THE HONORABLE MARY ROBERTS
Hearing Date: May 28, 2021
Hearing Time: 9:00 a.m.

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 SEATTLE CHAMBER'S MOTION FOR SUMMARY JUDGMENT

Perkins Coie LLP
1201 Third Avenue, Suite 4900
Seattle, WA 98101-3099
Phone: 206.359.8000
Fax: 206.359.9000

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Perkins Coie LLP
1201 Third Avenue, Suite 4900
Seattle, WA 98101-3099
Phone: 206.359.8000
Fax: 206.359.9000

I. INTRODUCTION AND RELIEF REQUESTED

Plaintiff Greater Seattle Chamber of Commerce, d.b.a. Seattle Metropolitan Chamber of Commerce (the "Seattle Chamber"), respectfully moves the Court for entry of summary judgment declaring that the City of Seattle's Ordinance 126108 (the "payroll tax") is unlawful, invalid, and unconstitutional. Although nominally labeled as a tax on engaging in business, the tax is actually an impermissible levy on paying employee compensation.

In 1951, the City of Bellingham attempted to impose a tax "on all persons receiving compensation for services performed within the city," measured by the compensation paid for such services. *Cary v. City of Bellingham*, 41 Wn.2d 468, 468–69, 250 P.2d 114 (1952). A unanimous Washington Supreme Court held that the tax was unconstitutional because the "the right to earn a living by working for wages is not a 'substantive privilege granted or permitted by the [city].'" *Id*. at 472. Seven decades later, in the midst of the unprecedented COVID-19 pandemic and in the face of the mayor's concerns about the tax's legality, Defendant City of Seattle (the "City" or "City of Seattle") enacted a new tax on employee compensation through Ordinance 126108. The City attempted to avoid the fate of Bellingham's unconstitutional tax by changing the party responsible for paying the tax from the employee to the employer. Thus, rather than imposing a tax on "receiving compensation" as in Bellingham, Seattle taxes the payment of that same compensation. This sleight of hand does not change the fact that Seattle—like Bellingham before it—is attempting to impose an illegal tax on employment for compensation. The right to work and the obligation to pay employees compensation for that work are two sides of the same employment relationship and are not substantive privileges the City grants or may withdraw. Accordingly, Seattle's Ordinance 126108 is unlawful, invalid, and unconstitutional.

Perkins Coie LLP
1201 Third Avenue, Suite 4900
Seattle, WA 98101-3099
Phone: 206.359.8000
Fax: 206.359.9000

II. STATEMENT OF FACTS

A. Background of the City's Illegal Payroll Tax

The City recently enacted several taxes aimed at expanding City revenues. In July 2017, the City enacted an "income tax on high-income residents." Ord. No. 125339 (Declaration of Robert L. Mahon ("Mahon Decl.") ¶ 5, Ex. D). The Honorable John Ruhl declared that tax unconstitutional, and the Court of Appeals, Division I affirmed in *Kunath v. City of Seattle*, 10 Wn. App. 2d 205, 211, 444 P.3d 1235, *review denied*, 195 Wn.2d 1013, 460 P.3d 183 (2020). In May 2018, the City enacted a $275 per employee per year "employee hours tax." Ordinance No. 125578 (Mahon Decl. ¶ 6, Ex. E). The City repealed that tax the following month in the face of a public effort to repeal the ordinance by referendum. Ordinance No. 125592 (Mahon Decl. ¶ 7, Ex. F); Summary and Fiscal Note for Ordinance No. 125592 (Mahon Decl. ¶ 8, Ex. G) at 2.

In the wake of the COVID-19 pandemic, the City Council revisited its prior attempts to impose an employee hours tax or payroll tax. *See* Ordinance No. 126108 (Mahon Decl. ¶ 2, Ex. A) (recounting the City's efforts from 2017 through 2019 to study and impose an employee hours tax or payroll tax). On July 6, 2020, the City Council passed the payroll tax at issue by a veto-proof margin of 7–2.

