HONORABLE JOHN R. RUHL
Noted for Hearing November 17, 2017 10:00 am

IN THE SUPERIOR COURT OF THE STATE OF WASHINGTON

IN AND FOR THE COUNTY OF KING

S. MICHAEL KUNATH, Plaintiff, v. CITY OF SEATTLE, Defendant, and ECONOMIC OPPORTUNITY INSTITUTE, Intervenor-Defendant.	CONSOLIDATED No. 17-2-18848-4 SEA CITY OF SEATTLE'S COMBINED REPLY IN SUPPORT OF ITS MOTION FOR SUMMARY JUDGMENT AND OPPOSITION TO PLAINTIFFS' CROSS-MOTIONS FOR SUMMARY JUDGMENT
SUZIE BURKE, *et al.*, Plaintiffs, v. CITY OF SEATTLE, *et al.*, Defendant.	
DENA LEVINE, *et al.*, Plaintiffs, v. CITY OF SEATTLE, Defendant.	
SCOTT SHOCK, *et al.*, Plaintiffs, v. CITY OF SEATTLE, Defendant.	

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I. INTRODUCTION

In order to address pressing issues of public importance, the City has imposed an excise tax on residents. The tax is a modest percentage on every resident's total personal income over one-quarter million dollars per year (one-half million dollars for joint filers). The threshold for the tax was calibrated to be significantly above both the average cost of living and average income in Seattle. Plaintiffs' arguments seeking to evade the tax are without merit.

First, Plaintiffs improperly ask this Court to re-write the statutory bar on cities adopting a "net income" tax to bar any kind of income tax. Plaintiffs further mischaracterize federal income tax law by asserting that what the IRS (and therefore the City) considers "total" unadjusted personal income is actually not "total", but is instead an adjusted net income tax prohibited by state law. Line 22 on IRS Form 1040's unadjusted gross personal income is before any reductions that result in adjusted gross income and before additional reductions that result in net taxable income.

Second, Plaintiffs do not dispute the City's in-depth analysis of how *Culliton*'s legal basis is infirm. They offer nothing that contradicts the history of the constitutional amendment that added the definition of property, that *Aberdeen* is no longer good law, or that the weight of judicial authority holds that income is not property. The nature of income is that it is not property. Plaintiffs' citations and analogies to the contrary are inapposite.

Third, the City's income tax is an excise tax on residents who benefit from the protection of local laws and government. This basis for such an excise tax has been widely recognized and upheld. Contrary to Plaintiffs' claims, the City's income tax on high-income residents is not based on the privilege of working to earn a living or of simply existing. Washington law expressly permits cities to impose an excise tax to raise revenue based on any lawful voluntary

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activity including choosing to reside in Seattle.

Finally, Plaintiffs' equal protection claim fails because there is a rational basis for the City's tax. The City respectfully requests that this Court grant it summary judgment and deny Plaintiffs' motions for summary judgment.

II. RESPONSE TO PLAINTIFFS' STATEMENTS OF FACT

The Ordinance at issue is a local tax on residents in Seattle assessed against total personal income above thresholds of $250,000 (individuals) and $500,000 (joint filers). SMC 5.65.030.B. Plaintiffs do not dispute that the City's tax is imposed on personal "total income" as that amount is reported to the IRS (Form 1040, line 22), without any adjustments and deductions. SMC 5.65.030.G. Nor do they dispute that for federal tax purposes, this "unadjusted" gross personal income (line 22) is reduced by the taxpayer's adjustments and deductions to calculate "adjusted gross income" (line 37) and further reduced to calculate "taxable income" (line 43). *See* Wong Decl., Ex. D (Form 1040).

Further, Plaintiffs do not put forward evidence that the City Council's factual findings in the Ordinance are obviously false. *See City of Tacoma v. Luvene*, 118 Wn.2d 826, 851, 827 P.2d 1374 (1992) ("Legislative declarations of fact…are deemed conclusive unless they are obviously false and a palpable attempt at dissimulation." (quotation omitted)). For example, the City Council found that Washington and Seattle have among the most regressive tax systems in the country. Wong Decl., Ex. A at 2. The City Council further found that the total income thresholds of $250,000 for single filers and $500,000 for joint filers would target high-income households in Seattle, based at least in part on an analysis by the City Budget Office ("CBO"). *Id*. at 3-4; Ex. C. Although Burke/Levine assert that the City Council's factual findings are hearsay, they cite no authority to support their theory. Burke/Levine Mot. at 10. To the contrary, "[l]egislatures must

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necessarily make inquiries and factual determinations as an incident to the process of making law, and courts ordinarily will not controvert or even question legislative findings of facts." *City of Tacoma v. O'Brien*, 85 Wn.2d 266, 270, 534 P.2d 114 (1975). In sum, Plaintiffs have not disputed the facts contained in the Ordinance and the legislative record, and those facts should be deemed established for purposes of these cross-motions.

Burke/Levine offer irrelevant commentary about Intervenor Economic Opportunity Institute's ("EOI's") advocacy efforts to promote progressive taxation in Washington at the state and local level. EOI's advocacy efforts have no bearing on this case. *See State v. Brayman*, 110 Wn.2d 183, 204-05, 751 P.2d 294 (1988). Moreover, Burke/Levine make policy arguments such as the alleged impact of the tax on housing prices or the need to increase revenue in light of current conditions. But those policy judgments are not for this Court to determine. As the Washington Supreme Court has explained: "'It is not the function of this Court in cases like the present to consider the propriety or justness of the tax, to seek for the motives, or to criticize the public policy which prompted the adoption of the legislation.'" *Sonitrol Nw., Inc. v. City of Seattle*, 84 Wn.2d 588, 593-94, 528 P.2d 474 (1974) (quoting *State Bd. of Tax Comm'rs of Ind. v. Jackson*, 283 U.S. 527, 537, 51 S. Ct. 540, 75 L. Ed. 1248 (1931)). Policy matters are for the City Council. The City will not waste the Court's time rebutting this irrelevant record.

Finally, Burke/Levine suggest the Ordinance does not reflect the will of the people because it was not put to a popular vote. Burke/Levine Mot. at 2-4. Yet, the Ordinance was passed unanimously by the elected City Council after public comment and signed into law by the elected Mayor. Wong Decl., Ex. A. This process is consistent with the most basic tenets of our representative democracy, which entrusts policy decisions to elected officers who are accountable to the voters. Indeed, the Supreme Court has rejected as unconstitutional efforts by

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activists to require a referendum on all tax measures. *See Amalgamated Transit Union Local 587 v. State*, 142 Wn.2d 183, 192, 11 P.3d 762 (2000), *as amended* (Nov. 27, 2000), *opinion corrected*, 27 P.3d 608 (Wash. 2001). If Plaintiffs believed a majority of voters oppose the Ordinance, Plaintiffs could have petitioned for a referendum rather than making the strategic decision to file lawsuits. *See* Seattle City Charter, art. IV, sect. H.

III. ARGUMENT

A. The City's tax on total personal income is not a net income tax.

1. In RCW 36.65.030, net means net.

RCW 36.65.030 does not, as Burke/Levine contend, prohibit cities from enacting all forms of income tax. *See* Burke/Levine Mot. at 21 ("Thus, when the Legislature subsequently prohibited cities from imposing taxes on net income in RCW 36.65.030, it prohibited cities from imposing income taxes."). Interpreting RCW 36.65.030 so broadly would improperly read the term "net" out of the statute in violation of the rule that "'each word of a statute is to be accorded meaning.'" City's Mot. at 6 (quoting *HomeStreet, Inc. v. State, Dep't of Revenue*, 166 Wn.2d 444, 452, 210 P.3d 297 (2009)); *see also State v. Reis*, 183 Wn.2d 197, 215, 351 P.3d 127 (2015) ("It is not this court's job to remove words from statutes or to create judicial fixes, even if we think the legislature would approve."). Burke/Levine offer no response.

Further, interpreting RCW 36.65.030 to bar any type of tax on income would raise serious questions about the validity of municipal B&O taxes levied on gross income received by a business. *See* RCW 35.102.030(3) ("Business and occupation tax" of a city means "a tax imposed on or measured by the value of products, the gross income of the business, or the gross proceeds of sales, as the case may be, and that is the legal liability of the business."); *State ex rel. Stiner v. Yelle*, 174 Wash. 402, 413, 25 P.2d 91 (1933) (upholding gross business income tax).

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RCW 36.65.030 does not distinguish between business and personal income. Thus, to the extent RCW 36.65.030 permits a B&O tax on gross business income, a personal income tax on unadjusted gross personal income is also permissible.

