

An Income Tax for Washington? Not Likely

by Roxanne Bland



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corporate income, analyzed and reported on proposed federal legislative initiatives affecting state taxation, worked with legislative consultants and representatives from other state organizations on international issues affecting states, and assisted member state representatives in federal lobbying efforts. Before that, she was an attorney with the Federation of Tax Administrators for over seven years.

In this installment of The SALT Box, Bland discusses Washington's tax structure, and the effort over the years to introduce an income tax in the state.

For years, study after study has consistently ranked Washington near or at the top of states with the most regressive tax systems. Indeed, the author of one study went so far as to call the state's tax system dysfunctional.¹ The most recent survey by the Institute of Taxation and Economic Policy places Washington at the top of the Terrible 10 list of states with highly regressive tax systems.²

Washington relies chiefly on the sales tax to meet its revenue needs, followed by the business and occupation (B&O) tax, the property tax, and various excise taxes. Without a personal or corporate income tax, the revenue burden falls most heavily on the poorest of Washingtonians. Studies show that those who make \$20,000 or less pay over 17 percent of their income in various taxes, while the wealthiest, with income of \$130,000 or more, pay less than 3 percent.³ On the commercial side, the B&O tax system is lopsided because it favors low-volume, high-profit industries like aerospace and aluminum, to the detriment of high-volume, low-profit businesses like retailers. Moreover, the B&O tax, a type of gross receipts tax imposed exclusively on businesses, is usually passed through to the customer, thus raising the price of purchases upon which the sales tax is charged. All studies conclude that these disparities can be alleviated by a broad-based personal income tax.⁴

Jason Mercier, director of the Center for Government Reform at the Washington Policy Center, asserts that "the methodology of these reports is flawed." He gives the example of the gross receipts tax, which "is a tax on employers, not individuals, yet it is measured as a sales tax, so the results are skewed." Mercier concedes that Washington has the highest excise tax rates in the country, "but in 2008, the Legislature passed the Working Family Rebate, which would be the equivalent of the [earned income tax credit]. It was intended to provide relief to low-income families from the sales tax burden. [However,] the program was never funded."

¹Richard S. Conway Jr., "Washington State and Local Tax System: Dysfunction and Reform" (Feb. 2017).

²Institute on Taxation and Economic Policy, "Who Pays?" (Oct. 18, 2018).

³*Id.*

⁴Hugh D. Spitzer, "A Washington State Income Tax — Again?" 16 *U. Puget Sound L. Rev.* 515-70 (1993).

A benefit of Washington's tax system, Mercier argues, is that unlike states that rely heavily on income taxes, the state's tax structure remains relatively stable even during economic downturns. He asserts that the sales tax is not cyclical in the same way as the income tax, because "though it's counterintuitive, in economic downturns people still purchase things, even when they're unemployed, whereas if you don't have a job, there's no income to tax." While it is true that in an economic downturn every state will take a hit, states with income taxes on high earners or capital gains "will fall deeper into the trough" because those income streams may decline precipitously. Washington, by relying on the sales tax, the B&O tax, and property taxes, has a "relatively stable tax base compared to other states, which is reflected in our tax collections. For the past 15 years, Washington's revenue collections have been on a consistent upward slope except when you hit a recession, but even then, you don't have a lot of swing" that characterizes income tax collections, he explains. Evidence of this stability, even in the current downturn, "is reflected in the high ratings Washington has from Standard & Poor's and others," he says, adding: "The bottom line is Washington's tax system is not broken. The stability of our tax base shows that. We would like to provide relief to those who need it, but we can't do that if funds aren't provided by the Legislature."

Why Washington Doesn't Have an Income Tax

It is commonly believed that Washington does not have an income tax because the state's constitution forbids it. That is not true. In 1929 Washington voters approved a constitutional amendment providing that "all taxes shall be uniform upon the same class of property . . . the word 'property' as used herein shall mean and include everything, whether tangible or intangible, subject to ownership."⁵ In 1932 various organizations, spearheaded by farming groups angered by rising property taxes, gathered enough signatures to put on the ballot an initiative that would impose a ceiling on the

property tax and institute a graduated net income tax, thereby forcing profitable urban and financial interests to pay their fair share of supporting government. Voters overwhelmingly approved the initiative. Business groups that opposed the initiative immediately filed suit. In *Culliton*,⁶ these groups argued that the definition of property as contained in the state constitution encompassed income, and that as property, income could only be taxed in uniformity with respect to all other property. The graduated net income tax violated the requirement of uniformity in property taxation and was therefore unconstitutional.

The state supreme court issued its decision in 1933, finding the graduated income tax unconstitutional. The court pointed to the breadth of the constitutional definition of property as including everything capable of ownership. To the majority, regarding income, the answer was obvious: "Income is either property under our [constitution], or no one owns it," and if the latter, income can simply be taken, unfettered by law, from one by another because it does not belong to anyone. Therefore, income must be intangible property, and thus subject to the constitution's uniformity provision. The difficulty with *Culliton* is that the opinion engaged in no analysis, no inquiry into the fundamental nature of income and property that might distinguish one from the other; it merely slapped the property label onto income and equated them. Although perhaps unfortunate, in every instance where the income/property issue was before it, the supreme court made it clear it would not overturn *Culliton*. In *Apartment Operators Association of Seattle*,⁷ involving a tax on rental property exceeding \$300 per month, the supreme court's testy, one-page opinion affirmed that it would adhere to *Culliton* and ruled that a tax such as the one before it was a tax on property. If there was a need for some property to be treated differently, "the constitution can be amended by vote of the people," the court said. *Culliton* and its progeny may be short on analysis, yet it answers the question of whether Washington has the constitutional power to levy a statewide income

⁵ Wash. Const. Art. VII, section 1.

