

POLICY BRIEF

Citizens' Guide to Olympia Measure 1, to create a local income tax to fund a college grant program

By Jason Mercier
Director of WPC's Center for Government Reform

October 2016

Key findings

- Supporters of a statewide income tax engaged in a “city-shopping” strategy in proposing Measure 1 in Olympia.
- Their stated goal is to force a local test case due to their consistent failure to impose an income tax at the state level.
- State law bans local governments from enacting any type of income tax.
- To get around this legal prohibition on income taxes, supporters of Measure 1 claim it is not an income tax but an “excise tax.”
- The state Supreme Court, however, has already barred attempts to call an income tax an “excise tax” to evade the legal prohibition.
- Although the income tax proposal is limited to the city of Olympia, its approval could have a huge future impact on taxpayers statewide.
- This is because Olympia’s income tax proposal is really about creating a test case to see if the state Supreme Court will overturn more than 80 years of case law banning graduated income taxes in Washington and allow a statewide income tax without changing the state constitution.



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Introduction

In November Olympia voters will consider Measure 1, a proposal to create a city income tax to fund a college grant program. Due to state and local prohibitions on graduated income taxes, Measure 1 has already been the subject of many Olympia City Council meetings and court rulings concerning its legality. The measure will face additional legal scrutiny and may be struck down in court should Olympia voters approve it.

Although this income tax proposal is limited to the city of Olympia, its approval could have a huge future impact on taxpayers statewide. This is because Olympia's income tax proposal is really about creating a test case to see if the state Supreme Court will overturn more than 80 years of case law banning graduated income taxes in Washington and allow a statewide income tax without changing the state constitution.

Text of Measure 1

The ballot title and summary of Measure 1 was subject to a legal challenge about whether the words "income tax" should appear on the ballot. Here is the ballot title the City of Olympia originally proposed for Measure 1: "Initiative Measure No. 1 concerns establishment of a 1.5% annual income tax within the City."¹

Supporters of Measure 1 said the words "income tax" would "prejudice" voters against the proposal. They went to court to have the title changed.

On September 14, Thurston County Superior Court Judge Anne Hirsch agreed and struck the words "income tax" from the ballot title. Here is the new title voters will see: "Initiative Measure No. 1 concerns establishing and funding a college grant program."²

1 "Court removes words 'income tax' from Olympia ballot proposal," by Andy Hobbs, *The Olympian*, September 16, 2016, at <http://www.theolympian.com/news/local/article102255102.html>

2 Ibid.

Also, here is the summary of Measure 1 as changed by Judge Hirsch:

“This measure would establish a City of Olympia college grant program. City residents who graduate from public high school or receive a GED could receive grants for at least one year of community college tuition, or an equivalent sum to attend public colleges and universities in Washington. Grants would be funded by a 1.5% tax on household income above \$200,000, and also may be privately funded. Administrative expenses would be capped at 5%.”

A graduated income tax is illegal in Washington

Since the 1930s, the Washington State Supreme Court has issued numerous opinions to enforce Article 7, sections 1 and 2 of the state constitution which requires taxation of property, including income, be uniform and limited to a flat rate of 1 percent.³

While there is no ban on a flat income tax of 1 percent, 80 years of legal precedents show that a graduated or targeted income tax that discriminates among people with different income levels differently is unconstitutional in Washington.

State law also bans local governments from enacting any type of income tax. According to RCW 36.65.030:

“Tax on net income prohibited. A county, city, or city-county shall not levy a tax on net income.”⁴

To get around this legal prohibition on income taxes, supporters of Olympia’s Measure 1 claim it is not an income tax but an “excise tax.” As pointed out by former Supreme Court Justice Phil Talmadge, however, the state Supreme Court has already barred attempts to call an income tax an “excise tax” to evade the legal prohibition. Writing about a similar attempt to call an income tax an “excise tax” with Initiative 1098 in 2010, Justice Talmadge pointed to prior court rulings rejecting these arguments:

