

# Initiative 722

*(MRSC Note: We offer this analysis of the potential effects of the passage of Initiative 722 with a caution. These are our views at the time we are going to press – a short time after this initiative appears to have qualified for the ballot. As with Initiative 695, however, every time we review it, new issues seem to arise. We will keep you posted on any changes in or additions to our interpretation through mailings by us or our sister organization, the Association of Washington Cities, and postings on our Web site at [www.mrsc.org](http://www.mrsc.org).)*

The July 7, 2000, edition of the Seattle *Post-Intelligencer* reported that the backers of Initiative 722 had submitted 262,100 signatures to the Secretary of State. To be certified and put on the November ballot requires 179,248 valid signatures. Historically, approximately 10-15 percent of the signatures gathered are found to be invalid. Although the Secretary of State may not have completed the review of the signatures by the time we have to go to press, it appears that Initiative 722 will be found to have enough valid signatures to be on the ballot.

Initiative 722 has six provisions:

- It invalidates any tax increase adopted by local governments between July 2, 1999 and December 31, 1999.
- It exempts motor vehicles from the property tax.
- It puts limits on property tax increases on individual properties.
- It puts a new limit on the increase in regular tax levies of taxing districts.
- It amends RCW 84.55.0101, the “substantial need” statute.
- It would repeal RCW 84.55.092, the “you don’t lose it if you don’t use it” statute.

The legislature, in passing SSB 6115 (ch.136, Laws of 2000), has already exempted motor vehicles from the property tax. So, let’s look at the meaning and effects of the other provisions. Note that some observers think Initiative 722 has the same drafting problems that the King County Superior Court found unconstitutional in Initiative 695 – the requirement that an initiative have a single subject (Article II, Section 19 of the State Constitution). The inclusion of all these provisions may violate that requirement.

## **Invalidating Previous Local Government Tax Increases**

Section 2(2) of Initiative 695 defined “tax” in the following manner:

For the purposes of this section, "tax" includes, but is not necessarily limited to, sales and use taxes, property taxes, business and occupation taxes, excise taxes, fuel taxes, impact fees, license fees, permit fees, and any monetary charge by government.

Compare this to the definition of “tax” in section 1(2) of Initiative 722, which states:

For the purposes of this section, “tax” includes, but is not necessarily limited to, sales and use taxes; property taxes; business and occupation taxes; fuel taxes; impact fees; license fees; permit fees; **water, sewer, and other utility charges, including taxes, rates, and hook-up fees; and any other excise tax, fee,** or monetary charge imposed by the state. [Emphasis added.]

As the reader can see, the definition of “tax” in Initiative 722 is much more specific, and potentially more broad, than that of Initiative 695. The authors of the initiative apparently wanted to remove any ambiguity in the meaning of “any other monetary charge by government” in the definition of “tax” in Initiative 695. Does it include utility charges, for example? The new definition in Initiative 722 says it does.

What is ironic is that, while the petitions for Initiative 722 with this new definition were circulating, the attorney for the Initiative 695 campaign was preparing briefs and arguing before the Washington State Supreme Court on June 29 that the term “tax” in Initiative 695 meant what the average voter understood “tax” to mean. The “any other monetary charge by government” phrase in section 2(2) of Initiative 695, he argued, should be interpreted in terms of the specific taxes and fees that preceded it in the definition and should not be interpreted to include such things as “hamburger prices in Husky Stadium.”

Why was it so important for the attorney for the campaign to narrow the definition of “tax” in his argument before the Supreme Court? Because one of the grounds on which King County Superior Court Judge Robert Alsdorf found Initiative 695 to be unconstitutional in his March 14 ruling was that the ballot title was misleading.

Judge Alsdorf agreed that the drafters of the initiative had intended the term “tax” to apply to fees that do not meet the traditional definition of a tax. However, he said, that if that was the case, then the ballot title – “Shall voter approval be required for any tax increase, license tab fees be \$30 per year for motor vehicles, and existing vehicle taxes be repealed?” – would not alert the voters to the fact that a vote would be required on monetary charges that they did not think of as “taxes.”

Even if the Washington State Supreme Court finds Initiative 695 to be constitutional, it will still probably offer some guidance as to what the phrase “any other monetary charge” in section 2(2) means. Therefore, local governments that did increase taxes, fees, utility rates, charges, etc. will have some indication of where their risks lie.

