

When is a User Fee Actually a User Fee?
Design and Implementation Challenges Faced by Canadian Municipalities

by

Kelly Isabel Emmerson Farish
B.Phil, University of New Brunswick, 2006

A Thesis Submitted in Partial Fulfillment of the
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ABSTRACT

The objective of this thesis is to provide guidance for Canadian municipal public administrators concerning the economic and legal criteria in the policy design and implementation of user fees. User fees are levies charged for a particular good or service, as compared to a tax, which is charged generally and not specifically allocated. The focus on municipalities is as a result of the unique revenue limitations faced by municipal governments. The thesis is based on a public administration framework that establishes four stages of public policy analysis: problem definition, design, implementation, and evaluation. With a focus on the design and implementation stages, this thesis clarifies the economic literature and jurisprudence in their respective disciplines and sets out design and implementation stage criteria that integrate both disciplines with a view to improving Canadian municipal user fee design and implementation.

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1.0 Introduction

Property taxes and user fees are common revenue sources used by Canadian municipalities to fund the goods and services they provide to their communities. A municipality may be understood as the body politic and corporate constituted by the incorporation of the inhabitants of a city or town for the purposes of local government.¹ While both municipal property taxes and user fees are used to generate revenue, there are significant differences in how the revenue is generated and how government holds and spends the collected revenue. General definitions of these revenue sources provide a basic understanding. A general definition of a user fee is “the amount of money per unit of goods or service produced or provided by the government which is collected from the recipient.”² Revenues from user fees are usually allocated to a specific fund that goes back into funding the good or service, as opposed to being allocated to general revenue. Some common examples of municipal user fees include fees for garbage removal and disposal or a fee to use recreation facilities. Taxes, such as those charged by municipalities on property, are mandatory payments and apply regardless of whether the taxpayer uses the services that are funded by the taxes. Tax revenue typically goes to a general government revenue fund without a specific use for particular good or service.

Generating sufficient revenue to fund municipal areas of responsibility is a concern for municipalities and raises complex public policy challenges. Two examples of these issues are reductions in senior government transfers coupled with downloading of services from other

¹ Ian MacF Rogers, *The Law of Canadian Municipal Corporations*, 2d ed loose-leaf (consulted on April 23, 2012) (Toronto, ON: Carswell, 1988), ch 1 at 1.

² Richard M Bird, *Charging for Public Services: A New Look at an Old Idea* (Toronto: Canadian Tax Foundation, 1976) at 3 [Bird, *Charging for Public Services*].

levels of government, and disintegrating municipal infrastructure.³ Municipalities are receiving less financing through federal and provincial government transfers.⁴ The reduction in funding from other levels of government is further exacerbated by the devolution of responsibilities to municipalities. Bird and Slack write in *Cities in Canadian Federalism*,

Upper-tier governments reduced their own expenditures in services that impacted localities, such as immigration settlement and, in some provinces, education. Moreover, the federal and provincial governments imposed service standards—for example, water quality standards—on municipalities without providing the resources. The objectives of such policies may be sound, but municipalities are left to foot the bill. All this offloading placed considerable fiscal pressure on local governments⁵

The second example of complex policy issues placing financial strain on municipalities is the state of municipal infrastructure. The Federation of Canadian Municipalities (FCM) reports that “municipalities are at an infrastructure breaking point” because much of municipal infrastructure is due for replacement and the FCM acknowledges that municipalities are experiencing strain on their financial resources.⁶ These are only two examples of the significant financial burdens challenging municipalities.

In addition to these complex policy challenges that are straining municipal resources, municipalities face a further financial limitation in their available funding sources. As “creatures

³ Federation of Canadian Municipalities, *Policy Statement on Municipal Finance and Intergovernmental Arrangements* (March 2011), online <http://fcm.ca/Documents/corporate-resources/policy-statements/2011_Municipal_Finance_and_Intergovernmental_Arrangements_Policy_Statement_EN.pdf> at 1-2 [FCM, *Policy Statement*].

⁴ Harry Kitchen, “Pricing of Local Government Services” in Paul A R Hobson & France St Hilaire, eds, *Urban Governance and Finance: A Question of Who Does What* (Montreal: Institute for Research on Public Policy, 1997), at 164 [Kitchen, “Pricing of Local Government Services”].

⁵ Richard M Bird & Enid Slack, *Cities in Canadian Federalism* (May 2006), online: University of Toronto <http://www.munkschool.utoronto.ca/imfg/uploads/106/birdslack_cities_in_canadian_federalism_2006.pdf> at 72-73 [Bird & Slack, *Cities in Canadian Federalism*]; see also FCM, *Policy Statement*, *supra* note 3.

⁶ Federation of Canadian Municipalities, *Immediate and Long-Term Federal Funding Support for Infrastructure* (September 2006), online <http://www.fcm.ca/Documents/reports/Immediate_and_Long_term_Federal_Funding_Support_for_Infrastructure_EN.pdf> at 5 [FCM, *Immediate and Long-Term Federal Funding Support for Infrastructure*].

of the provinces”, municipalities are only allowed to raise revenue through means legally authorized by the provinces, resulting in fewer forms of revenue generating devices than provinces and the federal government have. Another limitation on municipalities is that the political aspect of revenue raising as increasing property taxes is widely recognized to be politically unfavourable. Canadian municipalities are also constrained from incurring operational deficits,⁷ further limiting public finance options to assist in solving public policy problems.⁸ The unique financial circumstances of municipalities coupled with significant financial challenges, including the municipal infrastructure deficit and downloading from other levels of government, demonstrate a rationale for municipal interest in exploring the revenue generating devices that are available, such as municipal user fees.

Some reasons a municipality may decide to implement a user fee include funding a municipal good or service through a user fee rather than a property tax so that revenues generated by property taxes can be allocated to funding for other goods or services or to meet new financial obligations. New applications of user fees have been reported in the news; for example, CBC News reported on August 25, 2011, that the City of Edmonton was considering

⁷ *Ibid* at 4; Bird & Slack, *Cities in Canadian Federalism*, *supra* note 5 at 73; Derek Burleton & Beata Caranci, *Mind the Gap - Finding the Money to Upgrade Canada's Aging Public Infrastructure* (May 2004) online: TD Economics <<http://www.td.com/document/PDF/economics/special/td-economics-special-infra04-exec.pdf>> at 7; Harry M Kitchen & Enid Slack, *Trends in Public Finance in Canada* (May 2006), online: University of Toronto <<http://www.utoronto.ca/mcis/imfg/pdf/trends%20in%20public%20finance%20in%20Canada%20-%20June%201.pdf>> at 14-15; Paul Boothe, *Paying for Cities: The Search for Sustainable Municipal Revenues* (Edmonton: The Institute for Public Economics, University of Alberta, 2003) at 23.

⁸ Note that the term “operating deficit” is a simplification of the financial planning requirements of municipalities. The legislation regarding deficits may indeed be more complex. For instance, the British Columbia *Community Charter*, SBC 2003, c 26, Part 6 deals with Financial Management. This Part requires that a financial plan be adopted annually before the annual property tax by-law is adopted (s 165(1)) and that the planning period for financial plans is five years (s 165(3)). Section 165(5) provides that “the total of the proposed expenditures and transfers to other funds for a year must not exceed the total of the proposed funding sources and transfers from other funds for the year.” However, s 178 provides that short term capital borrowing may take place subject to certain requirements and s 179 provides that long term borrowing may take place for specific purposes with loan authorization from the Inspector of Municipalities. Furthermore, to finance longer term projects, ss 188 and 189 deal with a municipality establishing reserve funds. Broader municipal financing concerns such as deficits are not considered in this thesis.

implementing a community revitalization levy to fund specific projects in a designated downtown area, including a new arena.⁹ Another example of a reason to adopt a user fee is to assist a municipality to ensure better use of its resources and evaluate the use of a specific good or service. User fees may also be used to encourage users to modify their use or to evaluate the use of a specific good or service.¹⁰ An example of encouraging behaviour changes through user fees is to impose a user fee for each bag of garbage, incentivizing people to save money by putting out less garbage. In order to do this, a municipality would have to look at their governing statute to determine if it is able to set a by-law for the removal of garbage and if there are limitations on the type of user fees that may be imposed. If the decision is made to implement a user fee, the amount charged for user fees has to be carefully considered by municipalities because user fee rate is intended to generate adequate revenue to fund the specific good or service provided by the municipality and user fees also have to meet certain legal requirements with respect to the amount that is being raised.

When a municipality decides to implement a user fee, the user fee has to be designed to meet certain legal requirements, which are found in both legislation and previous cases on similar issues. The first step will be to examine the relevant legislation to determine if the municipality has authority to charge a user fee, if there are any limitations on the type of user fee, and if a user fee can be applied to the service the municipality is considering. Further understanding of these requirements may require additional case law research to interpret what is meant by user fee and the general legal principles that are applied to user fees. Case law on

⁹ “Downtown levy could raise millions for arena: report”, *CBC News* (August 25, 2011), online: CBC News <<http://www.cbc.ca/news/canada/edmonton/story/2011/08/25/edmonton-crl-report-downtown-arena.html>>.

