NO. 98470-1

IN THE SUPREME COURT OF

THE STATE OF WASHINGTON

KMS FINANCIAL SERVICES, INC.,

Respondent,

vs.

CITY OF SEATTLE,

Petitioner.

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

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I. INTRODUCTION

Amicus, the City of Tacoma ("Tacoma"), submits this brief to support the City of Seattle's petition for discretionary review of City of Seattle v. KMS Fin. Servs., Inc., 12 Wn. App 2d 491, 459 P.3d 359 (2020).

The Court of Appeals' decision in this case will affect every city in the state that imposes a B&O tax on service income and will affect every taxpayer who provides services in this state and pays local B&O tax.

II. IDENTITY AND INTEREST OF AMICUS CURIAE

The City of Tacoma ("Tacoma") is a first class Washington city and the third largest city in the state. Like the city of Seattle, Tacoma is one of 47 cities in the state that imposes a local business and occupation (B&O) tax.[1] In 2007, Tacoma adopted the state required B&O tax apportionment provisions,[2] and like Seattle, has complied with the mandatory amendments pursuant to the state Municipal Business and Occupation Tax, RCW 35.102.130.[3]

The Court of Appeals decision deprived Seattle of fairly apportioning income for B&O tax purposes to its city, and will effectively deprive other cities like Tacoma, from fairly apportioning income for

[1] See Appendix D, City of Seattle's Petition for Discretionary Review.
[2] See Tacoma Ordinance No. 27676 (Dec. 18. 2007).

B&O tax purposes as well. The ability of all 47 cities to impose B&O taxes is critical to the municipalities' ability to provide public essential services. If the Court of Appeals' decision is not reversed, it would call into question the B&O taxes on service income paid to 43 Washington cities[4] and would adversely affect their ability to provide vital public services.

Per biennium, Tacoma receives more than 20% of its general fund revenue from B&O taxes.[5] This revenue source is significant and will be severely reduced and more difficult to collect if the Court of Appeals' decision is allowed to remain.

III. STATEMENT OF THE CASE

Amicus Tacoma adopts the Statement of the Case as set forth in the City of Seattle's Petition for Review.

IV. ISSUES PRESENTED

Amicus Tacoma adopts the Issues Presented as set forth in the City of Seattle's Petition for Review.

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[3] See LAWS of 2010, ch. 111, § 305; LAWS of 2017, ch. 323, §511; LAWS of 2019, ch. 101, §1; Tacoma Ordinance Nos. 28106 (November 27, 2012), 28593 (July 2, 2019), 28647 (December 17, 2019).

[4] See Appendix D, City of Seattle's Petition for Discretionary Review. Of the 47 local jurisdictions that impose a B&O tax generally, 43 of them impose the tax on service income.

[5] See City of Tacoma's Adopted Biennial Operating and Capital Budget for 2019/2020, page 20:
https://cms.cityoftacoma.org/finance/budget/2019-2020/2019-2020%20Adopted%20Budget%20Book.pdf

V. ARGUMENT

Pursuant to RAP 13.4(b), the City of Seattle has petitioned this Court to review the underlying decision in this matter for three independent reasons:

1) The Court of Appeals' decision is in conflict with a decision of the Supreme Court;

2) A significant question of law under the Constitution of the State of Washington or of the United States is involved;

3) An issue of substantial public interest that should be determined by the Supreme Court.

Tacoma supports Seattle's petition for all three reasons.

A. This case presents an issue of substantial public interest.

Like the other cities that impose a B&O tax, Tacoma is dependent on B&O tax revenue to fund essential public services. Tacoma also depends on a straightforward and clearly understood apportionment statute.

RCW 35.102.130(3), in effect during the audit in this matter,[6] outlines the two-factor apportionment formula for service income. As the Court is aware, the central issue is how the "payroll factor" should be calculated, and whether independent contractors have "the status of the employee of [the] taxpayer." See RCW 35.102.130(4)(c).

[6] RCW 35.102.130 was amended after the audit period in this matter.

KMS admits that most of its payroll is for "independent contractors", and not employees. See KMS's Answer to Petition for Review, page 5. Nonetheless, the Court of Appeals stretched its analysis to find that independent contractors were the same as employees for purposes of securities laws, regulations, and requirements, and so must be "employees" for purposes of tax apportionment in RCW 35.102.130.

