Hon. Mary Roberts
Oral Argument: Friday May 28, 2021
9:00 a.m.

IN THE SUPERIOR COURT OF THE STATE OF WASHINGTON
FOR KING COUNTY

GREATER SEATTLE CHAMBER OF COMMERCE d/b/a SEATTLE METROPOLITAN CHAMBER OF COMMERCE, Plaintiff, v. CITY OF SEATTLE, Defendant.	No. 20-2-17576-5 SEA DEFENDANT CITY OF SEATTLE'S MOTION FOR SUMMARY JUDGMENT

I. INTRODUCTION AND RELIEF REQUESTED

This case concerns the City of Seattle's payroll expense tax or "PET." The PET is a tax on businesses that spend $7 million or more on payroll in the City. Simply put, the PET is an excise tax on businesses for the privilege of doing business in the City, measured by the payroll expense of the business. The business pays the tax, *not* the employee. Indeed, the business is prohibited from deducting the tax from its employees' compensation.

The Washington State Attorney General issued an opinion in 1951 declaring that cities may impose just such a tax on employers measured by payrolls. The PET also resembles the unemployment compensation tax imposed on employers by Washington and other states, as well as

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the payroll expense taxes imposed by other U.S. cities.

Plaintiff asks this Court to rule that the tax applies not to the business as the ordinance dictates, but to the employee's "privilege to earn a living," ignoring the City's broad legislative authority and specific legislative intent. Plaintiff's position also contradicts longstanding Washington law that allows cities to impose excise taxes on the privilege of engaging in business. The case that forms the gravamen of plaintiff's Complaint, *Cary v. Bellingham*, 41 Wn.2d 468, 250 P.2d 114 (1952), is plainly inapposite. *Cary* struck down a requirement that individual employees obtain a license and pay a percentage of their earnings to be authorized to work. *Id.* at 471.

This Court should dismiss plaintiff's complaint and rule as a matter of law that the City's PET is a valid excise tax on businesses under the taxing authority granted to cities by the Washington State Constitution and statutes.

II. STATEMENT OF FACTS

On July 6, 2020, the Seattle City Council passed Ordinance 126108, imposing a payroll expense tax on certain entities engaged in business in the City. (Declaration of Kent Meyer, Ordinance attached Ex. A.) That same day, the Council also passed Ordinance 126109, which established a spending plan for the proceeds generated by the PET. (Ex. B, p. 1.) The Council passed these ordinances during the COVID-19 civil emergency declared by the Mayor, the Governor, and the President of the United States. (Ex. A, p 1; Ex. B, pp. 6-7.)

The Council made extensive findings that supported these ordinances, including that the "COVID-19 crisis has had a significant impact on the local economy impacting the retail, restaurant, construction, gig economy, and other industries resulting in layoffs and reduced work hours for a significant percentage of this workforce and loss of income for small businesses." (Ex. B, p. 7.)

The Council found that before the pandemic struck, at least 38,000 businesses operated in the

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City, employing at least 655,000 people. (Ex. B, p. 7.) The pandemic severely affected that figure. In the Seattle/Bellevue/Everett area, the unemployment rate rose from 5.6 percent in March 2020 to 14.5 percent in April 2020. (Ex. B, p. 7.) That equated to approximately 248,000 unemployed individuals facing financial peril after just one month. *Id*. The Council further found:

- The impacts from the pandemic are "felt most strongly by low income workers, people of color, immigrants, and members of the LGBTQIA community, who have become unemployed or had their work hours severely reduced and will have both immediate and long-term impacts." (Ex. B, p. 7.)

- The pandemic posed "a serious threat to the housing stability of households" that will extend beyond 2020. (Ex. B, p. 8.)

- The economic impacts from the COVID-19 emergency "are drastic and immediate but are also expected to last much longer than the civil shut-down emergency itself." (Ex. B, p. 8.)

- Providing financial assistance to small businesses was necessary to prevent them from having to close permanently due to the hardships associated with government-mandated closures and public health practices. (Ex. B, pp. 7-8.)

The pandemic also caused a dramatic decline in the City's General Fund. (Ex. B, pp. 9-10.) The City Budget Director estimated that the City faced a reduction in General Fund revenues for 2020 of between $113 million and $300 million. (Ex. B, pp. 9-10.) The City faced both reduced revenues and a historic demand for assistance from its residents and businesses. The City Council enacted the PET in direct response to this crisis. (Ex. B, p. 10.)

The City estimated that the PET would generate $214.3 million in new revenue annually. (Ex. A, p. 26.)[1] To that end, the City Council stated:

> The City will impose a new payroll tax through Council Bill 119810 that is expected to provide new and sufficient revenues to allow the City, in 2021, to replenish emergency funds used in 2020 to make public assistance available to households most impacted by the COVID-19 civil emergency and to provide resources to maintain services and provide longer terms solutions to address the

[1] The fiscal note to the ordinance estimated annual revenue of $173.5 million. (Ex. C, p. 2.) A subsequent amendment increased the rates and the annual revenue estimate. (Ex. A, p. 26.).

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inequities exacerbated by the COVID-19 crisis.

(Ex. B, p. 10; Ex. A, pp. 1-5.) From 2022 on, the tax proceeds will help fund affordable housing investments, Equitable Development Initiative projects, and support for local business and workforce stability. (Ex. B, pp. 1-6; Ex. C, p. 3.)

The City Council enacted the PET because it is a progressive tax that is "based on the concept of ability to pay." (Ex. A, p. 4.) The Council's consideration of a PET relates back to at least 2017, when the Council passed Resolution 31782. (Ex. A, pp. 4-5; Ex. D.) That resolution established a "Progressive Revenue Task Force" to "determine new sources of progressive revenues" and expressed the Council's intent to impose new progressive taxes. (Ex. A, pp. 4-5; Ex. D, p. 9.) The Task Force consisted of councilmembers, community members, subject matter experts, and small and large business owners. (Ex. D, p. 7.)

