Jaeger, Matthew

From: John Burbank <john@eoionline.org>
Sent: Friday, April 07, 2017 5:47 PM
To: Aldrich, Newell
Subject: FW: Message from KMBT_C552
Attachments: SKMBT_C55215021903340.pdf

Here are my thoughts about that old memo. I have no idea how I got it!

From: John Burbank
Sent: Tuesday, February 24, 2015 1:43 PM
To: 'Greg Wong' <Greg.Wong@pacificalawgroup.com>
Cc: Paul Lawrence <Paul.Lawrence@pacificalawgroup.com>
Subject: RE: Message from KMBT_C552

It makes me optimistic because the first argument against this is that income taxes are unconstitutional, and so if we pursue an income tax, in the guise of a privilege tax, then we want the challenge to a victory at the polls to be that it is an income tax, and in this way follow the courts up to the State Supreme Court, so that they have a chance to rule on the constitutionality of an income tax and review and perhaps reverse their decision from 1933 and 1935. And that is exactly what we want to do.

The second argument is that localities are prevented specifically from taxing net income. We are proposing taxing individuals' gross income (the net income is a concept from corporate income taxes, as I understand it), so an argument can be made that this does not apply. Further, the argument is that cities don't have the authority to tax without express legislative permission. But the author goes on to describe that express authority "to license for any lawful purpose..." - including raising revenue. Then the author discounts licensing for an income tax on the basis of the Bellingham decision, which was thrown out NOT because it was an income tax, but because it was a payroll tax on work, and work is not considered a privilege.

But the Bellingham decision is silent on an income tax, and references only earned income. It says nothing about unearned income, or a tax determined by the total aggregation of income for an individual or family.

So I think we can thread the needle with the very arguments in this brief!

Those are my brief thoughts. Not necessarily well connected.

From: Greg Wong [mailto:Greg.Wong@pacificalawgroup.com]
Sent: Tuesday, February 24, 2015 1:30 PM
To: John Burbank
Cc: Paul Lawrence
Subject: RE: Message from KMBT_C552

Hi John,

Thanks for sending this on. In your email to Lisa you mention that this memo makes you more optimistic. Can you elaborate on that thought? Also, for the first phase we discussed drafting concepts for one or more initiatives for poll testing. Is there a particular form of work product that would be most useful for this purpose?

Thanks,

Greg

From: John Burbank [mailto:john@eoionline.org]
Sent: Tuesday, February 24, 2015 12:10 PM
To: Greg Wong
Subject: FW: Message from KMBT_C552

Of interest.

From: John Burbank
Sent: Saturday, February 21, 2015 6:13 PM
To: Lisa MacLean
Cc: knoll lowney; Emma Tupper
Subject: Re: Message from KMBT_C552

This entire opinion actually makes me more optimistic regarding the legal pathway for us!

Pacifica should have own analysis by end of February

Sent from my iPhone

On Feb 19, 2015, at 4:20 PM, Lisa MacLean <lisa@moxiemedia.biz> wrote:

> Latest on that timing, John?
>
> Lisa MacLean
> Founding Partner
> Moxie Media
> Lisa@moxiemedia.biz
> 206-669-4355 mobile
>
> On Feb 19, 2015, at 3:59 PM, knoll lowney <knoll@igc.org> wrote:
>
> > This may be of interest to Pacifica in its legal analysis of the millionaires tax.
> >
> > Knoll Lowney
> > Smith & Lowney PLLC
> > 2317 E. John St.
> > Seattle WA 98112
> > (206) 860-2976
> > fax (206) 860-4187
> > knoll@igc.org
> > **Note: the content of this message may be confidential and/or subject to attorney client privilege.**
> >
> > ---------- Forwarded message ----------
> > From: <smithlowneyscanner@gmail.com>
> > Date: 2015-02-18 16:34 GMT-08:00
> > Subject: Message from KMBT_C552
> > To: knoll@igc.org