¹⁰ As discussed in this thesis, public administrators must be cautious if their objective is only to modify behaviour because this may mean that the user fee is in fact a regulatory charge and is treated differently under the law. See the discussion in Chapters 4 on the issue of regulatory charges and Chapter 5 with respect to terminology of user fees.

municipal user fees has been developed because of the challenges that a number of types of user fees have sustained. Municipal user fees in a number of forms, including campground fees,¹¹ volumetric gravel removal fees,¹² waste disposal fees¹³ and educational development charges¹⁴ have faced legal challenges across Canada. Often these legal challenges come from businesses that will see a significant increase in their costs should the user fees be imposed, so the businesses argue that the user fee is invalid and cannot be charged.¹⁵

Canadian municipalities must first look to their governing statute to determine their authority with respect to charging user fees. Where interpretation of this authority is required, the case law on user fees further informs the legal requirements for a municipality when implementing a user fee. Depending on the nature of the user fee, case law from other levels of government may be relevant. The complexity of user fee design is acknowledged by Justice La Forest of the Supreme Court of Canada (SCC) in the dissent of *Ontario Home Builders Ass'n v York Region (Education)* [*Ontario Home Builders*]¹⁶ when he wrote that user fee design “rais[es] highly technical issues concerning the extent and manner in which a province is constitutionally

¹¹ *Carson's Camp Ltd v Amabel (Township)*, 159 DLR. (4th) 180, 47 MPLR (2d) 31, 1998 CarswellOnt 1852 (Ct of Jus, Gen Div) [*Carson's Camp*] (*Carson's Camp* cited to WL Can).

¹² *Allard Contractors Ltd v Coquitlam (District)*, [1993] 4 SCR 371, 85 BCLR (2d) 257, 1993 CarswellBC 317 (WLeC) [*Allard Contractors*] (*Allard Contractors* cited to WL Can).

¹³ *Antigonish (Town) Waste Disposal Charges Bylaw, Re*, 7 MPLR (3d) 165, 181 NSR (2d) 68, 1999 CarswellNS 413 (NSSC) (WLeC) [*Antigonish*] (*Antigonish* cited to WL Can).

¹⁴ *Ontario Home Builders' Assn v York Region Board of Education*, [1996] 2 SCR 929, 137 DLR (4th) 449, 1996 CarswellOnt 3403 [*Ontario Home Builders*] (*Ontario Home Builders* cited to WLeC).

¹⁵ An individual could also make a claim against a municipality, but this is not frequently the case. Three reasons may account for the lack of individuals making claims. First, there may be the lack of awareness of user fee requirements and that a municipality may not be meeting the requirements. Second, the onus will be on the plaintiff to demonstrate that the user fee is not meeting these requirements and it may be difficult to accumulate the required evidence to make such an argument. Third, the individual would incur court filing fees and likely have to retain a lawyer which could be more expensive than their potential recovery under a claim. Note that some legislation provides that information must be made available upon request. See for example the British Columbia *Community Charter*, SBC 2003, c 26, s 194(4), which provides, “[a] municipality must make available to the public, on request, a report respecting how a fee imposed under this section was determined.”

¹⁶ *Ontario Home Builders*, *supra* note 14.

prohibited to finance its legislative measures [...].”¹⁷ While *Ontario Home Builders* required the SCC to make a decision on Ontario’s constitutional authority to raise revenue for the provision of a service through a certain type of charging scheme, the sentiment of this statement also applies to the challenges that municipalities face to implement user fees. Municipalities must ensure that when they decide to implement user fees, the user fee is designed to meet the legal requirements established in the relevant legislation providing statutory authority and in case law.

The legal requirements for user fees form only part of the considerations for designing a user fee to fund a municipally provided good or service. Municipalities must also be concerned with whether the revenues generated by the user fee to fund the good or service are sufficient to fund the specific good or service. An example of a municipality that has faced challenges in setting its user fees is the City of Ottawa. On September 8, 2011, the Auditor General for the City of Ottawa released the 2010 Audit Report, reviewing the City’s performance in certain departments over the last year.¹⁸ The City of Ottawa Revenue Branch was one of the departments subject to review, with a focus on revenue management. The Auditor General made three criticisms. First, there was no recent comparison of planned amounts to actual costs and volumes to validate the user fees charged by the City of Ottawa. Second, the Council was not provided with the details of the costing used to justify the user fees. Last, some user fee calculations included costs that were not attributable to the service being provided.¹⁹ A writer at the Ottawa Citizen picked up on these criticisms and commented,

I suspect most councillors wouldn’t be really eager for a public airing of the calculation, which probably goes something like: “How high can we set these

¹⁷ *Ibid* at para 92.

¹⁸ City of Ottawa, Office of the Auditor General, *2010 Audit Report* (Ottawa: Office of the Auditor General, 2011) online: Office of the Auditor General <<http://ottawa.ca/cs/groups/content/@webottawa/documents/pdf/mdaw/mdy3/~edisp/con064285.pdf>>.

¹⁹ *Ibid* at 130.

without causing so much outrage that people talk about user fees instead of how we're meeting council's target for property-tax rates? OK, let's set them there."²⁰

This is one example of the lack of consideration of how much revenue is required to fund the good or service. Furthermore, by not making an economic link between the user fee and the cost of the services, the City's user fees could be legally questionable. Considering user fees with respect to economic *and* legal concerns is important to ensuring their validity and success.

There are a number of reasons that have been identified for a municipality to consider implementing a user fee for a specific good or service that it provides to its community. Municipalities may be interested in implementing user fees to fund a municipally provided good or service through user fees rather than through property taxes in order to shift spending to other goods or services, to meet new financial obligations, to encourage users to modify their use, or to evaluate the popularity of a specific good or service. Depending on the objective of a user fee, certain areas of study (for example, urban planning) will be relevant, but for all user fee implementation decisions, municipalities will have to look to legal and economic factors to design and implement a user fee that can withstand legal challenges and generate sufficient revenue to fund the municipally provided good or service. However, as has been discussed above, municipalities have sometimes experienced difficulties in implementing user fees and there is little comprehensive literature on user fee design and implementation. The remaining sections of Chapter 1.0 set out the specific issue this thesis addresses, the purpose and objectives of the thesis, an overview of the research methodology, and a summary of the existing research. The chapter concludes by providing an outline of the remaining structure of the thesis.

²⁰ David Reevely, "How city user fees are calculated", *Ottawa Citizen* (September 9, 2011), online: Ottawa Citizen <<http://blogs.ottawacitizen.com/2011/09/09/how-city-user-fees-are-calculated/>>.

1.1 The Current Issue

In many ways, the existing literature on user fees is insufficient to support implementation by municipalities. Economic literature and jurisprudence provide guidance for municipalities towards successful implementation of municipal user fees, but these disciplines lack both detailed user fee implementation information within their discipline and integration of the other's contributions. Municipal public administrators, charged with designing and implementing user fees, must consider economic and legal factors in an integrated manner, because there are crucial stages in implementation where both legal and economic factors will be relevant. Given the difficulties outlined regarding implementation of municipal user fees, this thesis addresses whether it is possible to clarify and integrate economic and legal requirements to guide future municipal user fee implementation in Canada. To answer this question, this thesis argues that legal and economic user fee information can be clarified in their respective disciplines and that information can be integrated into a public administration framework to provide guidance for future municipal user fee implementation in Canada.

The purpose of this thesis is to bring together the economic standards and legal requirements for user fees in the theoretical context of a public administration policy analysis framework. This thesis:

- (i) proposes a public administration policy framework within which literature on user fees can be integrated;
- (ii) conducts a review of the existing economic and legal literature on user fees within this framework; and

(iii) concludes by developing a set of implementation criteria for user fees, informed by economic and legal literature and the public administration policy framework, to guide the implementation of municipal user fees by municipal staff and council.

Two gaps in the existing literature on user fees are identified and addressed in an original manner by this thesis. First, this thesis identifies and contributes to the topic of implementation of municipal user fees in the general public administration literature, with specific attention to the economic and legal aspects of user fees. Second, this thesis addresses the need to integrate economic, legal, and public administration insights to strengthen the implementation of user fees as an applied policy tool. These contributions supplement the growing literature on the identified issue of implementation, which integrates academic concerns with those of public administrators,²¹ and undertakes an interdisciplinary approach supporting the comment by Bird that “[g]ood tax policy planning involves economists, lawyers, [and] administrators [...]”²²

The key audience for the thesis is municipal public administrators charged with considering, designing, and implementing user fees. What this thesis proposes is that such practitioners cannot fulfil their task without integrating multiple fields of research and paying specific attention to the design and implementation phases of user fees. This is crucial to supporting success in the use of user fees as a potential revenue generating device for municipalities. In providing guidance to this practitioner audience, the thesis also contributes to the theoretical literature on user fees, especially from a public administration perspective.