The Task Force issued a report that recommended several taxes, including a per-employee "head tax" and a PET. (Ex. A, p. 5; Ex. E, pp. 3-8, App. B-1, B-2.) The Task Force determined that a tax on employers is "inherently progressive . . . because it is levied on *employers* rather than individuals or households . . ." (Ex. E, p. 4 (emphasis in original).) The Task Force also found that basing a tax on an employer's payroll, rather than just on the number of employees as with a head tax, would make the tax more progressive and equitable. (Ex. E, p. 4, App. B-2, p. 1.) The PET on employers is consistent with the Task Force's report and the Council's intent to impose a progressive tax. (Ex. A, p. 5; Ex. D; Ex. E.)

The PET applies to every business entity "engaging in business within Seattle." SMC 5.38.030.A.[2] It is based on each covered business's "payroll expense," which is defined as "compensation paid in Seattle to employees." SMC 5.38.030. "Compensation" includes all

[2]SMC ch. 5.38, which imposes the PET, is set forth in Ordinance 126108, attached as Ex. A.

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remuneration as defined in RCW 50A.05.010 for the Washington Family and Medical Leave Act "earned for services rendered or work performed." SMC 5.38.020. Compensation includes wages, commissions, salaries, stock grants, and most other earnings that employers commonly pay to employees. *Id*. SBTR 5-980 §2(a).[3]

Any business with payroll expense in the prior calendar year of less than $7 million is exempt from the tax. SMC 5.38.040.A; SBTR 5-980, p. 2. Because of the thresholds and exemptions, not all businesses in the City will pay the tax. It is estimated that the tax will apply to approximately 800 businesses, which is a fraction of the businesses in the City.[4]

The tax has a progressive rate structure, with three tiers that increase as a business's payroll expense in Seattle increases. SMC 5.38.030.B; SBTR 5-980 §3. Rates are applied to the payroll expense of employees with annual compensation of $150,000 or more. *Id.* SBTR 5-980 contains examples that illustrate the amount of tax owed by businesses of various sizes. For example, if a company has payroll expense of $10 million, with 55 employees earning $100,000 per year, 10 employees earning $200,000 per year, and 5 employees earning $500,000 per year. That company would pay $56,000 in tax. SBTR 5-980 § 3, example 14.

The tax is levied on the business entity, not the employee, and taxpayers "may not make any deductions from employees' compensation to pay" for the tax. SMC 5.38.030.C; SBTR 5-980 §10.

The tax became effective January 1, 2021. (Ex. A, §13.) But the council delayed the date of the first payment to January 31, 2022. SMC 5.38.060.

[3] The City's Finance Director has published a rule to facilitate the administration and calculation of the tax. *See* Seattle Business Tax Rule ("SBTR") 5-980 (attached as Ex F).

[4] *See e.g.,* Daniel Beekman, *Seattle Times*, "Seattle City Council passes 'JumpStart' tax on high salaries paid by big businesses" (July 6, 2020), *available at* www.seattletimes.com/seattle-news/politics/seattle-city-council-passes-new-jumpstart-tax-on-high-salaries-paid-by-big-businesses/.

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III. STATEMENT OF ISSUES

Whether the City may impose a tax on businesses engaged in business in the City, measured by their payroll expense?

IV. EVIDENCE RELIED UPON

This motion relies on the Declaration of Kent Meyer and its attached exhibits A through F, incorporated herein by reference.

V. LEGAL AUTHORITY AND ARGUMENT

A. As a matter of law, the City's payroll expense tax falls within the constitutional taxing power vested in the City by the state legislature.

1. The City's tax is presumed constitutional and plaintiff has the heavy burden of proving the contrary.

The City's payroll expense tax is constitutional as a matter of law. A city's statutory authority and the constitutional limitations on that authority are issues of law for the Court to decide. *See Okeson v. City of Seattle*, 150 Wn.2d 540, 548-49, 78 P.3d 1279 (2003); *Lakehaven Water & Sewer Dist. v. City of Fed. Way*, 195 Wn.2d 742, 757, 466 P.3d 213 (2020) (summary judgment is appropriate when there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law); *Avanade, Inc. v. City of Seattle*, 151 Wn. App. 290, 297, 211 P.3d 476, 479 (2009).

To start, the City's tax ordinance is "presumed to be valid and constitutional" and "the challenging party has the burden of showing unconstitutionality." *Watson v. City of Seattle*, 189 Wn.2d 149, 158, 401 P.3d 1 (2017). *See also Larson v. Seattle Popular Monorail Auth.*, 156 Wn.2d 752, 757, 131 P.3d 892 (2006) (taxpayer must show "that there is no reasonable doubt that the statute violates the constitution"); *Bellevue v. State*, 92 Wn.2d 717, 720, 600 P.2d 1268 (1979) (challenger bears the burden of demonstrating the invalidity of an ordinance beyond a reasonable doubt); *Silver*

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Shores Mobile Home Park, Inc. v. City of Everett, 87 Wn.2d 618, 624, 555 P.2d 993 (1976) ("Every presumption will be in favor of the constitutionality of an ordinance."). The reviewing court "gives considerable deference" to the construction of the challenged ordinance "by those officials charged with its enforcement." *Ford Motor Co. v. City of Seattle*, 160 Wn.2d 32, 42, 156 P.3d 185 (2007). The City's tax is presumed constitutional and plaintiff must show beyond a reasonable doubt that it is not.

2. Cities have extensive taxing authority under the Washington State Constitution.

The Washington State Constitution authorizes the legislature to grant cities the power to levy taxes for local purposes. *See Watson,* 189 Wn.2d at 166-167. Article VII, § 9 provides that "[f]or all corporate purposes, all municipal corporations may be vested with authority to assess and collect taxes…." *Id.* Further, Article XI, § 12 authorizes the legislature to grant municipalities the power to levy taxes for "county, city, town, or other municipal purposes." *See Larson v. Seattle Popular Monorail Auth.*, 156 Wn.2d at 758 (legislature may delegate power to tax to municipal corporations). Local taxes must serve local purposes, but otherwise these constitutional provisions do not limit the objects or subjects of municipal taxation. *See City of Wenatchee v. Chelan Cnty. Pub. Util. Dist. No. 1*, 181 Wn. App. 326, 337, 325 P.3d 419 (2014).