Mayor Durkan returned the payroll tax bill to the City Council unsigned, declining to support the City's improper proposal: "I regretfully cannot support this law in its current form. Council's fast track approach to passing one of the largest taxes proposed in City history has led to serious concerns about not just the legality, size and scale of this tax, but its long-term impacts on the city and our small businesses." Letter from Mayor Jenny A. Durkan to Monica Martinez Simmons, Seattle City Clerk (July 17, 2020) (Mahon Decl. ¶ 4,

Perkins Coie LLP
1201 Third Avenue, Suite 4900
Seattle, WA 98101-3099
Phone: 206.359.8000
Fax: 206.359.9000

Ex. C). Notwithstanding her disproval, the bill ultimately became Ordinance 126108 without the mayor's signature.

B. Contours of the City's Illegal Tax

Beginning January 1, 2021,[1] Seattle imposes a tax on "every person engaging in business in Seattle" measured by "compensation paid in Seattle to employees." Seattle Municipal Code ("SMC") §§ 5.38.030(A); 5.38.020 (defining "payroll expense"). The tax rate applied to employee compensation depends on a combination of the employer's total Seattle employee compensation and each individual Seattle employee's annual compensation. SMC § 5.38.030(B). For example, if Company A has 55 employees who earn $100,000 in compensation per year, ten employees who earn $200,000 per year, and 5 employees who earn $500,000 per year, Company A's payroll tax would be $56,500 computed as follows:

Compensation	# of Emp.	Ann. Salary	Payroll Exp.	Rate	Tax
$0–$149,999.99	55	$100,000	$5,500,000	N/A	$0
$150,000.00–$399,999.99	10	$200,000	$2,000,000	0.70%	$14,000
$400,000 and greater	5	$500,000	$2,500,000	1.70%	$42,500
TOTAL:	**70**		**$10,000,000**		**$56,500**

Seattle Rule 5-980(3)(b) (Example 14).

III. STATEMENT OF ISSUES

Does the City have authority to impose a tax on the payment of compensation to employees by shifting the payment of the tax from the employee to the employer?

May the City avoid the constitutional prohibition against the city taxation of employee compensation by labeling the tax as a tax on "engaging in business" rather than a tax on paying compensation to employees?

[1] The first tax returns and payments are not due until January 2022.

Perkins Coie LLP
1201 Third Avenue, Suite 4900
Seattle, WA 98101-3099
Phone: 206.359.8000
Fax: 206.359.9000

IV. EVIDENCE RELIED UPON

In support of its motion, the Seattle Chamber relies upon the pleadings on record and the Declaration of Robert L. Mahon.

V. AUTHORITY AND ARGUMENT

A. Standards for Summary Judgment and Declaratory Judgment

Summary judgment should be granted where no genuine issue of material fact exists and the moving party is entitled to judgment as a matter of law. *Herskovitz v. Grp. Health Coop. of Puget Sound*, 99 Wn.2d 609, 613, 664 P.2d 474 (1983). In a motion for summary judgment seeking a declaration under RCW 7.24.020, judgment should be entered in the moving party's favor where a justiciable controversy based on allegations of harm personal to the party are substantial rather than speculative or abstract. *Grant Cnty. Fire Prot. Dist. No. 5 v. City of Moses Lake*, 150 Wn.2d 791, 797, 802, 83 P.3d 419 (2004). Under this standard, the Seattle Chamber is entitled to judgment as a matter of law on its request for a judgment declaring the City of Seattle's Ordinance 126108 unlawful, invalid, and unconstitutional. *See generally Kelso Educ. Ass'n v. Kelso Sch. Dist. No. 453*, 48 Wn. App. 743, 740 P.2d 889 (1987).

B. The City's Tax Is a Tax on Paying Compensation to Employees.

1. The City's Tax Must be Evaluated by Its Incident and Not Its Label.

The City's payroll tax is nominally imposed on "every person engaging in business within Seattle." SMC § 5.38.030(A). However, "[t]he nature of a tax is revealed by examining the subject matter of the tax and the incidents of the tax, 'i.e., the manner in which it is assessed and the measure of the tax.'" *Harbour Vill. Apartments v. City of Mukilteo*, 139 Wn.2d 604, 607 n.1, 989 P.2d 542 (1999) (quoting *Weaver v. Prince George's Cnty.*, 281 Md. 349, 356, 379 A.2d 399 (1977)). The United States Supreme

Perkins Coie LLP
1201 Third Avenue, Suite 4900
Seattle, WA 98101-3099
Phone: 206.359.8000
Fax: 206.359.9000

Court has squarely rejected the use of statutory labels in evaluating the nature of a tax: "A tax on sleeping measured by the number of pairs of shoes you have in your closet is a tax on shoes." *Trinova Corp. v. Mich. Dep't of Treasury*, 498 U.S. 358, 374, 111 S. Ct. 818, 112 L. Ed. 2d 884 (1991) (quoting Jenkins, *State Taxation of Interstate Commerce*, 27 TENN. L. REV. 239, 242 (1960)); *Hunt-Wesson, Inc. v. Franchise Tax Bd. of Cal.*, 528 U.S. 458, 464, 120 S. Ct. 1022, 145 L. Ed. 2d 974 (2000) (quoting *Trinova*).