²¹ Catherine Althaus, Lindsay M Tedds & Allen McAvoy, “The Feasibility of Implementing a Congestion Charge on the Halifax Peninsula: Filling the “Missing Link” of Implementation” (2011) 37(4) *Canadian Public Policy* 541 at 543.

²² Richard M Bird, *Tax System Change and the Impact of Tax Research* (2009), online: Rotman School of Management Working Paper No. 1500018 (4 November, 2009) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1500018> at 31; Richard M Bird, “Tax System Change and the Impact of Tax Research” in Emilio Albi & Jorge Martinez-Vasquez eds, *The Elgar Guide to Tax Systems* (Northampton, MA, Edward Elgar Publishing, 2011) at 443.

1.2 *Research Methodology and Summary of Existing Information*

The methodology guiding this research was based on academic literature reviews of economics and law, and primary research of case law on user fees. In the literature reviews, the databases searched included Google, Google Scholar, University of Victoria Summons, Academic Search Complete, JSTOR, Emerald, and Heinonline. Grey literature from public policy sources was also reviewed, including the Federation of Canadian Municipalities (FCM) and the CD Howe Institute. The literature reviews were conducted using search terms including ‘user fee’, ‘user charge’, ‘implement’, and ‘municipal’.

Case law research is conducted using different techniques than a literature review. With respect to the case law research, the leading cases were identified and their subsequent treatment in courts was assessed.²³ Searches were also conducted on the main legal databases WestlaweCarswell, LexisNexis, and Canlii using search terms including ‘user fee’, ‘user charge’, ‘direct tax’, ‘indirect tax’, and ‘municipal’. Legal academic literature is also available on the legal search databases and was found by looking at how relevant cases have been treated. The case law research was not strictly limited to instances of municipal user fees, because, as mentioned above, many user fees are subject to the same legal principles, regardless of the implementing government entity.

The first objective of this thesis is to propose a public administration policy framework as the analytical foundation. This is so the information and research are provided to municipal public administrators, the primary target audience of this thesis, in a manner that can be applied. As in the economic and legal literature, there is little information available in the public

²³ For further detail on the methodology of the legal analysis conducted for this thesis, please see Chapter 4.0: *Jurisprudence*, Section 4.1: *Research Methodology*.

administration literature concerning the implementation of user fees. An exception is an article by Bowlby, MacDonald, and Gilbert that summarizes some broad issues to be considered in general user fee implementation, but is not specific to municipal concerns.²⁴ The authors' first recommendation in this article is to ensure that there is appropriate legal authority to charge fees for particular services. Second, that municipalities invite citizens to join a consultation process early in the development stage both to garner information that may be useful for the implementation strategy and to explain to citizens the need for a fee. Third, the authors advocate for payment schedules and timelines to be clearly published and penalties for non-payment to be transparent to consumers. The fourth recommendation is to ensure the collection system is efficient so as to avoid artificially inflating the price of the service. The final recommendation is that the pricing of the service follows a clear rationale.²⁵ This article, while providing a basis for user fee implementation, lacks detail and an explanation of the rationale behind its recommendations. A gap remains with respect to consideration of municipal user fee implementation in the public administration literature, and the existing information often fails to demonstrate an understanding of the legal and economic issues. For example, Pal writes, after identifying user charges or fees as a policy instrument, "[t]he distinction between taxes and other types of government levies is increasingly blurred."²⁶ This is not the case in either law or economics as both fields offer definitions that distinguish taxes and user fees.

The first objective of this thesis, to propose a public policy framework as an analytical foundation, is achieved by adopting a rational comprehensive policy analysis framework, using

²⁴ J Mark Bowlby, Patricia MacDonald & Mark Gilbert, "Establishing User Fees: Theory and Practice in Canada", (February 2001) 17(1) *Government Finance Review* 19.

²⁵ *Ibid* at 20-21.

²⁶ Leslie A Pal, *Beyond Policy Analysis: Public Issue Management in Turbulent Times*, 4th ed (Toronto, Nelson Education Ltd, 2010) at 163.

the framework described by Leslie Pal in *Beyond Policy Analysis: Public Issues Management in Turbulent Times* (4th ed). Pal's framework describes four stages in public policy analysis which consider the problem definition, policy design, implementation, and evaluation. Pal's framework is only one example of the multiple frameworks in public administration literature for public policy analysis in which implementation of public policy is described and considered. Pal's public administration framework was selected because it provides a staged framework to which key economic and legal questions and concerns can be applied in the design and implementation stages.²⁷

The second objective of this thesis is to review the existing economic and legal literature on user fees within the public policy analysis framework.²⁸ The economic academic literature is examined through a literature review and offers a number of useful design and implementation criteria. The economic literature gives a rationale for the adoption of user fees and significant research on the costing of user fees. In relation to the legal literature and case law, the economic literature provides more extensive information on how to select the good or service to which a user fee may be best applied. After the municipally-provided good or service has been selected for user fee application, the economic literature also informs pricing and fee design for the user fee. However, two issues arise from the economic literature. First, the literature is not tailored to specific implementation concerns, though in certain areas of services provided by municipalities, this literature has been developing (for example, charging user fees for storm water drainage). Second, the legal requirements are not well-understood nor often considered by the economic

²⁷ For more detail regarding the selection of the stages framework for this thesis, please see Chapter 2.0: *Overview of Public Policy Analysis*, Section 2.1: *Introduction*.

²⁸ The order selected for the presentation of this research is based on the features of the public policy analysis framework. A further explanation may be found in Section 2.3: *Situating the Thesis Research in Pal's Public Policy Analysis Framework*.

literature. For example, the FCM dismissed legal analysis in a guide entitled *Water and Sewage Full Cost Recovery*, writing, “the user rates must be legal and defensible. Legal restrictions are not normally imposed on the structure of user rates.”²⁹ This statement is false; as this thesis will discuss, there are legal requirements for user fees that must be considered in the policy analysis process and implementation. In another policy paper considering municipal user fees as an infrastructure funding option, the CD Howe Institute wrote in *Running on Empty*, that “[f]or analytical simplicity, we assume the case where an increase in user fees results in an increase in gross revenues.”³⁰ However, this assumption results in a legally impermissible allocation of funds generated by a user fee to general revenue accounts. These examples highlight the need for increased understanding and integration of economic and legal parameters in the municipal user fee context.

Understanding that municipalities must first examine their statutory authority to determine if they can charge user fees, and that municipal statutory authority will vary between provincial and territorial jurisdictions, the objective of this research is to analyze how user fee provisions have been applied and the general principles from interpretation of user fee requirements. Primary research was conducted to assess the requirements of the case law, further contributing to the second objective of this thesis, to review the legal literature on user fees within a public policy analysis framework. There is limited legal academic literature on user fees and particularly implementation of user fees. However, there is significant case law, or jurisprudence, on user fees which establishes the legal requirements for user fees. The

²⁹ Federation of Canadian Municipalities, *Water and Sewer Rates: Full Cost Recovery* (March 2006), online: Federation of Canadian Municipalities <http://www.fcm.ca/Documents/reports/Infraguide/Water_and_Sewer_Rates_Full_Cost_Recovery_EN.pdf> at 32 [FCM, *Water and Sewer Rates: Full Cost Recovery*].

³⁰ Jack M Mintz & Tom Roberts, *Running on Empty: A Proposal to Improve City Finances* (February 2006), online: CD Howe Institute <<http://www.cdhowe.org/running-on-empty-a-proposal-to-improve-city-finances/4837>> at 16.

jurisprudence primarily considers the authority of the governing body to impose the user fee, where the revenues are being allocated, and if the amount being charged is linked to the cost of the good or service and is 'reasonable'.

With respect to the third objective of this thesis, developing a set of implementation criteria for user fees that integrates both economic and legal design and implementation criteria, there are two main overlapping issues between economics and law disciplines and these are addressed. First, how user fee revenue is generated and where the revenues are allocated. The second issue is the cost of the good or service and correlated pricing of the fee.

1.3 Thesis Outline

Chapter 2.0 is a summary of the Pal public administration framework, which is used as the framework for the integrated user fee implementation criteria. Chapter 3.0 is the literature review of the relevant economic academic literature on municipal user fees. Chapter 4.0 compiles and analyzes the jurisprudence on user fees and summarizes the relevant tests and thresholds that must be addressed when considering implementing a user fee. Chapters 3.0 and 4.0 give a thorough review of the existing information in each discipline so that this information can be integrated in the public administration framework discussed in Chapter 2.0.

Chapters 5.0 and 6.0 are discussion chapters that integrate the principles set out in the economic literature and the legal requirements on user fees into the public policy analysis framework. Each chapter is devoted to considerations integrating the information from Chapters 3.0 and 4.0 at the crucial public policy stages set out and discussed in Chapter 2.0. Chapter 7.0 provides a conclusion and summary of the thesis.

