* In 1965, the legislature convened a special committee to prepare a code of laws for city governments with "a form of statutory home rule." Laws of 1965, Ex. Sess., ch. 115, § 2 at 2061; *see also* CP 416-17. In a report to the legislature the following year, the committee confirmed that Chapter 35A.11 of the proposed Optional Municipal Code "expresses the state legislature's intent to confer the greatest power of local self-government, consistent with the State Constitution, upon the cities and directs that the laws be liberally construed in favor of the city as a clear mandate to abandon the so-called 'Dillon's Rule' of construction." CP 419. In 1967, the legislature enacted the Optional Municipal Code proposed by the committee, granting code cities (and, by extension under RCW 35.22.570, first class cities like Seattle) "all powers of taxation for local purposes" limited only by the Constitution and specific statutes. RCW 35A.11.020. Along with this taxing power, the legislature delegated "all powers possible for a city or town to have under the Constitution of this state, and not specifically denied to code cities by law." *Id.* The Optional Municipal Code's stated purpose confirms the legislature's intent to supersede Dillon's Rule and grant municipal powers to first class and code cities to the fullest extent

permitted by the Constitution. RCW 35A.01.010 ("The purpose and policy of this title is to confer…the broadest powers of local self-government consistent with the Constitution of this state.").

Nothing in the Constitution or state law excludes total income as a subject of municipal taxation. Indeed, the statutory prohibition of local net income taxes discussed above suggests that gross or total income taxes are otherwise permitted. Thus, the Ordinance is authorized by the comprehensive tax authority granted under RCW 35A.11.020.

Ignoring this legislative history, the trial court ruled that RCW 35A.11.020's express grant of all local tax powers does not confer any tax authority. CP 1309 (ruling that the "general grant of taxing power recited in RCW 35A.11.020, standing alone, confers no specific authority…to impose any tax"). But this Court recently confirmed that "RCW 35A. 11.020 is a grant of authority" allowing the full exercise of local tax powers within constitutional limits. *City of Spokane v. Horton*, 189 Wn.2d 696, 708, 406 P.3d 638 (2017) ("The statute provides that code cities have powers of taxation within constitutional limits.").[19]

The legislature need not specifically identify each type of tax included within a statute that expressly confers taxing powers on local

[19] *See also id.* at 713 (Madsen, J., dissenting) ("By granting 'all powers of taxation' to code cities, the legislature's intent is clear—code cities are to have all taxing powers at the local level that the legislature possesses at the state level.").

governments. *See, e.g.*, *Watson*, 189 Wn.2d at 167-68, 170 n.8 (holding that RCW 35.22.280(32) and RCW 35A.82.020 "expressly" authorize the City's tax on retail sales of guns and ammunition, even though those licensing for revenue statutes say nothing about taxing firearms). A second layer of express authority (i.e., expressly authorizing a type of tax) may be required where a city seeks to tax governmental activities of another municipality. *King County v. City of Algona*, 101 Wn.2d 789, 793, 681 P.2d 1281 (1984); *City of Wenatchee*, 181 Wn. App. at 330 ("[W]hen governmental immunity is implicated, a two-layered express authorization is needed[:]…the legislature [must] provide an express grant of general taxing authority [and], if it intends to tax governmental functions of a municipality,…an additional expressed intention overcoming what would otherwise be the implied immunity from tax of those functions."). Here, however, the City's tax applies to personal income of individual city residents—not other municipalities. Thus, contrary to the trial court's ruling, two-layered express authorization is not required.

The City's personal income tax—whether characterized as an excise or *sui generis* tax—falls within the express omnibus grant of "all" local tax powers under RCW 35A.11.020. The trial court's ruling would render RCW 35A.11.020 meaningless and should be reversed.

H. Respondents' constitutional claims fail.

Whether the City's Ordinance is characterized as an excise tax or *sui generis*, the end result is the same: an income tax is not a property tax. Respondents' claims based on constitutional provisions applicable to property taxes, therefore, must fail. Article VII, § 1's uniformity requirements and Article VII, § 2's one-percent cap apply only to property taxes. *High Tide Seafoods v. State*, 106 Wn.2d 695, 700, 725 P.2d 411 (1986).

Respondents' equal protection claim also fails. Courts have long upheld taxes against equal protection challenges as long as there is a rational basis for the classifications. *See, e.g.*, *Hemphill v. Wash. State Tax Comm'n*, 65 Wn. 2d 889, 891-93, 400 P.2d 297 (1965) (tax classification distinctions need only a rational basis and do not violate the Equal Protection Clause if any state of facts reasonably can be conceived that would sustain them); *Brushaber v. Union Pac. RR Co.*, 240 U.S. 1, 24-25, 36 S. Ct. 236, 60 L. Ed. 493 (1916) (upholding progressive rate structure of a federal income tax statute). The City's decision to tax only high-income residents is rational in light of the regressive nature of Washington's tax system and the City's current affordability crisis. The City did not want to further exacerbate these issues nor tax living wages. Therefore, the City set thresholds that tax only those who can afford it. *See* CP 407-09.