In *Watson*, the court relied on these constitutional provisions to uphold the City's excise tax on "making retail sales of firearms or ammunition." *Watson,* 189 Wn.2d at 168. The court noted that "these provisions reflect Washington's adoption of what scholars refer to as 'home rule,' shorthand for the presumption of autonomy in local governance." *Id.* at 166.[5] The court held that home rule "seeks to increase government accountability by limiting state-level interference in local affairs." *Id.* at 167. By pushing power to the local level and reducing interference by the legislature, home rule

[5] *Citing* Hugh Spitzer, "Home Rule" vs. "Dillon's Rule" for Washington Cities, 38 Seattle U. L. Rev. 809, 839-42 (2015).

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increases government accountability, which is "particularly important with respect to local taxation authority." *Watson,* 189 Wn.2d at 166. The court concluded: "In this context, it is appropriate for Washington courts to liberally construe[ ] legislative grants of power to cities, particularly first-class cities." *Id*. (citation omitted). *See also Lakehaven,* 195 Wn.2d at 755 (court must liberally construe legislative grant of taxing authority in favor of city).

The converse is also true: exceptions to legislative grants of taxing power are narrowly construed. *See Shoulberg v. Pub. Util. Dist. No. 1,* 169 Wn. App. 173, 179, 280 P.3d 491 (2012). Here, the legislature's liberal grants of taxing authority allow the City to adopt a payroll expense tax on businesses engaged in business in the City.

3. The State Legislature has authorized the City to impose excise taxes such as this payroll expense tax.

The legislature has authorized the City to levy excise taxes under three statutes. First, under RCW 35.22.280(32), first class cities like Seattle are authorized to "grant licenses for any lawful purpose, and to fix by ordinance the amount to be paid therefor…." As the Washington Supreme Court has explained, the licensing power granted to first class cities is dual: cities have the right to impose license taxes either for the lawful purpose of regulation or for the lawful purpose of raising revenue. *Watson,* 189 Wn.2d at 168. When the power is exercised for revenue purposes, licensing is "merely the method provided for raising the revenues." *Id*. (quotation omitted). The *Watson* court held: "Absent restriction, RCW 35.22.280(32) grants Seattle broad authority to tax retailers for the privilege of doing business within city limits." *Watson*, 189 Wn.2d at 170.

Second, under RCW 35A.82.020, code cities are authorized 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…." As a first-class city, the City of Seattle possesses the same excise tax authority granted to code cities. *See*

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RCW 35.22.570; *Watson*, 189 Wn.2d at 170 n. 7-8. Under RCW 35A.01.010, this broad taxing power is liberally construed in favor of the city imposing the tax. *Lakehaven,* 195 Wn.2d at 755.

Third, the City has authority to impose its payroll expense tax under RCW 35A.11.020, which confers "all powers of taxation for local purposes" within the City's territorial limits subject only to constitutional and statutory constraints.[6] This statute provides a sweeping grant of tax authority that reflects the legislature's decision to implement the "home rule" principle for Washington cities. *Lakehaven*, 195 Wn.2d at 757.[7] Nothing in the Constitution or state law excludes a tax on business measured by payroll expense as a subject of municipal taxation. The City's tax is thus authorized by the comprehensive tax authority granted under RCW 35A.11.020.

Washington's constitution expressly enables the legislature to grant cities broad taxing powers, the legislature has done so, and the supreme court has repeatedly affirmed the extensive authority of cities to impose excise taxes for raising revenue.

B. The City has the authority to impose an excise tax on the privilege of doing business in the City, measured by the payroll expense of the business.

1. The incident, measure, and rate of the City's PET establish that the tax is not a tax on the employee's right to earn a living.

Contrary to plaintiff's claim, the PET is not a tax on the employee's right to earn a living. It is an excise tax on businesses for the privilege of doing business in Seattle. Regardless of the label a legislative body affixes to a tax, it is the court's role to determine the nature and effect of the tax. *Power, Inc. v. Huntley*, 39 Wn.2d 191, 196, 235 P.2d 173, 176 (1951) (*citing Jensen v. Henneford*,

[6] Under RCW 35.22.570, Chapter 35A.11 RCW applies to first class cities. *Watson*, 189 Wn.2d at 170, n. 8.

[7] In 1965, the legislature convened a committee to prepare a code of laws for city governments with "a form of statutory home rule" *Lakehaven*, 195 Wn.2d at 757. The committee report preceding Title 35A RCW's enactment noted that one of the drafters' basic objectives was "[t]he *broad grant of home rule authority to municipalities"* and a "*clear mandate to abandon the so-called* "*Dillon's Rule*" *of construction.*" *Id., citing* Mun. Code Comm., Wash. State Legislature, A Review of the Objectives of the Municipal Code Committee 2 (1966) (emphasis added by court).

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185 Wn. 209, 53 P.2d 607, 608 (1936)). However, the "primary objective of courts interpreting an ordinance is to 'ascertain and carry out the legislature's intent' by giving effect to the ordinance's 'plain meaning.'" *Watson*, 189 Wn.2d at 158 (*citing Arborwood Idaho, LLC v. City of Kennewick*, 151 Wn.2d 359, 367, 89 P.3d 217 (2004)).

The supreme court has outlined a structure for analyzing taxes. First, a tax "must fall into one of three categories: property, income, or excise taxes." *Watson*, 189 Wn.2d at 167–68; *Lakehaven*, 195 Wn.2d at 754. Second, these taxes possess three common elements: the incident, the measure, and rate:

- The *incident* is the "activity that the legislature has designated as taxable."
- The *measure* is the "base that represents the value of the taxable incident."
- The *tax rate* is that "which, when multiplied by the tax measure, determines the amount of tax due."

