HONORABLE JOHN R. RUHL

IN THE SUPERIOR COURT OF THE STATE OF WASHINGTON
IN AND FOR KING COUNTY

S. MICHAEL KUNATH,

Plaintiff,

vs.

CITY OF SEATTLE,

Defendant.

No. 17-2-18848-4 SEA

ECONOMIC OPPORTUNITY INSTITUTE'S RESPONSE AND REPLY ON CROSS-MOTIONS FOR SUMMARY JUDGMENT

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SUZIE BURKE, *et al.*,

Plaintiffs,

vs.

CITY OF SEATTLE, *et al.*,

Defendants.

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DENA LEVINE, *et al.*,

Plaintiffs,

vs.

CITY OF SEATTLE,

Defendant.



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## I. INTRODUCTION

Economic Opportunity Institute ("EOI") respectfully submits this brief responding the arguments of the Plaintiffs on the the validity of Seattle Ordinance 125339 (the "Ordinance"), and in reply to Mr. Kunath's brief opposing EOI's Motion for Summary Judgment. As discussed herein, the Ordinance is valid and is not a tax on net income under RCW 36.65.030.

Furthermore, the Court should declare that RCW 36.65.030 is null and void because its enacting bill violated the single-subject and subject-in-title rules. Despite the hyperbole in Mr. Kunath's brief, it is indisputable that the Legislature's purpose in enacting RCW 36.65 was to facilitate the creation of combined city-county form of government. To slip in a sentence that purports to restrict the taxation powers of all cities and counties is the precise type of logrolling prohibited by Article II, section 19 of the Washington Constitution. If the Legislature wanted to prohibit cities and counties from taxing net income, it should have done so through a separate statute. It cannot pass a restriction on all local governments' taxation authority within a statute that legislators were led to believe covered only the combined city-county form of government.

## II. AUTHORITY & ARGUMENT IN RESPONSE AND REPLY

### A. The City has the express general taxation authority to impose the income tax.

EOI hereby incorporates by reference the City's authority and arguments showing that the City has the requisite authority to impose the Ordinance's income tax.

### B. RCW 36.65.030's prohibition on net income taxes does not preclude the Ordinance.

As is plain from the text of the Ordinance and as further explained in EOI's and the City's motions for summary judgment, the Ordinance taxes individuals' total income. It is no wonder then, that Plaintiffs' argument that the Ordinance levies a prohibited tax on net income



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depends on their illogical and inconsistent definition of the term "net income." The Court should reject these strained arguments and rely instead on the plain meaning dictionary definitions set forth in the City's motion for summary judgment and herein.

RCW 36.65.030 purports to prohibit cities, counties, and combined city-counties from levying a tax on "net income." However, the statute does not define the term "net income." The plain meaning of "net income" indicates that it is a term for business income, not individual income. *Graphic Packaging Corp. v. Hegar*, 471 S.W.3d 138 (Tx. Ct. App. 2015) (dictionaries define "net income" as business revenue less costs and losses). *Levine* and *Burke* plaintiffs' reference to the Multi-State Tax Compact, RCW 82.56.010, which uses the term net income, reinforces this plain meaning, as RCW 82.56.010 only applies to business entities. RCW 82.56.010, Art. II, § 3.

However, *Levine* and *Burke* plaintiffs rely on the Multi-State Tax Compact for an entirely different and untenable argument. They argue that because the Multi-State Tax Compact defines "income tax" to mean "a tax imposed on or measured by net income," the phrase "tax on net income," in RCW 36.65.030 should be interpreted to mean *any* income tax. This argument is illogical and violates multiple cannons of statutory interpretation. First, RCW 36.65.030 does not reference the Multi-State Tax Compact, RCW 82.56.010, or any other source. Moreover, the definitions in RCW 82.56.010 explicitly apply only when the terms are used "in [the] compact." The Court cannot import a definition of a different term from a completely unrelated statute where the Legislature did not include any such reference. *Perez-Crisantos v. State Farm Fire & Cas. Co.*, 187 Wn.2d 669, 683, 389 P.3d 476 (2017). Second, plaintiffs' interpretation requires the Court to ignore the word "net" in RCW 36.65.030. It is well-established that the Court must



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"interpret a statute to give effect to all language, so as to render no portion meaningless or superfluous." *Rivard v. State*, 168 Wn.2d 775, 783, 231 P.3d 186 (2010).