In summary, user fees are a common revenue generating source used by municipalities and may be used to alleviate some of the financial burdens that municipalities are facing by

generating service-specific revenue, evaluating use of municipal resources, or incentivizing certain behaviour. User fee implementation is cause for concern as the economic standards established in the literature and the legal requirements established in the jurisprudence do not appear to be well-understood by public administrators, nor have these factors, which will affect every user fee implementation decision, been integrated to examine their effect on each other. This thesis takes the perspective of a public administrator in asking what economic and legal criteria should be considered and applied when implementing user fees. In taking the public administration approach, this thesis provides a public policy framework foundation, commonly used in public administration for policy decision-making, to provide order and organization to the economic and legal criteria in a manner that addresses the needs of public administrators. The following chapter discusses the selected public policy analysis framework in detail.

2.0 Overview of Public Policy Analysis

2.1 Introduction

As the overall objective of this research is to provide practical criteria for user fee implementation, it is appropriate to consider the needs of those who would likely be responsible for user fee implementation. Municipal public administrators are the primary audience for this thesis as they are most likely to have responsibility to develop the policy process to implement user fees. To best serve the practical needs of this audience, the first objective of the thesis, as set out in Chapter 1.0, is to propose a public administration policy framework within which user fees can be analyzed. This objective was identified for three reasons. First, public administrators often implicitly rely on a public administration policy framework to guide a decision-making process, so it is appropriate to provide user fee research in a manner that follows the existing practices of public administrators. A second related reason is that the overall implementation criteria of a user fees are not likely to be limited to economic and legal concerns, so a public administration policy framework readily allows public administrators to integrate additional relevant criteria, adapted to their particular circumstances. A third reason to convey this research through a public administration policy framework is to provide order and organization to the information relevant to public administrators, which reduces the possibility of missing or overlooking a key element that must precede other decisions. By identifying the individuals who are likely to be responsible for the practical implementation considerations of user fees, examining their practices, and how best to convey the research to fit into their existing practices, this thesis intends to provide practical and relevant implementation criteria for user fees.

Public administrators implicitly use public policy frameworks as the foundation on which pertinent decision-making information can be applied to guide problem-solving processes toward

a solution. Many diverse frameworks of policymaking have been identified in the public administration literature across a range of schools of thought regarding how policymaking occurs.³¹ It is acknowledged that these frameworks differ widely on summative and normative ideas concerning the policy process and this thesis does not purport to take a stand on which framework is or should be a preferred approach. Instead, a single framework has been chosen to meet the needs of the analysis conducted in this thesis, namely to provide organization and order to the criteria that public administrators should review when considering and implementing user fees. Public administrators know that policy occurs regardless of whether frameworks are purposefully followed or not, so it is not intended that use of a particular framework in this thesis indicate definitive suggestions for policymaking or conclusions regarding processes followed. On the contrary, it is hoped that public administrators will identify the concepts highlighted in this thesis and apply the lessons in their own manner in their own unique settings.

The selected public policy framework in this thesis for the user fee policy analysis is a rational comprehensive policy analysis framework, developed by Canadian public administration academic Leslie Pal in 2010 in *Beyond Policy Analysis: Public Issues Management in Turbulent Times*, 4th ed. This framework is useful for the analysis conducted in this thesis because it provides a breakdown of the stages of the public policy analysis, which is relevant for municipal public administrators in terms of practical implementation as the stages provide a broad ordering of what questions and concerns need to be decided before moving on to the next stage. Pal describes four stages in the public policy process: problem definition, policy design, policy implementation, and evaluation.

³¹ Catherine Althaus, Peter Bridgman & Glyn Davis, *The Australian Policy Handbook*, (Crows Nest, NSW, Allen and Unwin, 2007).

It is important for the municipal public administrator to have an understanding of the key elements of each of these stages so as to both understand why certain decisions must precede others in the following analysis and to apply to the framework to specific public administration circumstances. The next section explains the four stages described by Pal in his framework, describing the elements of each stage. However, for the implementation of user fees, each stage does not merit equal consideration because this thesis is focused on the criteria relevant to implementation. The second section explains the stages that are the focus of the thesis and projects where the critical economic and legal implementation information will be relevant throughout these stages.

2.2 The Stages of Public Policy Analysis: Problem Definition, Policy Design, Policy Implementation, and Evaluation

In line with the rational comprehensive school of thought regarding policymaking, the policy process described by Pal in *Beyond Policy Analysis* provides an approach to policy analysis that defines ‘stages’ of public policy analysis. Pal’s approach to policymaking characterizes this school of thought with a set of procedures that canvasses potential courses of action and weighs the consequences of each action before arriving at a final decision.³² The stages described by Pal refer to different aspects of public policy analysis that move from the beginning of a policy problem to a solution being implemented. The stages are an appropriate framework for this analysis because they provide for a further breakdown of the elements that need to take place when implementing user fees and organization and order that addresses the needs of public administrators.

³² John R Gist, “Decision Making in Public Administration” in Jack Rabin, W Bartley Hildreth, & Gerald J Miller, eds, *Handbook of Public Administration*, 2nd ed (New York: Marcel Dekker, Inc., 1998) 265 at 266-268.

Pal identifies the first stage of the policy process as problem definition, which he describes as having three components: reality (what is, the unrealized needs or values), a desired state of affairs (what should be, the improvement), and the gap between them (the discrepancy).³³ A clear problem definition, for Pal, is the starting point of the public policy analysis process. Pal cites Dunn in writing, “[p]roblem structuring is a central guidance system or steering mechanism that affects the success of all subsequent phases of policy analysis.”³⁴ Examples of problems that municipalities may face were provided in Chapter 1.0, and included situations such as raising revenue for new municipally provided good or services. This thesis takes the position that the policy problem definition associated with user fees has already been identified and the municipal public administrator is working through the remaining stages of the policy analysis process. Figure 2.1 shows the beginning of the public policy analysis at the problem definition stage.

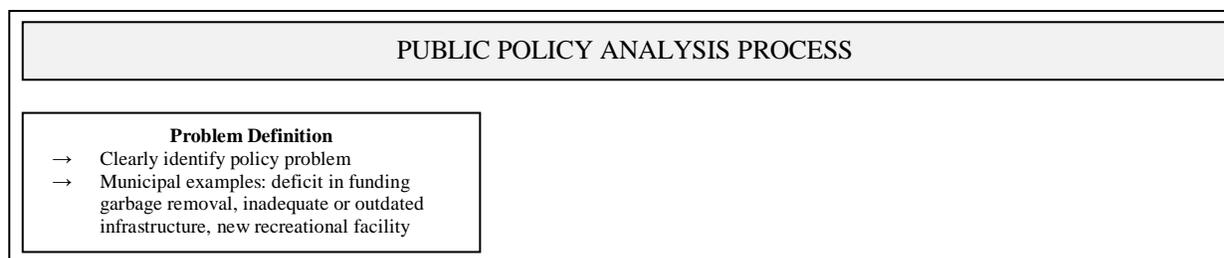


Figure 2.1: Problem Definition Stage Elements

The second stage that Pal identifies is policy design. Pal defines policy design as “choosing the most appropriate instrument to deal with the policy problem as it has been defined in order to achieve a given policy goal.”³⁵ This definition denotes two elements comprising the policy design stage. The first element is the development of policy options which would apply

³³ Pal, *supra* note 26 at 110.

³⁴ *Ibid* at 107.

³⁵ *Ibid* at 144.

one or more instruments to the policy problem to render a solution. The instruments to which Pal refers are different means chosen to address the policy problem and achieve the policy goals.³⁶ Furthermore, multiple policy instruments may be combined into a single proposed policy solution. In a municipal public finance context, it is likely that there will be a limited number of instruments to select from as municipalities are limited to certain revenue raising policy instruments, particularly property taxes and user fees, as a result of legal constraints.

The second element of the design stage is to compare the proposed policy solutions to determine which potential solution will best achieve resolution of the identified policy problem. Generally, this is achieved by setting objectives for the policy solution and measuring each of the proposed policy solutions against the objectives to identify the most preferable solution. This element is informed by this thesis because the information and research provided assists a public administrator to evaluate the features of a user fee. The conclusion of the policy design stage is when a solution has been selected to be implemented. A significant amount of the information in this thesis falls in the policy design stage, as municipal public administrators will be charged with discerning whether a user fee should be implemented, comparing the user fee to other policy instruments, and potentially identifying different components of user fees that may or may not be taken into consideration with respect to the user fee that is selected. Figure 2.2 summarizes the design stage elements.

³⁶ *Ibid* at 38.