"Engaging in business" and "doing business" have long been recognized as privileges that may be taxed. But Washington courts held that merely labeling a tax as a tax on the privilege of engaging in business does not make it so. Washington courts have repeatedly invalidated income taxes that, although ostensibly framed as taxes on "privileges," were actually taxes on an impermissible event or incident.

In *Culliton v. Chase*, 174 Wash. 363, 25 P.2d 81 (1933), for example, the Washington Supreme Court held that a state tax labeled as a tax "on all net income" was actually an income tax that violated the state constitution. *Id.* at 382–83. The Legislature attempted to sidestep that holding by enacting an excise tax nominally characterized as the "privilege of receiving income" measured by "income." The court ignored the Legislature's labeling, in favor of examining the true nature of the tax:

> [T]he 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. (citations omitted)
>
> The 1935 act purports to levy a tax upon 'the privilege of receiving income.' But an examination of the various provisions of the act shows clearly that the Legislature was

Perkins Coie LLP
1201 Third Avenue, Suite 4900
Seattle, WA 98101-3099
Phone: 206.359.8000
Fax: 206.359.9000

> concerned with the property (income) upon which the amount of the tax was to be levied, not with the mere privilege of the individual to receive the income.

Jensen v. Henneford, 185 Wash. 209, 217–18, 53 P.2d 607 (1936) (emphasis added).

Fifteen years later, the court applied the "event or incident" test to invalidate a similar tax that the Legislature "masquerad[ed] as an excise." *Power, Inc. v. Huntley*, 39 Wn.2d 191, 196, 235 P.2d 173 (1951). In *Power, Inc.*, the Washington Supreme Court addressed a state tax on corporations "for the privilege of doing business in this state" measured by "net income." *Id.* at 193. The court acknowledged "the right to levy an excise tax on the privilege of doing business," but noted the familiar requirement that the "character of a tax [be] determined by its incidents, not by its name." *Id.* at 196–97. The court concluded that the tax on the "privilege of doing business" was an income tax "masquerading as an excise." *Id.*

2. Looking at the Incident, the City's Tax Is a Tax on Paying Employee Compensation, Not Engaging in Business.

Applying the rules articulated in *Culliton*, *Power Inc.* and their progeny, the Court can and should declare that Ordinance 126108 is an impermissible tax on the payment of compensation to employees. Looking past the perfunctory labels of the Ordinance, the true incident of the City's payroll tax is paying employee compensation. The tax is measured by "compensation paid in Seattle to employees" and not the business activity of the taxpayer. SMC §§ 5.38.030(B), 5.38.020; *see also Power, Inc.*, 39 Wn.2d at 196–97 (concluding that an income tax labelled a tax on the privilege of doing business was an unconstitutional income tax). In *Power, Inc.*, the Washington Supreme Court distinguished the corporate income tax from the business and occupation tax—"a true excise tax"—because the

Perkins Coie LLP
1201 Third Avenue, Suite 4900
Seattle, WA 98101-3099
Phone: 206.359.8000
Fax: 206.359.9000

corporation's net income did not reflect the extent of its business activity in the state. 39 Wn.2d at 196–97.

The measure of Seattle's payroll tax has even less connection to business activity than net income. *See Sheehan v. Cent. Puget Sound Reg'l Transit Auth.*, 155 Wn.2d 790, 800–01, 123 P.3d 88 (2005) (requiring a legitimate relationship for a taxable measure to exist); *see also Klickitat Cnty. v. Jenner*, 15 Wn.2d 373, 380, 130 P.2d 880 (1942) ("[T]he incidence of a tax, rather than its name, determines its character"). A business with significant business activity in Seattle and hundreds of employees might pay no tax because it conducts that business with employees who are assigned or reside outside Seattle or conducts business activity with employees who are paid less than $150,000 per year. *See* SMC § 5.38.020 (defining "payroll expense" and sourcing compensation).

