

## POLICY NOTE

# Analysis of the recent effort to pass an unconstitutional tax

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### Key Findings

1. Last year Governor Inslee signed a bill to impose a new tax on out-of-state banks.
2. The measure was introduced as a “title-only” bill with no text.
3. Bill sponsors added the text two days before the end of the 2019 legislative session.
4. Democrats in the House passed the bill 24 hours later; the Senate passed the bill and sent it to the governor the next day. No Republicans voted for the bill.
5. Those targeted by the tax said it violated the commerce clause of the U.S. Constitution, which protects citizens against discriminatory state laws.
6. In May 2020 a state court struck down the law as unconstitutional. The ruling is on appeal.
7. Analysts noted that, had lawmakers taken the time to critically examine the bill, passage of an unconstitutional law could have been prevented.

### Introduction

On May 21st last year Governor Inslee signed a bill that imposed a new tax on out-of-state banks. Opponents in the legislature argued the bill violated the interstate commerce clause, illegally targeted certain entities and was unconstitutional. It turns out they were right.

The banks singled out by the tax filed a lawsuit saying it interfered with the right of all Americans to be treated equally when doing business in a particular state. In other words, in normal commerce state law cannot discriminate against the citizens of another state.

Recognizing this principle, the King County Superior Court struck down the bill on May 8th, 2020 just short of one year after the governor signed it. The tax had gone into effect on January 1st, meaning banks that were illegally taxed are owed a refund. The ruling is on appeal.

This Policy Note analyzes of how such a bill could have been passed in the first place, the policy intentions of its sponsors, the arguments presented by legislative opponents, and the legal reasoning of the court that decided the issue. The analysis is a case study in how an unconstitutional law can be enacted at the state level, and the remedy that is available to Americans who are targeted by an unjust law.

The study shows that often only the courts are available to protect the rights of citizens who have no elected representation within a particular state. The positive resolution of the case also prevents other states from retaliating against Washington in an effort to protect their own citizens from unfair laws.

### The text of HB 2167

HB 2167 was introduced as a blank, title-only bill on April 10, 2019 by Rep. Gael Tarleton, (D-Seattle). It had only Democrat support; no Republicans signed on to the bill. The bill stating in the title that, “The legislature intends to enact legislation concerning tax revenue.”<sup>1</sup>

The text was added to the bill in the House Finance Committee and on April 26th passed the committee and was sent to the full House.

<sup>1</sup> House Bill 2167, “An Act relating to revenue...” 2019 Regular Session, Washington State Legislature, April 10, 2019, at <http://lawfilesexternal.wa.gov/biennium/2019-20/Pdf/Bills/House%20Bills/2167.pdf?q=20200624112944>.

Committee Democrats Gael Tarleton, Amy Walen, Mike Chapman, Nicole Marci, Jeff Morris, Tina Orwall, Larry Springer and Sharon Wylie voted for the bill. Committee Republicans Ed Orcutt, Jesse Young, Drew Stokesbary and Brandon Vick voted against it.<sup>2</sup>

After the binding text was added in committee, the bill proposed an additional tax of 1.2 percent on out-of-state financial institutions. This was on top of the existing 1.5 percent state Business and Occupation tax. Both taxes were designed to apply to gross receipts for the year, so that even businesses that “may not have any profits or may be operating at a loss” would still have to pay.<sup>3</sup>

The extra 1.2 percent tax proposed by HB 2167 applied to any person or entity that was a “member of a consolidated financial institution group” that reported “for the previous calendar year annual net income of at least \$1 billion.”<sup>4</sup> Strict penalties were applied to any person or entity that state officials deemed not in compliance.

The bill sponsors defined the new tax so it only applies to out-of-state banks. The provisions were drafted so that no constituent represented by a state lawmaker who voted for the bill would be required to pay the tax.

In sum, the bill text was introduced the afternoon of April 26, 2019, two days before the scheduled end of the 105-day legislative session.

The bill passed the House less than 24-hours later, at 4:00 a.m. on April 27th. It was sent to the Senate Ways and Means Committee at 10:00 a.m. the same day, and passed the full Senate the next day, April 28th, a little over 48 hours after the bill text was introduced. It was sent to the governor on the same day as Senate passage, April 28th.

