Washington Research Council

Policy Brief

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Seattle Should Give Up Its Quixotic Pursuit of an Income Tax

Briefly

On November 22, 2017, Superior Court Judge John Ruhl declared the City of Seattle's income tax void. The city has appealed the decision. Seattle Mayor Jenny Durkan has called the appeal a "longshot." The prolonged litigation represents a considerable and unnecessary expense for the city. There's a well-established and more appropriate avenue for changing the state constitution and state statute: legislative action and voter approval. The city should abandon its appeal.

On July 10, 2017 the Seattle City Council passed an ordinance establishing a high-earners income tax on residents of the city. Suits challenging the legality of this tax were filed in King County Superior Court, On Nov. 22, Judge John Ruhl granted plaintiffs' motion for summary judgment and declared the ordinance void. On Dec. 8, the city appealed Judge Ruhl's decision, requesting that the state Supreme Court take the case directly, bypassing the Court of Appeals.

Background

The Washington State Constitution prohibits graduated income taxes. Article VII, Section 1, of the Constitution requires taxes on property to be uniform ("all taxes shall be uniform upon the same class of property . . . all real estate shall constitute one class") and defines property very broadly ("the word 'property' as used herein shall mean and include everything, whether tangible or in-tangible, subject to ownership"). Citing this "peculiarly forceful constitutional definition" of property, the state Supreme Court in 1933 ruled income to be property and declared graduated personal and corporate income taxes to be unconstitutional because they are not uniform (Culliton v. Chase).

The issue has been revisited, of course. The Washington Secretary of State reports Washington voters have been asked on 10 occasions to approve a corporate or personal income tax since the 1933 ruling (Secretary of State n.d.). All of been overwhelmingly rejected. Most recently, in 2010 voters turned down Initiative 1098—36 percent for, 64 percent against—which would have established "a steeply progressive graduated tax targeted at high earners" (WRC 2010).

Faced with repeated defeats in statewide elections, proponents—following a lead established by backers of an increased minimum wage and paid sick leave—have turned their attention to local governments they identify as more receptive to the income tax.

In 2016, intending to create a test case for the constitutionality of an income tax, the Seattle-based Economic Opportunity Institute (EOI) led an initiative campaign to establish an income tax on residents of the City of Olympia. Under the proposal households would have paid 1.5 percent tax on incomes in excess of $200,000, with the funds to be used to provide grants to needy college students. Speaking to the Olympia City Council, University of Washington law professor Hugh Spitzer predicted that

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the courts would invalidate EOI's proposed city income tax on grounds that the Legislature had not authorized cities to impose an income tax. "People will wind up being quite disappointed," he concluded (Hobbs 2016a).

Olympia Mayor Cheryl Selby eventually led the opposition to the initiative, which went to the November 8, 2016 ballot. Opponents argued the tax would be difficult to administer and the city could not afford the $300,000 to $400,000 it would cost to defend the measure in court. When the votes were counted, the initiative failed, with 52.2 percent voting "No."

Seattle ordinance

Early in 2017, EOI teamed with the Transit Riders Union to assemble a coalition of organizations to pressure for a high earners income tax in Seattle. They named the coalition Trump-Proof Seattle and kicked off the campaign on March 1,2017 with a "Lunch and Learn" session in City Council Chambers. On May 1 the city council passed a resolution stating its intent "to begin consideration of a progressive income tax ordinance by May 31, 2017, with the goal of Full Council passage by July 10, 2017." The resolution stated the Council would work with Trump Proof Seattle in writing the ordinance, one purpose of the which would be "to test the constitutionality of a progressive income tax . . ."

The City Council passed the income tax bill, Ordinance 125339, on July 10; it was then signed by then-Mayor Ed Murray on July 14, 2017.