2. Unadjusted gross personal income is not net personal income.

Burke/Levine agree with the definition of "net income" proposed by the City, namely, "the amount left after reducing gross income by 'deductions, exemptions, and other reductions.'" Burke/Levine Mot. at 22 (quoting City's Mot. at 6). Although Kunath contends the Court should rely on dictionaries in use when RCW 36.65.030 was adopted in 1984, the earlier editions' definitions are either identical or in accord.[1] *See* Kunath Mot. at 4-6. The City's tax on total personal income does not meet any of these definitions.

The City has **not** "admitted that its Ordinance taxes net income", as Kunath asserts. Kunath Mot. at 8. "Total" personal income (line 22) subject to the City's tax is the unadjusted gross personal income received by the individual or joint resident taxpayer. It does not account for any adjustments or deductions attributable to the taxpayer taken below line 22 to calculate "adjusted gross income" (line 37) and "taxable income" (line 43). Unadjusted gross personal income cannot be characterized as net income, which the remainder of gross personal income after deductions, exemptions and other reductions. *See also* Shu-Yi Oei & Diane M. Ring, *The New "Human Equity" Transactions*, 5 Cal. L. Rev. Circuit 266, 275 (2014) (cited in Burke/Levine Mot. at 22; describing total income on line 22 as "**all** of the Recipient's income"

[1] *See* Kunath Mot. at 6; Webster's Third New Int'l Dict. 1520 (1993) ("net income" means "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 New Int'l Dictionary (1981) ("Webster's") (same); Black's Law Dictionary (10th ed. 2014) ("net income" means "Total income from all sources minus deductions, exemptions, and other tax reductions."); Black's Law Dictionary (5th ed. 1979) ("Income subject to taxation after allowable deductions and exemptions have been subtracted from gross or total income. The excess of revenues and gains for a period over all expenses and losses of the period. Net income for income tax purposes is what remains out of gross income after subtracting ordinary and necessary expenses incurred in efforts to obtain or to keep it."). Notably, both versions of Black's Law Dictionary make a distinction between "net income" and "total income", and the term "total income" (line 22) was used by the IRS on Form 1040 in the same manner during that time period as it is today. Second Wong Decl., Ex. D.

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(emphasis added)).

Plaintiffs' arguments rest on the faulty premise that any measure of income that involves subtraction is "net income". To the contrary, there are accepted measures of income that do not include every penny attributable to the recipient but are **not** net income. In general, the calculation of gross income for a business may include deductions. Washington state and municipal B&O taxes on "gross income" do not apply to all of the income attributable to the business. For example, the state B&O tax statute allows professional employer organizations to deduct a range of business expenses including "the actual cost of wages and salaries, benefits, workers' compensation, payroll taxes, withholding, or other assessments paid to or on behalf of a covered employee" from gross income derived from performing professional employer services. RCW 82.04.540(2); *see also* RCW 82.04.298(2) (deduction of actual cost of merchandise for certain sales by qualified grocery distribution cooperatives); RCW 82.04.280(1)(f) (standard or itemized deductions for certain advertising fees received by broadcasting stations). Despite various reductions from income attributable to a business, the state B&O tax is a valid tax on gross income and not a net income tax. *See supra* at 5.

The definition of "net income" in the Multistate Tax Compact at ch. 82.56 RCW, cited by Burke/Levine, reinforces the point. RCW 82.56.010 (Compact, art. II, para. 3). Under its "net income" definition, the remainder of gross income after deducting expenses that are "specifically and directly related to particular transactions" would not be characterized as "net income". *See* RCW 82.56.010 (Compact, art. II, para. 4) ("net income" requires, at a minimum, deduction of "one or more…expenses that are not specifically and directly related to particular transactions").[2] Thus, the mere fact that certain income is not included in calculating total gross personal income

[2] The Compact applies solely to businesses and governmental entities, not individuals. *Id*. (Compact, art. II, para. 3).

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(line 22) is not dispositive on whether it can be characterized as "net income". The question is whether the City imposes a tax on net personal income remaining after deductions, exemptions and other reductions attributable to the taxpayer. It does not.

Plaintiffs do not understand the difference between the inputs above and below line 22. The inputs above line 22 (lines 7-21) are what the IRS defines as elements of "total" income attributable to an individual taxpayer. The inputs identify the source of personal income and include, for example, personal income earned from wages, owning a business or selling an asset. These inputs added together result in "total income". By contrast, the inputs below line 22 are amounts that are deducted from "total" income, namely, personal deductions, exemptions, or other reductions attributable to the individual taxpayer, that reduce unadjusted "total" income to "adjusted gross income". Thus, the inputs and calculations made above line 22 do not transform unadjusted gross personal income into net income.

To illustrate, an associate at a law firm is paid an annual salary and possibly a bonus. Overhead and other business expenses are absorbed by the firm. Thus, the unadjusted gross personal income she receives from her work at the firm is her annual salary and bonus, which she reports on line 7. By contrast, an equity partner receives a distribution of the firm's annual profits (or, hopefully not, losses). Each partner's distribution reflects her share of the gross business income less expenses, deductions and credits attributable to the firm, including the associate salaries. The result of these calculations is the partner's unadjusted gross personal income distributed by the firm. The fact that business expenses were already accounted for in the partner's total personal income does not mean that amount is personal net income rather than personal unadjusted gross income. Taxpayers receiving money from other businesses, including sole proprietorships and farms, report their profits in a similar manner based on gross business

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income less business expenses.[3] *See, e.g.*, Wong Decl., Ex. D, ln. 12, 17, 18. Similarly, total personal income from stock trading is generally reported as gains (or losses) actually received by the individual taxpayer. *See, e.g.*, *id*., ln. 13.

Tax reporting for gambling income is also instructive. A professional gambler reports her gambling income as business income (line 12) based on her winnings less her losses and other business expenses. *See id*., ln. 12; Ex. G. By contrast, a casual gambler who hits the jackpot reports her total winnings as Other Income (line 21). *Id*., Ex. D, ln. 21; Ex. H at 29. Because the proceeds do not derive from her profession or business, she is not allowed to deduct personal gambling losses or other related expenses above line 22. Instead, she may be able to claim her personal losses as an itemized deduction. *See* Second Decl. of Gregory J. Wong ("Second Wong Decl."), Ex. A (Schedule A), ln. 28 (Other Miscellaneous Deduction).[4] Under either scenario, line 22 reflects the unadjusted gross personal income received by the taxpayer without any personal deductions or other reductions—not the taxpayer's net income.

Kunath draws a false distinction between expenses and statutory tax deductions. Kunath Mot. at 7. The business expenses deducted above line 22 that Kunath contends transform total personal income into net income are themselves statutory tax deductions allowed, in whole or in part, at the discretion of Congress. *See, e.g.*, Wong Decl., Ex. G (Schedule C), ln. 9, 12 (business travel deductions based on standard mileage rate, standard meal allowance, and standard snack rate). Conversely, many of the statutory tax deductions below line 22 that Kunath contends are "utterly irrelevant to the determination of net income" are the taxpayer's personal expenses, such as educator expenses (line 23) and moving expenses (line 26). *See* Kunath Mot. at 7-8. The

[3] *See* IRS Self-Employed Individuals Tax Center, at https://www.irs.gov/businesses/small-businesses-self-employed/self-employed-individuals-tax-center (last visited on Oct. 31, 2017).
[4] *See* IRS Topic Number 419: Gambling Income and Losses, at https://www.irs.gov/taxtopics/tc400/tc419 (last visited Oct. 31, 2017).

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material distinction is that deductions above line 22 are attributable to the business or asset generating personal income, while those below are attributable to the individual taxpayer.

Burke/Levine erroneously points to statutory exclusions as evidence of netting. Burke/Levine Mot. at 23 (citing exemptions to wages, salaries, tips, etc. (line 7), taxable interest (line 8), capital gain or (loss) (line 13), IRA distributions (line 15), and Social Security benefits (line 20)). Rather than a deduction, Congress has placed these categories of income outside the scope of federal taxation (e.g., employer contributions to retirement plans, interest on municipal bonds, and the first $250,000/$500,000 (single/joint) realized on the sale of a principal residence). *See id*. Thus, the exclusions are defined as non-taxable rather than deducted from income. The adjustments and deductions below line 22, by contrast, are personal expenses and other deductions attributable to the taxpayer (e.g., moving expenses, education expense) that reduce taxable personal income, not categories of personal income excluded from taxation. IRA distributions and contributions illustrate this distinction. IRA distributions (Line 15) exclude distributions received by the taxpayer that Congress has "deemed untaxable for federal income tax purposes, including distributions from Roth IRAs and Roth 401Ks." Burke/Levine Mot. at 23. By contrast, IRA deductions (Line 32) allow the taxpayer to deduct contributions she paid into a tax-deductible IRA. The exclusion of income not subject to taxation cannot be equated with personal adjustments and deductions subtracted from unadjusted gross personal income to calculate a taxpayer's net personal income.