## **Bill rushed through the legislature**

Regular committee review procedures and the reasonable time required for public comment were suspended and replaced with sham hearings as the bill was rushed to the governor. This procedure directly violated safeguards provided by the state constitution to prevent poorly-drafted legislation and deceptively-enacted laws.

To avoid abuse of power, the state constitution requires that bills be considered for at least ten days before passage. The provision in Article II states:

*“No bill shall be considered in either house unless the time of its introduction shall have been at least ten days before the final*

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2 “Brief Summary of Substitute Bill,” Report, House Committee on Finance, Washington State Legislature, April 26, 2019, at <http://lawfilesexternal.wa.gov/biennium/2019-20/Pdf/Bill%20Reports/House/2167%20HBR%20FIN%202019.pdf?q=20200624112944>.

3 Ibid.

4 Ibid.

*adjournment of the legislature, unless the legislature shall otherwise direct by a vote of two-thirds of all members elected to each house.”<sup>5</sup>*

The hurried process was noted by some lawmakers in floor statements when brought before the full House.

At a quickly-called committee hearing on the bill, a representative of the Washington Banking Association said:

*“We found out about it [HB 2167] about three-and-half hours ago. That is very difficult to process even with the best [committee] staff, it is hard to get information back on a bill of this nature that raises this kind of money in that period of time... We have not seen a fiscal note. We don’t know exactly what this bill does or who it applies to. It is very difficult to even understand how to testify on this bill not knowing that information.”*

During Senate floor consideration Senator Mark Mullet (D - Issaquah), chair of the Financial Institutions Committee, noted that the bill came, “out of the blue, from nowhere”, adding:

*“What is the point of passing a bill if we know we are going to get sued for a violation of the constitution’s commerce clause and then we are going to have to spend a bundle of legal [tax] money defending that lawsuit? We will never get a single penny of revenue from this bill. I think it makes no sense.”<sup>6</sup>*

In a floor statement Senator Steve O’Ban (R-University Place) noted that the bill was “rushed” and “ill-conceived,” and that, “We’re buying a lawsuit; any revenues received will have to subtract what we’re going to have to pay in a legal suit.”<sup>7</sup> As it happened, the bill did lead to a lawsuit, and produced no revenue for the state.

Shortly after passage, on May 13th, a bipartisan group of lawmakers led by Senator John Braun (R-Centralia) wrote to Governor Inslee asking that he veto the bill as an unconstitutional tax.<sup>8</sup> The senators noted that the tax violated the commerce clause of the U.S. Constitution.

In vetoing an earlier bill, one that lowered taxes, Governor Inslee said tax policy “should be considered in a thoughtful, transparent process that incorporates public input and business accountability.”<sup>9</sup> Even so, the senators’ veto request was denied. As noted, Governor Inslee signed the bill on May 21, 2019.

5 When bills must be introduced,” Article II, Section 36, Constitution of the State of Washington.

6 Washington state Senate, floor debate on HB 2167, Financial Institutions Tax, April 28, 2019.

7 Ibid.

8 Letter to the Honorable Jay Inslee from state senators, May 13, 2020, at <http://johnbraun.src.wastateleg.org/wp-content/uploads/sites/16/2019/05/veto-request-letter-HB-2167.pdf>. The other signers were Senators Mullet, Schoesler, Wilcox and Stokesbary.

9 “Veto message on SSB 5977,” by Jay Inslee, Governor, State of Washington, July 7, 2017, at <http://lawfilesexternal.wa.gov/biennium/2017-18/Pdf/Bills/Vetoes/Senate/5977-S.VTO.pdf>.

## Lawsuit against HB 2167

As predicted, those who were harmed by the new tax sued under the U.S. Constitution to protect their civil right against unfair treatment. On November 5th the Washington Bankers Association (ABA) filed a lawsuit against HB 2167 in King County Superior Court.<sup>10</sup> The lawsuit stated:

“The dormant Commerce Clause of the United State Constitution prohibits states from passing protectionist taxes that punish out-of-state business interests and wall their citizens off from free and competitive markets.