To the extent that the term "net income" requires an interpretive aid, the Court should look to the legislative history of RCW 36.65. That history suggests that the Legislature meant "net income" to have the same meaning as "net income" discussed in the Attorney General Opinion that directly prompted the Legislature to enact RCW 36.65. 2d Tonry Decl., Ex. 4 (bill reports). The relevant Attorney General Opinion discusses "net income" as the term is used in *Jensen v. Henneford*, 185 Wash. 209, 53 P.2d 607 (1936). 1975 Op. Att'y Gen. 2 at 15. The "net income tax" statute in *Jensen v. Henneford* distinguished gross income from net income. "Gross income" included gains, profits, salaries, wages, and compensation, and **excluded** insurance payouts, gifts, inheritances, interest from federal obligations, the value of a housing furnished to a minister as part of his compensation, federal salaries and pensions, and stock dividends. 185 Wash, at 212. "Net income" was calculated by **deducting** certain business expenses, interest on debt, taxes, and ten other deductions from "gross income." *Id.* at 213. "Net income" defined by *Jensen* thus distinguished between excluded or exempt income, which is not a "net" concept, and deductions of certain expenses and taxes, which yields "net income."

Applying the relevant definitions from *Jensen* to the Ordinance and its use of Line 22 of IRS form 1040 shows that the Ordinance taxes individual taxpayers' "gross" or total income, not their net income. Plaintiffs argue that Line 22 reflects "net income" because certain portions of income are exempted or excluded from Line 22. But merely exempting or excluding certain income does not yield net income under *Jensen.* Rather Line 22 is consistent with the definition of "gross income" in *Jensen,* which excluded certain types of interest, dividends, and housing benefits. Similarly, "gross income" in *Jensen* counted profits as opposed to total business



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income from a pass-through entity. As the City explains in its motion, profits distributed to the individual taxpayer, as opposed to *the business's* total receipts, are the appropriate measure of *the individual's* total income. City's Mot. at 7-8. Any additional business expenses attributable to the individual taxpayer (i.e., those that the individual's business has not already accounted for on its own tax forms) are included in the individual's total income reported on Line 22, and not deducted until Line 40, and only then if the individual itemizes their deductions. *See* Wong Decl., Ex. D and IRS Form 1040, Schedule A https://www.irs.gov/forms-pubs/about-schedule-a-form-1040. Again, this is consistent with the gross-versus-net income distinctions at issue in *Jensen* and relied on by the Attorney General opinion that prompted RCW 36.65.

**C. RCW 36.65.030 is unconstitutional and void.**

EOI moved for summary judgment declaring that RCW 36.65.030 is void because its enacting bill violated Washington Constitution's single-subject and subject-in-title rules. Const., Art. II, § 19. Only plaintiff Kunath timely responded to EOI's motion. Mr. Kunath's simplistic argument that the statute's title is general ("AN ACT Relating to local government…") fails to engage with the relevant and directly on-point case law provided by EOI which demonostrates that the statute is invalid because it comprises two subjects. Moreover, this is true even if Mr. Kunath were correct about the title.

**1. The statute's title is restrictive.**

Putting Mr. Kunath's dramatic allegations of fraud aside, he is simply incorrect that the Court must disregard the first half of Substitute Senate Bill 4313's title, which reads "CITY-COUNTY MUNICIPAL CORPORATIONS ---- CLARIFICATION." Washington courts regularly look to the full title of the relevant session law to assess compliance with Article II, section 19 of the Constitution. *See, e.g., Wash. Citizen Action v. Ins. Comm'r*, 94 Wn. App. 64,



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70 (1999) ("The bill containing RCW 48.13.220(4)(g) was entitled 'Insurance Companies--Investment Requirements,' and was described as "AN ACT relating to insurance."); *State v. Harris*, 97 Wn. App. 647, 653-55 (1999) ("RCW 2.42.120 was passed as a section of chapter 389, LAWS OF 1985, the title of which reads: 'COURT COSTS--COLLECTION AND REMITTANCE -- AN ACT Relating to court costs. . .'"); *Certification v. Murphy*, 136 Wn.2d 845, 851, 966 P.2d 1271, 1273 (1998).