***So, if the Supreme Court does find that some of the “tax” increases we passed between July 2, 1999 and December 31, 1999 do fall within the definition of “tax” under Initiative 695, will we have to refund the money if Initiative 722 passes?***

If the Supreme Court decision in the 695 case invalidates any increases that were made to fulfill the conditions of a contract (such as raising utility rates to maintain coverage for bonds), and if Initiative 722 were eventually upheld by the Supreme Court, the taxing jurisdiction (or at least bondowners and others contracting with a taxing jurisdiction) can still sue for impairment of contract in violation of the state constitution.

For increases in other taxes and fees, we don't know. This determination would have to be made by the courts. However, the courts often do consider the costs of making refund compared to the benefits to the recipient of the refund.

## **Limiting Property Tax Increases – The Sections That Affect the Amount That Can Be Levied**

A couple of the sections of Initiative 722 deal with property tax limitations that affect the amount that taxing jurisdictions can levy. Another deals with the increase in taxes on individual parcels. We will start with the first.

### ***Changes in the definition of “limit factor.”***

Section 5 of the initiative amends the definition of “limit factor” in RCW 84.55.005 – the amount by which a taxing jurisdiction can increase the amount of its regular property tax levy. Currently, the limit factor for jurisdictions with a population of under 10,000 is six percent. Under Initiative 722, the limit factor for these jurisdictions would fall to two percent.

For taxing districts with a population of 10,000 or over, the “limit factor” is currently the lesser of six percent or the increase in the implicit price deflator for personal consumption expenditures (IPD) for the 12-month period ending in July of each year as published in the *Survey of Current Business* by the Bureau of Economic Analysis. Under the provisions of Initiative 722, the limit factor for these jurisdictions would fall to the lesser of the IPD or two percent.

How does one reconcile the levy increases allowed by Initiative 722 without a vote of the people with the requirement of Initiative 695 that all tax increases be put to a vote of the people? We don't know.

### ***Changes in “substantial need” statute.***

Section 6 of Initiative 722 amends RCW 84.55.0101, the “substantial need” statute. Currently, those taxing districts with a population of 10,000 or more can authorize a regular property levy increase of more than the growth in the IPD up to an amount of six percent by a finding of “substantial need” by a supermajority vote of the council or two out of three commissioners. Under the provisions of Initiative 722, they could levy an increase more than the IPD, up to a maximum of two percent, upon a finding of substantial need.

### ***Implications for cities and counties of these changes.***

Using April 1, 1999 population figures from the Office of Financial Management, there were 215 cities and 9 counties with a population of less than 10,000. Some of these are at or close to their statutory rate limits and already cannot increase their levy by the full six percent. However, they may not be at their statutory maximum forever and other cities and counties are currently below theirs. Reducing the maximum increase in their levy from six to two percent would have a severe impact on their ability to raise revenues.

The legislative bodies of cities and counties with a population of 10,000 or more currently have the option of finding “substantial need” and increasing their levies by an amount up to six percent. Since this “substantial need” provision was passed under Referendum 47, a number of them have decided that it was fiscally prudent to do so. This local option choice would now be taken away from them if Initiative 722 should pass. Their findings of “substantial need” would only allow them to increase their levies to two percent if, indeed, the increase in the IPD were less than that amount.

## **The “You Don’t Lose it If You Don’t Use It” Statute – RCW 84.55.092 Would Be Repealed by the Passage of Initiative 722**

This statute allows the legislative bodies of taxing jurisdictions, which don’t wish to increase their levies by the maximum amount allowed by law in the current year, to “bank” their unused levy capacity and use it in future years. This provision means that jurisdictions can protect future levy capacity but still keep property taxes lower in the current year. Repeal of this statute will mean that local taxing jurisdictions will be under pressure to take the maximum amount allowed by law in any year, even if they don’t believe they need to for the current year’s budget, in order to protect themselves for future years.

