No. 95295-7

SUPREME COURT OF THE STATE OF WASHINGTON

S. MICHAEL KUNATH, et al., Respondents, v. CITY OF SEATTLE, et al., Appellants.	)))))))	STATEMENT OF GROUNDS FOR DIRECT REVIEW BY THE SUPREME COURT

Economic Opportunity Institute, appellant and intervenor below, respectfully requests that the Supreme Court directly review the trial court's November 22, 2017 decision on the parties' cross-motions for summary judgment for the reasons set forth herein.

I. NATURE OF THE CASE AND DECISION BELOW

On July 10, 2017, the Seattle City Council ("Council") unanimously passed Ordinance No. 125339 (the "Ordinance"), which enacted an income tax. In passing the Ordinance, the Council found that "Seattle faces many urgent challenges, including a homelessness state of emergency; an affordable housing crisis; inadequate provision of mental and public health services; the growing demand for transit; educational equity and racial achievement gaps; escalating threats from climate change; and the threat of imminent and drastic reductions in federal funding." Ordinance, § 1.1. The Council recognized that Washington's

and Seattle's current tax systems are among the most regressive in the nation and that a progressive revenue source is critical to meeting Seattle's urgent challenges. *Id.*, § 1.

The Ordinance would raise needed revenue by imposing a progressive tax and restricts tax spending to those needs. Specifically, the Ordinance would impose a 2.25% tax on the portion of a Seattle resident's total income that exceeds $250,000 (or $500,000 for married couples who file their federal taxes jointly). *Id.*, 5.65.030. The Ordinance restricts Seattle's use of tax receipts to the following: (1) lowering the property tax burden and the impact of other regressive taxes, including the business and occupation tax rate; (2) addressing the homelessness crisis; (3) providing affordable housing, education, and transit; (4) replacing federal funding potentially lost through federal budget cuts, including funding for mental health and public health services, or responding to changes in federal policy; (5) creating green jobs and meeting carbon reduction goals; and (6) administering and implementing the tax. *Id.*, 5.65.010.

Shortly after the Ordinance was signed into law, twenty-eight individual plaintiffs[1] filed four separate lawsuits, all primarily challenging

[1] Hereinafter referred to collectively as "Plaintiffs." The plaintiffs for the individual lawsuits are referred to by the last name of the first-named

Seattle's statutory and state constitutional authority for the Ordinance, and arguing that the Ordinance's tax on *total* income violated RCW 36.65.030, which purports to prohibit cities, counties, and city-counties from enacting taxes on *net* income.

Economic Opportunity Institute intervened in defense of the Ordinance and asserted a cross-claim for a declaratory judgment that RCW 36.65.030 is void for violating the Washington Constitution's single-subject and subject-in-title rules, and impermissibly seeks to use a statute concerning the combined city-county form of government to curtail traditional cities' authority.

The four cases were quickly consolidated and all parties agreed that the case should be resolved in an expedited fashion on cross-motions for summary judgment. The trial court heard arguments on November 17, 2017, and issued a written decision on November 22, 2017.

The trial court's November 22, 2017 decision declared the Ordinance invalid. Specifically, the trial court held that (1) the Ordinance's tax is not an excise tax authorized by RCW 35.22.280(32) or RCW 35A.82.020; (2) RCW 35A.11.020 does not authorize cities to impose income taxes, or any particular type of tax; (3) the Ordinance's tax

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plaintiff, i.e., *Kunath* plaintiff, *Burke* plaintiffs, *Levine* plaintiffs, and *Shock* plaintiffs.

violates RCW 36.65.030, which prohibits cities, counties, and city-counties from levying a tax on "net income"; and (4) the bill that enacted RCW 36.65.030 does not violate the single-subject or subject-in-title rules of Article II, section 19 of the Washington Constitution.

The City of Seattle and EOI timely filed notices of appeal seeking the Court's direct review of the trial court's November 22, 2017 decision.

II. ISSUES PRESENTED FOR REVIEW

1. Does the broad taxing authority of Washington's cities, as recognized by *Watson v. City of Seattle,* 189 Wn.2d 149, 401 P.3d 1 (2017) and other precedent, authorize the Ordinance's income tax?

2. Is RCW 36.65.030, which purports to prohibit net income taxes, inapplicable to Seattle's tax on total income?

3. Is RCW 36.65.030 void for violating Article II, Sections 19 or 37 of the Washington Constitution?

4. Should Washington join with the majority of courts nationwide in concluding that a tax on personal income, like a tax on business income, is not a property tax?

III. GROUNDS FOR DIRECT REVIEW

A. Standards for Direct Review

Rule of Appellate Procedure 4.1 enumerates the types of cases that are subject to direct review by this Court. Such cases include: a case in

which the trial court invalidated an ordinance or a tax on the ground that it is repugnant to the Washington Constitution; a case involving an issue in which there is an inconsistency in the decisions of the Supreme Court; and a case "involving a fundamental and urgent issue of public import which requires prompt and ultimate determination." RAP 4.1(a)(2) – (4). This case qualifies for direct review under all three of these standards, though EOI will focus on the latter two.

B. This Case Involves Fundamental Urgent Issues of Broad Public Import.

The parties all appear to agree that this case presents issues of broad public import.