⁶ *Culliton v. Chase*, 25 P.2d 81 (Wash. 1933).

⁷ *Apartment Operators Association of Seattle v. Schumacher*, 351 P.2d (Wash. 1960).

tax: It does, if the tax is imposed at a uniform rate with all other property taxes, which is constitutionally set at 1 percent of assessed value. The reason there is no state income tax is that since *Culliton*, all attempts to enact one by ballot initiative, or by legislative proposals put to the voters, have failed.

Tax Advocates Press On

Despite decades of setbacks, tax reformers continue their fight for a progressive income tax, or another tax measured by income. It is possible that in recent months, the movement for a progressive income tax may have gotten a foot in the door. In 2017 Seattle enacted a graduated 2.25 percent income tax on individual incomes above \$250,000, and over \$500,000 for married couples. Not surprisingly, the measure was immediately challenged as violating the state constitution, and moreover, violating a 1984 law prohibiting cities and counties from enacting income taxes. In *Kunath*, the court of appeals, stating that it was bound by the supreme court's decision in *Culliton* and its progeny, struck Seattle's law as violating the constitution's requirement for uniformity in property taxation. However, it also struck the 1984 law as unconstitutional because it violated the constitution's single-subject rule for legislative enactments. Thus, Seattle has the authority to impose an income tax, but it must conform to the constitutional requirement of uniformity.⁸ In April the supreme court declined to hear the matter without opinion.

Of course, *Kunath* is of no benefit to the state. However, there are some who think the supreme court's refusal raises a few possibilities. If the court is willing to revisit *Culliton*, it may be waiting for the appropriate vehicle, such as a case involving a statewide graduated income tax enacted by ballot initiative. As of now the Legislature would be wary of even mentioning the possibility of enacting an income tax of any kind. Yet if income tax advocates can build a strong coalition to lobby legislators, coupled with educating voters about how the current state tax system works and how a progressive income tax would be beneficial, legislative reluctance could

change. If the Legislature did so, the tax would immediately be challenged, presenting to the supreme court another vehicle to revisit *Culliton*. Another consideration is that the court has a new justice, G. Helen Whitener. Speculation is that if Whitener is of the progressive mindset, and if the right vehicle arises, *Culliton* could be revisited and overruled.⁹ Yet even if these speculations are true, the downside — and it is a big one — is that it will take years of maneuvering, possibly a decade or more, for the progressives' efforts to reach fruition.

Another effort underway, and endorsed by Gov. Jay Inslee (D), is to enact a capital gains tax. The idea is that although capital gains is generally thought of as income, and is referred to as such, in truth, it is not. An income tax is levied annually on a stream of income earned by or arising from an asset owned by a person. The income is classified as property under *Culliton*, and thus subject to the constitutional uniformity requirement. In contrast, a capital gains tax is a one-time levy when an asset is sold, in the same manner as the imposition of a real estate excise tax on the sale of property; that is, a capital gains levy is on the gain realized from the incidence of the transfer, not the property itself. Stated another way, a capital gains levy is a tax on the discretionary and voluntary act of transferring property from the seller to the buyer, rather than on ownership of property. Because a capital gains tax is not a property tax within the meaning of the state's constitution, it is not subject to the uniformity requirement. Andy Nicholas, associate director at the Washington State Budget & Policy Center, said that "given the eccentricity of Washington's tax system, the capital gains tax [proposal] is structured in such a way so that it works like an excise tax on the sale of an asset by an individual, or on behalf of an individual."

Conclusion

Washington is one of the few states that does not levy an income tax, relying mainly on the sales tax, the B&O tax, and the property tax to raise revenue. Over the years, numerous studies have

⁸ *Kunath v. Seattle*, 444 P.3d 1235 (Wash. Ct. App. 2019).

⁹ Doug Trumm, "Seattle Now Has the Right to Levy a 1% Income Tax," *The Urbanist*, Apr. 15, 2020.

concluded that the state's tax structure is highly regressive, with the tax burden falling disproportionately on the poor. However, some observers believe these studies are a bit misleading because of flawed methods. In any event, these observers say, the state's tax system is more stable than those in states that place a heavy reliance on the income-based taxes, because during economic downturn, incomes can decline precipitously and tax collections fall. While consumption taxes also fall during downturns, they do not fall as far. Still, there are tax reformers in Washington who appear determined to add a progressive income tax to the mix. The difficulty is that court interpretations of the state's constitution have repeatedly held, for almost 90 years, that income is property that must be taxed at a uniform rate, and a progressive income tax is unconstitutional. There is also a proposal in circulation to impose a capital gains tax, structuring the law so that it resembles more of an excise tax. Moreover, a close analysis of the tax reveals that even though the capital gains tax is usually thought of as an income tax, it is not unreasonable to conclude that it is not. The long-running income tax drama in Washington has taken many twists and turns over the years, and it is undoubtedly a show worth watching. ■

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