If this decision stands, taxpayers all over Washington will scramble to take advantage of this confusing analysis to lower their local B&O tax obligation. Every city that imposes a B&O tax on service income—and there are 43 of them—will face this.

Repeatedly, KMS attempts to minimize the statewide impact of the Court of Appeals' decision. It says the Court of Appeals found "Seattle's tax unconstitutional only 'as applied" because of the unique role of KMS's registered representatives…." See KMS's Answer, p. 2. KMS even baldly claims "The holding is expressly limited to KMS" and that the "holding is limited to a single taxpayer. See KMS Answer, pp 16, 18. This is not accurate and not what the Court of Appeals stated.

The Court of Appeals stated that its decision "does not totally invalidate the statute, only its *future application in a similar context*." City of Seattle v. KMS Fin. Servs., Inc., 12 Wn. App at 504 (emphasis added). As a result, taxpayers with a "similar" business model—and no

one knows what that is—will attempt to reduce the amount of local B&O tax it has always been obligated to pay under the payroll factor. Cities will face the question of what other "similar" taxpayers can take advantage of this decision. This will only lead to confusion about how the newly interpreted payroll factor is to be applied. Cities and taxpayers alike will face the question of when "independent contractors" are employees and when they will not be for purposes of apportionment.

KMS further attempts to downplay the statewide significance of this decision by implying that Seattle, alone, made the decision to enact the apportionment law. KMS repeatedly refers to the state's apportionment law as "Seattle's, tax". (See e.g. KMS's Answer, p. 7, "*Seattle Enacts* a Two-Factor Apportionment Formula" and "*Seattle replaced* the apportionment formula considered in *KMS I*" (emphasis added); p. 8, "*Seattle recognized* that strict application of this two-factor formula may not lead to fair or constitutional apportionment in all cases." (emphasis added)). But this is a state law and any city that imposes a B&O tax must follow it.

RCW 35.102.130 states, "A city that imposes a business and occupation tax must provide for the allocation and apportionment of a person's gross income…" and then provides the formula for apportionment. As stated herein, the Court of Appeals' decision in this

case will affect cities across the state and will affect every taxpayer who provides services in this state and pays local B&O tax.

B. This case presents a significant question of constitutional law and conflicts with a decision of this Court.

The Court of Appeals' decision appears to apply a federal commerce clause analysis addressing *interstate* activity. Yet it also mentions the test under Washington law for local taxation: "Washington imposes a three-part test on a city's power to tax: (1) the relevant taxable event must be identified, (2) the taxable event must occur within the municipality's territorial limits, and (3) there must be a minimum connection between the municipality and the transaction it seeks to tax." KMS Fin. Servs., Inc., 12 Wn. App. 2d at 503. The Court of Appeals provided no analysis of the issue under Washington law. It is thus unclear whether or how this analysis, recognized by this Court in Dravo Corp. v. City of Tacoma, 80 Wn.2d 590, 594-5, 494 P.2d 504 (1972) still applies, or whether this Court intends to apply a federal commerce clause analysis to *intrastate* activity. The Court of Appeals decision thus raises a significant constitutional question and presents a conflict with this Court's decision in Dravo.

Again, this only leads to more confusion. While KMS states that the federal commerce clause analysis "applies equally to intrastate transactions" and cites to Tacoma v. Fiberchem, Inc., 44 Wn. App. 538, 543, 722 P.2d 1357 (1986), this Court has not said that. Cities and

taxpayers alike will be left wondering which test applies when faced with apportioning service income from *intrastate* activity.

VI. CONCLUSION

For all of the foregoing reasons, Tacoma asks this Court to review the Court of Appeals' decision and hold that the word "employee" in RCW 35.102.130(4)(c) means "employee" and not "independent contractor ".

Respectfully submitted this 18th day of August, 2020.

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CERTIFICATE OF SERVICE

I, Amber Eddy, certify that on August 18th, 2020, I caused City of Tacoma's Brief of Amicus Curiae in Support of City of Seattle's Petition for Review to be filed in the Supreme Court of the State of Washington and this document to be served using the email addresses indicated below:

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