Ford Motor Co. v. City of Seattle, 160 Wn.2d 32, 39, 156 P.3d 185 (2007) (*citing* 1B *Kelly Kunsch et al*., Washington Practice: Methods Of Practice § 72.3, at 449 (1997)). As discussed below, the incident of the PET is engaging in business in the City, the measure is the payroll expense of the business, and the tax rates are set out in the code. SMC 5.38.030.

2. The incident of the PET is on *engaging in business* in the City, not, as plaintiff asserts, the employee's act of earning a living.

Washington courts have repeatedly ruled that "excise taxes are levied on an activity—such as the sale, consumption, or manufacture of goods—or upon a privilege or license granted by the state." *Kunath v. City of Seattle*, 10 Wn. App.2d 205, 213–14, 444 P.3d 1235 (2019), *review denied*, 195 Wn.2d 1013, 460 P.3d 183 (2020) (*citing Culliton v. Chase*, 174 Wn. 363, 377–78, 25 P.2d 81, 83 (1933)). In *Sheehan v. Cent. Puget Sound Reg'l Transit Auth*., 155 Wn.2d 790, 799–800, 123 P.3d 93

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(2005), the court held:

> [E]xcise taxes require two conditions: First, excise taxes are imposed upon a voluntary act of the taxpayer, which affords the taxpayer the benefits of the occupation, business, or activity that triggers the taxable event. Second, excise taxes are directly imposed based upon the extent to which the taxpayer enjoys the taxable privilege.

See also Covell v. City of Seattle, 127 Wn.2d 874, 889, 905 P.2d 324 (1995); *High Tide Seafoods v. State*, 106 Wn.2d 695, 699, 725 P.2d 411 (1986).

For example, the Washington Supreme Court held that the City's "B&O tax is an excise tax imposed upon the act or privilege of engaging in business activities, for which the taxing authority provides services, measured by the application of a legislatively set rate against a valuation of the operation of the business, established by some standard such as gross revenues, gross sales, gross income, or the valuation of products." *City of Seattle v. Paschen Contractors, Inc*., 111 Wn.2d 54, 57, 758 P.2d 975, 977 (1988). The PET is also an excise tax imposed on the privilege of engaging in business, but with a different measure than the B&O tax—payroll expense instead of gross receipts.

In *Watson*, the court held that it "categorizes business license taxes as excise taxes." *Id.* at 167 (*citing Pac. Tel. & Tel Co. v. City of Seattle*, 172 Wash. 649, 654, 21 P.2d 721 (1933), *aff'd*, 291 U.S. 300, 54 S.Ct. 383, 78 L.Ed. 810 (1934)). The court in *Watson* explained that an excise tax is based on a city's authority to license for revenue:

> As the court explained in *Pacific Telephone*, the "power granted to the city to issue licenses is dual: (1) for regulation; (2) for revenue." *Id*. When the power is exercised for revenue purposes, licensing is merely the "method provided for raising the revenues." *Id*. A tax that is imposed pursuant to this power is an excise because it is "levied upon the right to do business, not upon the right to exist." *Id*. The most common tax paid by Washington businesses, the business and occupation (B & O) tax, is an excise tax. *See* Tax Reference Manual, *supra*, at 3 (noting that although a B & O tax is measured by gross income or receipts, "it is levied on the privilege of engaging in business and is categorized ... as an excise tax"). In this case, the Ordinance imposes a different type of excise tax: a flat tax on "the business of making retail sales of firearms or ammunition."

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Watson, at 167-68. *See also Dravo Corp. v. City of Tacoma*, 80 Wn.2d 590, 597–98, 496 P.2d 504 (1972) (city empowered to tax activity within its jurisdiction because it provides environment of services and protection, which enable the taxpayer to engage in the activity that is the subject of the tax).[8] The City's payroll expense tax is an excise tax on businesses imposed under the power vested in the City by the state legislature and the State constitution.[9]

C. **The Attorney General concluded that a city may impose an excise tax on businesses that is measured by the payroll expense of each business.**

The Washington State Attorney General has issued an opinion directly on point. In response to the question of whether a city could impose a payroll expense tax on businesses, the Attorney General declared: "[a] city may impose a tax for general revenue purposes upon employers based on payrolls for persons employed within the city." 1949-51 Wash. Att'y Gen. Op. No. 469 (1951). The Attorney General said that the power of cities to impose "excises as licenses to do business" has "long since been established by statute and upheld by the courts." *Id*. The Attorney General confirmed that "payrolls as a measure of such excise" are reasonable, related to the privileges enjoyed, and that "all objections to a tax measured by payrolls . . . have been laid to rest by the Supreme Court of the United States . . . ." *Id.*[10] The Attorney General concluded by stating:

> It is our opinion that a city may, under its power to license for revenue purposes, impose a tax upon those employers within its borders measured by its payroll for persons employed within the city.

[8] In addition to the power to tax, the Washington Constitution grants cities, in a separate provision, police power to regulate businesses. *Arborwood*, 151 Wn.2d at 366; Const. art. XI, § 11. *See, e.g. Filo Foods, LLC v. City of SeaTac*, 183 Wn.2d 770, 357 P.3d 1040 (2015) (approving use of police power to set minimum wage).

[9] Cities impose other excise taxes with different incidents, measures, and rates. *See* Municipal Research & Services Center, *A Revenue Guide for Washington Cities and Towns*, pp. 61-121 (November 2020) (city excise taxes include B&O, Sales and Use, Lodging, Real Estate, Admissions; Commercial Parking, Gambling, Gas, Timber; Utilities).

