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Memorandum

TO: Michigan Recycling Partnership

FROM: Jaffe, Raitt, Heuer, & Weiss, P.C.

RE: Evaluation of proposed constitutional amendment and statutory language

DATE: January 20, 2006

I. Introduction.

A constitutional amendment and implementing legislation have been proposed to fund recycling and litter prevention education by collecting a one cent per transaction fee at each sales transaction involving a sale of goods to an ultimate consumer (not sales at wholesale for resale) subject to certain exceptions and exemptions.

You have asked us the following four questions:

1. Does the proposed amendment of the Michigan Constitution immunize this fee from challenges that it violates the Michigan Constitution?

2. Does the proposed fee place the State in conflict with the terms of the Streamlined Sales Tax Agreement to which Michigan is a party?

3. Should a court evaluate the proposed fee pursuant to the *Bolt* case, what would that analysis likely conclude?

4. Are there changes to the proposed legislation that should be considered.

While not a formal legal opinion of this firm, the following are our conclusions.

II. Executive Summary

The short answers to these questions are as follows: (1) yes, if the Michigan Constitution is amended, this fee should be immune from challenge as an invalid tax; (2) no, we conclude that it should not place the State in conflict with the Agreement; (3) a *Bolt* analysis should be

preempted by the Constitutional amendment, but if a court were to conduct such an analysis it is possible for it to come out either way. Given the Court of Appeals' published decisions following *Bolt*, we conclude that it is very likely that a court would uphold the fee as a valid exercise of the State's police powers rather than as an invalid tax.

III. <u>Constitutional Analysis</u>

House Joint Resolution O proposes an amendment to the Michigan Constitution pursuant to Article XII Section 1, whereby an amendment is proposed in the Legislature and then presented to the electors for their approval. Upon approval, it becomes part of the Constitution and abrogates or amends existing provisions of the Constitution at the end of 45 days after the date of the election. Const. 1963, Art 12, §1.

At present, the most significant concern raised is the possibility that this fee would be deemed a tax and therefore would run afoul of the Constitutional provisions requiring that any law enacting a tax "state the tax," Const 1963, Art 4, § 32, or that its adoption by the Legislature without a vote of the electorate would violate the Headlee Amendment. Const 1963, Art 9, §§25 - 31.

Well settled principles of Michigan jurisprudence are:

- those who draft a constitution or its amendments are presumed to have known of existing constitutional provisions and laws and to have drafted accordingly, *Mahaffey v Attorney General*, 222 Mich App 325 (1997), *app den* 456 Mich 948 (1998); *Richardson v Hare*, 381 Mich 304 (1968) and *Michigan v Thompson*, 424 Mich 118 (1985);

- conflicting constitutional provisions must be reconciled as much as possible to accomplish the intent of the provisions, *Thoman v Lansing*, 315 Mich 566 (1946), overruled on other grounds, *East Grand Rapids School District v Kent Cty Tax Allocation Bd*, 415 Mich 381 (1982); and

- when a constitutional amendment qualifies or restricts an earlier constitutional provision, the later amendment must control, *Thoman, supra*.

Therefore, the drafters of this amendment are presumed to be aware of the Constitutional provisions listed above and the *Bolt* decision and its progeny, discussed *infra*. They will be deemed to have understood the tax vs. fee issue articulated by *Bolt* and therefore, will be deemed to have taken it into account in their drafting. Further, by clearly calling the charge here a fee and not a tax, the drafters of the amendment would be deemed to have understood that they were not within the realm of Article 4 Section 32 or the Headlee Amendment.[1] Further, as the proposed amendment would be of more recent vintage than either of the two constitutional law provisions cited above, it would take precedence and in harmonizing the provisions, a Court would be expected to give effect to the electorate in authorizing the fee in question.