## **Limits on Tax Increases on Individual Properties**

Section 3 of Initiative 722 would exempt a property owner from having "to pay the portion of property taxes attributable to any increase in value of the property (other than new construction or manufacture) over its 1999 valuation level, plus the lesser of 2% per year or inflation." Subsection (3)(c) of section 3 defines "inflation" to be "the percentage change in the implicit price deflator for personal consumption expenditures for the United States as published for the most recent twelve-month period by the bureau of economic analysis of the federal department of commerce in September of the year before the taxes are payable..." In other words, the same IPD that is used for the "limit factor" in calculating allowable levy increases under RCW 84.55.010.

We have heard two different views on how this section would be implemented by the assessors, and they are discussed below.

### ***Method 1***

If the initiative passes, the assessor would put all properties on the tax rolls at their full market value. Upon receipt of the taxing jurisdiction's levy request (which would be subject to the restrictions in section 5 of the initiative), the assessor would calculate the tax rate. On a parcel by parcel basis, the assessor would then calculate the taxes due on each property, using its market value. If that calculation produces a tax bill that is higher than the property's 1999 taxes, plus the lesser of inflation or two percent, then that additional amount would be waived unless it was the result of new construction. **If any of the properties in the taxing jurisdiction have increased in value by more than the lesser of inflation or two percent, the sum total of the tax bills that the assessor sends out will be less than the levy submitted.**

How much less would this be? It depends. If the increases in assessed valuation of individual properties are “tightly packed” – all within a few percentage points of each other – the total tax bills

sent out by the assessor will not differ that much from the levy request. However, if a taxing jurisdiction has some properties that have experienced large increases in assessed valuation and some very little, the difference between the levy request and the total tax bills will be much greater.

Fred Saeger, Director of the Washington Association of County Officials, wrote in a recent issue of *The Courthouse Journal*: "This may not be as serious a problem for a general operations type levy, but for certain levies that are voted in a specific dollar amount, for a bond levy which also requires a specific amount to redeem or pay off the bonds, not collecting the full amount would be a direct conflict to a previous vote by the public to collect certain amounts for specific projects or activities."

He is probably correct in saying that this is less of a problem for the property tax levy for the general or current expense fund than a bond levy. But, there still will be plenty of unhappy local officials who would receive less money than they levied – a levy already constrained to two percent (for taxing jurisdictions with a population under 10,000) and the lesser of the IPD or two percent for everyone else – and not know how much less until the assessor did all the individual calculations.

## **Method 2**

Proponents of this view believe that this section 3 of the initiative would be implemented as a tax exemption in the same manner as assessors currently implement other exemptions for senior citizens, historic preservation, etc. The assessor would value all properties at their market value. Then, on a parcel by parcel basis, it would calculate the "taxable assessed value" which, under the terms of section 3, would be the assessed value in 1999 plus the lesser of the IPD or two percent, plus new construction. The difference between the market and the taxable assessed value would be the exempt assessed value. Using this taxable assessed valuation, they would then calculate the tax rate necessary to fulfill the jurisdiction's levy request. Under this scenario, the sum total of the tax bills sent out would be the same as the jurisdiction's levy request rather than falling short as described above.

## **Potential Legal Challenges**

If this initiative passes, you can expect to see lawsuits. As mentioned above, the initiative may be challenged under the single subject rule. If Method 1 is used to implement section 3, and if taxing jurisdictions do not get all the money they levy for debt service on bonds, there will be impairment of contract suits. Either method used to implement the initiative would almost certainly lead to challenges under the uniformity clause of the constitution in Article VII, Section 1, which requires that all taxes shall be uniform upon the same class of property, with all real estate constituting a class. In the 1998 *Belas v. Kiga* case, the Washington Supreme Court threw out the provisions of Referendum 47 that slowed down increases in property values because those provisions were inconsistent with Article VII, Section 1.

If Method 1 were used, even though all property would be valued at market value, property taxes paid as a percent of market value would be lower for properties that appreciate more rapidly. If Method 2 were used, the market value of two properties that had equal market (and assessed) values in 1999, might grow at different rates. But, since the valuations on which their taxes are based would both grow by the same maximum two percent a year, the taxes paid would be identical. Article VII, Section 1 of the Washington State Constitution does provide that the legislature may

exempt property from taxation. However, an exemption that is based upon the increase in value could be viewed by the courts as a way of trying to get around the uniformity clause.