[10] *Citing Carmichael v. Southern Coal Co*., 301 U.S. 495 (1937) (upholding tax on Alabama employers based on payrolls to support state Unemployment Compensation Fund), *Steward Machine Co. v. Davis*, 301 U.S. 548 (1937) (upholding federal excise tax on employers' payroll expense to fund social security).

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1951 Att'y Gen. Op. No. 469.

Attorney General opinions construing the State Constitution or interpreting statutes are generally entitled to "great weight" by the courts. *Five Corners Family Farmers v. State*, 173 Wn.2d 296, 308, 268 P.3d 892 (2011); *Belas v. Kiga*, 135 Wn.2d 913, 928, 959 P.2d 1037 (1998). The City's tax is precisely the type of tax that the Attorney General declared to be lawful. This Court should give the Attorney General's opinion the great weight to which it is entitled, and uphold the PET.

D. **The City's tax is similar to the payroll expense taxes and "head taxes" imposed by the state and by other cities and recognized by municipal law treatises.**

1. The State of Washington, and other states and cities, impose payroll expense taxes on businesses.

There is nothing unique or unusual about the PET. In addition to the Washington Attorney General's confirmation seventy years ago that cities can impose this tax, the state of Washington itself imposes a payroll expense tax on employers. Under Title 50 RCW, Washington employers pay Unemployment Compensation Tax on the first $56,500 of each employee's taxable wage base. RCW 50.24.010. *See also* RCW 50.04.072 (employer's payments "deemed to be taxes due to the state of Washington"); Wash. State Dep't of Revenue Tax Reference Manual, p. 123 (2018); Employment Security Dept. website (esd.wa.gov); *Bates v. McLeod*, 11 Wn.2d 648, 654, 120 P.2d 472 (1941) (State Unemployment Compensation Act imposes on employers "an excise tax upon the privilege of employing others").

The State enacted its payroll expense tax in 1937 and has amended it repeatedly since then, including major revisions to the tax structure in 2005. *See* Wash. State Dep't of Revenue Tax Reference Manual, p. 123. There is no relevant legal distinction between the City's and the State's payroll expense taxes. Both taxes are imposed on employers engaged in business in the taxing jurisdiction and are measured by the employer's payroll expense.

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Other states fund their unemployment compensation programs with taxes measured by the payroll expense of employers. Many, like Washington, impose the tax upon the employer and prohibit deductions from wages, mirroring the scheme of the PET. *E.g.* Ariz. Rev. Stat. § 23-726(A); Colo. Rev. Stat. § 8-76-101; Fla. Stat. § 443.131(1); Ga. Code § 34-8-150(a); Idaho Code § 72-1349(2); Ind. Code § 22-4-10-1(a),(h); Me. Rev. Stat. tit. 26, § 1221(1)(A); Md. Code, Lab. & Empl. § 8-607(f); Mont. Code § 39-51-1103(2); Nev. Rev. Stat. § 612.535(1); N.M. Stat. § 51-1-9(A); N.Y. Lab. Law § 570(6); N.C. Gen. Stat. § 96-9.2(a); N.D. Cent. Code § 52-04-01(1); Tex. Labor Code § 204.003. Others, like California, divide the burden between employer and employee. *See* Cal. Unemp. Ins. Code § 984.

In addition to those state taxes, the City's PET is similar to the payroll expense taxes that other cities impose on businesses, including:

- San Francisco (until January 2021, imposed a payroll expense tax on "every person engaging in business within the City")
- Pittsburgh (payroll expense tax on employers "conducting business activity within the City")
- District of Columbia (employers pay a percentage of the wages of covered employees)
- Eugene (tax on all employers in the city based on the amount of wages paid by the employer).[11]

Plaintiff's argument that the PET is an unconstitutional tax on the right to earn a living contradicts the fact that states and cities throughout the nation have imposed such taxes on employers, not employees, and those jurisdictions have recognized the distinction.

2. Municipal law treatises affirm the validity of payroll expense taxes.

The leading municipal law treatise, *McQuillan*, recognizes that a payroll expense tax is a

[11] S. F. Bus. & Tax Reg. Code, art. 12–A, § 903; Pittsburgh City Code, Title II, Article VII, Sec. 258.02-258.03; Code of the District of Columbia, § 32–541.03; Eugene City Code, § 3.754.

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"valid tax measure" to be imposed by cities:

> A payroll expense tax levied upon persons engaging one or more persons to perform services in a given municipality is a valid tax measure.

16 McQuillin Mun. Corp. § 44:54 (3d ed.) (footnotes omitted).

Another municipal law treatise, *Matthews*, contains a model payroll expense tax ordinance. *Matthews Municipal Ordinances* § 32:16 (3d ed.). The model ordinance imposes, similarly to the City's ordinance, a tax on "every person, firm, corporation or association doing business within the boundaries of the city." *Id*. The *Matthews* model ordinance tax is measured by the taxpayer's "payroll expense," which includes the "compensation paid by any employer to any employee, including wages, salaries, commissions, bonuses and all other kinds of employee compensation whatsoever." *Id*.

Contrary to plaintiff's assertion that the City's tax is an unconstitutional tax on the right to earn a living, many cities and states impose payroll expense taxes like the City's tax. The Washington State Attorney General, courts, and legal treatises all have recognized for decades that a payroll expense tax is a valid form of excise tax on businesses.

3. The "head taxes" imposed by other Washington cities are also excise taxes measured by the size of the business's payroll.

Several Washington cities impose "head taxes" on businesses. Those cities typically apply a flat rate measured by the number of full-time employees on the payroll in a city. As with the City of Seattle's tax, the amount of tax owed rises and falls based on the number of the taxpayer's employees on its payroll and, for some cities, the number of hours worked. For example, these Washington cities impose head taxes based on the number of employees working in the city:

> Bothell (BMC § 5.04.400-.410; Resolution No. 1393, p. 9)
> Ellensburg (EMC § 6.54.120)
> Lynnwood (LMC Table 3.104.050)
> Mill Creek (MCMC §§ 3.42.050, 5.04.060)

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Redmond (RMC § 5.04.080)
Kirkland (KMC § 7.02.160)
Sunnyside (SMC § 5.52.020).