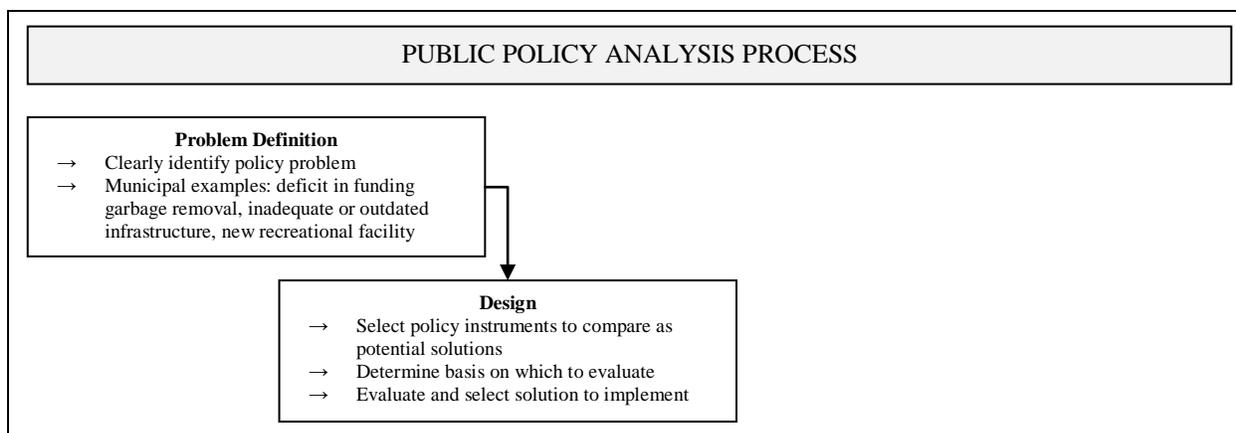


Figure 2.2: Problem Definition and Design Stage Elements

The third stage that Pal identifies in his framework is the implementation stage. Pal describes implementation as, “an execution process, an elaboration, a realization of schemes and conceptions, the building of links in often long chains of decision and agreement.”³⁷ Pal distinguishes the implementation and design stages in his policy process analysis framework but acknowledges that while the components are conceptually different, they can overlap in practice and that decisions made in either the design or implementation stage may in turn force re-evaluation of certain considerations in other stage.³⁸ Implementation is the other critical stage of the policy analysis process where the information in this thesis is situated. Pricing schemes for the user fee, deciding the accounts to which the revenues generated from the user fee will be designated, and drafting the enabling policy for user fee will be prominent components of the municipal public administrator’s implementation of the user fee. Figure 2.3 represents the implementation stage elements and the dashed arrow shows they may overlap or force reconsideration of design stage elements.

³⁷ *Ibid* at 213.

³⁸ *Ibid* at 205; Althaus, Tedds & McAvoy, *supra* note 21 at 545.

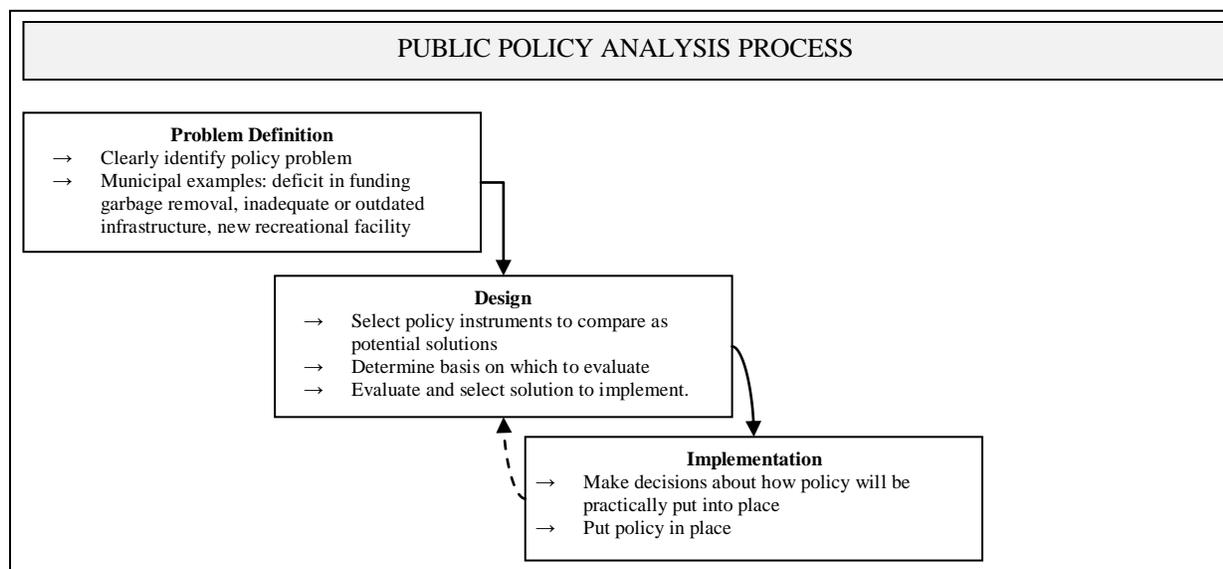


Figure 2.3: Problem Definition, Design, and Implementation Stage Elements

The fourth stage that Pal identifies is the evaluation stage. Pal states that “evaluation typically is *ex post* analysis, or after the launch of a policy program.”³⁹ Pal’s framework places emphasis on evaluation which determines if the program has had its intended effect.⁴⁰ However, Pal also acknowledges that certain types of evaluation can occur throughout the public policy analysis process. For example, Pal discusses Process/Implementation Evaluation, which looks at how something happens, rather than its success. An example of a process evaluation is evaluating reporting mechanisms.⁴¹ Pal’s broader description of evaluation taking place throughout the policymaking process is reflective of the public administration literature on evaluation, which considers that evaluation can take place at different times throughout the policy analysis process. With respect to a user fee, evaluation could be ensuring that the revenue generated matches the revenue that was predicted and that the service is adequately funded, or it may mean determining if a behaviour change has taken place and whether the levy needs to be

³⁹ Pal, *supra* note 26 at 311.

⁴⁰ *Ibid* at 306.

⁴¹ *Ibid* at 321.

adjusted to generate adequate revenues or to further alter behaviour. The focus of this thesis is not on evaluation, though it is acknowledged that in the process of evaluation some of the design and implementation elements may be reconsidered. Figure 2.4 shows the stages and key elements of the Pal public policy analysis framework and their general relationship to each other. The dashed arrows demonstrate that evaluation may force reconsideration of each stage of the public policy analysis.

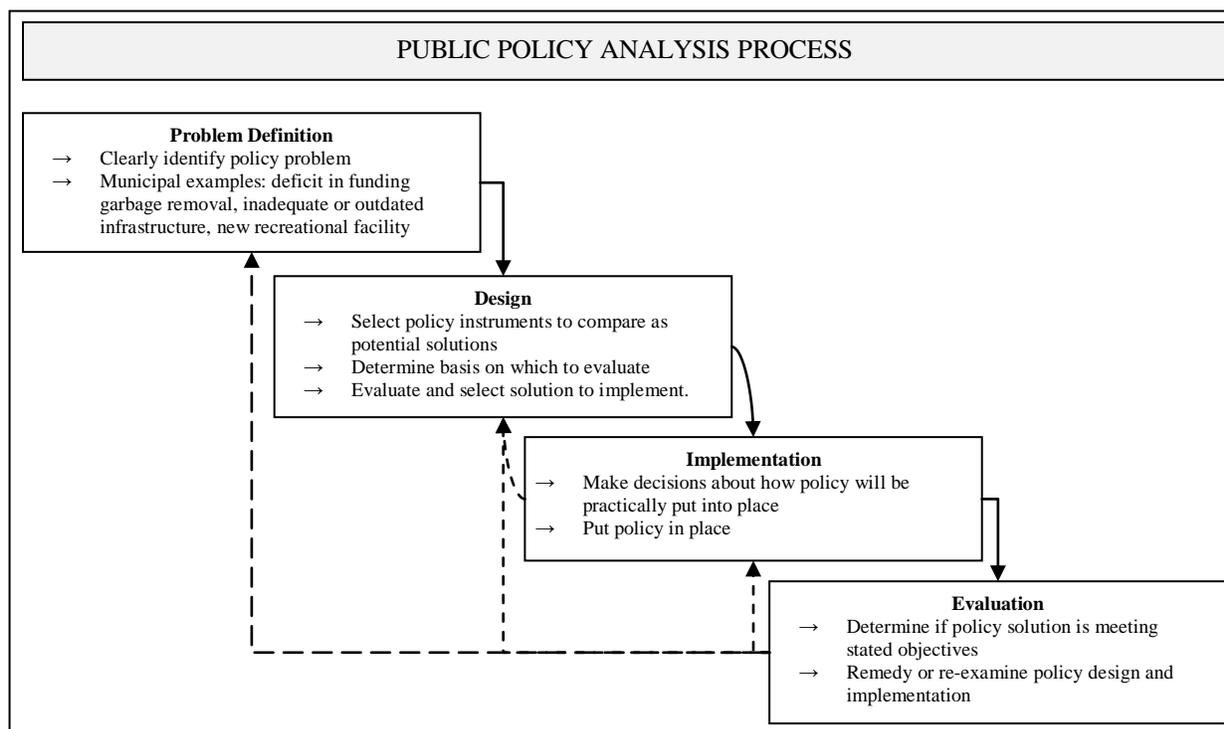


Figure 2.4: Pal Public Policy Analysis Process Framework

Municipal public administrators may use public policy frameworks to guide, order, and organize decision-making for policy problems. The foundation of this thesis is established on a public policy framework so as to provide design and implementation criteria to public administrators in a format that acknowledges the practical and necessary concerns facing public administrators. Pal's rational comprehensive framework, describing four stages of the public policy analysis process, was selected because it facilitates the ordering and organizational

concerns of public administrators within its stages. The stages Pal describes are: (i) problem definition, (ii) design, (iii) implementation, and (iv) evaluation. By highlighting the components of each stage, it is intended that public administrators can integrate implementation criteria specific to the policy problem they are facing or adapt the information provided in each stage to a different policy problem.