“The Legislature attempted to describe the income tax as an excise tax on the ‘privilege of receiving income’ in the State of Washington. The Supreme Court was unmoved. The Jensen court stated that the 1935 Legislature’s effort to rename the tax did not make it an excise tax . . . Subsequently, in *Power, Inc v. Huntley*, the Legislature enacted what it described as a corporate excise tax, which was actually a graduated new

3 “Constitutionality of Initiative 1098,” by Phil Talmadge, Legal Analysis, Washington Policy Center, August 19, 2010, at <http://www.washingtonpolicy.org/library/doclib/Talmadge-Letter-Initiative-1098.pdf>

4 Revised Code of Washington 36.65.030, “Tax on net income prohibited,” at <http://app.leg.wa.gov/rcw/default.aspx?cite=36.65.030>

income tax on corporations. Again, the Supreme Court indicated that legislative labels for a tax are not controlling.”⁵

Former state Supreme Court Chief Justice Gerry Alexander agrees that Olympia’s Measure 1 proposed income tax is unconstitutional. Chief Justice Alexander is part of the official no campaign and recently told me:

“As a lifelong Olympian I am opposed to the proposed income tax. My concerns are numerous, but start with the fact that the tax would be unlawful, In that regard, see RCW 36.65.030 which provides that a city ‘shall not levy a tax on net income.’ On top of that, the Washington Supreme Court has twice ruled that graduated income taxes violate the 14th Amendment to the State constitution.”⁶

Timeline of Measure 1

Still, the Olympia income tax proposal was placed on the ballot in conflict with 80 years of case law banning graduated income taxes and a very clear state law prohibiting local income taxes. Here are the steps that led to that result. All dates are for 2016.

- **February 4** – State Supreme Court in a 9-0 ruling says that illegal local ballot measures can be kept off the ballot (a different standard is applied to the broader statewide initiative power).⁷ In an apparent conflict with this ruling, the Appeals Court later allowed the Olympia income tax proposal to remain on the ballot.
- **April 19** – Olympia City Council holds a public hearing with its attorney Hugh Spitzer to discuss legality of Olympia income tax proposal. Mr. Spitzer testifies that he, “sees the Olympia proposal as a ‘test case’ that will attempt to address the constitutionality of the state’s ban on an income tax. However, even though he is a longtime advocate of an income tax, Spitzer predicts that a court will rule that code cities such as Olympia cannot tax individual income.”⁸
- **May 17** – Olympia City Council discusses proposing an alternative income tax proposal due to “flaws” in Measure 1, such as how the city will receive tax information from citizens. The alternate income tax proposal would apply to all Olympia households.⁹

5 “Constitutionality of Initiative 1098,” by Phil Talmadge, Legal Analysis, Washington Policy Center, August 19, 2010, at <http://www.washingtonpolicy.org/library/doclib/Talmadge-Letter-Initiative-1098.pdf>

6 E-mail to the author from Gerry Alexander, former Supreme Court Justice, Washington State, October 17, 2016, copy available on request.

7 “Spokane Entrepreneurial Ctr. v. Spokane Moves to Amend,” Case No. 91551-2, Washington State Supreme Court ruling, February 4, 2016, at <http://www.courts.wa.gov/opinions/pdf/915512.pdf>

8 “Will a tax on Olympia’s richest households hold up in court?,” by Andy Hobbs, *The Olympian*, April 20, 2016, at <http://www.theolympian.com/news/local/article72960067.html>

9 “Olympia council responds to local income tax plan with its own,” by Andy Hobbs, *The Olympian*, May 18, 2016, at <http://www.theolympian.com/news/local/article78267042.html>