In sum, the plain language of RCW 36.65.030 prohibits a single type of income tax (tax on "net" income), such as a city tax on adjusted gross income (line 37) or taxable income (line 43)r. But RCW 36.65.030 allows all other types of taxes on income, including the City's B&O tax on gross business income and the City's tax on total unadjusted gross personal income (line

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22) of Seattle residents. RCW 36.65.030's bar on city taxes on net income does not apply.

B. Plaintiffs fail to establish how and why income is property.

"The 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 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."); *Lenci v. City Seattle*, 63 Wn.2d 664, 667-68, 388 P.2d 926 (1964). Plaintiffs fail to meet this heavy burden.

1. Plaintiffs do not dispute key premises of the City's argument regarding the improper characterization of income as property.

a. Plaintiffs' authority supports the City's historical context for the adoption of Amendment 14.

Plaintiffs do not dispute the history that led up to the people's adoption of Amendment 14 in 1930. That Amendment, which added the current uniformity requirement and definition of property to the Washington Constitution, was intended to allow taxation of ownership of previously uncaptured intangible property, such as stocks and bonds, and to give flexibility in taxation by permitting different rates of taxation between classes of property. *See* City's Mot. at 10. While both Shock and Kunath discuss history leading up to Amendment 14, none of those discussions contradict this history.

Indeed, Plaintiffs' authority supports the City's argument. Kunath cites *State v. Wooster*, 163 Wash. 659, 2 P.2d 653 (1931), in his discussion of the history of Amendment 14. Kunath Mot. at 11. *Wooster* decided whether certain assets were subject to taxation. *Wooster*, 163 Wash. at 660-61. The court noted that under the pre-1930 uniformity clause of the Washington Constitution, which was inflexible in that all property was taxed at one uniform rate, "mortgages, bonds, warrants, and other like **intangibles** might by the Legislature be classified as credits and

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so **escape** direct taxation…" *Id.*at 662 (emphasis added) (credits, in this context, were exempt from taxation). As a result, "'[e]fforts to conceal the existence of credits [i.e., intangibles] are so successful that a few honest persons pay the taxes, and the large majority of holders do not.'" *Id.* at 663 (quoting *State ex rel. Wolfe v. Parmenter*, 50 Wash. 164, 96 P. 1047 (1908)). The court concluded that this evasion of taxation by owners of intangible property was one of "the evils sought to be eradicated and abolished" by Amendment 14. *Id.* Thus, *Wooster* supports the City's position that Amendment 14 was intended to cure the problem of people putting their wealth into intangibles in order to escape taxation.[5]

Shock lays out a similar history, agreeing that "the fundamental purpose of the amendment [] was to authorize the Legislature to separately classify intangible property so it could be brought into the tax base." Shock Mot. at 8-9. The two Voter's Pamphlets Shock cites emphasize the exact problem the City identified in its Motion. In 1928, a proposed constitutional amendment would have changed the then-existing rule of absolute uniformity for property taxation to allow for classification of property and uniformity within each class. Second Wong Decl., Ex. B at 2 (1928 Voter's Pamphlet). The supporters of the measure argued that "wealth represented by intangibles in the form of bonds, notes, etc., now amounting to about one-half of the wealth of the state, pays nothing toward the cost of local government, and practically the whole burden therefore falls on land.… Land is not only excessively taxed but it is being confiscated by taxation.… Means must be found of making all forms of wealth bear some share of the burden of government." *Id.* at 5 (noting the tax burden on land had doubled). Opponents of the measure agreed that "[i]ntangibles should be taxed." *Id.* at 7. They pointed out, however, that

[5] Ultimately, the court upheld the legislature's single classification of money and "what are popularly called credits or intangibles", including mortgages, notes, accounts, certificates of deposit, tax certificates, judgements, government bonds and warrants, and the bonds, stocks or shares of private corporations, and the reasonableness of the decision to exempt this class of property from taxation. *Id.* at 664 (noting it was a political question whether to tax money and intangibles at a lower rate or not at all).

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the measure did not expressly state it would tax intangible property and that the language allowed for real property to be taxed at different rates, thereby creating a situation where a tax exemption for a farm owner could add to the tax burden of a home owner. *Id.* at 7-8. The measure did not pass. In 1930, the measure was put before the people again with two important revisions: (1) a definition of property was added to make clear that the intangible property evading taxation would be subject to taxation, and (2) all real property was placed into a single class. Second Wong Decl., Ex. C at 29 (1930 Voter's Pamphlet). Again, supporters noted that the legislature's "hands were tied by the rigid 'uniform and equal' provision of the constitution" then in effect. *Id.* The unfairness of property taxation where "[s]tocks and bonds…escape altogether under our present system" was illustrated by noting that "[t]he dog tax brings in more revenue than is received from all of the bonds and stocks owned in the state." *Id.* By adding a definition of property that expressly included intangible property and providing for classification of property, it became "possible to tax bonds and stocks…at moderate rates…." *Id.* There was no opposition statement against the amendment. The measure passed as Amendment 14 and comprises the current constitutional language on property taxation. Significantly, there is nothing in the history to suggest that income (as opposed to held investment assets) was included as intangible property.

Plaintiffs' authority not only supports the City's historical background, but it also makes clear that the overall purpose of the constitutional amendment was to provide for **broader** taxation. In *Wooster*, the Supreme 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

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constitutional provisions." 163 Wash. at 663. And as supporters of the ultimately successful constitutional amendment noted in the 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." Second Wong Decl., Ex. C at 29. It is ironic that Plaintiffs attempt to evade taxation by hiding behind a constitutional amendment that liberalized taxing authority.

Finally, the City notes that Shock repeatedly misstates the Constitution's uniformity requirement. Shock asserts multiple times, using varying language, that "Washington's unique constitutional requirement that all property—whether tangible or intangible—be taxed uniformly as a single class was adopted as part of Amendment 14 to the state constitution in 1930." Shock Mot. at 8. This statement disregards the plain language of the constitution. Article VII, § 1 states: "All taxes shall be uniform upon the same class of property…. All real estate shall constitute one class…." Shock ignores that uniformity applies only **within** classifications of property and the only unitary class of property established is real estate.[6]

b. *Aberdeen* is not good law.

None of the Plaintiffs dispute that *Aberdeen Savings & Loan Assoc. v. Chase*, 157 Wash. 351, 289 P. 536, 290 P. 697 (1930), is no longer good law. Nor could they. *Aberdeen's* holding was limited to a federal Equal Protection Clause challenge based primarily on the U.S. Supreme Court case of *Quaker City Cab Co. v. Pennsylvania*, 272 U.S. 389, 48 S. Ct. 553, 72 L. Ed. 927 (1928). The U.S. Supreme Court could not have been more clear regarding the status of *Quaker City Cab Co.* than when it said the case was "a relic of a bygone era." *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356, 93 S. Ct. 1001, 35 L. Ed. 2d 351 (1973). *Aberdeen* was the only

[6] The City agrees with the general premise Plaintiffs assert that uniformity of taxation within classes of property is important. But that does not make the rule relevant here. If income is not property (which it is not), then uniformity does not apply.

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authority the *Culliton* court relied on for the statement that "[i]t has been definitely decided in this state that an income tax is a property tax, which should set the question to rest here." *Culliton v. Chase*, 174 Wash. 363, 376, 25 P.2d 81 (1933). Because *Aberdeen* is no longer good law, that reliance is no longer supported.

Contrary to Kunath's suggestion otherwise, the City in fact discussed and quoted the Washington Supreme Court's denial of reconsideration of *Aberdeen* and its companion case. *See* City's Mot. at 12; Kunath Mot. at 15. Indeed, Kunath's quote of the denial of reconsideration supports the City's argument: *Aberdeen*'s holding was limited to "the questions presented by the cases at bar, and those questions only" and it relied solely on "the decisions of the Supreme Court of the United States" (*i.e.*, *Quaker City Cab Co.*) in reaching its holding. Kunath Mot. at 15 (quoting *Wash. Mut. Savings Bank v. Chase*, 157 Wash. 351, 392, 290 P. 697 (1930)). There are two logical consequences of the Supreme Court's clarification on reconsideration: (1) the Court was **not** deciding the question whether income is property under Article VII of the Washington Constitution, and (2) if the U.S. Supreme Court case law on which *Aberdeen* relied is not good law, then *Aberdeen* itself is not good law.

