SEATTLE CITY ATTORNEY
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M E M O R A N D U M

CONFIDENTIAL: ATTORNEY-CLIENT PRIVILEGED

TO: Councilmember Nick Licata

FROM: Kent Meyer

SUBJECT: Income Tax and Mansion Tax

DATE: November 10, 2014

Millionaire's Tax. You asked whether the City Council could impose a "millionaire's tax," i.e. an income tax on high incomes. The short answer is that the City cannot, even if the tax is framed as an excise tax.

The City cannot impose such an income tax because the Washington Supreme Court has ruled that a graduated income tax violates the state constitution and because the legislature has not authorized cities to impose an income tax. In fact, the legislature specifically prohibits cities from imposing a net income tax.

Income as Property. First, an income tax would be unconstitutional under a line of State Supreme Court cases that holds that income is property and that an income tax violates the uniformity provisions of the state constitution. Article VII, section 1 of the Washington State Constitution states:

> All taxes shall be uniform upon the same class of property within the territorial limits of the authority levying the tax.....

The Washington Supreme Court has held that "Tax uniformity requires both an equal tax rate and equality in valuing the property taxed." *Covell v. City of Seattle*, 127 Wn.2d 874, 878, 905 P.2d 324 (1995). The Court has also noted that "tax uniformity is 'the highest and most important of all requirements applicable to taxation under our system.'" *Inter Island Tel. Co. v. San Juan County*, 125 Wn.2d 332, 334, 883 P.2d 1380 (1994).

In a line of cases beginning with *Culliton v. Chase*, 174 Wash. 363, 25 P.2d 81 (1933) and *Jensen v. Henneford*, 185 Wash. 209, 53 P.2d 607 (1936), the State Supreme Court ruled that income is property and that a tax on income is subject to the constitutional constraints on property taxes. So, under Article VII, Section 1 of the State Constitution, a graduated income tax,

i.e., a tax with higher rates on high incomes, is unconstitutional because the tax rate is not uniform.

Also, article VII, Section 2 of the State Constitution caps the tax rate for property taxes at one percent of the value of the property. So, if income is property as the court held in *Culliton*, then the tax rate on that property cannot exceed one percent.

Current Validity of *Culliton*. There is some debate about whether the current court would overturn these cases, but the law today is that an income tax is an unconstitutional property tax. In 2010, the state voted on Initiative 1098 that would have imposed a graduated net income tax statewide. Former Supreme Court Justice Philip Talmadge and constitutional law expert Hugh Spitzer debated whether the current court would follow the *Culliton* line of cases. Justice Talmadge said, "Washington law is unambiguous. Income is property."[1] He concluded that I-1098 "would violate Washington's Constitution" and quoted a 1974 Attorney General Opinion:

> Of course, it is possible that the supreme court, as presently constituted, could be persuaded to reverse its earlier rulings and uphold a graduated net income tax such as is here proposed without a constitutional amendment. But this, obviously, is something upon which we cannot properly speculate in attempting to provide you with an objective opinion as to the constitutionality of such a tax at the present time. Until and unless those decisions are thus overruled, we must continue to be guided by them – and so conclude that at this time, the constitution of this state continues to prohibit the imposition of a tax upon corporate or individual net income such as would be provided for under the bill you have asked us to review. Accordingly, we must necessarily advise you, in direct response to your question, that this aspect of that bill would not be constitutional.

Talmadge Letter, p. 7 (*quoting* AGLO 174, No. 105).

In contrast, Hugh Spitzer questioned the validity of the *Culliton* line of cases in a 1993 law review article and also in a shorter article prepared in 2002.[2] Prof. Spitzer argued that *Culliton* "was based on an earlier Washington case which the State Supreme Court clearly misread." He concluded:

> Accordingly, there is a reasonable likelihood that if the Washington State Legislature or voters enacted an income tax today, Washington's courts would approach the issue with a fresh view and might very well decide the matter in a

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[1] *See* Talmadge letter to Washington Policy Center, p. 3 (August 19, 2010); available on-line at: http://www.washingtonpolicy.org/press/press-releases/legal-analysis-former-state-supreme-court-justice-says-i-1098-income-tax-uncons.