See Mun. Research Servs Ctr, *A Revenue Guide for Cities and Towns*, pp. 83, 91-93 (2020).

A head tax is similar to a payroll tax in that taxpayer's tax burden may rise if it hires more employees or if its hourly employees work more hours. Similarly, the PET is a type of head tax that bases the tax on not just the number of "heads," but also on how much each head is paid. But neither a head tax nor a payroll expense tax is a tax on the right to earn a living.

E. The tax in *Cary v. Bellingham* was on the *employee,* not on the *business* like the payroll expense taxes imposed by the City of Seattle and the State of Washington.

Plaintiff bases its case on the Washington Supreme Court's decision in *Cary v. City of Bellingham*, 41 Wn.2d 468, 250 P.2d 114 (1952). But that case hurts rather than helps plaintiff. *Cary* expressly recognized the authority to tax "those engaged in a business activity [while excluding] those performing the same activity as employees." *Cary*, 41 Wn.2d at 471. The court said, "[W]e have recognized an inherent, fundamental difference between one engaged in business for himself and one who is simply employed by others." *Id*.

In *Cary*, the City of Bellingham imposed a tax on *employees*, requiring "that all employees within the city of Bellingham secure a yearly license." *Id*. at 468. In other words, the incident of Bellingham's tax was the activity of *being employed*. Likewise, the *measure* of Bellingham's tax was the *individual employee's* "gross income, revenues, receipts, and commissions" received for their services. *Id*. at 468-469. The issue presented to the *Cary* court was "whether the activity of working for salaries or wages may be reached by the city's excise tax." *Cary*, 41 Wn.2d at 470.

The court struck down the tax and held that "[t]he right to earn a living by working for wages is not a 'substantive privilege granted or permitted by the state.'" *Cary*, 41 Wn.2d at 472 (*quoting Power Inc. v. Huntley*, 39 Wn.2d 191, 53 P.2d 173 (1951) (holding a corporate net income tax

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unconstitutional as a property tax because taxpayers were liable by nature of receiving net income, not by nature of operating a business)). The court said that the right of individuals to earn a living by working for wages was "one of those inalienable rights covered by the statements in the Declaration of Independence and secured to all those living under our form of government by the liberty, property, and happiness clauses of the national and state Constitutions." *Id.* (internal citation and quotation to Wyoming case law omitted).

The *Cary* court relied on two Washington cases that upheld the state B&O tax that applied to employers but not to employees. *Id*. at 471 (*citing State ex rel. Stiner v. Yelle*, 174 Wash. 402, 411, 25 P.2d 91 (1933); *Supply Laundry Co. v. Jenner*, 178 Wash. 72, 75, 34 P.2d 363 (1934)). In the present case, plaintiff's reliance on *Cary* is at odds with the court's consistent distinction between a tax on employees, as in *Cary*, and on the businesses that employ them, as in *Stiner*, *Supply Laundry*, and the City's tax.

Cary's holding is fundamentally inapplicable to the PET, which is levied on businesses based on their aggregate payroll expense, and which the City has expressly prohibited businesses from passing on to employees in the form of wage deductions. The PET does not require employees to pay any taxes, much less burden their "right to earn a living by working for wages."

F. Plaintiff asks the Court to ignore the plain language of the ordinance, to disregard the City Council's intent to tax businesses, and to misconstrue the ordinance as imposing a tax on employees' right to earn a living.

1. The Court should carry out the Council's intent by giving effect to the plain meaning of the tax ordinance.

Plaintiff asks the Court to disregard the plain language of the ordinance, that applies the tax to businesses, and instead rule that it applies to the right to earn a living in violation of *Cary*. (Complaint, ¶ 3.) But the "primary objective of courts interpreting an ordinance is to 'ascertain and carry out the legislature's intent' by giving effect to the ordinance's 'plain meaning.'" *Watson*, 189

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Wn.2d at 158 (*citing Arborwood Idaho, LLC v. City of Kennewick*, 151 Wn.2d 359, 367, 89 P.3d 217 (2004)). Courts will impose restraints on a city's taxing authority only if the legislature has provided "specific, express statutory language" to restrain that authority. *Watson,* 189 Wn.2d at 170 (*citing Enterprise Leasing, Inc. v. City of Tacoma*, 93 Wn. App. 663, 669, 970 P.2d 339 (1999).

Plaintiff's argument contradicts the plain language of the ordinance. The PET is imposed on businesses and "shall constitute a part of the operating overhead or cost of doing business." SMC 5.38.030, 5.38.090. The ordinance states that a "business may not make any deductions from employees' compensation to pay for this tax." SMC 5.38.090. Simply put, the taxpayers' employees do not pay the tax. There are no grounds for the Court to disregard the plain language of the PET.

2. The measure of the tax does not determine the identity of the taxpayer or the nature of the tax.

Plaintiff incorrectly contends that "examining how the tax is applied and measured, demonstrates that the Ordinance is, in substance and in truth, a tax on the privilege to earn a living." (Complaint, ¶ 3.) But using payroll expense as the *measure* of the tax does not transform the tax on businesses into a tax on the right of employees to earn a living. Washington courts have repeatedly held that the measure of the tax does not transform its nature. Or, as the court said *Lorillard Co. v. City of Seattle*, 83 Wn.2d 586, 591, 521 P.2d 208 (1974), "[t]he character of the imposition is not determined by the mode adopted in fixing its amount." (Internal citations omitted).