*Judd* and *State v. T.A.W.*, the two cases Mr. Kunath relies on to arrive at his preferred truncated title, are not on point. Those cases merely hold that labels and margin notes added by the Code Reviser do not determine legislative intent. *See Judd v. Am. Tel. & Tel. Co.*, 152 Wn.2d 195, 203 n.4, 95 P.3d 337 (2004); *State v. T.A.W.*, 144 Wn. App. 22, 26, 186 P.3d 1076 (2008). Neither case concerns what the title is for the purposes of Article II, Section 19 analysis. The Court should analyze the whole title, consistent with *Washington Citizen Action*, *State v. Harris*, *Certification v. Murphy*, and other Article II, section 19 caselaw.

Mr. Kunath's effort to apply the truncated title is revisionist history. The whole title reflects the actual legislative history and the Legislature's stated purpose of address city-county municipal corporations, including their taxing powers, not to address the taxing powers of traditional cities and counties. Thus, the Court should consider the whole title, which Mr. Kunath concedes is a restrictive title. Kunath's Resp. to EOI's Mot., 7:16-17.

**2. SSB 4313 violates the single-subject rules regardless of its title.**

As stated in EOI's motion, even if SSB 4313's title is general, the bill is void for violating the single subject rule. If the title is general, the matters within the legislation must still be germane not only to the title, but also to each other. *Filo Foods, LLC v. City of SeaTac*, 183 Wn.2d 770, 782-83, 357 P.3d 1040 (2015); *Lee v. State*, 185 Wn. 2d 608, 623, 374 P.3d 157



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(2016). Permissible taxes in a traditional city or county are not germane to the formation of combined city-county municipal corporations. *See Potter v. Whatcom Cty.*, 138 Wash. 571, 576, 245 P. 11 (1926) (bill primarily concerning townships violated the single subject rule by imposing a requirement on a county); *Cory v. Nethery,* 19 Wn.2d 326, 329-31, 142 P.2d 488 (1943) ("An act relating to local improvements in cities and towns . . ." does not embrace any other kind of taxing district); *Lee v. State,* 185 Wn. 2d at 623 (sales tax reductions and procedures for approving future taxes are different subjects). Indeed, the Legislature has historically treated traditional cities separately from combined city-counties, the latter having been authorized by a 1948 constitutional amendment and never having existed in Washington since then. That the Legislature has not historically treated the two subjects together further indicates that SSB 4313 violates the single subject rule. *Lee v. State,* 185 Wn. 2d at 623; *Fed'n of Emps. v. State,* 127 Wn. 2d 544, 575, 901 P.2d 1028 (1995); *Swedish Hospital of Seattle v. Department of Labor and Industries,* 26 Wn. 2d 819, 831, 176 P.2d 429 (1947).

Mr. Kunath argues that legislative staff believed that a limitation on the taxing powers of combined city-counties needed to also apply equally to cities and counties, but that is irrelevant to the instant analysis.[1] It does not change the fact that city taxation authority is a different subject from the formation of combined city-counties, which is the essential subject of SSB 4313. SSB 4313, § 1 ("It is the intent of the legislature in enacting this chapter to provide for the implementation and clarification of Article XI, section 16 of the state Constitution, which authorizes the formation of combined city and county municipal corporations.") Moreover, if one were to accept Mr. Kunath's argument, there would be no limit to the changes the Legislture

[1] Contrary to his briefing on other issues, Mr. Kunath's argument indicates that but for RCW 36.65.030, he believes that cities like Seattle have the authority to levy taxes on net income.



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could make to traditional municipal government' powers under the guise of regulating the combined city-county form of government. That would fly in the face of Article II, section 19, which serves to prevent logrolling and ensure that legislators and the public are aware of what is contained in proposed new laws. *Lee v. State*, 185 Wn.2d at 620. *See also* Const. art. II, § 37 ("No act shall ever be revised or amended by mere reference to its title, but the act revised or section amended shall be set forth at full length.")