IV. Streamlined Sale Tax Analysis

Michigan is a full member and signatory to the Streamline Sales and Use Tax Agreement, most recently amended in October 1, 2005. The purpose of this Agreement is primarily to clarify, streamline and standardize the tax treatment of sales from a vendor in one state to a purchaser in another and to ensure taxes are collected on all such transactions. Michigan also adopted 2004 Public Act 174 to qualify for membership in the Agreement. That Act defines "sales tax" and "use tax" as those taxes adopted pursuant to MCL 205.51 *et seq*. and 205.91 *et seq.*, respectively. 2004 Public Act 174, MCL 205.803. By defining these taxes that way, the 2004 Act excludes the fee under consideration. The State could further designate the fee as excluded from coverage under the Agreement if it wanted to be certain, but, again, this is likely not necessary due to the proposed Constitutional definition which is consistent with the existing statutory definition. We conclude that this fee should not result in Michigan being out-of-

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[1] Query whether the Headlee Amendment (which does not require a state-wide vote to impose taxes as long as the overall state tax burden remains below a set historic percentage) would even apply here, as we understand the State is well below the Amendment's tax threshold.

compliance with the Streamlined Sales Tax Agreement. *See* the discussion below regarding Subsection 16203(7).

V. **Bolt Tax Analysis**

1. **The Legal Standard**

Courts have used a three-part test to determine if an assessment is a fee. In 1998, the Michigan Supreme Court stated a three-part test to be used in determining whether an assessment was a fee or a tax. *Bolt v Lansing*, 459 Mich 152 (1998). The Court stated the three criteria which demonstrate that a charge is a fee rather than a tax: (1) the fee serves a regulatory purpose rather than a revenue raising purpose; (2) user fees must be proportionate to the necessary cost of the service; and (3) the fee must be voluntary. *Id*. at 161-62; *see also Mapleview Estates, Inc v City of Brown City*, 258 Mich App 412, 415 (2003), *app den* 469 Mich 1000 (2004) (reiterating the *Bolt* test and stating "to be considered a fee, a charge must: (1) serve a regulatory purpose rather than a revenue raising purpose; (2) be proportionate to the necessary cost of the service; and (3) be voluntary, in the sense that the payer may choose not to avail himself of the benefit and thereby avoid the charge."); and *Graham v Kochville Twp,* 236 Mich App 141, 156 (1999) (holding that a water connection charge is a fee rather than a tax because it serves a regulatory purpose, is proportionate to the necessary cost of the service and is voluntary).

In *Bolt*, the Michigan Supreme Court reviewed a Lansing ordinance creating a stormwater service charge without seeking voter approval under the Headlee Amendment. Const 1963, Art 9, §31. The money collected pursuant to the storm water service charge was used to defray the cost of a $176 Million program implemented to avoid the combination of wastewater with storm water drains in the Lansing area. Plaintiff was billed $59.83 for his parcel of property that represented his pro-rata share of the storm water service charge.

The Supreme Court concluded that the stormwater service charge violated the Headlee Amendment because it was a tax and not a valid user fee. The Supreme Court stated:

> Determining whether the storm water service charge was properly characterized as a fee or a tax involves consideration of several factors. ***Generally, a 'fee' is exchanged for a service rendered or a benefit conferred, and some reasonable relationship exists between the amount of the fee and the value of the service or benefit. . . . Exactions which are imposed primarily for public rather than private purposes are taxes***. Revenue from taxes, therefore, must inure to the benefit of all, as opposed to exactions from a few for benefits that will inure to the persons or group assessed.

Id. at 161 (internal citations omitted) (emphasis added).

The Court then applied the three criteria. With respect to the first criterion, the Court stated

> to be sustained [as a regulatory fee], the act we are here considering must be held to be one for regulation only, and not as a means primarily of producing revenue. Such a measure will be upheld by the courts when plainly intended as a police regulation, and the revenue derived therefrom is not disproportionate to the cost of issuing a license, and the regulation of the business to which it applies.

Id. at 163 (internal citations omitted). The Court held that because the "surcharge" was not structured to simply defray the cost of a regulatory activity but rather was used to fund a public improvement designed to provide a long-term benefit to the city and all of its citizens, the fee was really a tax. *Id.* at 163-64. The Court also stated that because the amount the city received was disproportionate to the city's benefit, in terms of infrastructure, this has to be a tax. *Id*. The Court recognized that for this charge to be a fee, it must reflect a corresponding benefit on the person paying the charge "which benefit is not generally shared by other members of society." *Id.* at 165. The Court concluded that because those not paying the charge were sharing in the benefits of the charge, the charge was a tax.