Conversely, a business with little or no business activity in Seattle might pay significant payroll tax solely because its employees reside in Seattle: "compensation is paid in Seattle to an employee if . . . [t]he employee is not primarily assigned to any place of business for the tax period, the employee does not perform 50 percent or more of their service in any city, and **the employee resides in Seattle**." SMC § 5.38.020 (emphasis added). For example, the City's Rule 5-980 explains that compensation paid to an employee who "spends 15% of their time performing services in Seattle, 20% in Redmond, 25% in Bellevue, 30% in Renton, and 10% out-of-state" is taxed entirely in Seattle if the employee resides in Seattle. Seattle Rule 5-980(2)(d) (Example 10).

The City's payroll tax is not determined by reference to business activity but merely the sum of the tax on compensation paid to individual employees. SMC § 5.38.030(B). Significantly, the tax cannot be computed without examining each employee's facts, including total compensation for the year, place of service, and personal residence. For

Perkins Coie LLP
1201 Third Avenue, Suite 4900
Seattle, WA 98101-3099
Phone: 206.359.8000
Fax: 206.359.9000

example, the chief executive officer of a Bellevue-based business might reside in Seattle, spend 40% of her time working at the company's Bellevue headquarters and 60% of her time at other business locations outside of Washington. The Seattle payroll tax would be due in this situation because Seattle's tax is, in fact, a tax on paying compensation to employees and not a tax on "engaging in business." SMC § 5.38.050 underscores the true nature of the tax and provides that "if payroll expense . . . **does not fairly represent the extent of the compensation paid by the taxpayer to its employees**" the Director may permit or require "another method to effectuate an equitable allocation and apportion" (emphasis added). The City's goal is not to fairly represent the extent of the taxpayer's **business activity**, but its "compensation paid . . . to its employees." *Id*.

The Court can further glean the improper nature of Ordinance 126108 by reviewing the tax's redundancy. Indeed, the City already imposes a "true excise tax" on engaging in business in Seattle—the business license tax, or B&O tax, chapter 5.45 SMC. The B&O tax is imposed on "the act or privilege of engaging in business activities" measured by "gross proceeds of sale, gross income of business, or value of products [manufactured]." SMC § 5.45.050. In contrast to the payroll tax, the B&O tax contains an "equitable" apportionment provision that properly connects the activity the City says it is taxing (engaging in business) with the measure of the tax (gross income). Thus, the Director must grant or require equitable adjustment if the business license tax "do[es] not fairly represent the extent of the taxpayer's **business activity** in the city." *Compare* SMC § 5.45.081(G)(4) (emphasis added), *with* SMC § 5.38.050(B) (requiring equitable adjustment if the payroll tax "does not fairly represent the extent of the compensation paid by the taxpayer to its employees").

Finally, if the payroll tax were, in fact, a tax on engaging in business, it would violate the requirement that an excise tax be "directly imposed based upon the extent to

Perkins Coie LLP
1201 Third Avenue, Suite 4900
Seattle, WA 98101-3099
Phone: 206.359.8000
Fax: 206.359.9000

which the taxpayer enjoys the taxable privilege." *Sheehan*, 155 Wn.2d at 800. The City's tax is not measured on the extent of the taxpayer's business activity in Seattle, but on compensation paid to individual employees who may work in Seattle in whole, in part, or not at all. Large companies with extensive business activity in Seattle may pay no tax; small companies with little or no business activity in Seattle may pay significant tax. As such, the City's payroll tax is, in fact, a tax on the payment of compensation to employees and not a tax on engaging in business.

C. The City Has No Authority to Tax Employee Compensation.

A valid excise tax must be "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." *Sheehan*, 155 Wn.2d at 799–800. Further, an excise tax must be "'in truth, levied for the exercise of a substantive privilege granted or permitted by the [taxing authority].'" *Cary*, 41 Wn.2d at 472 (quoting *Jensen*, 185 Wash. at 218).

The taxable incident under the City's payroll tax is paying employees. The voluntary act that gives rise to the payment of that compensation is the employment relationship between the employer and employee—the individual employee's performance of work for compensation and the employer's payment of compensation for such work. This is not a substantive privilege granted or permitted by the City.