Kunath inaccurately states that the *Culliton* court treated *Aberdeen* only as "background". The court in *Culliton* cited *Aberdeen* for one of the fundamental premises of the holding in *Culliton*: it was already decided that income is property in Washington. Moreover, subsequent income tax cases continued to cite *Aberdeen* for the same premise. *See, e.g.*, *Petroleum Nav. Co. v. Henneford*, 185 Wash. 495, 496-97, 55 P.2d 1056 (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*). But that was before the U.S. Supreme Court definitively discarded *Quaker*

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City Cab Co., the linchpin of *Aberdeen*. Plaintiffs cannot escape the infirmity of *Aberdeen*, and therefore of *Culliton* and its progeny as well.

c. The weight of judicial authority is an income tax is not a property tax.

Plaintiffs also do not offer authority that refutes the conclusion that the weight of judicial authority at the time of *Culliton* held that income is **not** property. *See* City's Mot. at 14-15. The *Culliton* court stated the opposite without citation. 174 Wash. at 374. But, as the City established in its Motion, that statement was unfounded and incorrect. City's Mot. at 14-15. That *Culliton* distinguished decisions from other states, as Plaintiffs note, is beside the point. The *Culliton* court led with the unsupported premise that the overwhelming weight of judicial authority held income is property, then distinguished three state court cases (from Wisconsin, Idaho, and Montana) that held otherwise. 174 Wash. at 374-77. Contrary to that unsupported premise, both Professor Newhouse and courts such as the Illinois Supreme Court examined the jurisprudence and found that the majority of the courts in the *Culliton* era held an income tax is *not* a property tax. *See* City's Mot. at 14-15. Similar to its misplaced reliance on the now-overruled *Aberdeen* case, the Supreme Court's statement regarding the weight of judicial authority is yet another leg of the *Culliton* case that collapses under scrutiny.

2. The nature of income is that it is not property.

a. Plaintiffs misunderstand the nature of income.

Plaintiffs assert that because the constitutional definition of property—"everything, whether tangible or intangible, subject to ownership"—is broad, it must include income. The City does not deny that the definition is broad. But it still does not answer the question of whether the flow of income prior to it being realized by an individual is subject to ownership in the same way as an asset. Income transformed into an asset, such as money in a bank account,

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investment in a stock or bond, or real estate is property. That is different from income, which is money in motion but not yet realized by being turned into a tangible or intangible asset. The U.S. Supreme Court articulated this concept to distinguish between property and income in *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): "[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." *See 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").

Plaintiffs' assertion that "everything" is property is overly broad. Otherwise, every tax that is incidental to the use or enjoyment of an item would be a property tax. But that is not the law. A sales tax on the purchase of personal property such as a new cell phone is not a property tax. A motor vehicle licensing tax to drive a car on public roads is not a property tax. And our Supreme Court recently upheld a tax on the purchase of guns and ammunition as valid without subjecting it to the restrictions placed on property taxes. *See Watson v. City of Seattle*, 189 Wn.2d 149, 155-56, 401 P.3d 1 (2017).

Similarly, Kunath's reliance on the maxim *nomen generalissimum* in support of a sweeping reading of the term property is unavailing. *Nomen generalissimum* does not mean that property is universal, as Kunath suggests. Rather, it means that the term is a general one and "its meaning should be gathered from the context in which it is used. The term may have many

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meanings depending upon the circumstances in which it is used." *Retail Store Emp. Union v. Wash. Surveying & Rating Bureau*, 87 Wn.2d 887, 896-97, 558 P.2d 215 (1976) (quoting *Farmers Ins. Co. v. U.S.F. & G. Co.*, 13 Wn. App. 836, 841, 537 P.2d 839 (1975)). Here, the context of the definition of "property" in the Constitution was that it was drafted to make sure that people no longer could evade taxation by putting their wealth in certain types of intangible property rather than in real property. Given this context, it makes no sense to read the constitutional definition of property to include income, as income is not an asset in which one can move one's wealth to evade taxation.

Further, the *nomen generalissimum* cases Kunath cites do not stand for the proposition that the constitutional definition of property includes income. In *Labberton v. General Cas. Co. of America*, 53 Wn.2d 180, 186-88, 332 P.2d 250 (1958), the Supreme Court interpreted the word "property" in the context of an insurance policy and held that the policy covered a farmer when a defect in a fertilizer spreader caused him to lose his crops. Because the defect affected the farmer's right to use his property (the land), it triggered the policy's property coverage. In *Brooklyn City R. Co. v. Kings Ctny. Trust Co.*, 214 A.D. 506, 510-11, 212 N.Y.S. 343, 346 (App. Div. 1925), *aff'd*, 242 N.Y. 531, 152 N.E. 414 (1926), the New York court interpreted the word "property" as used in a contract and held that the term included both real and personal property. And in *Jones v. Union Pac. R.R. Co.*, 120 N.W. 946, 947 (Neb. 1909), the Nebraska court interpreted the term "personal property" in a state statute that exempted certain personal property from execution of judgments. The court held that for purposes of the specific statute, wages were personal property exempt from garnishment under a judgment. *Id.* None of these cases have anything to do with income, much less Article VII, § 1 of the Washington Constitution.

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b. The U.S. Supreme Court cases Plaintiffs cite do not hold that income is property.

The U.S. Supreme Court cases Plaintiffs cite regarding income and property are inapposite. In *Hoeper v. Tax Comm'n of Wis.*, 284 U.S. 206, 215, 52 S. Ct. 120, 76 L. Ed. 248 (1931), the Court stated the "question presented is whether the state has power by an income tax law to measure [a taxpayer's] tax, not by his own income, but, in part, by that of another." The Court held that to tax a husband on his wife's income when Wisconsin law treated their property as separate would violate due process. *Id.* at 218. Although the nature of income was not at issue in the case, the Court's language supports the notion that income and property are different: "The effort to tax B for A's **property or income** does not make B the owner of that **property or income**…." *Id.* at 216 (emphasis added).[7]

In *Blair v. Comm'r of Internal Revenue*, 300 U.S. 5, 7, 57 S. Ct. 330, 81 L. Ed. 465 (1937), the "case present[ed] the question of the liability of a beneficiary of a testamentary trust for a tax upon the income which he had assigned to his children prior to the tax years and which the trustees had paid to them accordingly." Thus, the question was not whether income is property, but who pays federal income tax when a beneficiary of income from property kept in a trust assigns an interest in receiving that income to others: the beneficiary of the trust or the assignees? The Court held that if the assignments were valid, then the assignees were liable for the federal income tax. *Id.* at 14. The case makes no statement whether income is property.

Plaintiffs' remaining citations are to irrelevant Takings Clause cases. They have nothing to do with income and are inapplicable.[8] None of Plaintiffs' cited U.S. Supreme Court cases

[7] The Wisconsin law statutorily defined a wife's separate personal property, and that definition included her income. *Id.* at 214-15. While the court discussed the wife's income as her own property it was in the context of the Wisconsin statute.

[8] *See Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1003–04, 104 S. Ct. 2862, 81 L. Ed. 2d 815 (1984) (holding, in part, that a company's trade secret protected by state law was property for purposes of the Fifth Amendment's

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stand for the proposition that the City's income tax is a tax on property.

c. Plaintiffs' analogies to other legal schemes are without merit.

Plaintiffs unsuccessfully attempt to analogize income to inapplicable legal concepts. First, Shock's analogy between the flow of income and the flow of water fails. One may have a right to use a physical, tangible asset such as water, even though it is moving, because it is part of one's real property. Indeed, the case Shock cites notes that water rights exist because they are "so far incident to the land that it has been held to be a part of the land itself." *Domrese v. City of Roslyn*, 101 Wash. 372, 373, 172 P. 243 (1918). That is entirely unlike the nature of income as a flow that only becomes property only after it is received and invested.