<SKMBT_C55215021903340.pdf>

MEMORANDUM

CONFIDENTIAL: ATTORNEY-CLIENT PRIVILEGED

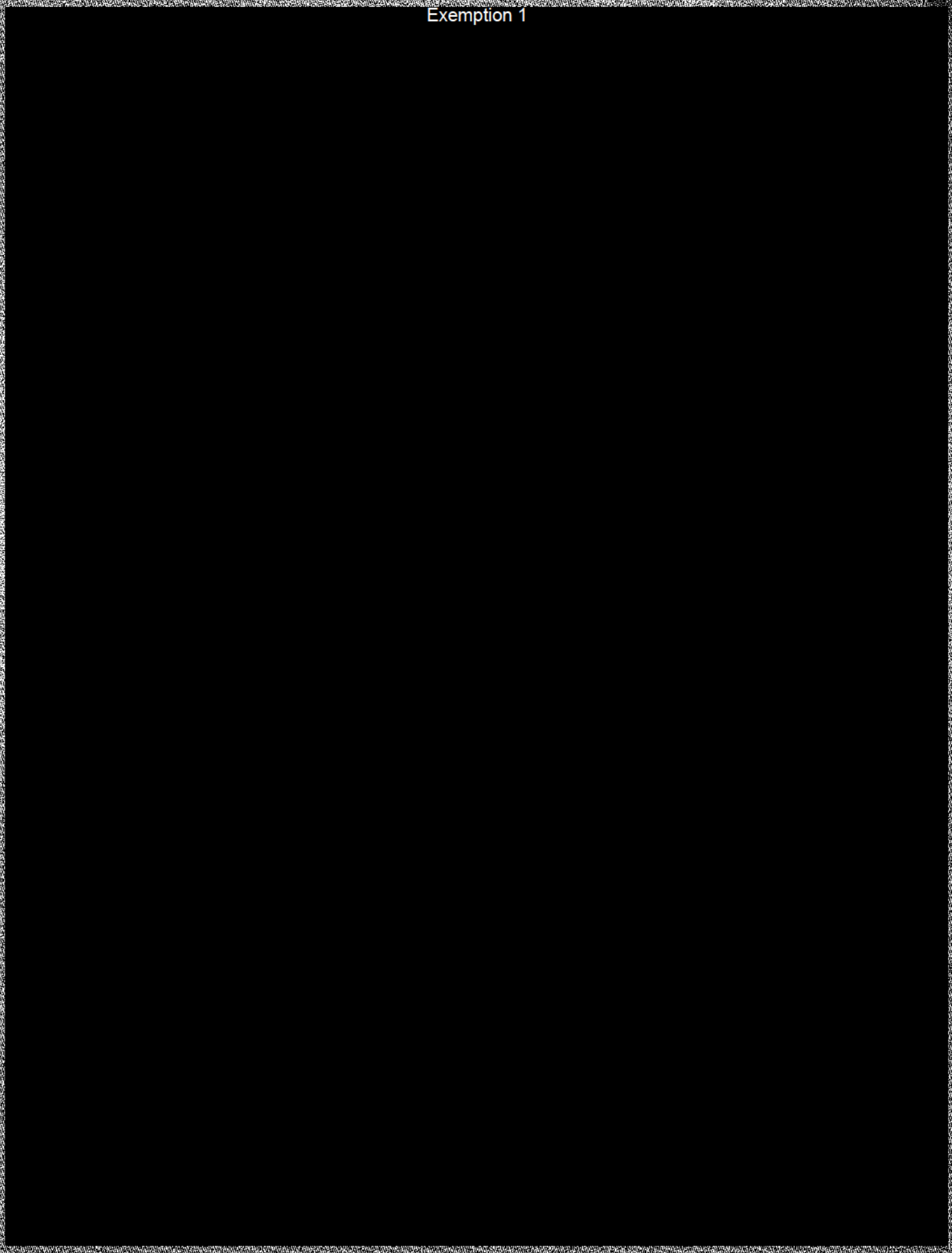
TO: Councilmember Nick Licata

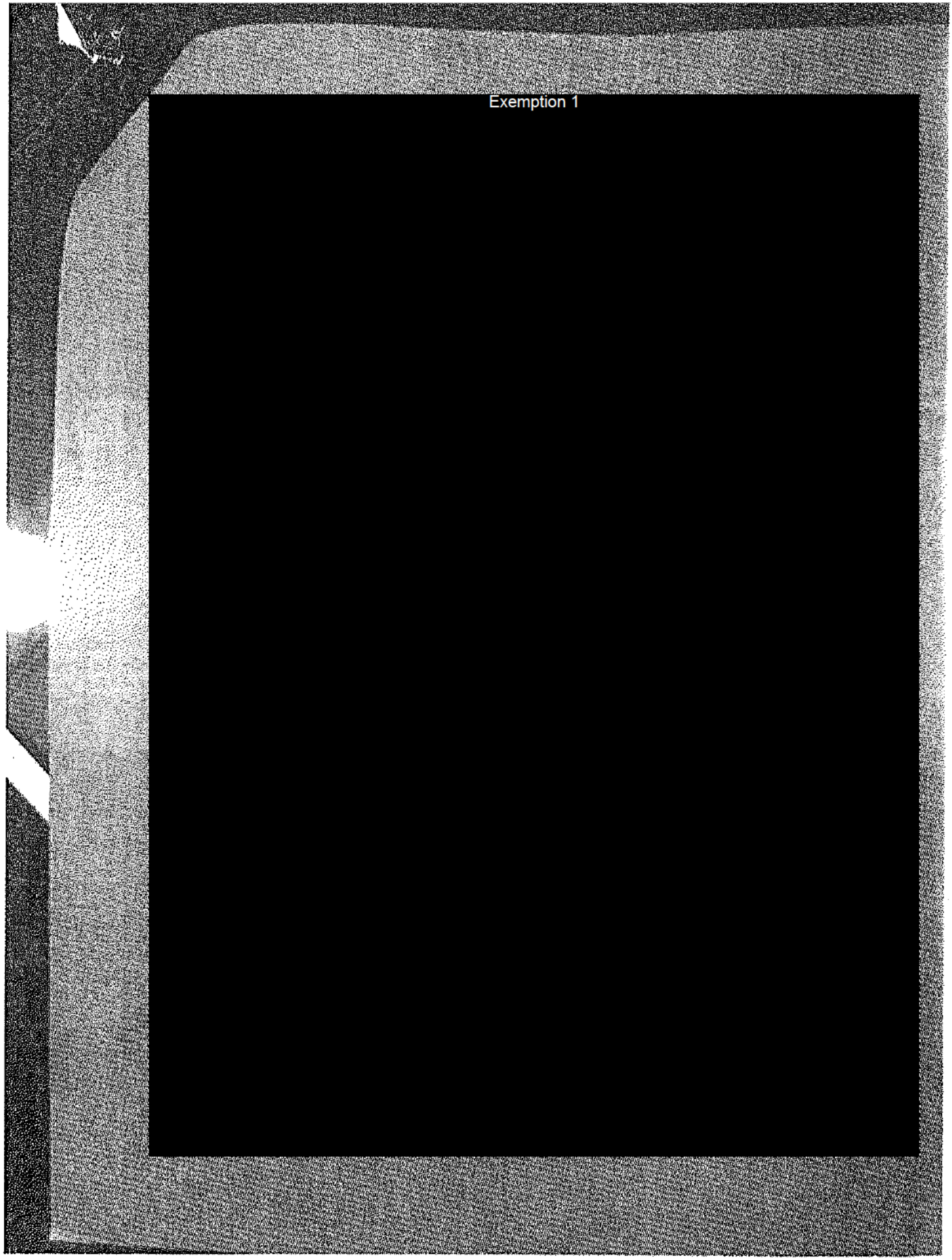
FROM: Kara Mayer

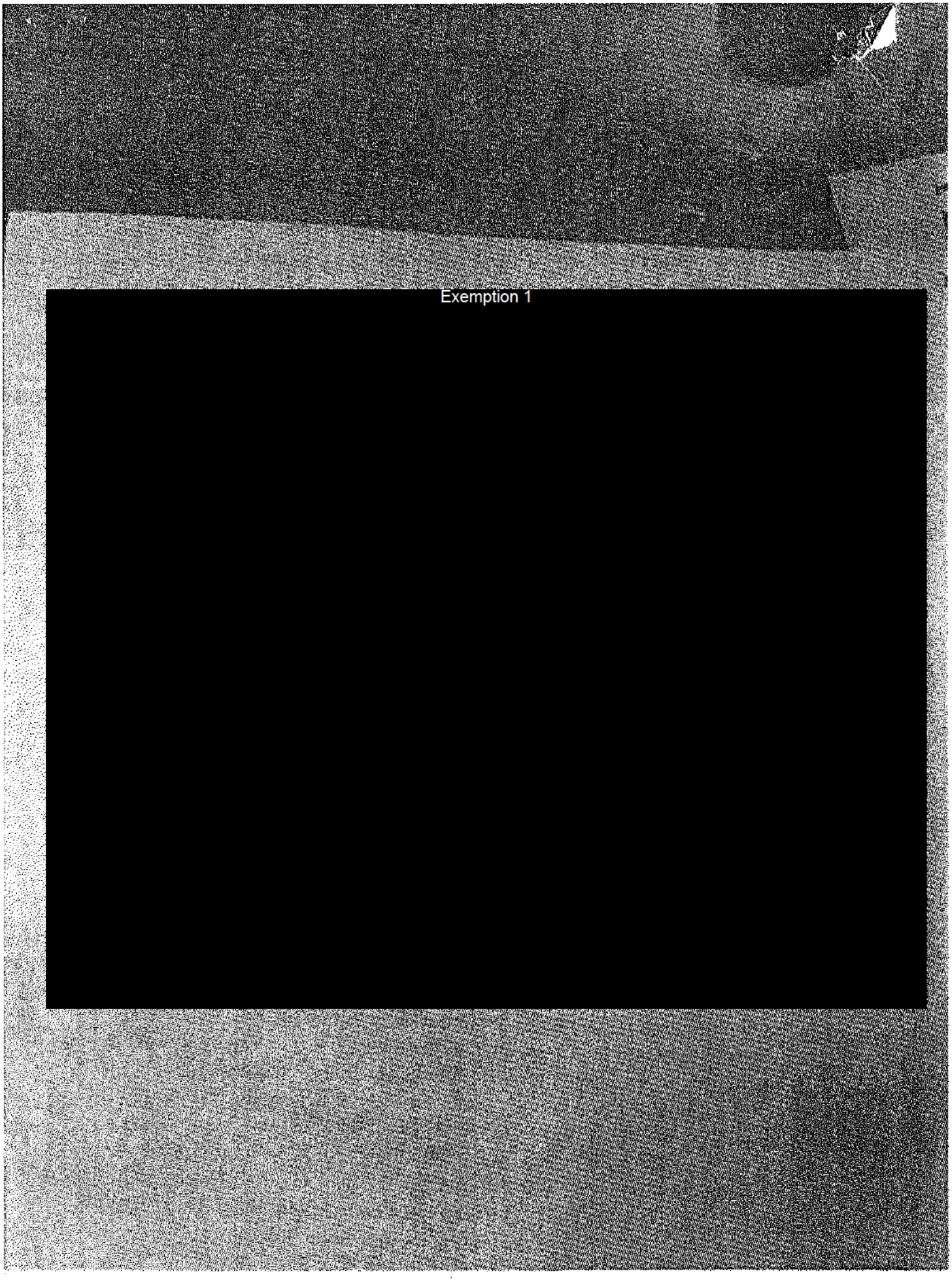
SUBJECT: Exemption 1

DATE: November 10, 2014

Exemption 1


Exemption 1


Exemption 1


Exemption 1

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MEMORANDUM

TO: John Burbank, Economic Opportunity Institute

FROM: Pacifica Law Group LLP

DATE: March 9, 2015

SUBJECT: Income-Targeted City Initiatives

Question Presented

The Economic Opportunity Institute, Washington Education Association, SEIU 775 and other parties wish to enact a local initiative that, if possible, (1) sets up a legal challenge to current law in Washington that holds graduated income taxes are unconstitutional, (2) provides a launching point for a potential future statewide initiative, and/or (3) establishes a progressive tax that generates revenue for the public benefit. What options exist to structure such a ballot measure?

