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Tax Policy

In Washington State the same class of property, including income, must be taxed uniformly. Graduated income taxes are not uniform and are prohibited. In this article, Seattle University School of Law Adjunct Professor Victoria S. Byerly discusses Seattle's new high income earner tax in light of Washington's prohibition on graduated income taxes.

Will Seattle Be Able to Keep an Income Tax?



BY VICTORIA S. BYERLY

On July 10, 2017, Seattle City Council Members unanimously voted to impose a 2.25% tax on individuals earning over \$250,000 a year and on couples earning over \$500,000 a year who are residents. Ordinance 125339 was signed by Seattle's Mayor on July 14, 2017 and has an effective date of January 1, 2018. SMC 5.65.030(A).

There are around a century of cases in Washington dealing with an income tax, as a tax on property. Each time, the State Supreme Court has ruled that a graduated income tax violates Article VII's requirement of uniformity or the fourteenth amendment of the United States Constitution. The City of Seattle has expected le-

gal battle over Ordinance 125339. Indeed, several law suits are now pending.

Property Uniformly Taxed

Article VII of the Washington Constitution mandates that all taxes be uniform on the same class of property. WA Const. art. VII. Uniformity has been held as the highest and most important of all requirements applicable to taxation under Washington's system. *Belas v. Kiga*, 135 Wn.2d 913 at 938, 959 P.2d 1037 (1998) citing *Savage v. Pierce Co.*, 68 Wash. 623, 625, 123 P. 1088 (1912); *Boeing Co. v. King Co.*, 75 Wash.2d 160, 165, 449 P.2d 404 (1969). Since income has long been defined as property in this state, it must be taxed uniformly, if it is taxed. *Power Inc. v. Huntly et al.*, 39 Wn. 2d 191, 194, 235 P.2d 173 (1951).

In *Power Inc. v. Huntly et al.*, 39 Wn. 2d 191, 194, 235 P.2d 173 (1951) (hereafter *Power*) and *Jensen v. Henneford*, 185 Wash. 209, 53 P.2d 607 (1936) (hereafter *Jensen*), two laws taxing income were at issue. At issue in *Jensen*, was a three percent income tax on the net income of all residents of the state, with a surtax of four percent on all net incomes in excess of \$4,000, which the state legislature had declared as the privilege of receiving income and protections in Washington State, in an attempt to enact an excise tax. *Jensen v. Henneford*, 185 Wash. 209, 53 P.2d 607 (1936). At issue in *Power*, was a law enacted by the state legislature imposing an income tax of four percent on corporate net income. *Power Inc. v. Huntly et al.*, 39 Wn. 2d 191, 194, 235 P.2d 173 (1951). Both laws were held to be unconstitutional using a substance over form approach and, in *Power*, the court recognized that the law was geared to federal income tax legislation. *Id.* at 196.

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What Is Property?

But, was it easy to rule that an income tax is unconstitutional using a substance over form approach? Let's face it. The question before us is: What is property? Black's Legal Dictionary defines it as "The ownership of a thing is the right of one or more persons to possess and use it to the exclusion of others." BLACK'S LAW DICTIONARY (2nd ed.) available at <http://thelawdictionary.org/property/>. According to Merriam Webster's Dictionary, it is "something owned or possessed." MERRIAM-WEBSTER'S DICTIONARY available at <https://www.merriam-webster.com/dictionary/property>. So then, we must ask: Is income something? Looking at Merriam-Webster's Dictionary again leads to the following definition: "whatever may be possessed or owned or be the object of a right." MERRIAM-WEBSTER'S DICTIONARY available at <https://www.merriam-webster.com/dictionary/thing>. According to Black's Law Dictionary, "things" are the most general denomination of the subjects of property, as contra-distinguished from persons." BLACK'S LAW DICTIONARY (2nd ed.) available at <http://thelawdictionary.org/things/>.

When we take a look at both dictionaries for the meaning of income, money, and property, the difficulty becomes apparent. Income is defined as "a gain or recurrent benefit usually measured in money" and income is also defined as "that which comes in or is received. . .without reference to the outgoing expenditures." "Money" is defined as something that is generally accepted as a medium of exchange. MERRIAM-WEBSTER'S DICTIONARY available at <https://www.merriam-webster.com/dictionary/income>; BLACK'S LAW DICTIONARY (2nd ed.) available at <http://thelawdictionary.org/income/>; MERRIAM-WEBSTER'S DICTIONARY available at <https://www.merriam-webster.com/dictionary/money>; and BLACK'S LAW DICTIONARY (2nd ed.) available at <http://thelawdictionary.org/money/>. Can income be both property and an excise? Perhaps, then, it is no wonder why there have been so many years of legal debate (and why Washington has its current tax scheme).