## **If Initiative 722 Passes, How Would It Affect the Way We Budget This Year?**

If your city or county increased some tax or fee between July 2, 1999 and December 31, 1999; and if Initiative 695 is found to be constitutional; and if Initiative 722 passes; and if it is found to be constitutional, it is possible that you would have to return some of the monies that had been collected after the date of the increase. At the time you adopt your budget for 2001, you will not know whether refunds will have to be made or when, but you should assess your potential liability during the budget process.

In determining the effect of Initiative 722 on your property tax levy for 2001, you need to look at Initiative 695 and Initiative 722 together. At the time you set your levy, you will know whether Initiative 695: 1) has been found constitutional; 2) has been found unconstitutional; or 3) has not been ruled on. Similarly, at the time you set your levy, you will know that Initiative 722 passed or it did not. Therefore, there are six combinations of these possibilities.

1. **You know that Initiative 695 was found constitutional and Initiative 722 passed.** Initiative 695 requires a vote of the people for a levy increase and Initiative 722 lets you increase your levy by the lesser of the increase in the IPD or two percent. These provisions could possibly conflict and might have to be reconciled by the courts. Note, that even if you decide to be conservative and take no levy increase, you still won't know whether you can "take" levy increases due to new construction and an increase in state-assessed utility property without a vote of the people. The question of what is meant by "any monetary increase in an existing tax" in section 3 of Initiative 695 was not addressed in the arguments before the Supreme Court and, therefore, their opinion will almost certainly not address this question.
2. **You know that Initiative 695 was found constitutional and Initiative 722 did not pass.** You probably need a vote of the people to increase your levy. The question of whether you can "take" new construction without a vote of the people is still open. See the comments in paragraph 1 above.
3. **You know that Initiative 695 was found unconstitutional and Initiative 722 passed.** With certainty, jurisdictions with a population under 10,000 can increase their levies by two percent, plus new construction. Larger jurisdictions can increase their levies by the lesser of the increase in the IPD or two percent. If the increase is less than two percent, they can increase their levies by two percent with a finding of substantial need. Unless Initiative 722 is invalidated later, you cannot bank any levy capacity you don't use this year.
4. **You know that Initiative 695 was found unconstitutional and Initiative 722 did not pass.** You are back in the world as it existed before the passage of Initiative 695.
5. **There has been no ruling on Initiative 695 and Initiative 722 passed.** All you know is that the outcome will be either the one discussed in paragraph 1 or paragraph 3.

6. **There has been no ruling on Initiative 695 and Initiative 722 did not pass.** By the time you set your levy, you should know whether the March 14th ruling by King County Superior Court Judge Robert Alsdorf, which enjoined political subdivisions from taking any action to implement the voter approval section of Initiative 695, was lifted by the Supreme Court. (See page 47 for more on this injunction). If it was not, then you can increase your property tax under the current statutes, taking a maximum six percent increase, with a finding of substantial need, if that is required. You must realize there is a risk, probably very small, in doing so. Even if, subsequently, Initiative 695 is found to be constitutional, attorneys with whom we have talked agree that it is unlikely that a future court would “unwind” an increase you made without a vote of the people when, in fact, you were enjoined from having such a vote.

## **Initiative 745 – Where Is the Discussion?**

The backers of this initiative submitted more than 260,000 signatures on July 6, and since only 179,248 valid signatures are required, this initiative is likely to be certified for the November ballot. The Ballot Measure Summary as shown on the Secretary of State's Web site is:

This measure would require that 90% of state and local transportation funds, including local transit taxes but excluding ferry and transit fares, be spent on road construction, improvement, and maintenance. Road and lane construction and maintenance would be the top transportation priority. Performance audits of transportation and public transit agencies would be required. Materials and labor used in road construction or maintenance would be exempt from sales tax. Counties and cities would update transportation plans.

MRSC has no staff with expertise in transportation funding and we are deferring to our sister organization, the Association of Washington Cities (AWC), which does have staff who are knowledgeable in this area, to provide an analysis of this initiative. Our staff has concentrated on the property tax initiatives.

AWC will be mailing a “fact sheet” on this initiative in the near future, perhaps even before you have received this publication. MRSC will be establishing an Initiative 745 Web page and it will have a link to the material that AWC produces. Any county officials who do not have access to the Internet may call our library to get a copy of the AWC publication.