“[Upholding HB 2167] will open the floodgates to protectionist taxes from state lawmakers across the country who...are eager to fill their state’s coffers with tax revenues from a select few out-of-state sources while simultaneously providing a home-court advantage to local businesses.”<sup>11</sup>

On May 8, 2020 the court agreed with the Bankers Association that the tax improperly harmed citizens of other states. The court issued a summary judgement finding the tax was unfair and imposed inequitable treatment and struck it down as unconstitutional.<sup>12</sup>

Since its founding, the United States has benefitted from having a single, national market in which each state treats all Americans the same, instead of the national economy being treated like it is composed of 50 separate countries. The principle of non-discrimination in interstate commerce has been long recognized by the courts:

“The Commerce Clause forbids the States to levy taxes that discriminate against interstate commerce or that burden it by subjecting activities to multiple or unfairly apportioned taxation.”<sup>13</sup>

## Raising taxes on the most vulnerable

The taxes imposed by government officials raise costs for consumers. Many lawmakers don’t know, or don’t care about how the taxes they impose raise the cost of living for everyone, and their decisions tend to fall hardest on low-income people and working families.

In analyzing the tax the sponsors of HB 2167 sought to impose, out-of-state banks would have raised their customers fees, or made some other policy change, to cover the tax. That would have conferred a competitive advantage on in-state banks that did not have to pay the new tax.

<sup>10</sup> “Washington Bankers Assoc. et ano. vs. State of Washington et. al.,” King County case no. 19-2-29262-8 SEA, Complaint for Declaratory Relief, November 5, 2019, at <https://www.washingtonpolicy.org/library/docLib/Title-Only-lawsuit.pdf>.

<sup>11</sup> “Washington Bankers Assoc. et ano. vs. State of Washington et. al.,” King County case no. 19-2-29262-8 SEA, Complaint for Declaratory Relief, November 5, 2019, at <https://www.washingtonpolicy.org/library/docLib/Title-Only-lawsuit.pdf>.

<sup>12</sup> “Washington Bankers Assoc. et ano. vs. State of Washington et. al.,” King County case no. 19-2-29262-8 SEA., May 8th, 2020, at <https://www.washingtonpolicy.org/library/docLib/Clerks-minutes.pdf>.

<sup>13</sup> “State taxation and regulation: The modern law, Taxation,” Legal Information Institute, Cornell Law School, accessed June 25, 2020, at <https://www.law.cornell.edu/constitution-conan/article-1/section-8/clause-3/state-taxation-and-regulation-the-modern-law>.



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In-state banks would have seen, however, that they could raise their fees or other customers charges to just below the rate paid by their targeted out-of-state competitors and still maintain their advantage.

In that way the sponsors of HB 2167, had they been successful, would have raised the cost of banking services for all Washington residents. Since access to banking is already difficult for the unemployed, the homeless and low-income families, the added burden of HB 2167 would have fallen disproportionately on these vulnerable groups, while upper-income bank customers would have remained proportionately less affected.

Lawmakers often think they are taxing “banks” and therefore not running the risk of political criticism, but they are actually imposing new costs on bank customers, since any business must pass on a new tax in the form of higher prices and fees.

## **Conclusion**

The basic and essential principle of any just, democratic society is equal treatment under the law.

HB 2167 violated this principle by discriminating against citizens of other states in how they are taxed when doing business in Washington state.

If the discriminatory policy behind HB 2167 were upheld, it would not be long before the legislatures of other states took similar actions on behalf of their own citizens. The result would be that the people of Washington state would hurt as much or more than the citizens of other states by a wide range of discriminatory laws.

The court came to the clear and obvious conclusion – the discriminatory tax imposed by HB 2167 is unconstitutional under the commerce clause.

Lawmakers were warned by members of both parties as the tax was rushed to the floor on the last day of the 2019 session that it was constitutionally suspect. The governor was asked to veto the tax increase by Sen. Braun, Sen. Mullet, Sen. Schoesler, Rep. Wilcox and Rep. Stokesbary. The governor declined to do so.

As Washington Policy Center budget analyst Jason Mercier said at the time, “Had there been any actual time to do a real analysis, it would have become clearer what perilous path it was. You should never pass a tax this way.”<sup>14</sup>

*Washington Policy Center research intern Marissa Gaston contributed to this study.*

<sup>14</sup> “Court overturns state bank tax,” by TJ Martinell, The Lens, May 12, 2020, at <https://thelens.news/2020/05/12/court-overturns-state-bank-tax/>.