V. CONCLUSION

Respondents fail to meet their burden in challenging the Ordinance. The City's total income tax is not a tax on "net income" and therefore is not prohibited by state law. The Washington cases holding income is property for tax purposes rest on faulty premises. Rather, an income tax is a privilege excise tax or a *sui generis* local tax authorized to raise revenue for local purposes. This Court should reverse the trial court and hold that the City's income tax is valid.

RESPECTFULLY SUBMITTED this 21st day of May, 2018.

PACIFICA LAW GROUP LLP

By */s/ Paul J. Lawrence*
Paul J. Lawrence, WSBA # 13557
Gregory J. Wong, WSBA #39329
Jamie L. Lisagor, WSBA #39946

PETER S. HOLMES
SEATTLE CITY ATTORNEY

By: Kent Meyer, WSBA #17245
Assistant City Attorney

And

Hugh D. Spitzer WSBA # 5827

Attorneys for Appellant City of Seattle

CERTIFICATE OF SERVICE

I, Tricia O'Konek, declare under penalty of perjury under the laws of the State of Washington, that on May 21st 2018 I electronically filed the foregoing document via the Washington State Appellate Courts' Secure Portal which will send e-mail notification of such filing to the following:

David Morgan Steven Dewhirst: ddewhirst@freedomfoundation.com
Hugh Davidson Spitzer: spitzerhd@gmail.com
Matthew F. Davis: matt@davisleary.com; matthew@davisleary.com
Daniel J. DunneJr.: ddunne@orrick.com;
sea_wa_appellatefilings@orrick.com
Eric D. 'Knoll' Lowney: knoll@smithandlowney.com
Adam Nolan Esq Tabor: atabor@orrick.com;
sea_wa_appellatefilings@orrick.com
Claire Elizabeth Tonry: claire@smithandlowney.com
Brian Trevor Hodges: bth@pacificlegal.org
Ethan Blevins: ewb@pacificlegal.org
Robert M. Mckenna: rmckenna@orrick.com;
sea_wa_appellatefilings@orrick.com
Jamie L Lisagor: jamie.lisagor@pacificalawgroup.com;
cindy.bourne@pacificalawgroup.com
Paul J. Lawrence: paul.lawrence@pacificalawgroup.com;
dawn.taylor@pacificalawgroup.com
Gerry Lee Alexander: galexander@bgwp.net
Scott M Edwards: edwardss@lanepowell.com
Philip Albert Talmadge: phil@tal-fitzlaw.com; matt@tal-fitzlaw.com
Kent Charles Meyer: kent.meyer@seattle.gov; lise.kim@seattle.gov
Ryan P Mcbride: mcbrider@lanepowell.com
Gregory J Wong: greg.wong@pacificalawgroup.com;

By: s/ Tricia O'Konek
Tricia O'Konek
Legal Assistant
PACIFICA LAW GROUP LLP
1191 Second Avenue, Suite 2000
Seattle, WA 98101-3404
(206) 245-1700

PACIFICA LAW GROUP

May 21, 2018 - 4:22 PM

Transmittal Information

Filed with Court:	Supreme Court
Appellate Court Case Number:	95295-7
Appellate Court Case Title:	S. Michael Kunath, et al v. City of Seattle
Superior Court Case Number:	17-2-18848-4

The following documents have been uploaded:

- 952957_Briefs_20180521155624SC316692_0226.pdf
  This File Contains:
  Briefs - Appellants
  The Original File Name was Opening Brief.pdf

A copy of the uploaded files will be sent to:

- atabor@orrick.com
- bth@pacificlegal.org
- cindy.bourne@pacificalawgroup.com
- claire@smithandlowney.com
- ddewhirst@freedomfoundation.com
- ddunne@orrick.com
- edwardss@lanepowell.com
- ewb@pacificlegal.org
- galexander@bgwp.net
- greg.wong@pacificalawgroup.com
- jamie.lisagor@pacificalawgroup.com
- kent.meyer@seattle.gov
- knoll@smithandlowney.com
- lise.kim@seattle.gov
- matt@davisleary.com
- matt@tal-fitzlaw.com
- matthew@davisleary.com
- mcbrider@lanepowell.com
- phil@tal-fitzlaw.com
- rmckenna@orrick.com
- sea_wa_appellatefilings@orrick.com
- spitzerhd@gmail.com

Comments:

Sender Name: Tricia O'Konek - Email: tricia.okonek@pacificalawgroup.com
Filing on Behalf of: Paul J. Lawrence - Email: paul.lawrence@pacificalawgroup.com (Alternate Email: dawn.taylor@pacificalawgroup.com)

Address:
1191 Second Avenue, Suite 2100
Seattle, WA, 98101

Phone: (206) 245-1700

Note: The Filing Id is 20180521155624SC316692