Second, Plaintiffs point to community property cases. But those cases are similar in nature to *Hoeper* discussed above—they pertain to whom income may be attributed for tax purposes and do not hold that income is property itself. In *Poe v. Seaborn*, 282 U.S. 101, 51 S. Ct. 58, 75 L. Ed. 239 (1930), the U.S. Supreme Court held that because Washington is a community property state, a husband and wife could file separate federal tax returns, each claiming one half of the community income on their returns. This simply means that in Washington the income of either spouse is attributed to the marital community for tax purposes. *Poe* makes clear, however, that community property and community income are different. A spouse has a "a vested property right in the **community property**, equal with that of her husband; **and in the income of the community**, including salaries or wages of either husband or wife, or both." *Poe*, 282 U.S. at 111 (emphasis added). But possessing a vested right to share in

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Takings Clause); *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 164–65, 101 S. Ct. 446, 66 L. Ed. 2d 358 (1980) (holding that under "narrow circumstances" of the case, a court keeping interest earned on monies deposited in a court's interpleader fund for the benefit of private parties only was an unconstitutional taking); *Phillips v. Washington Legal Found.*, 524 U.S. 156, 172, 118 S. Ct. 1925, 141 L. Ed. 2d 174 (1998) (holding that "interest income generated by funds held in [attorney] IOLTA accounts is the "private property of the owner of the principal" for purposes of the Takings Clause).

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income does not convert the income into property. Current IRS guidance is helpful. The IRS differentiates between "community property" as certain types of "property", and "community income" as "income from" certain sources (including salaries, wages, and other pay). *See* IRS Publication No. 555 (Feb. 2016).[9] Plaintiffs' quote from *Purser v. Rahm*, 104 Wn.2d 159, 702 P.2d 1196 (1985), also is helpful. It states that under Washington's community property law, "[e]ach spouse would own an undivided one-half interest in the community **income received** by either spouse." *Id.* at 164 (emphasis added). That is, the right is in the "gain resulting from the labors of the husband or wife." *Id.* at 171. Like *Poe* and *Hoeper*, the ultimate issue was whether community income should be attributed to an individual spouse—not whether income is property in general.[10] Finally, that a spouse has a "vested" right in community income does not make income property. The concept of whether a right is vested is separate from whether that vested right creates a property interest. *See, e.g.*, *Ortega v. Holder*, 747 F.3d 1133, 1134 (9th Cir. 2014) (whether an immigrant has a vested right under prior immigration law); *In re Estate of Haviland*, 177 Wn.2d 68, 75, 301 P.3d 31 (2013) (analyzing whether a statute applies retroactively to impact a vested right).

Third, Kunath argues that if income is not property then "wage garnishments will become a thing of the past." Kunath Mot. at 17. But Kunath fails to cite the actual wage garnishment statute, which directly contradicts this statement. Washington law expressly provides that "[a] judgment creditor may obtain a continuing lien on **earnings** by a garnishment…." RCW 6.27.330 (emphasis added). Further, in the context of wage garnishment a legal judgment has been entered and may be enforced. *Cf. Sniadach v. Family Fin. Corp. of Bay View*, 395 U.S. 337, 341, 89 S. Ct. 1820, 23 L. Ed. 2d 349 (1969) (holding a statute that allowed pre-judgment

[9] *Available at* https://www.irs.gov/publications/p555 (last visited Oct. 29, 2017).
[10] RCW 49.48.090, cited by Kunath, has nothing to do with the nature of income. It simply states the conditions on which an assignment of wages can be made to secure a loan.

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garnishment of wages unconstitutional); *State v. Adams*, 107 Wn.2d 611, 616, 732 P.2d 149, 154 (1987) (summary withholding of future employee wages to recover overpayments unconstitutional where the employees dispute the existence or amount of overpayments).[11] Garnishment of wages post-judgment therefore is a means of diverting one's income to another for purposes of fulfilling a legal obligation. It is similar in concept to the assignment of income from a trust beneficiary to others at issue in *Blair*. Garnishment answers the question who has a right to receive income, not whether income is property. Indeed, to hold otherwise would mean that a judgment creditor literally owns a judgment debtor's salary, rather than simply possessing an enforceable interest in receipt of the person's income as a means to fulfill the judgment.

Finally, Plaintiffs engage in hyperbole predicting "chaos in the legal and real world" and dire consequences of loss of residents and businesses should the definition of property not include income. Such statements ignore the reality that Washington State is an extreme outlier when it comes to income taxation. 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).[12] The federal government also imposes an income tax. The pervasiveness of income taxes in our country has not resulted in chaos or economic decline throughout the United States. Such statements simply reflect Plaintiffs' desire to preserve a status quo that benefits high-income residents.

3. This Court should recognize the infirmity of *Culliton*.

For the reasons stated above and in the City's Motion, *Culliton* is erroneous and should not be allowed to stand. Plaintiffs lean heavily on stare decisis based on *Culliton* and its

[11] *Thompson v. DeHart*, 84 Wn.2d 931, 939, 530 P.2d 272 (1975), is inapposite. In that case, the Court held only that "attachment…without notice or hearing, to secure a lien upon the defendants' real property for the creditor plaintiff at the outset of this litigation, was valid."

[12] *Available at* http://leg.wa.gov/House/Committees/OPRGeneral/Documents/2010/1098%20summary.pdf (last visited Oct. 29, 2017).

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progeny—case law that the City acknowledges and discusses in its Motion. While vertical stare decisis applies in Washington, that is true whenever erroneous case law is challenged. Courts are created to do justice. *See State ex rel. Washington State Fin. Comm. v. Martin*, 62 Wn.2d 645, 665–66, 384 P.2d 833, 845 (1963) ("courts are instituted among men to do justice between them, and between men and their government"). This is true for all courts, whether trial or appellate. Here, erroneous case law creates a significant harm by limiting the amount of revenue available for public services and forcing government to rely on regressive taxes. Washington is ranked "#1 of the Terrible Ten" in terms of the regressive nature of its state and local taxes. Wong Decl., Ex. I. 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.* Despite vertical stare decisis, the City asks this Court to do justice by deciding the significant legal questions presented.

Further, the claim that Washington courts cannot change their own holding is without merit. Shock alleges that an established property right exists in income, and therefore a Washington court cannot hold income is anything but property. Shock Mot. at 11. But the case cited holds only that a state—through any branch of government—cannot transform private property into public property without compensation. *Stop the Beach Renourishment, Inc. v. Florida Dep't of Envtl. Prot.*, 560 U.S. 702, 715, 130 S. Ct. 2592, 177 L. Ed. 2d 184 (2010) (addressing land owners' littoral rights given by the state, not income). Plaintiffs' assertion that *Culliton* is eternal and not subject to change, even by the Washington courts, has no basis. An incorrect judicial interpretation of the state constitution can be corrected by the state courts.

Plaintiffs' claim that they have acted in reliance of a property interest fails, too. Income is not property, therefore no property interest or right exists. And no taxpayer can reasonably rely

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on a premise that they will forever be free from certain types of taxation. The City's income tax is prospective only. It does not tax any prior earnings, only those starting in 2018. Thus, there can be no past reliance. While Plaintiffs may decide to make different personal decisions as a result of the City's income tax, they are of no legal consequence.

C. The City's income tax is a valid excise tax.

1. The income tax is based on the benefits residents receive by living in the City.

As most courts have held, an income tax is properly characterized as an excise tax. *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). The rationale is that an income tax is not a tax on the income itself, but on the receipt and enjoyment of income in the taxing jurisdiction. *See Graves*, 300 U.S. 308 at 314. "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." *Id.* at 313; *see also Reynolds Metal Co. v. Martin*, 107 S.W.2d 251, 258-59 (Ky. 1937) (The taxpayer "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."); City's Mot. at 19.

Washington courts fully understand the difference between property and excise taxes. The exact reasoning articulated above for why an income tax is an excise on privileges was used by the Washington Supreme Court in *Stiner*. There, the Supreme Court held that the B&O tax, as measured by a business' gross proceeds, sales, or income, "does not concern itself with income

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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." *Stiner*, 174 Wash. at 407. The Supreme Court laid out why this is the case: 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 exact language describes the City's income tax. The City's laws and government provide protection for residents, those who chose to live in Seattle, that allows them to pursue "any gainful occupation". The City simply asks that people pay their fair share of the cost of creating and maintaining that protective infrastructure.

2. *Cary v. City of Bellingham* is not to the contrary.