[2] *See* Hugh Spitzer, *Washington State Income Tax-Again?* 16 U. Puget Sd. L. Rev. 515 (1993); available on-line at: http://digitalcommons.law.seattleu.edu/sulr/vol16/iss2/1/. *See also* Tax Alternatives for Washington State: A Report to the Legislature, (Appendix B) (2002); available on-line at: http://dor.wa.gov/Content/AboutUs/StatisticsAndReports/WAtaxstudy/Volume_2.pdf

> manner consistent with the dominant view in other states with similar constitutional provisions [and uphold the tax].

In summary, under the current case law, a graduated income tax is unconstitutional, but there is a possibility that the current court would not follow the *Culliton* line of cases and uphold the tax.

Excise v. Income Tax. There is some speculation that the City could avoid the *Culliton* decision by framing a high-earner income tax as an excise tax on the privilege of earning income. But that would not affect the constitutionality of the tax. The court looks at the actual character of the tax and not just at the label. In fact, in *Jenson*, the second case in which the court overturned a state income tax in the 1930s, the legislature characterized the tax as an excise tax on the privilege of receiving income. Despite that characterization, the court ruled that the tax was an unconstitutional income tax and said:

> It is true that the Legislature has so labeled the 1935 act [as an excise tax.] But 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 Legislature may declare its intended purpose in an act, but it is for the courts to declare the nature and effect of the act. The character of a tax is determined by its incidents, not by its name.

Jensen v. Henneford, 185 Wash. 209, 217, 53 P.2d 607 (1936). The state legislature's attempt to characterize an income tax as an excise tax on receiving income was unsuccessful. It is likely that the City would face a similar result.

City's Authority To Tax. Even if the City could overcome the constitutional issues raised by *Culliton*, there are additional barriers to prevent any city from imposing an income tax. Under Article VII, section 9 and article XI, section 12 of the Washington State Constitution, the legislature can grant cities the power to levy and collect taxes for local purposes. *See King County v. City of Algona*, 101 Wn.2d 789, 791, 681 P.2d 1281 (1984). However, these constitutional provisions are not self-executing. A city must have express authority, either constitutional or legislative, to levy taxes. *Arborwood Idaho, L.L.C. v. City of Kennewick*, 151 Wn.2d 359, 365-366, 89 P.3d 217, 221 (2004). So, even if the current court overruled *Culliton*, the City would need a grant of authority from the legislature to impose an income tax.

The legislature has not granted cities the authority to impose an income tax. In fact, the legislature has specifically prohibited cities from imposing a net income tax. Under RCW 36.65.030, "A county, city, or city-county shall not levy a tax on net income." This statute prohibits the City from imposing the type of tax that was at issue in *Culliton* and that was proposed on a state-wide basis by I-1098.

Even if that statute did not exist, the City would still need an express grant of authority from the legislature to impose a net income tax. We impose our B&O tax (business license tax) under the authority of RCW 35.22.280(32) to "license for any lawful purpose . . . " This statute allows the City to license for the purpose of raising revenue.

But our authority to license for revenue is not sufficient to impose an income tax or an excise tax on earning income. In *Cary v. Bellingham*, 41 Wn. 2d 468, 472, 250 P.2d 114, 117 (1952), the city of Bellingham attempted to impose an excise tax on the privilege of working for salaries or wages in the city. The court held that Washington cities do not have the authority to impose such a tax because employment is "one of those inalienable rights" rather than a privilege, and could not be the subject of a local excise tax. Under the court's decision in *Cary*, the City of Seattle could not rely on its authority to license for revenue to impose a tax on the privilege of earning an income in the City.

Conclusion. To summarize, the Washington Supreme Court ruled in the 1930s that income is property and that a tax on income is subject to the same constitutional constraints as any other tax on property. That means that an income tax must have a uniform rate and that the tax rate is subject to the one percent cap. The court has rejected prior efforts to characterize an income tax as an excise tax on receiving income. Finally, cities must have express authorization from the legislature to impose a tax. The legislature has not authorized cities to impose an income tax and, under RCW 36.65.030, prohibits cities from levying a net income tax. Finally, the Washington Supreme Court has ruled that the authority of cities to license for revenue does not permit cities to impose an income tax or an excise tax on earning revenue.