2.3 Situating the Thesis Research in Pal's Public Policy Analysis Framework

Policy design and implementation, the second and third stages Pal describes, are the key stages for consideration of the integrated economic and legal user fee implementation criteria. As stated above, this thesis is intended to guide a public administrator *after* the policy problem has been identified. This thesis assumes that the public administrator will be considering user fees as a policy instrument in the policy design process and weighing user fees against other policy instruments (in a municipal context, likely funding through property taxes) to solve the established problem. This thesis is concerned with the process of selecting user fees as the policy instrument and ensuring that user fees are economically and legally appropriate and can be implemented. Municipal public administrators are likely to be responsible for the process of determining if a user fee should be implemented and may use a public policy analysis framework to conduct this assessment. By adopting the Pal public policy analysis framework and using it as a means to convey the information in this thesis, it is intended to be accessible and relevant to the practical needs of public administrators. This will be achieved through focusing on the economic and legal elements that should be considered in the policy design and implementation stages. This section provides an overview of the economic and legal criteria that are relevant in each stage and explains how the economic and legal elements were determined to fit into the Pal stages.

According to Pal's framework, after the problem definition is established, the second stage of public policy analysis is policy design which comprises policy instrument selection and evaluation. While there are certain important legal factors that must be considered in the design stage, the economic factors are more relevant to the key elements in this second stage. In the design stage, legally, the municipality must establish that it has the authority to apply a user fee to the good or service. The answer to this question may limit the policy options that are available to the municipality. Following establishing the authority of the municipality, a key element of the design stage is to determine which policy instrument best achieves certain objectives. The economic literature directly informs this question by providing criteria that assist in determining whether a user fee is appropriate for a municipally provided good or service, given the nature of the service. An issue that may be seen to overlap between the design stage and the implementation stage is the costing of the good or service. This thesis includes the costing of a user fee in the design stage because the objectives of the policy may affect the legal test that is applied to costing and thus these objectives need to be known in advance of implementation.

Implementation of the policy is the third stage of Pal's policy framework. In contrast to the policy design stage, legal requirements associated with user fees are more prominent in the implementation stage. Implementation is described by Pal as the execution process of public policy analysis. The pricing of the user fee, that is setting the price of the use of the good or service to the consumer, is key step in user fee implementation and there are economic and legal considerations that must be integrated with each other to ensure that the prices generate sufficient revenue and are legally valid. As may be anticipated, once the revenues have been generated, both economics and law have requirements about where the revenues are allocated. Additionally, to implement a user fee, the required laws will have to be drafted and enacted and the case law

provides guidance as to how user fees should be written into law. Figure 2.5 shows the stages in Pal's public policy analysis framework that are the focus of this thesis and a summary of the economic and legal factors that will be discussed in the key stages.

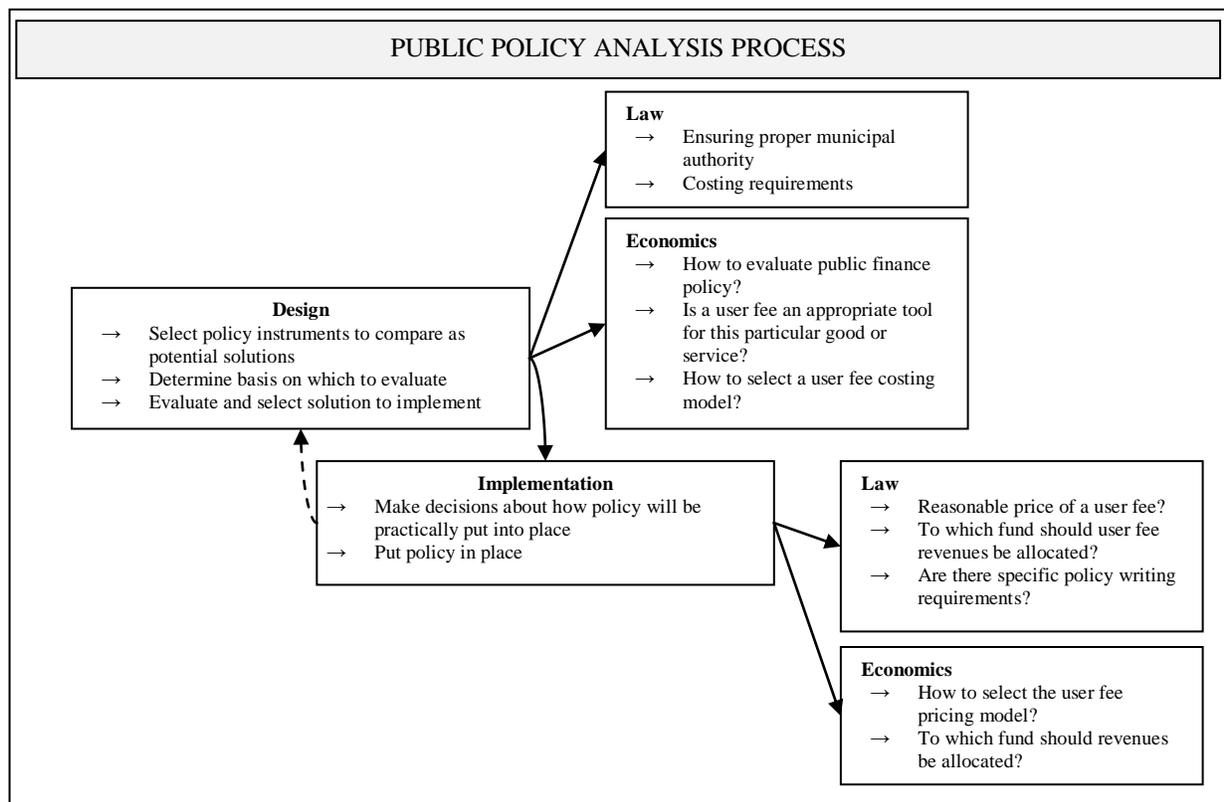


Figure 2.5: Focus Stages and Key Questions

2.4 Conclusion

The first purpose of this thesis is to propose a public administration policy analysis framework within which user fee literature can be integrated. This chapter provided a description of the rational comprehensive policy framework described by Pal which involves four stages: problem definition, policy design, policy implementation, and evaluation. Three assumptions are made by this thesis in relation to the policy stages: first, that the municipal public administrator has clearly identified the policy problem; second, that user fees are one of the policy instruments being compared in the design stage; and third, that the evaluation stage is not a focus of this

thesis. The chapter concluded by providing a number of the integrated economic and legal factors that can be found in the policy design and implementation stages to which economic and legal literature can contribute.

3.0 Economic Literature Review

There are a number of economic factors to consider in designing and implementing a municipal user fee. The design stage, as discussed in Chapter 2.0, is divided into two general steps, where potential policy instruments are selected and then the policy solutions are evaluated against each other to determine the best solution for the potential policy issue. The economic criteria are more prominent in the design stage compared to the implementation stage of the public policy analysis framework, which is why the economic criteria in user design and implementation are discussed in advance of the legal criteria, though there are also legal considerations that are crucial in the design stage. As may be expected, the economic literature informs public administrators in setting the cost of the good or service and determining the prices users will pay. The economics literature also provides guidance to public administrators to evaluate whether a user fee is appropriate for a municipally provided good or service, given the nature of the good or service. The information in this chapter can assist municipal public administrators to assess user fees against alternative revenue sources which are being contemplated as policy solutions, which, given the limitations on municipal revenue generating sources, are likely property taxes. This chapter clarifies the economic literature and establishes the economic user fee implementation criteria to assist municipal public administrators through the design and implementation stages of the public policy analysis process.

The first two sections of this chapter set out the research methodology and the terminology in this chapter. The first section explains the research methodology used to conduct the literature review. The second section examines the issue of terminology and definitions within the economic literature. One of the main difficulties throughout this thesis is the terminology of user fees. Throughout both the economic literature and the jurisprudence, the

terms describing ‘user fees’, ‘taxes’, and ‘user charges’ vary within the discipline and do not align between the economic and legal disciplines. The objective of this section is to provide an understanding of the key terms.

The next three sections focus on issues pertinent to the design stage and information that will be relevant to municipal public administrators when evaluating user fees against other potential policy solutions. The third section in this chapter sets out general economic principles to evaluate public finance instruments and applies these principles to user fees. The fourth section discusses the application of user fees in terms of the features of publicly provided goods and services that make them appropriate for user fees. The fifth section explores the different ways in which costing the municipal good or service can be done for user fees. This fifth section focuses on the elements that comprise the cost of the good or service, which arguably blurs the line between design of the policy solution and implementation of the user fee in determining the cost; however, when integrated with the legal criteria, the legal test that is applied is related to the objective of the user fee which falls more to design stage considerations. These sections are the prominent economic considerations for public administrators in the design stage.