If the Legislature wished to prohibit city-counties, cities, and counties from levying taxes on net income, it could comply with the Constitution simply by passing a stand-alone bill. What it cannot do is sneak through limitations on cities' authority in a bill that is otherwise entirely focused on a different and obscure (and, to date, non-existent) form of municipal government. SSB 4313 took the latter, impermissible approach; the Court should "not hesitate" to invalidate this unconstitutional law. *Wash. Ass'n for Substance Abuse & Violence Prev. v. State*, 174 Wn.2d 642, 654, 278 P.3d 632 (2012).

**D. The Ordinance does not levy a property tax.**

EOI hereby incorporates by reference the City's authority and arguments showing that the Ordinance does not levy a property tax, and instead the tax is either a type of excise tax, or an income tax in a class of its own.

**1. Taxes on individual income may be properly characterized as excise taxes and the Washington Supreme Court has characterized them as such.**

The Washington Supreme Court has consistently upheld state and local taxes on businesses' income as an excise tax. In *Stiner v. Yelle,* 174 Wn. 402, 405 (1933), the Supreme Court upheld a tax on gross business receipts as "an excise tax pure and simple." The court's rationale for doing so is equally if not more applicable to individual income. Specifically, the



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court held that the business income tax was levied not on property but on the privilege of receiving governmental protections that enable one to be secure in their economic gains. *Stiner v. Yelle*, 174 Wn. 402, 406 (1933). These protections include "the protection of our laws," specifically "laws for the protection of human rights [and] the rights of property," and "peace officers and courts." *Id.* *See also* Hugh Spitzer, A Washington State Income Tax – Again?, 16 Univ. Puget Sound L.R. 515, 534-35 (1993). But laws for the protection of human rights and other governmental protections that enable one to be secure in their economic gains are enjoyed at least as much at the individual level as at the business level. Indeed, city-enacted laws for the protection of "human rights" generally protect individuals *from* businesses. *See, e.g.,* Seattle Muni. Code Ch. 14.04 (fair employment practices), Ch. 14.16 (paid sick and safe time); Ch. 14.25 (hotel employees health and safety). The reasoning that led the court in *Jensen* to concluded that the B&O tax is an excise is therefore equally applicable to the Ordinance's individual income tax.

Furthermore, in *Supply Laundry Co. v. Jenner*, 178 Wn. 72, 78 (1934), the Supreme Court upheld an amendment to the business and occupation tax that included a tax on individual income of government employees above a certain threshold as an excise tax. By definition, these employees are not business owners or shareholders, and their income is not derived from an interest in a business. However, the court held that the income tax was appropriate because it only taxed employees who made over $200 a month and therefore their income was "in a general way, certain during the period of the life of the act." *Id.* Similarly, the Ordinance effectively taxes only persons making over $250,000 per year. SMC 5.65.030. There is no reasoned grounds for distinguishing the Ordinance from the excise tax upheld in *Supply Laundry.*



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The Washington Supreme Court has also repeatedly upheld taxes on transfers of money and property from one individual to another as excises taxes. For example, the court recently explained that an estate tax is an excise tax, because it taxes the transfer of property, and "excise" and "transfer" taxes are synonymous. *In re Estate of Hambleton,* 181 Wn.2d 802, 811, 832, 335 P.3d 398 (2014) ("An estate tax is an excise tax because the tax is 'not levied on the property of which an estate is composed. Rather it is imposed upon the shifting of economic benefits and the privilege of transmitting or receiving such benefits.'" (quoting *West v. Oklahoma Tax Com.*, 334 U.S. 717 (1948)). *See also Estate of Ackerley v. Dep't of Revenue,* 187 Wn.2d 906, 914-15, 389 P.3d 583 (2017) (upholding broad definition of "transfers" that are subject to the estate tax against challenge that a portion of the tax was a direct property tax). Where the taxable event is the transfer of ownership of real or personal property, the Supreme Court similarly finds the tax is an excise. *E.g., High Tide Seafoods v. State*, 106 Wn.2d 695, 700, 725 P.2d 411, 414 (1986) ("The event causing this food fish tax to be levied is the *transfer* of ownership from the fisherman to the fish purchaser. It is not based just on the ownership of the fish." (emphasis in the original)); *Mahler v. Tremper*, 40 Wn.2d 405, 409-10, 243 P.2d 627 (1952) ("a sales tax upon real property is a tax upon the act or incidence of transfer," not a property tax). The incident of the tax levied by the Ordinance is the transfer of money in a given tax year; there is no principled basis for distinguishing this tax on the transfer of money from the estate tax or other transfer taxes, i.e., excise taxes.