In addressing the third factor, the Court noted that this fee lacked any element of volition. "One of the distinguishing factors of a tax is that it is compulsory by law, whereas payments of user fees are only compulsory for those who use the service, have the ability to choose how much of the service to use, and whether to use it at all." *Id*. at 167-168.

In summing up, the Court stated:

> The distinction between a fee and a tax is one that is not always observed with nicety in judicial decisions, but according to some authorities, any payment exacted by the state or its municipal subdivisions as a contribution toward the cost in maintaining governmental functions, where the special benefits derived from their performance is merged in the general benefit, is a tax

Id. at 165-66; citing 71 Am Jur 2d, State and Local Taxation, § 15, p 352.

2. <u>The Fee – Arguments to validate</u>

A Court of Appeals case that followed *Bolt*, *Saginaw County v John Sexton Corp*, 232 Mich App 202 (1998), *app den* 461 Mich 881 (1999), gives some insight into how the Michigan Courts would view the fee. In *Saginaw v Sexton*, the County Board adopted a solid waste ordinance that included the imposition of a 50¢ surcharge on every cubic yard of solid waste disposed of in county landfills. The Michigan Court of Appeals concluded that the surcharge "was intended to fund the enforcement of the county's solid waste management plan, and therefore, it related to county affairs." 232 Mich App at 221. The monies received by the county were used for the operational costs of the county's health department, recycling department and solid waste (administrative) department for implementation of the county's solid waste plan.[2]

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[2] This included county solid waste employee salaries, benefits, travel expenses, promotion of the county's recycling program, ordinance enforcement and implementation activities such as monitoring who utilizes each landfill, recording the landfill activity of each hauler, ensuring that no improper waste enters a landfill and estimates of landfill space.

The court in *Saginaw v Sexton* looked to an earlier case, *Bowers v Muskegon*, 305 Mich 676 (1943), where the Michigan Supreme Court discussed whether revenue from newly installed parking meters constituted a fee or a tax. The Supreme Court in *Bowers* concluded that receiving revenue for traffic control devices and regulations, beyond the parking meter costs themselves, was not so remote from the parking problem and that parking meter proceeds in excess of that amount did not reflect an intent to raise revenue as part of a related police regulation. In other words, the Court held that using monies incidentally raised from parking meters for other parking related devices and regulations somehow immunized the excess revenue raised. The *Saginaw v Sexton* case held that the funds raised and used for recycling were merely excess and incidental to the remaining police power type charge.

The argument would be made that encouraging recycling and minimizing littering and waste disposal is a legitimate exercise of the State's police power. Therefore, the imposition of a fee to support the minimization of littering and the encouragement of recycling would be related to that legitimate police power and therefore a fee. Here, either the vendor or the purchaser's conduct is being subjected to the fee and the activity being "regulated" is the recycling, littering and disposing of the wastes generated by, and as a result of, the transaction in question.

The gravamen of the *Saginaw v Sexton* decision is that supporting recycling by a fee did not render the fee a tax when other legitimate police powers and regulatory activity were being funded with the same fee. Therefore, it is certainly reasonable to expect a Court would conclude that the anti-littering programs and pro-recycling programs of the proposed legislation were simply an extension of anti-litter and solid waste disposal regulations found in Michigan law. Therefore, the fee proposed here is a valid fee and not a tax.

3. **The Fee – Arguments to invalidate**

If one chooses to ignore the *Saginaw* decision and the proposed Constitutional Amendment, it might be argued that, under a strict reading of *Bolt*, the fee would be deemed a tax subject to invalidation. The arguments would be framed as follows. It is open to debate whether the fee serves a regulatory purpose. The uses of the fund are to fund recycling and litter prevention which are both public interests. The fee proposed does not directly relate to the regulation of solid waste generators or recyclers. These funds are not used to license, permit, inspect or enforce laws against anyone. *See, e.g., Grunow v Township of Frankenmuth*, 2002 WL 31376376 (Mich App 2002), *app den* 468 Mich 878 (2003).