Plaintiffs' reliance on *Cary v. City of Bellingham*, 41 Wn.2d 468, 250 P.2d 114 (1952), is misplaced. 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. The Supreme Court examined the claimed 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 Supreme Court also cited *Stiner* and *Supply Laundry Co. v. Jenner*, 178 Wash. 72, 34 P.2d 363 (1934), both of which rejected equal protection challenges to the same state B&O statute, in relevant part, based on

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statutory exemptions for workers. *Stiner*, 174 Wash. at 411; *Supply Laundry Co.*, 178 Wash. at 77-78. As explained in *Stiner*, the concern 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," the Supreme Court found it unlikely the employee would be able to pay, leading to potential double taxation on the business. *Id.* And as the *Supply Laundry Co.* court explained, 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.* In sum, the *Cary* court rejected an excise tax 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 wages. Non-residents working in the City are not taxed. Rather, the City is taxing the benefits residents enjoy from the City's laws, government and infrastructure as measured by receipt of income over the $250,000/$500,000 threshold. 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." Wong Decl., Ex. A at 3-4. Indeed, the CBO determined that income above the thresholds were "well above a

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comfortable standard of living" in the City.[13] Wong Decl., Ex. C at 3. 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*.

3. Plaintiffs misstate the scope of the City's excise tax authority.

Plaintiffs also misconstrue the City's authority to impose an excise tax. Such a tax is an exercise of the City's statutory authority to license for revenue. *See Pac. Tel. & Tel. Co. v. City of Seattle*, 172 Wash. 649, 654-55, 21 P.2d 721 (1933) (licenses can be regulatory under the police power or for purposes of raising revenue under the taxing power). Citing *Margola Assocs. v. City of Seattle*, 121 Wn.2d 625, 854 P.2d 23 (1993), Plaintiffs argue instead that licensing for revenue is limited to acts "that without such a license would be unlawful." Burke/Levine Mot. at 16. But *Margola Assocs.* only repeats the general rule the what is made "unlawful" by a licensing scheme is the failure to pay penalties if you do not comply with the requirements. 121 Wn.2d at 641. It does not stand for the proposition Plaintiffs appear to assert—that a revenue raising excise tax is valid only if part of a license that permits an otherwise unlawful activity.[14]

Plaintiffs argument is further undermined by the statute granting excise tax authority. The plain language of the statute states it may be invoked for "any lawful purpose", RCW

[13] The CBO used three different methodologies to evaluate the thresholds versus cost of living in the City: (1) the distribution of incomes in the City, (2) household expenditure data for the Seattle area, and (3) basic cost-of-living indices. Wong Decl., Ex. C. Under the first methodology, the CBO determined that the median household income in the City is $80,349. *Id.* The $250,000 threshold is more than three times greater than the median income, and the $500,000 threshold is over six times greater. *Id.* Under the second methodology, the CBO looked at data from the U.S. Bureau of Labor Statistics, which indicate that the average annual expenditures for households in the Seattle area is $69,017. *Id.* This number includes most common expenditures, such as housing, food, entertainment, clothing, healthcare, etc. *Id.* The $250,000 threshold is 3.6 times greater than the average household's annual expenditures and the $500,000 threshold is 7.2 times greater. Under the third methodology, the City looked at two cost-of-living indices, which measure the cost to live in the City at a basic level. *Id.* The cost-of-living estimates ranged from around $25,440 up to $103,246, depending on family composition. *Id.*

[14] *Margola Assocs.* involved a claimed regulatory fee, not a license tax, and the Supreme Court remanded the question whether it was a fee or tax and, if a tax, the validity of the measure. *Id.* at 634, 642.

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35.22.280(32), and on "all places and kinds of business,…upon all occupations,…**and** any other lawful activity…." RCW 35A.82.020 (emphasis added). That one may have to pay a fine for not paying an excise tax does not make the underlying activity unlawful. The failure to pay the Seattle income tax does not result in banishment, being fired, or forfeiting income as Burke/Levine suggest. Choosing to live in Seattle is a "lawful activity" subject to the City's excise tax authority.

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 tax itself is what creates the requirement of the license—i.e., receipt for payment. Plaintiffs mischaracterize *Pac. Tel. & Tel. Co.*, by implying it limits excise taxes to "only" the right to do business. Burke/Levine Mot. at 16. But the word "only" does not appear in the cited language. Rather, the Supreme Court was making the distinction Plaintiffs fail to make here: an excise tax is on the right to enjoy something (i.e., the lawful activity or privilege), not on property or a compelled status in which you have no choice. 172 Wash. at 654.[15]

4. The income tax meets the requirements of an excise tax.

Kunath incorrectly suggests that the City's income tax does not meet the requirements of an excise tax. The Supreme Court has held an excise tax must meet two conditions: "First, excise

[15] Plaintiffs' citation to *Covell v. City of Seattle*, 127 Wn.2d 874, 890, 905 P.2d 324 (1995), misstates the case. In *Covell*, the Supreme Court did not hold that a tax cannot be an excise "only" when it can be avoided by residing elsewhere as Plaintiffs state. Burke/Levine Mot. at 17. Rather, the Supreme Court said that because city residents could not refuse to pay a street utility charge assessed solely on their status as real property owners, the tax was on one owning real property (a property tax) and not an excise. 127 Wn.2d at 890.

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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*, plaintiffs 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. The Supreme Court rejected this 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 live 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 of Plaintiffs' declarations emphasize the point that they chose to live in Seattle to avoid another state's income tax. *See e.g.*, Horowitz Decl., ¶ 5; McKenzie Decl., ¶ 3; Rufo Decl., ¶ 3. Choosing to live in Seattle 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 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 high-income households enjoy the benefit of taking advantage of the City's protections without taxing residents' right to earn a living.

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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).

D. The City has authority to impose an income tax under the excise tax statutes and comprehensive delegation.

1. The tax authority statutes at issue should be liberally construed.

Initially, Burke/Levine argue the Court should apply an inapplicable rule of statutory construction that is favorable to their position. Burke/Levine Mot. at 15 (arguing for application of default rule that if there is "'doubt about a legislative grant of taxing authority to a municipality, it must be denied'" (quoting *Okesun v. City of Seattle*, 150 Wn.2d 540, 558, 78 P.3d 1279 (2003)).[16] As the *Watson* court held, however, the tax authority statutes at issue should be construed **liberally in favor of the City**. *See Watson*, 189 Wn.2d at 167 (describing Washington's adoption of the home rule principle for purposes of local taxation by first class cities). This liberal approach is mandated by law. *See* RCW 35.22.900 ("The rule that statutes in derogation of the common law are to be strictly construed shall have no application to this chapter, but the same shall be liberally construed for the purpose of carrying out the objects for which this chapter is intended."); RCW 35A.01.010 (similar).

The City agrees that it must have express statutory authority to levy a tax. It does not follow, however, that the legislature must specify each type of tax encompassed within a statute

[16] The *Okesun* court did not address whether the legislature had delegated authority to the City to impose the tax at issue. *Id.* Rather, the court struck down city ordinance because it failed to state the object of the tax as required under Const. art. VII, § 5, and exceeded the six-percent limit on city utility taxes. Other cases cited by Burke/Levine are also unhelpful. *See Hillis Homes, Inc. v. Snohomish County*, 97 Wn.2d 804, 810, 650 P.2d 193 (1982), *superseded by statute as stated in R/L Associates, Inc. v. City of Seattle*, 113 Wn.2d 402, 408, 780 P.2d 838 (1989) (statute on subdivision approval that made no reference to taxation did not give the county power to impose tax as condition for approval); *City of Seattle v. T-Mobile W. Corp.*, 199 Wn. App. 79, 82, 397 P.3d 931 (2017) (holding that the City could not levy utility tax on international roaming cell charges received by T-Mobile based on state law that limits municipal taxation of telephone businesses to intrastate telephone services).

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conferring tax powers on cities. *See* Burke/Levine Mot. at 14-15 (arguing City lacks "express" authority because the statutes relied on by the City do not list "income tax" as falling within the delegated tax authority). The Constitution does not prohibit the legislature from making a general grant of local tax power. If anything, it authorizes the legislature to do so. *See* Const. art. XI, § 12 ("The legislature…may, by general laws, vest in the corporate authorities thereof, the power to assess and collect taxes for [county, city, town or other municipal purposes]."). The legislature has discretion in how broadly (or narrowly) it crafts statutory delegations of tax power to municipalities, and the City has authority to impose any tax that falls within that delegation. *See Commonwealth Title Ins. Co. v. City of Tacoma*, 81 Wn.2d 391, 394, 502 P.2d 1024 (1972) ("In general, a city or municipality may define its taxation categories as it sees fit unless it is restrained by a constitutional provision or legislative enactment.").This rule was recently applied in *Watson*, where the Washington Supreme Court held 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. *See* 189 Wn.2d at 167-68 (noting the ordinance "imposes a different type of excise tax"); *see also* Washington State Department of Revenue Tax Reference Manual 125-27 (2010) (noting license taxes take the form of, among other things, B&O taxes, employee head taxes, and square footage taxes).[17]

It does not matter that the statutes at issue do not list personal income as an appropriate subject of taxation. *See* RCW 35A.82.020; RCW 35.22.280(32); RCW 35A.11.020. As explained in the City's Motion and below, the City's income tax falls within the express tax authority granted therein. No more is required.