**2. *Cary v. Bellingham* does not impede the Ordinance.**

Plaintiffs' reliance on *Cary v. Bellingham*, 41 Wn. 2d 468, 250 P.2d 114 (1952) is misplaced for several reasons. The ordinance at issue in *Cary* prohibited any person from engaging in business or working for wages in Bellingham without obtaining a license and paying



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a 0.1% tax on individual compensation. *Id.* at 468-69. The court recognized the city's right to levy the income tax on business owners and those with a say in the business or a share in a business's returns. *Id.* at 471. Plantiffs gloss over this helpful aspect of *Cary* and mistakenly suggest that *Cary* invalidated a city tax on income earned by any means. *Cary* expressly disavows such a holding. *Cary*, 41 Wn. 2d at 471.

*Cary* did hold that the plaintiff in that case adequately stated a claim that the city lacked the authority to "control the right to work for wages" and therefore could not raise revenue through licenses permitting individuals to "earn a living by working for wages." *Id*. at 472. Here, though, the City is only taxing income in excess of $250,000; it is not controlling, licensing, or prohibiting anyone from working. The actual holding in *Cary* is inapposite. Moreover, *Cary* was decided fifteen years prior to the passage of the optional municipal code statute, which provides for broad municipal authority to levy taxes for revenue in regard to "all . . . kinds of business . . . and upon all occupations, trades and professions and any other lawful activity." RCW 35A.82.020. To the extent that *Cary* suggests cities did not have such authority in 1952, the decision has been superceded by statute. Furthermore, as explained above, *Cary's* suggestion that an excise tax may only be levied upon a "substantive" privilege granted by the taxing authority is incompatible with the numerous Supreme Court cases upholding the estate tax and other transfer excises that do not rely on the government's grant of any particular privilege.

**E. Motion to Strike**

*Levine* and *Burke* plaintiffs' motion is filled with inadmissible and inaccurate hearsay, all of which is irrelevant to their legal arguments and included only to confuse and bias the Court. EOI respectfully requests that the Court strike this material. Specifically, EOI moves to strike the five articles from the Seattle Times, one article from The Stranger, and one segment from



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KIRO Radio listed as "other authorities" in *Levine* and *Burke* plaintiffs' motion, and all statements that reference these materials. These newspaper articles and the radio segment are offered to prove the truth of the matters asserted therein, and are thus hearsay. *State ex rel. Pierce Cty. v. King Cty.*, 29 Wn.2d 37, 45, 185 P.2d 134 (1947). No exception to the rule against hearsay applies. ER 802, 803, 804.

To make matters worse, *Levine* and *Burke* plaintiffs grossly mischaracterize what some of these materials actually report. For example, they claim that a September 2016 Seattle Times article titled "$80,000 median: Income gain in Seattle far outpaces other cities" refutes the Ordinance's finding that the existing regressive tax system disproportionatly harms communities of color and implies that the article finds that members of Seattle's African American community are doing particularly well. To the contrary, the article reports that "Seattle black households now have a median income of $37,000" – less than half the city-wide median income. All parties agree that there are no material issues of fact in this case. Plaintiffs should not be permitted to pad the record with hearsay and other inadmissible materials..

## III. CONCLUSION

For the foregoing reasons, and those stated in EOI's and the City's motions, EOI respectfully requests that the Court declare that the Ordinance is valid, and that RCW 36.65.030 is unconstitutional and void.



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RESPECTFULLY SUBMITTED this 1st day of November, 2017.

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The above-signed attorney certifies that this memorandum contains 3,463 words, in compliance with the Local Civil Rules.