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The Hottest Trend in Local Tax Hiking: Employee Head Taxes

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Seattle has garnered a great deal of national attention for its newly-passed employee head tax (EHT) proposal. The proposal levies a tax on mid- to large-size employers at a rate of $275 per employee per year—even businesses headquartered outside the city with enough receipts within city limits would be subjected to the tax as well. The tax has been derided as a tax on jobs by former governors and state legislators of both parties—even Seattle's mayor threatened to veto the tax increase before the rate was lowered.

But Seattle is neither the beginning nor the end of the EHT. In fact, the city already had an EHT on the books a decade ago, only to repeal it in 2009 for its negative impact on economic growth and its administrative difficulty. It was said to be "penalizing Seattle businesses for creating new jobs," and that was at the comparatively meager rate of $25 per employee per year. The new proposal is more than 10 times that amount.

Other cities have had taxes resembling an EHT in place before Seattle did, though the rate was not as high. Pittsburgh assesses a tax of $52 per year on employees, and Denver assesses an EHT on businesses at a rate of $117 per year. A major distinction is that these cities justified the taxes to fund community services such as firefighting or policing—services which are loosely tied to employment levels. Seattle's EHT was instituted for the express purpose of combating homelessness.

Since Seattle's announcement, other cities have latched on to the idea of milking big tech companies by taxing them per employee they have on their payroll. Silicon Valley is especially enamored: Cupertino, home to Apple, and Mountain View, Google's headquarters, are each considering versions of an EHT. Details on the Cupertino version are not out yet, but Mountain View's tax would aim to raise about $10 million.

What Are the Effects of an EHT?

As every economist will tell you, one of the first rules of tax policy is that if you want less of something, tax it. An EHT is no different—its most obvious and direct effect is to decrease employment, whether by causing layoffs or disincentivizing future hiring. And because an employee making minimum wage makes a business liable for the same EHT as a CEO making millions, businesses have every incentive to lay off low-wage workers first.

Beyond just these effects, an EHT sends a hostile message to local businesses. At a time when cities are falling over themselves to entice Amazon's new headquarters (and the high-paying jobs it promises) to their city, cities that tax employers for every job created stand out. Businesses receive a clear message from an EHT that the city intends to treat them as a source of revenue to drain, not as a partner that contributes financially to the city that houses it.

The distinction is important to businesses. Amazon made that clear in its response, stating: “We remain very apprehensive about the future created by the council’s hostile approach and rhetoric toward larger businesses, which forces us to question our growth here."

Smelling blood in the water, other cities are moving to try to lure Amazon away from Seattle. Tacoma, Washington, even offered $275 per job created paying $65,000 or more to businesses coming to the city. The fact that this number is exactly the same as Seattle’s head tax rate is likely not a coincidence.

So Why Are They Becoming So Popular?

One answer is that to cities seeking new revenue, large tech companies look like a cash cow. They are usually by far the largest employers in the city—for example, Seattle is far from a small city, but Amazon makes up over 10 percent of the city’s workforce. The ratio is even more significant in medium-sized cities like Cupertino or Mountain View, with populations below 80,000.

A common argument made by those defending Seattle’s EHT is that the structure of the tax is far from ideal, but the city does not have any alternatives. Washington state prohibits localities from imposing an income tax, defenders of the tax argue, so how else is the city supposed to raise revenue?

This line of thinking presupposes that Seattle is spending (and taxing) efficiently and has no choice but to raise taxes in order to fund responses to homelessness. That’s debatable at best. Seattle’s population has grown 11 percent over the past five years, but over this same period, government costs increased by an astonishing 40 percent, while tax revenues jumped by 35 percent. According to an investigation by *The Seattle Times*:

- Nearly every city department increased in size
- Public safety expenditures increased by $100 million
- Spending on transportation doubled
- Employee wages hit $1.1 billion as almost half of full-time city employees made over $100,000

Amid all this, pension obligations and other social service expenditures have continued to increase. That’s not the picture of a lean, efficient government struggling to find sufficient revenue sources, that’s the picture of a city that can’t control its spending habit. If homelessness is in fact a significant problem, the city should reprioritize its ample spending budget before coming back to taxpayers for more money.

Another issue with this argument is that there are, in fact, other options available to cities like Seattle looking to raise revenue in a less economically harmful way. Every tax harms someone, but there are more traditional approaches available.