In *Lorillard*, a wholesale seller of cigarettes objected to paying the City's B&O tax that was imposed on the "privilege of engaging in business activity within the city." *Id.* at 587. The B&O tax was measured by the gross receipts of wholesale sales. *Id.* The seller argued that the City's tax was preempted by the state's per-cigarette tax, which "preempts the field of imposing taxes . . . upon cigarettes." *Id.* The court ruled that the City's tax was not preempted because the state's per-cigarette tax was "not of the same nature" as the City's B&O tax:

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> What is being taxed is the privilege of doing business within the city. In return for this tax the business receives the myriad services provided by municipal government. The measure is gross proceeds of wholesaling. Plaintiff is subject to the city's business and occupation tax not because it wholesales cigarettes, but because it is a wholesaler.

Lorillard, 83 Wn.2d at 590. The B&O tax on engaging in business did not become a preempted tax on cigarettes simply because the measure of the tax included gross receipts from the wholesale sale of cigarettes. *Id*. at 591. In the present case, the PET does not magically become a tax on the right of employees to work for a living simply by *measuring* the tax by the employer's payroll expense.

The *Lorillard* court relied on *Ropo, Inc. v. City of Seattle*, 67 Wn.2d 574, 409 P.2d 148 (1965). In *Ropo*, plaintiff cabaret owners contended that the State's Liquor Act, which preempted cities from imposing an "excise tax upon liquor," barred a local admissions tax on customers measured by the cost of food and refreshments. *Id*. at 578. The supreme court upheld the tax, ruling that the admission tax was not an excise tax upon liquor, but was instead a tax "upon the privilege of being admitted to a place where free entertainment is provided." *Ropo*, 67 Wn.2d at 579. An admission tax on customers did not become a liquor tax on the cabaret owner by including the amounts spent on liquor in the measure of the admission tax. *Id*.

Similarly, in *Watson*, plaintiff contended that the City's per-unit flat tax on the retail sale of firearms and ammunition was preempted by the statutory cap on taxes measured by gross receipts. *Watson*, 189 Wn.2d at 168. The court rejected that argument, finding that the cap on gross receipts taxes did not apply to the per-unit tax:

> RCW 35.21.710 caps the B & O gross receipts tax rate, not the sum total of all taxes that can be levied on businesses. Statutory restrictions on one type of tax should not be misinterpreted as capping a taxpayer's total liability.

Watson, 189 Wn.2d at 169.

Courts in other jurisdictions have reached similar results. In *Western States Bankcard Assn.*

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v. City & County. of San Francisco, 19 Cal. 3d 208, 217, 561 P.2d 273 (1977), the taxpayer, Western, was a corporation owned by a group of banks to process credit card transactions. *Western States*, 15 Cal. 3d at 210. California law exempts banks from local taxes. Nonetheless, San Francisco imposed its payroll expense tax on Western. While Western was not a bank, it derived nearly all of its income from its member banks. It accordingly argued that given its "peculiarly close connection with its members," imposition of the payroll tax would impermissibly tax the member banks themselves. *Id*. at 217. The court disagreed and held that the incidence of the tax "is upon [Western], not its exempt bank members." *Id*. at 219. Although the tax might indirectly cause higher processing fees for the exempt member banks, the court held that the "the mere ability to recoup the loss by raising prices will not necessarily shift the legal incidence of the tax." *Id.* at 217-219.

The California Supreme Court upheld San Francisco's payroll expense tax as well in *A.B.C. Distributing Co. v. City & Cty. of San Francisco*, 15 Cal. 3d 566, 125 Cal. Rptr. 465, 542 P.2d 625 (1975). In *A.B.C.*, plaintiffs contended that the tax was an unlawful income tax "because it will be paid from plaintiffs' income." *Id.* at 576. The court rejected that argument and held that:

> the payroll expense tax is not a tax on or measured by their income. Instead, the tax is imposed upon plaintiffs by reason of their employment of labor within the city and county, measured by the expense incurred by plaintiffs in conducting this aspect of their business. The fact that the tax is measured by wages paid to the employees would not convert the tax to an income tax.

Id. at 576. Paying the tax from the taxpayers' revenues did not convert the tax to an income tax because "all taxes necessarily involve some reduction of and relationship to available revenues." *Id*. The court ruled that the tax was an excise tax on employers. *Id. See also Coblentz, Patch, Duffy & Bass, LLP v. City & Cty. of San Francisco*, 233 Cal. App. 4th 691, 706, 183 Cal. Rptr. 3d 47, 59 (2014) (payroll tax is not an income tax); *Blue Star Line, Inc. v. City & Cty. of San Francisco*, 77 Cal. App. 3d 429, 442, 143 Cal. Rptr. 647, 654 (1978) (payroll expense tax on businesses is "obvious

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'quid pro quo for benefits actually conferred' by San Francisco").

In Washington, just as in California, a payroll expense tax is a tax on the business, measured by its payroll expense, and not on the employees' right to earn a living.

3. The fact that plaintiff's tax burden may increase if it increases the compensation of some of its employees does not place the incidence of the tax onto those employees.

Plaintiff makes much of the fact that the PET owed by a taxpayer might rise as its payroll expense rises. But, as with other state and local excise taxes, the PET is just a component of business overhead. *See Peck v. AT & T Mobility*, 174 Wn.2d 333, 340-41, 275 P.3d 304, 307–08 (2012) (B&O tax "is a levy for operating a business in Washington" and "persons engaging in business must treat the tax as operating overhead costs"); *Nelson v. Appleway Chevrolet, Inc*., 160 Wn.2d 173, 180, 157 P.3d 847 (2007) (B&O tax is part of the operating overhead); *Adams v. City of Spokane*, 136 Wn. App. 363, 366, 149 P.3d 420, 422 (2006) (utility taxes charged to utilities are not indirect taxes on customer, but "are considered overhead and are part of the cost of providing service").