The funds raised by the proposed fee should match exactly the costs of the anti-litter and recycling programs it is intended to fund. No funds are to be conveyed to the State general fund and so the proportionality prong of the *Bolt* test should be satisfied.

As to voluntariness, one might argue that the fee is voluntary because all one has to do is minimize one's purchases. But purchases of goods at retail will be made. The universality of consumption, arguably renders the fee involuntarily applied.

4. **Conclusion**

As noted above, there should be no question but that this fee is proportionate to the services to be funded thereby. On balance, the Courts regularly defer to governmental authorities and so, it seems likely, given the *Saginaw v Sexton* and *Graham v Kochville* opinions, that a Court would view the fee as supported by valid police powers. The fee will be paid, to varying degrees, by almost every person in Michigan and every person in Michigan will receive benefits therefrom in the form of reduced litter, increased recycling and, hopefully, more recycling businesses in Michigan. There will be almost none of the "free rider" beneficiaries that

were problematic in *Bolt*. The voluntariness prong of the *Bolt* test tends to be the least weighty. *See, e.g., Westlake Transportation, Inc v Michigan PSC*, 255 Mich App 589 (2003).

Further, while it is expected that most persons in the State will both pay and benefit from the fee, the fee does depend on the number of sales transactions one engages in and, therefore, there is a voluntary component to it. This is not like the mandatory flat, per capita property assessment as was overturned in *Bolt*. Therefore, it seems very likely that a Court would uphold the fee as valid, if a challenge were ever permitted to be brought. Of course, as noted previously, because of the Constitutional definition of the fee as a fee, such a challenge should fail before ever reaching the *Bolt* analysis stage.

VI **<u>Language Issues</u>**

As to the Resolution, should it say in the third paragraph "a recycling fee of not more than 1 cent per sales transaction ***shall*** be levied" or "***may*** be levied" - i.e., should the Constitution compel the collection or simply permit it. Also, in the last paragraph, should it say that the section "does not apply if the [bottle bill] is amended to require a deposit on noncarbonated beverage containers." Or should it be that this "section shall be of no force or effect if the [bottle bill] is amended...."?

As to the Bill containing the proposed Part 162, we have the following thoughts:

In Section 16201(1), the term "utilities" is not defined in any meaningful way. There should be an example or a limited list, such as "utilities including such services as the provision of natural gas, electricity, telephone service, internet service and/or cable television." Bluntly, since it applies to the sale of tangible goods, we are not certain that a utility exemption isn't surplusage. Further, "recycling" should be defined to include the "acts of collecting, sorting,

treating and/or processing item(s) so that it or they or the materials from which it or they are made may be used again."

Section 16201(2) is awkwardly drafted in our view. We believe the intent is to say the following: "Sales that include both consumer goods at retail and other goods that are not consumer goods at retail are deemed a sales transaction to the extent that the value of the aggregate consumer goods that make up part of the sale have an aggregate pretax value of more than $2.00."

Section 16203(1) "levies" the fee on each sale transaction – this term should be replaced with the phrase "a recycling fee is to be paid with respect to each sales transaction…." Further, it does not say who is to pay the fee – it should say that fee is to be paid by the purchaser in the sales transaction but collected by the seller. Further, it would be worth seeing what sort of rules the Treasury Department will be generating here.

In Section 16203(5) the word "sales" is missing from the phrase "sales transaction" near the end of the subsection.

The discussion in the middle of Section 16203(7) appears to relate to the Streamlined Sales and Use Tax Agreement. We recommend deleting the clause "and is not inconsistent with another law, rule or interstate agreement" as it appears to concede that the fee might be subject to the Streamlined Agreement. We suggest revising it to state that "If it is practicable and will aid with reporting, the State Treasurer may require the submission of a form necessary for reporting information regarding the Recycling Fee and other information under this Section with forms for reporting taxes or other forms…."

As to Section 16215, the LSB should be asked whether the law can be automatically "repealed" or simply become invalid, terminate, expire or of no effect, upon an amendment of the bottle bill. It seems that a repeal would require an affirmative act of the Legislature.