[17] *Available at* https://dor.wa.gov/sites/default/files/legacy/Docs/reports/2010/Tax_Reference_2010/29localbando.pdf (last visited Oct. 31, 2017)

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2. The City's income tax is an excise tax or a *sui generis* tax, both of which are authorized by law.

As argued above, the City's income tax is an excise tax. Accordingly, it falls within the City's broad authority to license for revenue in RCW 35.22.280(32) and 35A.82.020.

If not an excise, Plaintiffs do not dispute that other jurisdictions and commentators treat income taxes as a unique category of taxes, nor do they attempt to rebut the authority cited by the City. City Mot. at 21-22; *see also Watson*, 189 Wn.2d at 167 (local "taxation must fall into one of three categories: property, income, or excise taxes." (quoting Washington State Department of Revenue Tax Reference Manual)). Nor do they argue that, in principle, a city income tax to raise revenue to pay for city services is not a tax for local purposes under RCW 35A.11.020.

Rather, Burke/Levine construe the comprehensive grant of local tax power in RCW 35A.11.020 as merely "giv[ing] code cities the same authority to levy taxes as other cities", Burke/Levine Mot. at 19, but fail to explain how a liberal construction of the statutory text—conferring "all powers of taxation for local purposes" subject only to constitutional and statutory constraints—supports such an interpretation. Nor do they explain how their interpretation can be squared with the legislature's undisputed intent in enacting Chapter 35A.11 RCW of the Optional Municipal Code "to confer the greatest power of local self-government…." Wong Decl., Ex. F at 4; *see also* Lyle Burt, *Seattle Times*, "Little-Understood Bill Called 'Most Important' for Cities" (Apr. 2, 1967) (noting the Optional Municipal Code was "drafted in answer to the plea of cities for more authority to run their affairs and impose taxes to meet their financial burdens"). The deliberative and public process that culminated in the legislature passing legislation that, on its face, confers "all powers of taxation for local purposes" on cities cannot be characterized as "silent." *See* Burke/Levine Mot. at 19.

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Burke/Levine's reliance on *Algona* is misplaced. Burke/Levine Mot. at 19 (citing *King County v. City of Algona*, 101 Wn.2d 789, 793, 681 P.2d 1281 (1984)). The *Algona* court held that the city of Algona could not levy a B&O tax on revenues generated by King County's solid waste transfer station without express statutory authority to tax another municipality. 101 Wn.2d at 793. Because RCW 28A.11.020 and RCW 28A.82.020 do not confer authority to tax other municipalities, the court held that the city of Algona lacked authority to impose its tax on King County. *Id*. Significantly, *Algona* "was decided on the basis of the governmental character of the activity that the city of Algona sought to tax." *City of Wenatchee v. Chelan Cnty. Pub. Util. Dist. No. 1*, 181 Wn. App. 326, 330, 325 P.3d 419 (2014) (holding City of Wenatchee could impose B&O tax on revenue generated from a public utility district's proprietary activities); *see also Algona*, 101 Wn.2d at 793 ("The governmental immunity doctrine provides that one municipality may not impose a tax on another without express statutory authorization."). Unlike in *Algona*, the City's Ordinance taxes Seattle residents, not other municipalities. As a result, whether the City has express authority to tax other municipalities is irrelevant.

The broad tax power delegated under RCW 35A.11.020 does not render more specific tax authority laws superfluous. Burke/Levine Mot. at 19 (citing *City of Port Angeles v. Our Water-Our Choice!*, 170 Wn.2d 1, 14 n.7, 239 P.3d 589 (2010)). RCW 35A.11.050 provides that "[s]pecific mention of a particular municipal power or authority contained in this title or in the general law shall be construed as **in addition and supplementary to**, or explanatory of the powers conferred in general terms by this chapter." (emphasis added); *see also* RCW 35A.01.010 (similar).[18]

[18] In fact, Burke/Levine's narrow interpretation would arguably render superfluous another sentence in RCW 35A.11.020, which states: "In addition and not in limitation, the legislative body of each code city shall have any authority ever given to any class of municipality or to all municipalities of this state…." The prior year, the legislature used similar language in the omnibus statute that grants first class cities all powers, including tax powers,

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Rather than supporting Burke/Levine's narrow construction, *City of Port Angeles* confirms that the powers granted in RCW 35A.11.020 are comprehensive. *See* Burke/Levine Mot. at 19. *City of Port Angeles* addressed whether voters could reverse through a local initiative the city council's action adding a water fluoridation facility. 170 Wn.2d at 5. In a footnote, the court declined to decide the question of whether RCW 35A.11.020's expansive delegation of powers to the local legislative body, as opposed to the corporate entity, placed those powers beyond the scope of the local initiative power. *Id*. at 14 n.7 (powers delegated exclusively to local legislative body are not subject to local initiative). Nevertheless, the court noted that given its breadth, reading RCW 35A.11.020 as an exclusive grant to a city's legislative body would render the provision conferring local initiative power a nullity. *Id*. *City of Port Angeles* "provides another example of judicial recognition that the 1967 code city law was meant to supersede Dillon's Rule." Hugh Spitzer, *"Home Rule" vs. "Dillon's Rule" for Washington Cities*, 38 Seattle U.L. Rev. 809, 847 (2015).

Liberally construed and viewed in historical context, RCW 35A.11.020 is susceptible to only one interpretation. It is a comprehensive grant of all local tax powers to cities for local purposes except as otherwise provided by the Constitution or law. The City's income tax falls within this broad delegation of tax power.

E. The income tax does not violate equal protection.

Shock raises an equal protection challenge to the City's income tax. Such a challenge is determined by applying minimal scrutiny. Shock fails to carry his "heavy burden" to show there is no reasonable basis for the Ordinance's thresholds or that the thresholds are contrary to the City's objectives. The equal protection claim thus fails.

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conferred on other cities and towns. *See* RCW 35.22.570; *see also Watson*, 189 Wn.2d at 170 n.8 (omnibus grant to first class cities includes taxing powers).

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1. Tax classifications are upheld if they have any rational basis.

Equal protection "was not intended to compel the state to adopt an iron rule of equal taxation." *Magoun v. Ill. Trust & Sav. Bank*, 170 U.S. 283, 295, 18 S. Ct. 594, 42 L. Ed. 1037 (1898). Nor does equal protection "deprive the state of the power to select the subjects of taxation." *Keeney v. Comptroller of State of N.Y.*, 222 U.S. 525, 535, 32 S. Ct. 105, 56 L. Ed. 299 (1912). Instead, only "palpably arbitrary exercises" can be "declared void under the [Fourteenth] Amendment." *Metropolis Theater Co. v. City of Chicago*, 228 U.S. 61, 70, 33 S. Ct. 441, 57 L. Ed. 730 (1913). Thus, equal protection challenges to tax laws are reviewed with a "minimal" level of scrutiny, absent involvement of fundamental rights or suspect classifications. *City of Seattle v. Rogers Clothing for Men, Inc.*, 114 Wn.2d 213, 233, 787 P.2d 39 (1990).

Applying minimum scrutiny, a city ordinance is "presumed constitutional and the party challenging it has the heavy burden of showing there is no reasonable basis for the classification or that the classification is contrary to the purpose of the legislation." *Id.* at 234; *see also Armour v. City of Indianapolis*, 566 U.S. 673, 681, 132 S. Ct. 2073, 182 L. Ed. 2d 998 (2012) (tax classification does not violate equal protection if "there is a plausible policy reason for the classification, the legislative facts on which the classification is apparently based rationally may have been considered to be true by the governmental decisionmaker, and the relationship of the classification to its goal is not so attenuated as to render the distinction arbitrary or irrational." (quotation omitted)); *Sonitrol Nw., Inc.*, 84 Wn.2d at 590 ("The test for purposes of classification is merely whether any state of facts reasonably can be conceived that would sustain (the classification)." (quotation omitted)). Given this deferential standard, courts have consistently rejected constitutional challenges to tax laws. *See, e.g.*, *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

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federal income tax statute); *Stebbins v. Riley*, 268 U.S. 137, 146, 45 S. Ct. 424, 69 L. Ed. 884 (1925) (upholding graduated inheritance tax under equal protection challenge).