Indeed, by plaintiff's theory, forty-five Washington cities impose a B&O gross receipts tax that is unlawful.[12] Local B&O taxes for many taxpayers are tied to the taxpayers' payroll expense. That occurs because under RCW 35.102.130(3)(a) all businesses providing services calculate their tax with a formula that includes a "payroll factor." The formula apportions gross receipts based on the taxpayer's business activity in the city. *Wedbush*, 189 Wn. App. at 364; RCW 35.102.130(3)(a). Thus, if a taxpayer pays its employees in Seattle more, then, by operation of the payroll factor, the taxpayer's gross receipts apportioned to Seattle increase and the taxpayer owes more B&O tax.

[12] All cities in Washington that impose a B&O tax must adopt a model ordinance to provide uniformity between different cities. RCW 35.102.010; *Wedbush Sec., Inc. v. City of Seattle*, 189 Wn. App. 360, 364, 358 P.3d 422 (2015). A committee of cities and businesses, led by the Association of Washington Cities, drafted the model ordinance, including the two-factor apportionment formula required by RCW 35.102.130. MRSC, *Revenue Guide for Cities*, p. 85 (2020). Forty-five cities in Washington impose a B&O tax using the model ordinance. *Id*. (*citing* Association of Washington Cities' List of Local Business (B&O) Tax Rates).

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This payroll factor is a common attribute of state and local business taxes.[13] Although these taxes rise together with increases to payroll in a city, the taxes remain on the employer, not on the employees' right to earn a living. Indeed, even plaintiff concedes that the "B&O Tax is a lawful excise tax . . . imposed on the privilege of doing business in Seattle . . . ." (Complaint, ¶ 21.) The B&O tax for all Washington cities, like the PET, uses payroll expense to measure the business activity in the taxing jurisdiction. But neither tax is a tax on the employee's right to earn a living.

G. Adopting plaintiff's position would invalidate the state's payroll tax and city head taxes.

If the Court adopts plaintiff's position—that a payroll expense tax is an unconstitutional tax on the right to earn a living—then the state's payroll tax, and city head taxes on employers, would all become unconstitutional. *Cary* did not distinguish between the taxing authority of cities and the state. Under *Cary*, "the right to earn a living by working for wages" is an "inalienable right," secured by state and federal constitutions, that cannot be "licensed" by government. *Cary*, 41 Wn.2d at 472. This holding applies equally to both city and state taxes because the taxing authority of Washington cities and the state derives from the same provision of the state constitution. *See Watson*, 189 Wn.2d at 165-166 (local taxation must be authorized by legislative delegation of taxing power). So if the City's tax is unlawful—which it is not—then the state's payroll taxes and the head taxes imposed by cities would also be unlawful.

Plaintiff's spokesperson has admitted that a state-level version of the City's tax would be lawful. On January 4, 2021, the news publication *Crosscut* reported:

> While the chamber doesn't question the state's authority to enact a similar payroll tax, the organization is concerned that enacting a new statewide tax would harm businesses at a time when they are already hurting, said chamber spokesperson Alicia Teel.

[13] *See* Multistate Tax Commission, Model Multistate Tax Compact, p. 9 (www.mtc.gov).

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Crosscut, "How Seattle's new payroll tax complicates efforts to enact one statewide" by Melissa Santos (January 4, 2021). The City agrees that the state has the authority to enact a similar tax. And the legislature has vested the City with the same authority.

H. Plaintiff's opposition is actually based on its belief that the PET is not an appropriate response to the challenges raised by the pandemic.

Plaintiff's complaint betrays the ultimate fact that it simply disagrees with the City's *policy choice* to require large businesses to pay their part in meeting the current fiscal crisis. (Complaint, ¶¶ 2, 3, 5, 9.) These allegations are irrelevant to the validity of the PET:

> Courts play a limited role in reviewing challenges to local tax policy. Under Washington's constitutional framework, the legislature delegates authority to local governments to levy taxes, and we interpret that delegation of local taxing authority for compliance with the constitution and the general laws of the state.

Lakehaven, 195 Wn.2d at 747. It is not the Court's function "to consider the propriety or justness of the tax, to seek for the motives, or to criticize the public policy which prompted the adoption of the legislation." *Sonitrol NW., Inc. v. City of Seattle*, 84 Wn.2d 588, 593–94, 528 P.2d 474 (1974). Indeed, courts owe deference to a city's elected officials:

> Our review is highly deferential, especially in light of the fact that the legislature "'possesses a plenary power in matters of taxation except as limited by the [c]onstitution,' " . . . We have previously observed that where the legislature holds plenary power, "the courts will not question the wisdom or desirability of such legislative requirements, so long as there is *any reasonable basis* upon which the legislative determination can rest.

Dot Foods, Inc. v. State, Dep't of Revenue, 185 Wn.2d 239, 249, 372 P.3d 747 (2016).

The Council adopted the PET as recommended by the Council's Progressive Revenue Task Force in 2017. (Exs. D, E.) The Council enacted the PET because it is a progressive tax. Plaintiff's contention that the PET is tax on the right to earn a living directly contradicts Council's stated intent. The PET is well-within the City's extensive authority to impose such taxes on businesses. The Chamber can lobby the City's political branches for the relief it seeks. Its answer is not in this Court.

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VI. CONCLUSION

The legislature vested the City with authority under the Washington Constitution to impose excise taxes on businesses. The PET is a tax measured by payroll expense and paid by businesses for the privilege of engaging in business in the City. Employees do not pay the tax. The State, other states nationwide, and other cities impose similar taxes. The Washington Attorney General issued an opinion declaring that cities may impose such a tax. Plaintiff's position contradicts the plain language of the ordinance, the intent of the City Council, and longstanding Washington caselaw. The Court should grant the City's motion and dismiss plaintiff's complaint for declaratory judgment.

CERTIFICATE OF COMPLIANCE

I certify that this Motion for Summary Judgment contains 8,146 words in compliance with the Local Civil Rules of the King County Superior Court as amended September 1, 2016.

DATED this 9th day of April, 2021.

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CERTIFICATE OF SERVICE

I certify that on the 9th day of April, 2021, I caused a true and correct copy of this document to be served via King County E-Service:

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