The End of Fees Disguised as Taxes?

City of St. Paul PILOT Committee Meeting
June 1, 2017

Todd Guerrero, Kutak Rock LLP

Issue:

- When is a municipal fee or assessment really a tax?

History

1857 | Minnesota Constitution Article X, Section 1:

Power of taxation; exemptions; legislative powers. The power of taxation shall never be surrendered, suspended or contracted away. Taxes shall be uniform upon the same class of subjects and shall be levied and collected for public purposes, but public burying grounds, public school houses, public hospitals, academies, colleges, universities, all seminaries of learning, all churches, church property, houses of worship, *institutions of purely public charity*, and public property used exclusively for any public purpose, *shall be exempt from taxation except as provided in this section…*

The legislature by law may define or limit the property exempt under this section other than churches, houses of worship, and property solely used for educational purposes by academies, colleges, universities and seminaries of learning.

The legislature may authorize municipal corporations to levy and collect assessments for local improvements upon property benefited thereby without regard to cash valuation.

A Municipality's Taxing Authority

Power to Tax

- Power to tax "inherent in the sovereignty"

- Essential to existence of government

- "Practically" absolute, except for constitutional limitations (i.e., Art. X, §1)

- Where legislature authorizes cities to tax (which it must), same limitations apply

A Municipality's Taxing Authority

Taxes Raise Revenue to Support Public Purposes

- Tax = general charges to raise revenue to fund public purposes/programs

- No need to draw connection between entities bearing tax and benefits provided

- Taxes usually deposited in general fund, but can also be earmarked

A Municipality's Taxing Authority

Power to Levy <u>Special Assessments</u> Originates from the Taxing Power

- Special assessments - local improvements that provide *direct benefit* to taxpayer

- Authority to levy special assessments originates from taxing authority

- Special assessments must

  - provide property with measurable benefit

  - be uniform upon same class

  - may not exceed benefit

- Assessment that exceeds benefit = government taking

- *See, e.g., Quality Homes, Inc. v. Village of New Brighton,* 183 N.W.2D 555 (Minn. 1971) (interpreting Art. 10, §1 of Constitution)

A Municipality's Taxing Authority

State Constitutional Limits to Taxation

- "Power to tax = power to destroy"

- Most important safeguard: government must win vote of approval from taxpayers

- Art. X, §1 additional safeguard: must be spent on public purpose; and special assessment must provide measureable benefit

The Police Power Authorizes Municipalities to Collect *Regulatory Service Fees*

Purposes and Characteristics of Fees

- In addition to taxes, municipalities may collect "regulatory service fees" under *police power* – to defray cost of regulating private activity

- For purpose of "preserving public health, safety, welfare, and abating public nuisances"

- Examples: permit and license fees; utility charges; building/inspection fees, nuisances, etc.

- Characteristic of fee: voluntary and charged to specific property owner

  ➤ Those not affected do not pay

The Police Power Authorizes Municipalities to Collect Regulatory Service Fees

Safeguards Against Abusing Fees

- Regulatory fee not required to show measurable benefit to property: must only be reasonably proportional to service provided

- Fewer safeguards: harder to hold elected officials accountable

Municipalities May Not Raise General Revenue Under Its Police Power

- Police power does not permit cities to raise general revenue – i.e., for general public purposes

- General revenue raising must come from <u>taxing</u> authority

- Designation of charge – i.e., "tax" or "fee" – not conclusive

- Where revenue is primary purpose = tax

- Where regulation is primary purpose = fee

- Question is to determine true nature of assessment

Municipalities May Not Raise General Revenue Under Its Police Power

How Other Jurisdictions Have Addressed Question

- Courts regularly called to decide whether municipal charge is tax disguised as fee

- Court have adopted tests (federal courts; Washington; Michigan; Florida)

  - what entity imposes charge – i.e., city council versus license bureau, etc.?

  - what population is subject to charge?

  - what purposes served by charge – i.e., public versus private?

Municipal Fee Examples

- St. Paul ROW assessment

- Duluth – street system maintenance fee

- "Downtown Improvement Districts"

- Mankato – street lighting

- St. Cloud – street lighting

- 20 + additional cities have fees

First Baptist Church v. City of St. Paul

Parties

- First Baptist Church of St Paul
- St Mary's Church of St Paul
- City of St Paul
- Center for the American Experiment
- Minnesota Council of Nonprofits
- League of Minnesota Cities

Facts

- ROW Assessment:
  - Sweeping, flushing, patching, chipsealing streets and alleys
  - Overlaying streets
  - Snow removal
  - 10 more services
  - In existence almost 80 years
- ROW assessment collected over $26M from 81,000 property owners
  - $15000 from First Baptist and over $8000 from St Mary's
  - Churches exempt from property taxes as houses of worship

Party Arguments

Churches

- City cannot avoid the constitutional limits of the ROW assessment by mischaracterizing it as a regulatory service fee
- ROW failed to meet constitutional requirements – i.e., cost of services exceeds special benefit
- The purpose of the ROW indicates it is a tax
- City charter and ordinances cannot violate the constitution

City of St Paul

- City of St Paul is authorized by statute to enact its own laws pertaining to special assessments, as a home rule charter city
- ROW services are performed under the City's police powers
- City's collection of costs for services under police power is a fee, not a tax
- A reasonableness of the fee analysis applies, not a special benefit analysis.

Amici Arguments in support of Churches

Center for the American Experiment

- Taxes raise revenue to support public purposes
- Fees collected defray the costs of regulating private activity authorized to regulate under the police power (public health, safety, morals, abating public nuisance)
- Cities cannot raise general revenue under its police power
- Also – allows property owners to challenge assessment if assessment exceeds benefit – if it were fee, this challenge makes no sense as fees only need be proportionate to cost of service

Minnesota Council of Nonprofits

- Minnesota nonprofits provide public services for the common good and lessen the burden of government
- ROW is a tax that evades the constitution and the state's policy for determining property tax-exemption

Amici Arguments in support of City

League of Minnesota Cities

- ROW is authorized under the city's home rule charter under its police power

- Special benefits test only applies to local improvements

- ROW is not a tax because they are not a revenue raising measure, but cost recovery

Issue:

Is St. Paul ROW assessment tax or fee?

Decision:

"[W]e conclude that the City's power to collect the ROW assessment derives from its power to tax rather than from its police power…"

Court's reasoning

- To determine primary purpose of ROW Assessment, court looked at **language** of city charter and code and **substance** of ROW Assessment, and at other jurisdictions

Language:
  - Improvements of a local character are a tax and the special benefits test applies
  - Intent to raise general revenue
  - Invokes elements of special benefit test

- Substance – what power is exercised when City collects assessment?
  - Not imposed on limited group of payers (all 81,000 taxpayers)
  - Charge not necessitated by cost of regulating any of charged properties in manner of true regulatory fee

- Other Jurisdictions
  - Idaho
  - Washington
  - Florida

Tax or Fee?

Tax

- Revenue raising for a public purpose
- Benefits general public
- Annually recurring assessment
- Imposed city-wide/large population
- Diverse services provided as needed

Fee

- Covers regulatory cost
- Imposed on a limited number of property owners
- Charged for use or consumption of specific types of services
- Not limited by benefit conferred

Q&A