For example, a payroll tax, particularly an employer-side version in which the employer pays taxes as a percent of wages paid (with the same gross receipts threshold), would be far less punitive to lower-wage workers since it would scale with income. It would also impose less of a burden on employers who are required to track employee hours under the EHT. In fact, the Seattle proposal is set to transition to a payroll tax within a few years, which begs the question of why they didn’t just start with a payroll tax to begin with. The city’s justification is that it has the infrastructure in place to collect on an EHT but not a payroll tax yet, but that is more of a reason to wait to impose any tax than a reason to have an EHT.

Cupertino and Mountain View are in similar situations. Despite arguments that rapidly growing cities need new sources of revenue, it's important to remember that influxes of highly-paid workers don't come without benefits. New highly-paid workers contribute to rising sales and property tax revenues, which most cities rely on for revenue. California, in particular, gives localities greater latitude in raising taxes to fund their own services.

A Troubling Line of Thinking

Arguably the root cause of Seattle's challenges, and those of its California counterparts, is simple: lack of sufficient housing supply. California ranks 49th in the nation in housing units per person, a problem seen most acutely in Silicon Valley, while Seattle housing has failed to keep pace with its population boom.

In this context, one is led to wonder if cities might consider the negative effect an EHT has on employment to be a feature, rather than a bug. Mountain View Mayor Lenny Siegel's assertion that the city has "too many good jobs" and not enough transit is telling. Provide a disincentive for new hiring, and cities can curb the strain on transit systems and housing markets.

But this misidentifies the issue. Influxes of workers are not the problem. Zoning rules that bar developers from responding with new high-rise housing, particularly near transit hubs, are the problem. Seattle has added 100,000 new employees since the recession, but only 32,000 new housing units. This is in large part due to zoning rules that "make it almost impossible to build anything other than a single-family house." Housing a hundred thousand young, often single tech workers in single-family homes built for the needs of a previous decade is simply not practical.

Cupertino and Mountain View face similar situations. Sprawl is common across tech hub cities, as workers move out to find more affordable housing. The result is that the transit networks are even *more* strained, as they have to span greater distances.

Treating Symptom, Not Disease

Trying to cut back on jobs to alleviate strain on housing and transit attacks a symptom, not the disease. And as Jared Walczak of Tax Foundation points out, if cities are struggling to raise enough funds to pay for their spending habits as is, imagine how difficult it will become when tech businesses pare back their staffs or worse, flee for greener pastures.

In this context, it's difficult to see how throwing more money at housing programs, many of which simply subsidize housing costs, will do anything other than make the problem worse. While it has been the subject of much debate among housing specialists, there is a growing realization that housing subsidies and affordability mandates common in cities like Seattle are inadequate to solving the basic problem of insufficient housing supply.

Consider the case of Houston. Despite being one of the largest and fastest-growing cities in the country, the city leads the nation in average income when adjusted for cost of living. While housing prices in cities like San Francisco, Seattle, and Los Angeles on the West Coast and New York City and D.C. on the East Coast have skyrocketed since 1980, Houston's housing prices have managed to remain well below the national average.

How has it managed this? Houston's success is largely attributable to what the city does *not* do, rather than what it does. Zoning rules allow residential, commercial and industrial developments are free to mix as they please and as the market dictates—different types of residential developments, such as apartments and single-family homes, are allowed to do so as well. The city naturally clusters into different types of areas, of course, but zoning is market-driven, not planned by the city government.

Yet alongside a lack of land-use and zoning regulation, Houston also has not succumbed to the pitfalls many cities struggling with a housing crisis have. The conventional approach to addressing housing crises is to pour money into public housing while enacting rent controls. But affordable housing has proven to be a money pit for many cities, costing more per housing unit than the market rate. Meanwhile, economists agree that rent control ends up hurting the housing market in the long run by disincentivizing the building of new housing. It's not a coincidence that Houston is one of the few cities that has avoided responding to rapid growth by investing relatively little in public housing or enacting rent controls.

Conclusion

EHTs, tempting as they may seem as an easy method of profiting off of wealthy tech companies, are far more harmful than they are helpful. They punish low-income workers and create a hostile business environment, directly contradicting their purpose of raising funds to address housing crises. Cities should seek to rein in their spending habits or restructure existing taxes before concocting tax schemes like an EHT.

About the Author

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