Short Answer

The ballot measure can be structured as an excise tax for the purpose of generating revenue for the city. There are two types of excise taxes that may be feasible. First, a privilege (or license) tax on business activity. Second, an excise tax on capital gains. Some potentially viable options are: (1) a privilege tax imposed on businesses measured by corporate net income, (2) a privilege tax imposed on businesses as a head tax, with the amount of tax measured by a percentage of each employee's salary and the percentage tied to graduated income bands, (3) a privilege tax imposed on a specific profession and measured by percent of the professional's income, or (4) a local capital gains tax.

The legality of all of these taxes is untested. Further, not all of the options address the income tax question. And for those options that do, it is possible that a court would invalidate the ballot measure (if it passed) based on the lack of sufficient authority to impose such a tax, without reaching whether a graduated income tax itself is constitutional. If brought, the initiative should filed in Olympia or Seattle.

Discussion

A. Graduated income tax measures are unconstitutional in Washington State.

The Washington Supreme Court squarely has held that a graduated income tax is unconstitutional. The basis for this opinion is the Court's holding that income is property, and under the Washington Constitution property taxes must be uniform. *Culliton v. Chase*, 174 Wash. 363, 25 P.2d 81 (1933); Const. art. VII, § 1. A brief overview of the relevant case law provides context for any potential challenge to this holding. The Court has struck down multiple tax measures because they were non-uniform income taxes. In *Culliton*, the Court invalidated a graduated personal income tax passed as an initiative by the people based on this reasoning. *Id.* Subsequently, the legislature enacted the same tax, but tried to avoid the uniformity rule by labeling it a tax on "the privilege of receiving income." But the Court held the tax unconstitutional for the exact same reason it held the initiative unconstitutional. *Jensen v. Henneford*, 185 Wash. 209, 53 P.2d 607 (1936). In doing so, the Court noted that "the legislative body cannot change the real nature and purpose of an act by giving it a different title or by declaring its nature and purpose to be otherwise…The character of a tax is determined by its incidents, not by its name." *Id.* at 217.

Fifteen years later, the Court held a tax on corporate net income unconstitutional on the same grounds. *Power, Inc. v. Huntley*, 39 Wn.2d 191, 235 P.2d 173 (1951). The Court began its analysis by stating: "It is no longer subject to question in this court that income is property." *Id.* at 194. The legislature declared in the law that the tax—a four-percent tax on corporate net income—was an excise tax imposed on corporations for the privilege of doing business in the state. *Id.* at 195. But the Court again looked beyond this designation and held that because the tax was imposed on income, it was a property tax, not an excise tax. *Id.* The Court noted the tax was imposed solely because the business received net income, not because "it does business in this state or exercises its corporate franchise". *Id.* at 197. This distinguished the tax from a "true excise tax", such as the B&O tax, which focuses on "business activities". *Id.* Thus, the Court recognized "the right to levy an excise tax on the privilege of doing business or exercising corporate franchises and to base that tax on income; but the tax must be, 'in truth, levied for the exercise of a substantive privilege granted or permitted by the state.'" *Id.* (quoting *Jensen*). Because the tax was imposed on corporations, but not on the income of individuals and partnerships that may be in competition with corporations, the Court held it was unconstitutionally non-uniform. *Id.* at 195-197.

There is a belief that the current Supreme Court may reverse its prior precedent if faced squarely with a graduated income tax today. In 2010, such a challenge would have been setup if Initiative 1098—a graduated income tax ballot measure—had passed. But it did not. The present question, therefore, is whether such a challenge may be set up by passing a local initiative in cities where I-1098 received a majority "yes" vote.

B. An excise tax is the only option for a local initiative that reaches personal income.

Any income tax measure imposed by a city initiative will face a threshold hurdle. Cities have limited taxing authority and no inherent authority to tax. A city must have express constitutional or legislative authority to levy taxes. *Arborwood Idaho, L.L.C. v. City of Kennewick*, 151 Wn.2d 359, 366, 89 P.3d 217 (2004). Absent a constitutional or statutory basis to impose a tax on income, a city initiative will be held invalid for reasons entirely separate from the non-uniform income tax question.

