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Note to Michigan Municipalities: A Tax Is Not a User Fee

by Lawrence W. Reed

Summary

A recent Michigan Supreme Court decision overturning Lansing's "rain tax" affirms that municipalities cannot increase taxes merely by calling them "user fees" without violating the state constitutional requirement to get voter approval for tax hikes.

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In a recent decision, the Michigan Supreme Court presented a ringing defense of the 1978 Headlee Amendment to the state Constitution and an eloquent affirmation of sound economic principles. The decision established an important precedent that puts municipalities on notice that the voters who approved the amendment intended for it to be enforced, not subverted.

Among the several provisions of Headlee is Article IX, Section 31 of the Constitution, which requires voter approval before a tax can be imposed or increased. In its 1994 report, the Headlee Amendment Blue Ribbon Commission found that a growing number of Michigan townships, counties, and cities were skirting the voter approval requirement by mislabeling certain taxes as "user fees." The Michigan Supreme Court's decision may end that practice once and for all.

In 1995, the city of Lansing adopted Ordinance 925, known by many as the "rain tax." It provided for the creation of a storm water enterprise fund "to help defray the cost of the administration, operation, maintenance, and construction" of a new storm water system that would separate sanitary and storm sewers. Heavy rains had occasionally caused the city's combined sanitary and storm sewer system to overflow, discharging untreated and partially treated sewage into the Grand and Red Cedar Rivers.

Taxes vs. User Fees in Michigan

	Tax	User Fee
Purpose	Raise Revenue	Defray Service or Regulatory Cost
Amount	Not Related to Cost of Service	Proportionate to Cost of Service
Participation	Compulsory	Voluntary
Approval	Voters	Government

Half of the 30-year, $176 million cost of the system was to be financed through an annual "storm water service charge" imposed on each parcel of property in the city. The city maintained that the service charge was a user fee and therefore did not have to be put before the voters for approval.

But Lansing citizen Alexander Bolt had read the state constitution and knew a tax when he saw one. Bolt challenged the Lansing "rain tax," taking the case all the way to the Michigan Supreme Court, a majority of which on December 28, 1998,

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declared, "We hold that the storm water service charge is a tax, for which approval is required by a vote of the people. Because Lansing did not submit Ordinance 925 to a vote of the people as required by the Headlee Amendment, the storm water service charge is unconstitutional and, therefore, null and void."

The Court's majority opinion refreshingly argues that "a primary rule in interpreting a constitutional provision . . . is the rule of 'common understanding.'" In other words, in this case the intent of the voters should be of utmost importance, as opposed to some judicially activist fabrication. The Court affirmed that the voters intended to place limits on taxes and governmental expansion.

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Just what exactly distinguishes a user fee from a tax? The Court advanced three main criteria: 1) a user fee is designed to defray the costs of a regulatory activity (or government service), while a tax is designed to raise general revenue; 2) a true user fee must be proportionate to the necessary costs of the service, whereas a tax may not be; and 3) a user fee is voluntary whereas a tax is not.

The Lansing ordinance failed all three tests of a user fee. The Court determined that it constituted "an investment in infrastructure as opposed to a fee designed simply to defray the costs of a regulatory activity" and agreed with the dissenting opinion in a lower court ruling that the revenue from the charge was "clearly in excess of the direct and indirect costs of actually using the storm water system." The Lansing rain tax applied "to all property owners, rather than only to those who actually benefit," contrary to a genuine user fee.

Most plainly, the rain tax was utterly involuntary. True user fees are only compulsory for those who choose to use a service, but Lansing property owners in this case had "no choice whether to use the service" and were "unable to control the extent to which the service" was used.

The Court's majority concluded by quoting the Headlee commission report, "This is precisely the sort of abuse from which the Headlee Amendment was intended to protect taxpayers." Amen!

The message is clear to Michigan municipalities: You now have no legitimate excuses for mislabeling taxes as "user fees." Be honest. If it's a tax, put it before the voters as the Headlee Amendment requires, and make your best case. You can't ignore the Constitution just because you need the money.

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(**Lawrence W. Reed is president of the Mackinac Center for Public Policy in Midland and, as a member of the Headlee Amendment Blue Ribbon Commission, he helped write the portion of the commission's report dealing with the user fee vs. tax issue.** More information on tax policy is available at **www.mackinac.org**. Permission to reprint in whole or in part is hereby granted, provided the author and his affiliation are cited.)

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