The tax applies to residents of Seattle. (Thus, people who work in the city but are not deemed to reside there would not be taxed.) The ordinance defines residents as persons who either are domiciled in the city or, if not domiciled in the city, spend at least 183 days in the city and maintain a permanent place of abode in the city. The tax rate is 2.25 percent of "total income" above $250,000 for residents who file singly or above $500,000 for married residents. "Total income" is defined to be the amount reported to the Internal Revenue Service on either line 22 of form 1040 or the equivalent lines of various other IRS forms filed in lieu of form 1040.

The fiscal note on the ordinance estimated that the tax would have generated revenue of approximately $140 million in 2014. Acquisition of a computer system to track tax returns and payments would cost $10 to $13 million. The annual cost of 20 to 25 staff to run this system would be $2.5 to $3.0 million. In addition, the annual cost of 20 to 25 enforcement staff would be $2.5 to $3.0 million.

Legal challenges

As expected, lawsuits arrived quickly. Four separate suits challenging the law were filed in King County Superior Court. These four suits were ultimately consolidated into a single case. The court also granted EOI's request to intervene as an additional defendant in the case.

Underscoring the statewide significance EOI placed on the Seattle ordinance, the motion to intervene stated:

> *. . . EOI has leaders and activists in code cities that desire to enact local income tax ordinances. EOI's advocacy in these other cities working on behalf of these individuals entails substantial staff time and resources. Elected officials and staff in these code cities believe that their ability to enact an income tax depends upon the success of Seattle's income tax."* (EOI 2017, citations omitted)

EOI has not been shy about the ultimate objective, noting on its website Nov. 24, 2017, ". . . the current Washington State Supreme Court can, and we believe will, overturn a decision which has resulted in massive inequities in taxation . . ." (Burbank 2017)

In briefs to the court, the plaintiffs presented three key arguments as to why the ordinance should be declared to be void:

1) Cities only have authority to impose such taxes as they are specifically

authorized by the Legislature to impose . There is no legislative authorization for the tax the city adopted.

2) Cities are explicitly prohibited by statute from imposing a tax on net income. The tax the city adopted is a tax on net income.

3) The income tax is a property tax that violates the constitutional requirement that taxes on property be uniform and the constitutional 1 percent rate limitation.

Ruhl concluded that the first two arguments (the tax is not authorized and it is a prohibited net income tax) are valid and on these bases declared the ordinance to be void. Having invalidated the ordinance on statutory grounds, Judge Ruhl found it unnecessary to consider the constitutional argument.

The tax is not explicitly authorized

Ruhl quoted a 2017 Washington Supreme Court decision:

> *The Washington State Constitution generally vests taxing power in the state Legislature . . . . Municipal corporations have no inherent power to tax . . . . [Article VII of the Constitution] permits the Legislature to delegate tax powers to cities and towns.* (Watson v. City of Seattle)

Also, he cited a 1994 decision:

> *It is clear that neither cities nor counties may levy taxes which have not been expressly authorized by the Legislature. It is also clear that neither the broad police powers nor any other general grant of power to cities and counties encompass the power to tax.* (Rivett v. City of Tacoma)

From these two precedents he concluded:

> *Unless the City can identify a statute that specifically authorizes it to impose the type of tax described in the Ordinance, the Ordinance cannot withstand the Plaintiffs' challenge.*

The city had cited three possible authorizing statutes; Ruhl dismissed each of these.

Two of the statutes cited by Seattle (RCW 35.22.280(32) and RCW 35A.82.020) authorize cities to levy excise taxes.

An excise tax, Ruhl noted, "is a tax that is imposed on a taxpayer for voluntarily exercising a certain right or privilege." The city offered two privileges that might justify the income tax as an excise tax: (1) receiving income in the city and (2) choosing to live in the city. Ruhl rejected both of these as valid bases for an excise tax. With respect to the first, he cited a state Supreme Court decision holding that "the right to earn a living is not a 'substantive privilege' subject to excise but rather an inalienable right" (Cary v. City of Bellingham). With respect to the second he cited a decision that excise taxes may not be levied simply "upon the right to exist" (Watson v. City of Seattle).