Shock contends "heightened, intermediate scrutiny" applies, even though he does not assert a fundamental right is at stake, based on a theory that "wealth and social class" are suspect classifications. Shock Mot. at 15. But courts have held repeatedly that poverty and financial need are not suspect classifications. *Harris v. McRae*, 448 U.S. 297, 323, 100 S. Ct. 2671, 65 L. Ed. 2d 784 (1980); *see also Maher v. Roe*, 432 U.S. 464, 471, 97 S. Ct. 2376, 53 L. Ed. 2d 484 (1977) ("[T]his Court has never held that financial need alone identifies a suspect class for purposes of equal protection analysis."); *Wings of the World, Inc. v. Small Cl. Ct., King Cnty. Dist. Ct., Ne.*, 97 Wn. App. 803, 810, 987 P.2d 642 (1999) (rejecting argument that wealth is a suspect or semi-suspect classification). To hold otherwise would mean that "every denial of welfare to an indigent creates a wealth classification as compared to nonindigents who are able to pay for the desired goods or services." *Maher*, 432 U.S. at 471.

The authority cited by Shock in support of heightened scrutiny does not support application of heightened scrutiny here. *See* Shock Mot. at 15-16. For example, in *State v. Phelan*, 100 Wn.2d 508, 514, 671 P.2d 1212 (1983), the court addressed whether a prisoner's time in pretrial detention must be credited against a discretionary minimum prison term. The court applied intermediate scrutiny because the classification involved a "basic human right" (physical liberty) of "'a discreet class…not accountable for their…status" (the poor). *Id.* In contrast, Shock does not claim the Ordinance implicates a basic human right, nor does he assert that high-income residents are a discreet class not accountable for their status. *See also Plyler v. Doe*, 457 U.S. 202, 223–24, 102 S. Ct. 2382, 72 L. Ed. 2d 786 (1982) (reviewing state law

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denying undocumented immigrant children a public education). Indeed, if poverty is not a protected class, how can wealth be one?

Shock also argues that heightened scrutiny applies based on the Council's alleged "class animus," relying on comments of a single Councilmember. Shock Mot. at 15. But statements by "individual legislator[s] do[] not show legislative intent." *State ex rel. Citizens Against Tolls (CAT) v. Murphy*, 151 Wn.2d 226, 238, 88 P.3d 375 (2004); *see also Watson*, 189 Wn.2d at 162-63 (reliance on "pro-gun-control statements by the Council's members as evidence that the Ordinance is part of a broader regulatory scheme to limit gun access…would unwisely embroil courts in second-guessing the motives of lawmakers"). Courts "view with caution comments of individual legislators" to prove improper legislative intent and will not "strike down an otherwise constitutional statute on the basis of an alleged illicit legislative motive…." *Brayman*, 110 Wn.2d at 204. As the Washington Supreme Court noted when reviewing tax laws, it is not the court's function to "seek for the motives" or "to criticize the public policy which prompted the adoption of the legislation." *Sonitrol Nw., Inc.*, 84 Wn.2d at 594 (quotation omitted).

For these reasons, the Court should apply minimum scrutiny.

2. The City has a rational basis to tax receipt of personal income above the thresholds set forth in the Ordinance.

The tax classifications in the Ordinance satisfy minimum scrutiny. The City's objectives in passing the Ordinance are to raise needed revenue without exacerbating the inequitable tax burden in Washington state and Seattle. Wong Decl., Ex. A at 1-3. Consistent with these objectives and the Supreme Court's holding in *Cary*, the Council sought to avoid taxing working wages or interfering with the ability of households to provide for a reasonable quality of life in Seattle by taxing only total personal income in excess of certain thresholds, with no tax applied to personal income below the thresholds. *See id*. at 3-4. The Council relied on the CBO's

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analysis (the bases of which are set forth above), testimony and other information to select high thresholds that are well above the amount an average household requires to live in Seattle. Wong Decl., Ex. C. And the Council decided that these thresholds would apply equally to all Seattle residents, with the same rate applicable to all personal income above the thresholds. *See* SMC 5.65.030.B. Thus, the classifications in the Ordinance as to what is (and what is not) subject to the tax reasonably relate to the City's objectives and this relationship is not so attenuated as to render the distinction arbitrary or irrational. *See Armour*, 566 U.S. at 681.

Contrary to this precedent, Shock contends that the Ordinance violates equal protection because its "classification relies on the central fallacy that 'income' equates 'wealth.'" Shock Mot. at 16 (citation omitted). Shock notes that "closely held companies…may generate large amounts of gross income, but, after the costs of doing business are deducted, the owners often take home only a modest amount." *Id.* at 17. The Ordinance, however, does not tax gross business income. Instead, as explained above, the City's tax applies to total personal income received by the taxpayer. For a taxpayer who owns a business, total personal income is measured based on the total amount the owner "take[s] home"—precisely what Shock argues would be a rational basis for progressive taxation. And while Shock may prefer as a policy matter that the City tax only net personal income, the question before this Court is only whether the City had a rational basis for setting the income thresholds at $250,000/$500,000. It did.

Shock's reliance on *Stewart Dry Goods Co. v. Lewis*, 294 U.S. 550, 558, 55 S. Ct. 525, 79 L. Ed. 1054 (1935), is misplaced. *Lewis* concerned a sales tax on gross receipts of all retailers—regardless of the type of merchandise they sold, their profit margin, or any other considerations—with the rate increasing based on the volume of sales. *See id.* at 555. In striking down the tax, the court explained the volume-of-sales classifications relied on the faulty premise

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that the bigger the business, the greater the ability to pay taxes. *Id*. at 558. The court explained, "It exacts from two persons different amounts for the privilege of doing exactly similar acts because the one has performed the act oftener than the other." *Id*. at 566. The court noted that such a tax is no different than "a tax on tangible personal property, say cattle, stepped up in rate on each additional animal owned by the taxpayer, or a tax on land similarly graduated according to the number of parcels owned." *Id*. at 557.

Stewart's reasoning does not translate to the City's tax on total personal income. Unlike successive sales of goods by retailers, the first dollar of personal income received by a taxpayer is materially different than dollar 250,001. An initial amount of income is needed to meet basic needs, and additional income improves quality of life. The Council deliberately selected thresholds well above the levels needed for a reasonable quality of life in Seattle. *See* Wong. Decl., Ex. A at 3-4; Ex. C.

Further, unlike the graduated tax classifications in *Stewart*, the Ordinance merely defines the class of personal income subject to the tax, applying the same tax rate (2.25%) to all personal income in excess of the thresholds. This is similar to *Benjamin Franklin Thrift Stores v. Henneford*, 187 Wash. 472, 60 P.2d 86 (1936). There, the Washington Supreme Court held *Stewart* does not apply where a "distinction exist[s]" between the class that is subject to the tax, and the class that is not. *Id.* at 479. Thus, the *Henneford* court upheld a statute that levied a tax on the distribution of merchandise from a warehouse to a group of two or more stores, without placing a corresponding tax on such distribution to a single store. *Id*. The court explained that the classification was valid because "the maintenance of a warehouse for the supply of one store and the maintenance of a warehouse for the supply of two or more…are essentially different." *Id*. Similarly, here, the Council reasonably defined the class of personal income subject to the tax.

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Applying minimal scrutiny, Shock thus fails to meet his substantial burden to prove that there is no reasonable basis for the Ordinance's thresholds or that the thresholds are contrary to the purpose of the Ordinance.[19]

IV. CONCLUSION

Plaintiffs fail to meet their burden in challenging the Ordinance. The City's 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 an excise tax for the benefit of choosing to live in Seattle or a *sui generis* local tax authorized to raise revenue for local purposes. The City respectfully requests the Court grant it summary judgment on all claims, and deny all of Plaintiffs' motions for summary judgment.

DATED this 1st day of November, 2017.

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[19] Plaintiffs do not put forth substantive argument in support of their Seattle City Charter, invasion of privacy, and takings claims.

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CERTIFICATE OF SERVICE

I am and at all times hereinafter mentioned was a citizen of the United States, a resident of the State of Washington, over the age of 21 years and not a party to this action. On the 1st day of November, 2017, I caused to be served a true copy of the foregoing document upon:

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I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct. DATED this 1st day of November, 2017.

/s/ Tricia O'Konek
Tricia O'Konek

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