The City of Bellingham previously attempted to impose a tax "on all persons receiving compensation for services performed within the city" measured by gross employee compensation. *Id*. at 468–69. The Washington Supreme Court held that the tax was illegal because "the right to earn a living by working for wages is not a 'substantive privilege granted or permitted by the [city].'" *Id*. at 472.

Perkins Coie LLP
1201 Third Avenue, Suite 4900
Seattle, WA 98101-3099
Phone: 206.359.8000
Fax: 206.359.9000

The City's payroll tax is measured **the same way** as the tax in *Cary* (through employee compensation) and applies to **the same voluntary act** as in *Cary* (the employee's work for compensation). The City attempts to bypass *Cary* by shifting the tax from the employee to the employer. Rather than a tax on "receiving compensation" as in Bellingham, Seattle taxes the payment of that same compensation. But the employee's right to work for compensation and the employer's obligation to pay compensation for that work are two sides of the same employment relationship. If "the right to earn a living by working for wages is not a 'substantive privilege granted or permitted by the [city],'" the City cannot grant or withdraw the employer's corresponding obligation to pay compensation for that work. The City does not grant the employer the "privilege" of paying compensation to employees; this is an *obligation* of state law. *See, e.g.*, RCW 49.46.020 (minimum wage), RCW 49.48.010 (prohibiting the withholding or diversion of employee wages); *Jumamil v. Lakeside Casino, LLC*, 179 Wn. App. 665, 676–78, 319 P.3d 868 (2014) (Washington state wage statutes were enacted to protect employees' rights to receive their full compensation and reflect the legislature's strong policy in favor of payment of wages to employees). As a matter of law, Ordinance 126108 is unlawful, invalid, and unconstitutional.

VI. CONCLUSION

The City's tax is a tax on paying employee compensation. Because the payment of employee compensation is not a substantive privilege that is granted or may be withdrawn by the City, the City's tax is unlawful. Plaintiff Seattle Chamber respectfully requests the Court to enter summary judgment declaring that the City of Seattle's Ordinance 126108 is unlawful, invalid, and unconstitutional. A proposed order is submitted with the Judge's copy of this motion.

Perkins Coie LLP
1201 Third Avenue, Suite 4900
Seattle, WA 98101-3099
Phone: 206.359.8000
Fax: 206.359.9000

RESPECTFULLY SUBMITTED this 9th day of April, 2021.

I certify that this motion/memorandum contains 3098 words, in compliance with the Local Civil Rules.

s/ James F. Williams
s/Robert L. Mahon
s/Zachary E. Davison
James F. Williams, WSBA No. 23613
JWilliams@perkinscoie.com
Robert L. Mahon, WSBA No. 26523
RMahon@perkinscoie.com
Zachary E. Davison, WSBA No. 47873
ZDavison@perkinscoie.com
Perkins Coie LLP
1201 Third Avenue, Suite 4900
Seattle, WA 98101-3099
Telephone: 206.359.8000
Facsimile: 206.359.9000

Attorneys for Plaintiff Greater Seattle Chamber of Commerce, d.b.a. Seattle Metropolitan Chamber of Commerce

CERTIFICATE OF SERVICE

On April 9, 2021, I caused to be served upon the following, at the address stated below, via the method of service indicated, a true and correct copy of the foregoing document.

Kent C. Meyer, WSBA #17245 Ghazal Sharifi, WSBA #47750 Jeremy F. Wood, WSBA #51803 Assistant City Attorneys E-mail: kent.meyer@seattle.gov E-mail: ghazal.sharifi@seattle.gov E-mail: jeremy.wood@seattle.gov Seattle City Attorney's Office 701 Fifth Avenue, Suite 2050 Seattle, WA 98104 Phone: (206) 684-8200 **Attorney for Defendant City of Seattle**	___ Via Hand Delivery ___ Via U.S. Mail, 1st Class, Postage Prepaid **X** Via E-Filing ___ Via Overnight Delivery ___ Via Facsimile **X** Via Email

I certify under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

EXECUTED at Seattle, Washington on April 9, 2021.

June Starr
June Starr

Perkins Coie LLP
1201 Third Avenue, Suite 4900
Seattle, WA 98101-3099
Phone: 206.359.8000
Fax: 206.359.9000