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No. 98470-1

IN THE SUPREME COURT
STATE OF WASHINGTON

KMS FINANCIAL SERVICES, INC.,

Respondent

v.

CITY OF SEATTLE,

Petitioner

ANSWER TO CITY OF TACOMA'S AMICUS CURIAE BRIEF IN SUPPORT OF PETITION FOR REVIEW

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Respondent KMS Financial Services, Inc. ("KMS") respectfully submits this Answer to the City of Tacoma's Amicus Curiae Brief in Support of the City of Seattle's Petition for Review. In an effort to obtain review for its sister city, Tacoma mimics Seattle's exaggerations regarding the extent, import and effect of the Court of Appeals' opinion. Notably:

1. The central issue in this case is not, as Tacoma deliberately overstates, "whether independent contractors have 'the status of an [sic] employee of [the] taxpayer.'" Tacoma Br. at 3 (quoting RCW 35.102.130(4)(c)). As the Court of Appeals properly recognized, the "***sole issue*** is whether the city of Seattle (City) used an unlawful method to calculate [B&O] taxes owed by KMS . . . ." Op. at 1 (emphasis added).

2. Tacoma likewise cries wolf when it claims the "the Court of Appeals held that "independent contractors were the same as employees . . . for purposes of tax apportionment in RCW 35.102.130." Tacoma Br. at 4. Wrong. The court narrowly held that Seattle's tax was "not externally consistent ***as applied to KMS***," "not fairly apportioned ***to KMS***" and, thus, "unconstitutional ***as applied to KMS***." Op. at 13 (emphasis added).

3. The Court of Appeals so held—as it did over a decade ago in *KMS I* under a different apportionment formula—because, as a matter of both federal and state law, the "point of fair apportionment is to ensure that a city only taxes income attributable and proportional to a taxpayer's

income-generating activity in the city." Op. at 12 (citing *KMS Fin. Servs., Inc. v. City of Seattle*, 135 Wn. App. 489, 146 P.3d 1195 (2006)).

4. In the case of KMS, this principle means that—regardless of apportionment methodology or worker classification—Seattle cannot constitutionally "attribute[] most of KMS's income to the work of approximately 50 employees based in the city when it is undisputed that the bulk of KMS's income comes from the work of the 300-plus registered representatives based outside the city." Op. at 13. "Either way, [the registered representatives] are not working in the city; the city has no claim to a 'fair share' of the income they generate." *Id.* at 12.

5. Nowhere did the Court of Appeals hold, or suggest, that all independent contractors of all taxpayers must be classified as "employees" when calculating the "payroll factor." The court required Seattle to do so on ***remand*** as a ***remedy*** for the city's failure to fairly apportion KMS's income, and it did so under the code's provision for alternative "equitable apportionment"—not the payroll factor itself. Op. at 13-14 (citing RCW 35.102.130(3)(c) and SMC 5.45.081(F)(3)). The court merely noted that the payroll factor's "plain language" would have produced the same result given the unique status of KMS's registered representatives. Op. at 14-15.

6. Thus, there is no basis for Tacoma's hysteria that the Court of Appeals' opinion will "call into question the B&O taxes on service

income paid to 43 Washington cities" and "severely reduce[]" their tax revenue. Op. at 2. Other than broker-dealers that, like KMS, generate all revenue through registered representatives—who are deemed "employees" under federal securities law—it is unlikely that any taxpayer is so "similarly situated" to KMS as to avail itself of the court's opinion. And any that can successfully do so will not be cheating the cities of B&O tax to which they are entitled; as was the case for Seattle here, no statute or ordinance permits a city to levy an unconstitutionally apportioned tax.

7. But perhaps the biggest hole in Tacoma's argument is its failure to explain how review would change anything—for Tacoma (like Seattle) identifies no error in the Court of Appeals' opinion. Tacoma does not and cannot argue that the court erred in applying federal commerce clause analysis as it relates to KMS's ***interstate*** activity. Rather, Tacoma (like Seattle) cites to an entirely contrived conflict with *Dravo Corp. v. City of Tacoma*, 80 Wn.2d 590, 494 P.2d 504 (1972), under state law as it relates to KMS's ***intrastate*** activity. Tacoma Br. at 6.[1] As KMS explained in its answer to Seattle's petition, even a cursory reading of *Dravo* reveals

[1] As KMS also explained, Seattle did not argue to the trial court or the Court of Appeals that there were different constitutional tests for fair apportionment under federal and state law—and, thus, it cannot raise the issue for the first time in a petition to this Court. It is equally axiomatic that this Court generally will not consider issues raised for the first time by amicus. *See Coburn v. Seda*, 101 Wn.2d 270, 279, 677 P.2d 173 (1984).

that it addresses nexus, not fair apportionment—much less did it articulate a different or conflicting apportionment analysis under state law.

8. Nor will the Court of Appeals' opinion leave "[c]ities and taxpayers . . . wondering which test applies when faced with apportioning service income from *intrastate* activity." *Id.* at 6-7. There is only one test for fair apportionment. No Washington decision (including those of this Court) addressing fair apportionment in the context of a city tax has ever articulated a different standard under state law for intrastate activities. *See, e.g.*, *Ford Motor Co. v. City of Seattle*, 160 Wn.2d 32, 156 P.3d 185 (2007); *Avanade, Inc. v. City of Seattle*, 151 Wn. App. 290, 211 P.3d 476 (2009); *Gen. Motors Corp. v. City of Seattle*, 107 Wn. App. 42, 25 P.3d 1022 (2001). As the *Dravo* court itself noted, apportionment is required "when the activity that is the incidence of the tax takes place both ***within and without the city***." *Dravo*, 80 Wn.2d at 602-03 (emphasis added). That is precisely what the Court of Appeals required the city to do here.[2]

* * *

[2] Indeed, and not coincidentally, RCW 35.102.130's two-factor apportionment formula (and the Seattle ordinance that implements it) draws no distinction between intrastate and interstate activities. For both the income and payroll factors, the only relevant distinction is income earned and compensation paid "in the city" verses income earned and compensation paid "everywhere" else.

The Court of Appeals' opinion was not only entirely correct on the law, it was narrowly focused on the particular circumstances of a single taxpayer, KMS. The petition for review should be denied.

RESPECTFULLY SUBMITTED this 14th day of September, 2020.

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CERTIFICATE OF SERVICE

I certify under penalty of perjury under the laws of the state of Washington that on this date I have caused a true and correct copy of the foregoing pleading to be served on the following person as indicated:

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DATED this 14th day of September, 2020, Bellevue, Washington.

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