In their complaint, *Levine* plaintiffs alleged that the case

> involves a controversy (1) of substantial public importance concerning the authority of cities to levy taxes on the personal income of individuals within their jurisdiction, (2) that immediately affects significant segments of the population, including income earners and small business owners who live in the most populous city in Washington, and (3) that has a direct bearing on commerce, finance, labor, industry, or agriculture …

Levine v. City of Seattle, Case No. 17-2-21076-6 SEA (Complaint, ¶ 14) (King County Superior Court, filed August 9, 2017). Indeed, this case implicates not only the taxing authority of first class cities like Seattle, but

all of the many cities that share the broad taxing authority conferred by the Optional Municipal Code, Chapter 35A RCW.

The record further confirms that the Ordinance would address urgent issues of broad public importance. In Washington State, households with incomes below $21,000 paid on average 16.8% of their income in state and local taxes in 2015, whereas households with income in excess of $500,000 paid only 2.4%, making our state and local tax systems the most regressive in the nation. Seattle City Res. 31747 at 1. This upside-down tax system aggravates the financial strain on low- and middle-income households in Seattle that are already struggling to cope with the region's affordable housing crisis and underfunded city services. *Id.* at 1-2. All of this comes at a time when Seattle is experiencing extremely rapid population growth and significant economic growth in certain sectors, which, despite creating opportunities for some, also compound the economic strain on low- and middle-income families. *Id.*, Ordinance at § 1, ¶¶ 2, 3, 5. These circumstances combine to underscore the urgency in resolving this appeal, so that Seattle may implement the Ordinance as soon as possible. *See* Seattle City Res. 31747 at 2 (finding urgency).

This Court has repeatedly recognized that issues of cities' taxing authority meet the criteria for Supreme Court review. *See, e.g., Watson v.*

City of Seattle, 189 Wn.2d 149; *City of Spokane v. Horton,* __ Wn.2d __, 406 P.3d 638 (2017). This is especially true here since the case will decide the breadth of municipal tax authority, and the applicability or constitutionality of a statute that purports to restrict that authority.

Moreover, this case will provide the first analysis in decades of the validity of 1930s case law holding that income taxes sometimes constitute property taxes. Such rulings are out of step with the analysis adopted by other courts throughout this country and overturning this precedent will allow elected and citizen policy makers to consider the breadth of options for addressing our state's long term revenue shortfalls.

C. This Case Involves Issues In Which There Are Inconsistencies Among the Decisions of the Supreme Court.

There are grave inconsistencies among Washington Supreme Court decisions regarding income taxes. The Court's reconciliation of this inconsistent precedent is essential to the resolution of this appeal.

On the one hand, the Court has consistently held that a tax on persons engaging in business activities and measured by their income is an excise tax. *Stiner v. Yelle,* 174 Wn. 402, 405 (1933); *H & B Commc'ns Corp. v. Richland*, 79 Wn.2d 312, 316, 484 P.2d 1141, 1145 (1971). In *Stiner v. Yelle,* the Court held that, despite "a maze of conflicting and bewildering decisions" and inconsistent language in the Court's prior

holdings, income is not property until it is acquired. 174 Wn. 402, 405. In *Supply Laundry Co. v. Jenner*, 178 Wn. 72, 78 (1934), the Supreme Court held that a tax on individual income of government employees making more than $200 per month was a valid extension of the excise tax upheld in *Stiner v. Yelle*. On the other hand, in *Culliton v. Chase*, 174 Wash. 363, 378, 25 P.2d 81 (1933) and *Jensen v. Henneford*, 185 Wash. 209, 217-18, 53 P.2d 607 (1936), the Court held that taxes on the one-time act of receiving income were property taxes, not excise taxes.

The Supreme Court's precedent holding that some income taxes are property taxes is also inconsistent with its precedent holding that functionally identical taxes on the transfer of money and real and personal property from one individual to another, measured by the value of the property, are excise taxes. For example, in *In re Estate of Hambleton,* 181 Wn.2d 802, 811, 832, 335 P.3d 398 (2014), the Court held that "[a]n 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." (internal quotation omitted). Likewise, in *Mahler v. Tremper*, 40 Wn.2d 405, 409-10, 243 P.2d 627 (1952) the Court held that "a sales tax upon real property is a tax upon the act or incidence of transfer," not a property tax. These cases and others like them hold that taxes upon "the exercise

of one of the powers incident to ownership" of property are excise taxes, not property taxes. *Morrow v. Henneford*, 182 Wash. 625, 630, 47 P.2d 1016, 1018 (1935). The holding of *Jensen v. Henneford*, that a tax upon any incident of ownership is a property tax, is entirely inconsistent with all of these lines of Washington Supreme Court excise tax precedent.

The Court should hear this case to lay these inconsistencies to rest by overruling *Culliton* and *Jensen.*

IV. CONCLUSION

This appeal involves Seattle's ability to collect taxes pursuant to an ordinance that was duly enacted to address urgent needs including homelessness and educational inequality. However this Court ultimately decides this question, the resolution of this dispute will impact both the citizens of Seattle and other cities throughout Washington. The questions at issue will ultimately be addressed by this Court and the magnitude, importance, and urgency of the issues strongly argue for direct review. EOI therefore respectfully requests that this Court grant direct review.

Respectfully submitted this 22nd day of January, 2018.

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