Here, the goal of the ballot measure is to impose a tax that sets up a legal challenge that allows the Supreme Court to address the constitutionality of a graduated income tax, sets the stage for a potential state-level income tax measure, and/or provides revenue for public benefits through a progressive tax. Traditional methods of municipal taxation that are authorized by statute, such as local sales taxes, local property taxes, and local leasehold excise taxes, would not meet these goals. *See* ch. 82.14 RCW, ch. 84.52 RCW; RCW 82.29A.040. Nor is there any grant of authority for a city to impose an income tax on personal income. There are, however, two novel (and therefore untested) paths to impose a tax that meets one or more of the goals.

1. Cities have statutory authority to impose privilege taxes on business activities.

Cities are specifically authorized by the legislature to "grant licenses for any lawful purpose, and to fix by ordinance the amount to be paid therefor..." RCW 35.22.280(32) (first-class cities); *see also* RCW 35A.82.020 (code cities). These statutes have long been interpreted to provide cities the ability to impose a license tax to generate revenue under the theory that businesses are paying for the "privilege" of doing business in the city (hence the common term "privilege tax"). *City of Seattle v. King*, 74 Wash. 277, 279, 133 P. 442 (1913) (upholding license tax for revenue on for-hire vehicles); *Fleetwood v. Read*, 21 Wash. 547, 552, 58 P. 665 (1899) (upholding license tax for revenue on businesses that use stamps, coupons, tickets, or cards for the purchase of goods). A license tax for the purpose of generating revenue is a type of excise tax. The amount of the tax or license fee is entirely within the discretion of the city as long as it does not discriminate within business classifications and is not "so heavy as to be prohibitory." *Pac. Tel. & Tel. Co. v. City of Seattle*, 172 Wash. 649, 658, 21 P.2d 721 (1933); *see also Diamond Parking, Inc. v. City of Seattle*, 78 Wn.2d 778, 784, 479 P.2d 47 (1971). And such a tax is not subject to the Washington Constitution's requirements on uniformity and equality of taxation because the tax is on a privilege and not property. *Town of Sumner v. Ward*, 126 Wash. 75, 79, 217 P. 502 (1923).

There are important limitations, however, on the scope of the privilege tax. First, a privilege tax must be imposed "on those engaged in some kind of businesses, not on the users of businesses." *Arborwood Idaho, L.L.C. v. City of Kennewick*, 151 Wn.2d 359, 366 n.6, 89 P.3d 217 (2004). That is, the privilege must be based on "business activities." *Power, Inc.*, 39 Wn.2d at 197. In rejecting the argument that a personal income tax can be justified as a privilege tax, the Supreme Court stated in *Culliton*: "The taxes here in question can in no sense be said to be

for licenses to pursue certain occupations, or upon corporate or business privileges, or for the manufacture, sale, or consumption of commodities within the state." 174 Wash. at 377-78 (citing Cooley on Constitutional Limitations (7th Ed.) 680). Thus, a city cannot impose a privilege tax on individuals in general; it may only do so on businesses or individuals engaged in specific professions.

Second, as the Supreme Court stated in *Jensen* and *Power, Inc.* above, "the tax must be, 'in truth, levied for the exercise of a substantive privilege granted or permitted by the state.'" *Power, Inc.*, 39 Wn.2d at 197 (quoting *Jensen*). A license tax will be held invalid if no "substantive privilege is granted or permitted." In *Cary v. Bellingham*, 41 Wn.2d 468, 468-69, 250 P.2d 114 (1952), Bellingham imposed a license "tax, based upon one-tenth of one per cent of gross income, revenues, receipts, and commissions, on all persons receiving compensation for services performed within the city." The city justified the tax as a license for the privilege of "working for salaries or wages." *Id.* at 471. The Supreme Court held the license tax invalid, reasoning 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. Rather, the right to earn wages is an inalienable right. *Id.*