The remaining two sections move into implementation stage considerations. The sixth section discusses establishing the price of user fees and different types of pricing schemes. The seventh section considers where the money goes once it has been collected by government, with particular attention on earmarking and how economists advise revenue generated by user fees should be allocated. Pricing and revenue allocation are the implementation stage considerations that arise from the economic literature. The chapter concludes by summarizing the economic literature design and implementation stage criteria for the implementation of municipal user fees.

3.1 *Research Methodology: Economic Literature Review*

A literature review was conducted to identify economic literature relevant to municipal user fee implementation. This literature review examined relevant books, academic papers and journal articles, government publications, policy papers published by think tanks, and newspaper articles. The findings of the literature review are used to inform the economic criteria that are integrated into the municipal implementation criteria for user fees.

This thesis topic arose from the paper entitled *The Feasibility of Implementing a Congestion Charge on the Halifax Peninsula: Filling the Missing Link of Implementation* by Dr. Lindsay Tedds, Dr. Catherine Althaus, and Allen McAvoy.⁴² The initial sources reviewed for this thesis were selections from the bibliography of that paper that considered both public administration and economic user fee literature. Additional searches for relevant literature were conducted through the University of Victoria library general search tool, Summon, through Google Scholar, and academic databases such as Heinonline, Social Science Research Network, and Science Direct. The search terms used included combinations of: ‘user fee’, ‘municipal’, ‘user charge’, and ‘tax’. In addition to reviewing the bibliographies of relevant sources, searches on author publications and for subsequent citations of papers were conducted. A daily search was set on Google news for articles which contained the terms (“user fee” and municipal) and was maintained throughout the course of the thesis process. The search generated a daily email of North American news stories with the search terms.

Two exclusions were applied to the literature so as to ensure relevancy to the general topic of implementation of municipal user fees. The first exclusion applied to specific areas of municipal goods and services. Within certain established goods and services where municipal

⁴² Althaus, Tedds & McAvoy, *supra* note 21.

user fees are more commonly applied, such as congestion charging, water and sewage metering, and garbage fees, there are specific bodies of literature. It was generally found that the literature in these areas was too specialized, for instance addressing specific geographic or pricing concerns, without a broader discussion about the implementation process for the user fee; however, some articles offered practical insight or examples that were useful to include. The second exclusion was applied to the body of literature on the implementation of user fees in developing countries. The governing structures in these countries are often different from Canada, which restricted the relevancy of that body of research; however, in some cases there was information that pertained to all governments, which was also included.

During the literature review certain difficulties arose in searching, reading, and analyzing the body of economic literature because of the definitions used in this area. ‘User fees’, ‘user charges’, and ‘levies’ are examples of terms that are used throughout the economic literature. In some cases the terms are used interchangeably, while in other papers the terms are distinguished. The inconsistency of definitions is an important issue to address because failure to do so may have resulted in misunderstanding the literature or overlooking potential search terms or search term combinations. The next section explains the varying definitions in the economic literature and the terms used in this chapter.

3.2 Definitions

One of the first issues arising in the literature was the definition issue in the economic literature. The definitions used in economics for the terms ‘taxes’ and ‘user fees’ can vary and many of the similar terms for ‘user fees’, such as ‘levy’ and ‘user charge’, are used interchangeably. A similar issue is mirrored in the jurisprudence, and while the labelling is not crucial to the recommendations provided by economists, it is a significant factor in law. The

purpose of this section is to describe the main issues in the user fee terminology and explain the approach this thesis applies.

A central definitional issue is if the term ‘tax’ is used sufficiently broadly to include user fees. Economists use the term tax in two ways. ‘Tax’ can be used as an umbrella term for a transfer of funds from the private sector to the public sector. For example, in discussing the types of taxes that municipalities use for revenue, Kitchen and Boadway write, implying that a user fee is a tax in broad language, “[a]dditional taxes, which include the yields from poll taxes and *numerous other levies*.”⁴³ In other instances, a ‘user fee’ will be considered a different type of revenue generating tool than a “tax”. Bird and Tsiopoulos define taxes as “mandatory levies that are not related to any specific benefit or government service,”⁴⁴ whereas they define ‘user fee’ as “payments levied to recover the cost of a particular government service that is received by a specific person but mandated for public purposes.”⁴⁵ For the purposes of this thesis, the term ‘tax’ is distinguished from ‘user fee’, because conflating these two revenue generating instruments would create difficulties in trying to clearly communicate research and recommendations. Furthermore, the jurisprudence also distinguishes these terms and concepts.

The second definitional issue that arises in the economic literature is the lack of an agreed upon definition for the term ‘user fee’. In economics, a ‘user fee’, ‘user charge’, and ‘levy’ are generally interchangeable terms. Some articles find additional means of differentiating between

⁴³ Robin W Boadway & Harry M Kitchen, *Canadian Tax Policy*, 3rd ed (Toronto: Canadian Tax Foundation, 1999) at 161 [emphasis added].

⁴⁴ Richard M Bird & Thomas Tsiopoulos, “User Charges for Public Services: Potentials and Problems” (1997) 45(1) *Canadian Tax Journal* 25 at 38.

⁴⁵ *Ibid* at 39.

the terms,⁴⁶ but these stricter definitions have yet to be adopted widely in the literature. However, in all cases when economists use the terms ‘user fee’ or ‘user charge’ it is with reference to the revenue levied from an individual benefiting from a specific good or service. This thesis takes the approach of using ‘user fee’ as synonymous with ‘user charge’ rather than distinguishing the terms, as there is no consistent treatment of the definitions and the principles discussed are generally applicable.

This section explains that the terminology describing ‘taxes’ and ‘user fees’ in the economic literature is inconsistent. This thesis distinguishes ‘taxes’ from ‘user fees’ both for clarity and to reflect the legal terminology. Furthermore, the term ‘user fee’ is used interchangeably with ‘user charge’ because the economic literature has not adopted consistently clear distinctions of these terms. As may be discerned from these initial difficulties in the research, public administrators should be cautious when using terminology to ensure that the underlying concepts and objectives are clearly communicated. After having set out the research methodology and the definitions used in this thesis in Sections 3.1 and 3.2 respectively, the next section moves into the substantive discussion on user fees and the design stage economic considerations.⁴⁷

⁴⁶ *Ibid*; Bird and Tsiopoulos define “user fee” as “payments levied to recover the cost of a particular government services that is received by a specific person but mandated for public purposes” and “user charge” as “charges levied on consumers of goods and services in relation to their consumption.”

⁴⁷ Section 3.3: *User Fee Design Stage Considerations from the Economic Literature: Economic Rationales for Policy Decisions as Applied to User Fees* comes before Section 3.4: *User Fee Design Stage Considerations from the Economic Literature: Features of the Good or Service Supporting the Implementation of User Fees* because Section 3.3 provides a rationale for user fees in a municipal context before looking at application to a specific good or service. It may be argued however, that a reverse order is more appropriate because if the goods and services that are identified for user fees are first identified, then the evaluation could take place based on rationales subsequently provided. This ordering was ultimately selected because it is believed that it more firmly establishes an argument for user fees, especially for an audience that may be unfamiliar with user fees, before discussing the particular goods and services that are most appropriate for user fees.

3.3 *User Fee Design Stage Considerations from the Economic Literature: Economic Rationales for Policy Decision as Applied to User Fees*

As discussed in Chapter 2.0, one of the central objectives of the design stage in public policy analysis is to evaluate potential policy options against each other to determine which would be the best solution to the policy problem. This section explores how a policy decision can be supported by examining certain economic principles and evaluates the proposed public policy, in this case user fees, against those principles. These principles are known in economics as ‘conditions of public welfare’, which evaluate an individual’s satisfaction in the goods and services provided by local government. When comparing alternatives in evaluating public welfare, the outcome that is sought is to provide the desired level of services at the lowest cost.⁴⁸ These public welfare conditions are used by economists to analyze public finance policy across many situations; their application is not limited to user fees. The public welfare conditions most often assessed when evaluating policy alternatives include efficiency, equity, administration and compliance cost, visibility, and accountability.⁴⁹ User fees will be assessed against each of these conditions to set out the advantages and disadvantages discussed in the economic literature. As has been established, municipalities have limited means to generate revenue, so comparisons will also be provided between a user fee and a property tax as these are the primary revenue generating devices accorded to Canadian municipalities. By understanding the conditions of public welfare and how user fees satisfy these conditions, particularly compared to the likely alternative for municipalities, property taxes, it is anticipated that public administrators will be assisted in the design stage to evaluate user fees against other potential policy options.

⁴⁸ Richard M Bird & N Enid Slack, *Urban Public Finance in Canada* (Toronto: Butterworth & Co Ltd, 1983) at 30 [Bird & Slack, *Urban Public Finance in Canada*].