The third state statute Seattle offered as authorizing it to impose the income tax was RCW 35A.11.020, which states:

> *Within constitutional limitations, legislative bodies of code cities shall have within their territorial limits all powers of taxation for local purposes except those which are expressly preempted by the state . . . .*

Ruhl found that this statement does not provide the explicit authority required to levy a specific tax. To this end, he cited a 1984 state Supreme Court decision in a case involving the City of Algona:

> *The general grant of taxation power on which Algona relies in RCW 35A.11.020 contains no express authority to levy a tax on the state or another municipality. To allow the City to impose the tax in this case would violate the established rule that municipalities must have specific legislative authority to levy a particular tax.* (King County v. City of Algona)

The tax is explicitly prohibited

RCW 36.65.030 provides that a "county, city, or city-county shall not levy a tax on net income." The City argued that this

statute does not prohibit its income tax because its tax would be a tax on gross income rather than net income. Recall that the measure of income subject to Seattle's tax comes from line 22 of IRS form 1040, which is labeled "total income." The number on line 22 is the sum of various income items entered on preceding lines 7–21. Some of these items come from other forms, such as Schedule C (net business income), Schedule D (net capital gains) and Schedule E (net income from rental real estate, royalties, partnerships, S corporations, etc.). The city argued that line 22's total income was gross income because the it did not include the particular adjustments, exemptions and deductions that are subtracted from total income to calculate taxable income recorded on line 43 of form 1040. Judge Ruhl rejected this reasoning. He held that "total income" was not gross income because it included "net income from pass-through business entities, sole proprietorships, and disregarded entities; net capital gain income; net rental income; and net royalty income." He explained: "Although the amount is labeled 'total income' on the respective IRS forms, it is not a gross figure, but rather a net figure, because it is the sum of net figures."

Constitutional issues not considered

Ruhl explained his decision not to consider the plaintiffs' constitutional challenges to Seattle's income tax ordinance:

> *The court declines to address this constitutional issue. "Where an issue may be resolved on statutory grounds, the court will avoid deciding the issue on constitutional grounds." Tunstall v. Bergeson, 141 Wn.2d 201, 210, 5 P.3d 691 (2000); Sinear v. Daily Journal-American, 97 Wn.2d 148, 152, 641 P.2d 1180 (1982); see also Kershaw Sunnyside Ranches, Inc. v. Yakima Interurban Lines Ass'n, 156 Wn.2 253, 277 n. 19 (2006).*
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> *The court has determined that no statute authorizes the City's net income tax and that RCW 36.65.030 prohibits the tax. The Ordinance being invalid on statutory grounds, it is unnecessary to consider the art. VII § 1 issue.*

Comment

It is not a surprise that Judge Ruhl voided the Seattle tax. As noted above, Spitzer predicted that the similar measure under consideration in Olympia in 2006 would have been thrown-out by the courts for the very reason Ruhl cited.

The city filed a notice to appeal Ruhl's decision on December 8, asking that the state Supreme Court take the case directly—normal procedure is for the case to go first to the Court of Appeals. Seattle Mayor Jenny Durkan, an attorney, while saying in early December she supports the decision to appeal, has called it a "longshot" (Beekman 2017c).

There are strong reasons for the mayor to withdraw the appeal. Going to court costs money, as has already been demonstrated—the city's contract with Pacifica Law Group for help with the Superior Court case had a $250,000 cap. Costs for the appeal would likely be comparable. Given the bleak prospects, it would be better not to spend the money. As the Seattle Times wrote on December 8:

> Seattle officials should not appeal. The city cannot afford such political vanity as long as it has broken sidewalks, underfunded social and police services, a backlog of park maintenance, and libraries that aren't open regular hours. (Seattle Times Editorial Board 2017)

Beginning the new year without the distraction and unnecessary cost of a quixotic pursuit of a municipal income tax would send a positive message about the city's policy priorities. There is, after all, a well-established process for changing the state constitution and state statute. It requires legislative action and voter approval; that is, the power of persuasion.

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