- **July 22** – Olympia City Council files an injunction to keep Measure 1 off the ballot as an illegal income tax proposal.¹⁰
- **August 24** – Thurston County Superior Court rules Measure 1 is an illegal income tax proposal and removes it from the ballot.¹¹
- **August 31** – *The Olympian* runs an editorial titled “Judge wise to block city income tax proposal.” From the editorial: “King County activists wanted to use Olympia as a test case for the legality of a graduated income tax, but it was clear early on that cities lack authority to enact such a tax. That is exactly what Judge Jack Nevin ruled.”¹²
- **September 2** – An Appeals Court Commissioner surprisingly stops the removal of Measure 1 from the ballot while the full appeal continues.¹³ This order appears to conflict with the unanimous February 4 state Supreme Court ruling.
- **September 14** – A different Thurston County Superior Court judge orders the words “income tax” removed from the ballot title for Measure 1, saying those words would “prejudice” voters against the proposal.¹⁴

If Measure 1 is approved, it will certainly be challenged in court due to the income tax ban in state case law and the prohibition against a local income tax provided in RCW 36.65.030.

Conclusion

Supporters of a statewide income tax engaged in a “city-shopping” strategy in proposing Measure 1 in Olympia. Their stated goal is to force a local test case due to their consistent failure to impose an income tax at the state level. The last nine times statewide voters have been asked to adopt an income tax, they have resoundingly said “no” (in 1934, 1936, 1938, 1942, 1944, 1973, 1975, 1982 and 2010).

If Olympia voters, however, approve the Measure 1 income tax and the state Supreme Court ignores prior precedents and declares it constitutional, the Olympia City Council will have the power to expand the tax. In fact, on May 17 the City Council voted 4-3 to expand the income tax proposal to tax all Olympia households

10 “City of Olympia tries to block income tax proposal from Nov. ballot,” by Andy Hobbs, *The Olympian*, July 27, 2016, at <http://www.theolympian.com/news/local/article92070162.html>

11 “Judge rules Olympia income tax proposal invalid for November ballot,” by Andy Hobbs, *The Olympian*, August 24, 2016, at <http://www.theolympian.com/news/local/article97709767.html>

12 “Judge wise to block city income tax proposal,” by editorial, *The Olympian*, August 31, 2016, at <http://www.theolympian.com/opinion/editorials/article98888207.html>

13 “Olympia income tax initiative likely to remain on November ballot,” by Andy Hobbs, *The Olympian*, September 2, 2016, at <http://www.theolympian.com/news/local/article99631172.html>

14 “Court removes words ‘income tax’ from Olympia ballot proposal,” by Andy Hobbs, *The Olympian*, September 16, 2016, at <http://www.theolympian.com/news/local/article102255102.html>

of all income levels. Councilmembers later realized the proposal faced the same legal failings as Measure 1 and did not send the proposal to voters.¹⁵

Olympia's Measure 1 remains controversial and legally suspect. If passed it will face an immediate legal challenge and will likely be reviewed by the state Supreme Court. Regardless of what happens with the Measure 1 income tax proposal in Olympia, however, income tax supporters will continue to focus efforts at the state level, most likely with proposals to impose a capital-gains income tax.

15 "Olympia council responds to local income tax plan with its own," by Andy Hobbs, *The Olympian*, May 18, 2016, at <http://www.theolympian.com/news/local/article78267042.html>

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Jason Mercier is the Director of the Center for Government Reform at Washington Policy Center and is based in the Tri-Cities. He serves on the boards of the Washington Coalition for Open Government and Candidate Verification, and was an advisor to the 2002 Washington State Tax Structure Committee. Jason is an ex-officio for the Tri-City Regional Chamber of Commerce. He worked with lawmakers in 2008 to create the state's renowned budget transparency website www.fiscal.wa.gov and has been a champion for many of the state's important budget reform tools including the 4yr balanced budget requirement adopted in 2012. In 2010, former Governor Gregoire appointed Jason as WPC's representative on her Fiscal Responsibility and Reform Panel. He has testified numerous times before legislative committees on government reform issues, and his op-eds regularly appear in newspapers around the state, including *The Seattle Times* and *Tri-City Herald*. Jason also provides a regular "Eye on Olympia" TV update for KVEW (ABC Tri-Cities) and can be heard frequently on the state's radio stations including on KOMO and KIRO.