Income as Property

The majority in *Power*, cited to *Culliton et al v. Chase, et al*, 174 Wash. 363 (Wash. 1933), (25 P.2d 81) (1933) (hereafter *Culliton*). It reasoned that "The word 'property' as used herein, shall mean and include everything, whether tangible or intangible, subject to ownership... Income is either property under our Fourteenth Amendment, or no one owns it. . .no more positive, precise, and compelling language could have been used in those words of our Fourteenth Amendment. . .The overwhelming weight of judicial authority is that 'income' is property and that a tax upon income is a tax upon property." *Power* at 194 citing *Culliton et al v. Chase, et al*, 174 Wash. 363 (Wash. 1933), (25 P.2d 81) (1933). At the same time, Justice Steinert recognized the following in his concurrence: "Income is necessarily the product of the joint efforts of the state and the recipient of the income, the state furnishing the protection necessary to enable the recipient to produce, receive, and enjoy it. . .and while a tax on income includes some of the elements both of a tax on property and of a tax on persons, it cannot be classified as strictly a tax on either."

Culliton et al v. Chase, et al, 174 Wash. 363, 390 (Wash. 1933), (25 P.2d 81) (1933).

Years later, the Washington Supreme Court was faced with a case involving a tax on rents that exceeded three hundred dollars a month. *Apartment Operators Ass'n of Seattle, Inc. v. Schumacher, et al.*, 56 Wn.2d 46 (Wash. 1960), 351 P.2d 124 (1960). Even though the state was confronted with a financial need (like in *Power*), our Supreme Court struck down the statute, as unconstitutional. *Id.* As if all of this was not enough, it is noteworthy that the City of Seattle has no inherent taxing power. WA Const. art. VII, §9; WA Const. art. XI, §12.

Amendments Unsuccessful

There have been six attempts by Washington's legislature to amend the State Constitution to permit a tax on net income. All were unsuccessful. H.J.R. 32 in 1934 (43.4% of the electorate voting yes, 56.6% voting no); S.J.R. 7 in 1936 (22.2% yes, 77.8% no); S.J.R. 5 in 1938 (33.1% yes, 66.9% no); H.J.R. 4 in 1942 (31.3% yes, 68.7% no); H.J.R. 42 in 1970 (31.5% yes, 68.4% no); and H.J.R. 37 in 1973 (22.1% yes, 77.1% no).

If the legislature decides to enact an income tax like Seattle's (as an excise tax), that also passes scrutiny under a state and federal constitution, certain resident taxpayers (single, head of household, and qualifying widower) who have total income beyond \$250,000 will be subject to a 2.25% tax. Taxpayers with a filing status of "married filing jointly" with total income in excess of \$500,000 will be subject to a 2.25% tax. SMC 5.65.030(B). Total income, at least as the City of Seattle has defined it, is limited to the figure on line 22 of federal income tax form 1040, line 15 on federal income tax form 1040A, and line 9 on federal income tax form 1041. This tax would apply so long as the taxpayer resided in Seattle for at least half of the calendar year. SMC 5.65.020(D),(E), and (G). An exception exists for taxpayers who can prove to the Director that his/her presence in the City is only for temporary or transitory purposes; presumably, the Director would consider all the facts and circumstances in this situation. As a result, it is possible that a person who is in the City only for the purpose of probating a family member's estate might not be subject to the tax.

Residents who may not have ever reached the income thresholds subjecting them to tax, may be subject to it if they sell a business or rental property. As a result, the local business owned by a married couple, who sells it for \$600,000 will be subject to the tax, even if the sale is supposed to fund their retirement. A credit is available for tax paid to another state, like California. SMC 5.65.060. Like the federal counterpart, tax returns would be due on April 15, extensions are permitted, and an assessment may be made by the Director for additional taxes, penalties, and interest. SMC 5.65.070(G), SMC 5.65.090(D), and SMC 5.65.100. In summary, there are many similarities to the Internal Revenue Code that cannot be discussed in detail in this article simply because the purpose here is to provide some insight. It is for the same reason that a more in-depth discussion regarding property, income, and constitutional law cannot be discussed here.

If Seattle wanted a legal challenge, it certainly took one on. Many eyes will be on our State, and many may

reconsider whether or not to reside in Seattle, if the City winds up with an income tax.