Third, any privilege tax must establish reasonable classifications for businesses subject to the tax. "To comply with the equal protection provision found in Const. art. 1, s 12, a classification must meet and satisfy three requirements. First, legislation must apply alike to all persons within a designated class. Second, there must be reasonable grounds for making distinctions between those who fall within the class and those who do not. Third, the disparity in treatment must be germane to the object of the law in which it appears." *Sonitrol Nw., Inc. v. City of Seattle*, 84 Wn.2d 588, 589-90, 528 P.2d 474 (1974). Legislative bodies have broad discretion in making classifications for taxation, and classifications will be upheld if they are not arbitrary and capricious and rest upon some reasonable consideration of difference or policy. *Id.* at 590-93. Current business license taxes such as B&O taxes, square footage taxes, and head count taxes all provide easy classifications in ranges based on the size of the business (i.e., businesses with a range of A to B gross proceeds/square footage/number of employees pay one rate; businesses with a range of C to D gross proceeds/square footage/number of employees pay a different rate).

The following are ways a privilege tax possibly could be used to accomplish the above goals:

1. A privilege tax on businesses as measured by net income. While this would not target individual wealth, it may square up a challenge to the cases that have held taxes on net income violate the uniformity requirement (such as *Power, Inc.*).

2. A privilege tax on businesses imposed as a head tax, but measured by a percent of each employee's salary, with salaries in graduated ranges. This is potentially viable, although untested. A court could hold that a head tax must be a flat rate on a per employee basis

or hold that an employee's salary is not sufficiently connected to the business activity to justify a privilege tax. There is a possibility, however, that this could create a backdoor challenge to whether assessing a graduated tax on income is permissible.

3. Identify certain professions as high wage earning professions and impose a privilege tax on those professions/occupations only. Even cleaner may be to impose the privilege tax on only one profession (such as IT workers, lawyers, or doctors) and measure the amount of tax based on the professional income of the individual.

Even under these scenarios, however, a court could refuse to reach the "income is property" rule by finding that the tax is not within the scope of the city's licensing authority. Finally, a privilege tax on businesses that overly compensate their top employees may not be a viable privilege tax. As described above, privilege taxes are normally applied generally to all businesses or specifically to businesses or professions engaged in some particular category of business activity. In this case, the privilege tax would apply only to some businesses based not on engagement in a particular category of business activity, but on executive compensation. Thus, such a tax may not be within the city's privilege tax authority.

2. Cities may impose excise taxes on transactions related to business or commerce, potentially including a local capital gains tax.

The Washington law that grants code cities the authority to impose a privilege tax also includes language regarding the ability of code cities to impose excise taxes. RCW 35A.82.020 provides in relevant part: "A code city may exercise the authority authorized by general law for any class of city to license and revoke the same for cause, to regulate, make inspections and to impose excises for regulation or revenue in regard to all places and kinds of business, production, commerce, entertainment, exhibition, and upon all occupations, trades and professions and any other lawful activity...." The plain language of this statute is "unambiguously broad" and "liberally construed." *City of Wenatchee v. Chelan County Pub. Utility Dist. No. 1*, 181 Wn. App. 326, 336-37, 325 P.3d 419 (2014). The courts have interpreted this statute in the context of the authority of a code city to impose B&O taxes, and have not addressed the law in the context of other excise taxes.

There is a viable argument that—given the plain language of the statute—code cities have the authority to impose excise taxes on almost any activity that relates to business or commerce. While untested, we believe this provides at least a viable argument that a city may impose a progressive excise tax in the form of a local capital gains tax. And there is a pathway for first-class cities, such as Seattle, to impose the same type of tax because first-class cities are granted all the powers granted to any other class of city in the state. RCW 35.22.570.

Further research is required to determine the appropriate reach of such a tax because there would need to be a nexus between the city and capital gains transactions subject to the tax. Moreover, the statute should not be read so broadly as to hold a city's power to impose excise

taxes unlimited. As noted above, we believe a reasonable limitation is that the excise tax is related to business or commerce. And we believe that where the legislature has set forth specific excise tax authority (for example with leasehold excise taxes and limitation on local sales taxes), those specific statutes will govern. For this reason an excise tax on purchases of luxury items such as yachts likely would not be valid as the tax would violate the legislature's desire to specifically limit local sales tax authority.

C. If brought, the initiative should be filed in Olympia and/or Seattle.

The target jurisdictions for a local initiative are the cities of Bellingham, Olympia, Seattle, and Shoreline, and San Juan County. Based on the following summary, Olympia and Seattle are the most viable options, with Shoreline as a potential option:

Bellingham. Bellingham is not a viable option for a local tax initiative because the Bellingham Charter prohibits initiatives "authorizing or repealing the levy of taxes." Art. IX, § 10.02; RCW 35.22.200. While we could argue that "levy" is a term of art limited to property taxes, Washington authority interprets the term "levy" more broadly. *See, e.g., Carkonen v. Williams*, 76 Wn.2d 617, 627, 458 P.2d 280 (1969) (property tax case stating broadly that "[t]he word 'levy' when used in connection with the authority to tax, while assuming other meanings through interchangeable or indiscriminate usage, strictly speaking denotes the exercise of a legislative function, whether state or local, which determines that a tax shall be imposed, and fixes the amount, purpose, and subject of the exaction." (*citing* 3 T. Cooley, Taxation s 1012, at 2043-44 (4th ed. 1924))); Wash. Att'y Gen. Op. No. 15 (1983) (suggesting referendum power available to voters in code cities would not include sales and use taxes because statute excludes referenda on ordinances "authorizing the levy of taxes").

Olympia. Olympia is a code city that may impose privilege taxes on business activities. RCW 35A.82.020. The Olympia city code does not contain any subject matter restrictions on initiatives like Bellingham. *See* Olympia Municipal Code § 1.16.000 (retaining power of initiative). As a code city, Olympia's referendum power is limited under RCW 35A.11.090, which prohibits referenda on ordinances "authorizing or repealing the levy of taxes." But there is not an analogous restriction on initiatives.

San Juan County. San Juan County is not a viable option for a local tax initiative because counties do not have the authority to impose privilege taxes. Like cities, counties must have express constitutional or statutory authority to impose taxes. But unlike cities, counties are not granted the authority to impose license taxes for the privilege of conducting business activities in the county. Absent this option, there is no path for San Juan County to impose a tax that implicates income.

Seattle. Seattle is a first-class charter city that may impose privilege taxes on business activities. RCW 35.22.280(32). The Seattle city code does not contain any subject matter restrictions on initiatives like Bellingham. *See* Seattle Charter, Art. IV, § 1.B (retaining power of initiative);

RCW 35.22.200. Any initiative must be submitted to the City Council, which may adopt the initiative in full, submit the initiative to the voters, or submit the initiative and a substitute proposal concerning the same subject matter to the voters. Seattle Charter, Art. IV, § 1.C, 1.D.

Shoreline. Shoreline is a code city that may impose privilege taxes on business activities. RCW 35A.82.020. The Shoreline city code probably does not contain any subject matter restrictions on initiatives like Bellingham, but the language is ambiguous and therefore presents some risk. The Shoreline city code provides that in accordance with RCW 35A.11.090, ordinances "authorizing or repealing the levy of taxes" shall not be "subject to the powers of initiative and referendum." Shoreline Municipal Code § 1.12.040. The plain language arguably extends the subject matter restriction to initiatives but only where the proposed initiative would amend or repeal an existing tax ordinance. *See* Wash. Att'y Gen. Op. No. 13 (1982) (explaining distinction between an initiative repealing or amending an ordinance and a referendum). Before filing in Shoreline, we would need to determine whether the proposed tax measure would amend or repeal any existing Shoreline tax ordinances. In the alternative, the RCW the city code cites does not refer to initiatives at all, only referenda, and there is an argument there was a drafting error. Regardless, the initiative pathway is not entirely clear and may be subject to litigation.

One final consideration is the adage that "bad facts make bad law". Each of the potential taxes outlined above are untested and therefore face a risk of invalidation. If that is the end result, there is a further risk that any adverse court decision may include language that could make future progressive tax measures more susceptible to constitutional challenges. The best means to setup a challenge to the "income is property" rule is to pass a graduated income tax at the state level. While this presents political challenges, it is the only way to ensure the question is squarely before the Supreme Court.

Conclusion

Imposing an income tax, or proxy thereof, by city initiative will be difficult. While there are arguable pathways, none directly tax individual income and all come with risk of invalidation. Any initiative should be framed as a privilege tax or capital gains tax and should be run in Olympia and/or Seattle.