⁴⁹ Harvey S Rosen et al, *Public Finance in Canada: Third Canadian Edition*, (Toronto: McGraw-Hill Ryerson, 2008) at 45.

3.3.1 *Allocative Efficiency*

The efficient allocation of resources is one of the objectives economists hope to achieve when solving policy problems. Economists look at the basic market in which a good or service is produced and sold as having demand and supply functions. The demand function describes the relationship between a consumer and the price of the good or service, focusing on how much a consumer is willing to pay for the good or service at a point in time. The supply function describes the relationship between the producer and the price of the good or service, focusing on how much of the good or service is provided at a point in time. Allocative efficiency is found when goods and services are produced at the lowest possible cost to the producer and the quantities that are provided are of the greatest possible benefit to the consumer. At the point of allocative efficiency it is not possible to produce more of a good without giving up an amount of another good that is more highly valued; in other words, an allocatively efficient market is not wasteful because the benefits to producers and consumers are at their maximum. This section examines how user fees promote allocative efficiency, compares property taxes to user fees in terms of allocative efficiency, and highlights two economic factors which may influence allocative efficiency.

One of the main economic arguments supporting user fees is that user fees support government to achieve the best use of its scarce resources. User fees promote efficient allocation of government resources because direct recipients of benefits pay for the goods and services they consume. The prices of user fees are based on the units of the good or service consumed, so consumers are aware of the cost of a unit and can adjust their consumption according to their preferences. This means that the consumer can decide how much of the good or service they are willing to pay to use. The result is that goods and services are delivered to those who are willing

to pay for those goods or services and that individuals who do not wish to pay for the good or service are not required to pay.⁵⁰ Allocative efficiency is supported when goods and services are consumed by those who value them most and those consumers demonstrate that value through a willingness to pay for the use of the good or service. As several economists argue,⁵¹ the approach of local finance should generally be “whenever possible, charge”⁵² so as to ensure the goods and services provided by a municipality are being used by the consumers who value them most and are willing to pay for the use of the goods and services.

Allocative efficiency is also supported when a user fee is compared to property tax for goods or services where consumption can be limited.⁵³ Generally, a municipality will be making a policy choice to determine if the publicly provided good or service should be funded between these two types of revenue instruments. User fees can be implemented on each unit of the publicly produced good or service consumed. This feature allows a user fee to be more allocatively efficient than a tax because the consumer is aware of how much each unit costs and in turn can be influenced by unit pricing. For example, if a user has to pay \$5.00 for each bag of garbage set out for pick-up and dump disposal, a second bag will cost an additional \$5.00. However, a general tax does not have the same affect on demand as user fees. Using the same example, if the garbage bag fee is integrated into the property tax, the taxpayer can readily set

⁵⁰ Donald N Dewees, “Pricing Municipal Services: The Economics of User Fees” (2002), 50(2) *Canadian Tax Journal* 586 at 588.

⁵¹ David G Duff, “Benefit Taxes and User Fees in Theory and Practice” (2004) 54 U Toronto LJ 391 at 397 (Heinonline) [Duff, “Benefit Taxes and User Fees in Theory and Practice”]; Kitchen, “Pricing of Local Government Services”, *supra* note 4 at 139; Bird & Tsiopoulos, *supra* note 44 at 27.

⁵² Richard M Bird, *Local Government Finance: Trends and Questions* (29 July 2010), online: Social Science Research Network <<http://ssrn.com/abstract=1659807>> at 16; James Alm, *Municipal Finance of Urban Infrastructure* (2011), online: Tulane University <<http://econ.tulane.edu/RePEc/pdf/tul1103.pdf>> at 12-13.

⁵³ This type of good or service is called a “private good”. Further discussion on private and public goods and services may be found in Section 3.4: *User Fee Design Stage Considerations from the Economic Literature: Features of the Good or Service Supporting the Implementation of User Fees*.

out as many bags of garbage as they want without incurring additional costs.⁵⁴ Efficiency is supported when the beneficiaries of the public services (in the example above, the public services are garbage removal and disposal) are required to incur the cost of the provision of the service.⁵⁵ Accordingly, user fees also allow users and potential users to adjust their consumption preferences in response to the pricing of the public good or service.⁵⁶

One way to measure losses in allocative efficiency is to examine a factor that economists term ‘deadweight loss’. Deadweight loss is an economic factor that has the potential to affect allocative efficiency of user fees and the decision of a public administrator in selecting a user fee as an appropriate policy solution. One policy objective may be to find allocative efficiency, because this is the point at which the most benefit is being gained for the least cost. However, economists also acknowledge that taxes and user fees will affect an individual’s behaviour, which in some cases will result in there being more or less demand for a good or service; that is, the supply of the good or service is no longer at the point of allocative efficiency. The amount of efficiency that is lost is called the ‘deadweight loss’. The difference in deadweight loss that is experienced between the implementation of a tax or a user fee is of concern to economists, because the objective is to remain as close as possible to the point of allocative efficiency.

Economists predict that greater deadweight loss is likely to occur with taxes as compared to user fees because consumers are more aware of how much they are paying for a specific good or service when they are paying user fees compared to when they are paying taxes. Research conducted by Cabral and Hornby on consumers’ perception of the amount they are being taxed suggests, “[i]n general, we expect far less deadweight loss from user fees than from other taxes

⁵⁴ Duff, “Benefit Taxes and User Fees in Theory and Practice”, *supra* note 51 at 399.

⁵⁵ *Ibid* at 399.

⁵⁶ Dewees, *supra* note 50 at 587.

[...].” This is because consumers can associate themselves with the benefits they receive from paying the user fee, which is more difficult with a general property tax.⁵⁷ As user fees are applied to a specific good or service it is easier for the consumer paying a user fee to know what benefit was received and how much it cost as a result. By contrast, property taxes are collected and applied to a broad range of goods and services, making it difficult for the consumer to know what benefits they are paying for and receiving. However, in order to reduce deadweight loss, the pricing of the good or service must also be accurate. In a specific example considering deadweight loss where user fees are applied to water units, Kitchen comments that pricing water and sewage below the actual unit cost of supply has resulted in consumers using more water than is allocatively efficient because there is less incentive to reduce consumption.⁵⁸ Reducing deadweight loss means that the policy is more likely to achieve allocative efficiency because the consumer demand will be more accurate to a consumer’s preferred price to pay for the good or service.

Another economic factor that will affect allocative efficiency is the ability of the payer to shift the burden of payment. There are some situations where a tax or a user fee will be imposed on an individual or business, but that entity will pass the burden of making the payment along to another party, shifting the burden of the user fee from one party to another. While the incidence of a user fee in comparison to the incidence of a tax is not discussed significantly in the literature, it may be predicted that a user fee is more likely to be paid by the person intended rather than passed on to another party. For example, a toll to use a bridge is likely to be paid by

⁵⁷ Marika Cabral and Caroline Hoxby, *The Hated Property Tax: Salience, Tax Rates, and Tax Revolts*, online: National Bureau of Economic Research <http://www.nber.org/public_html/confer/2010/SI2010/PETSI/Cabral_Hoxby.pdf> at 9.

⁵⁸ Harry Kitchen, *Municipal Finance in a New Fiscal Environment* (November 2000), online: CD Howe Institute: Commentary, <<http://www.cdhowe.org/municipal-finance-in-a-new-fiscal-environment/9706>> at 13-14 [Kitchen, *Municipal Finance in a New Fiscal Environment*].

the vehicle that crosses the bridge, whereas a property tax may be imposed on property owners, but then passed on to the tenants of the building. As the user fee is less likely to be passed on, it is more likely to give an accurate indicator of user preferences, which supports the condition of allocative efficiency.

In summary, allocative efficiency is one of the economic indicators that are examined by economists and as such may inform municipal public administrators when they are evaluating policy. Allocative efficiency refers to an economic situation where the best use is being made of scarce resources, because goods and services are produced at the lowest possible cost and the quantities provided are at the greatest possible benefit to the consumer. One of the main rationales for user fees in the economic literature is that they promote allocative efficiency because consumers can know how much a unit of a good or service costs and can indicate their preference accordingly. Where taxes are used to fund multiple goods or services, consumers are more likely to have difficulty knowing how much a specific good or service costs and therefore will not be able to readily communicate their preferences. Allocative efficiency can be affected by two additional economic factors, deadweight loss and indirect payments. Deadweight loss is the amount of efficiency lost when there is a shift away from the point of allocative efficiency. Deadweight loss is likely to be minimized through user fees because user fees allow consumers to have more knowledge of the cost of the good or service they are consuming. Allocative efficiency will also be affected if the consumer is not the paying for the good or service but is able to pass off the user fee to someone else. This has not been examined significantly in the literature, but is seemingly less likely with user fees as a consumer of a good or service will pay a user fee upon use of the good or service.

3.3.2 Equity

Equity is the second evaluative condition examined that is frequently used by economists when analyzing policy options. There are two central principles in considering equity. The first principle is the benefit principle, which can be seen where there is a link between the good or service provided and the benefit the consumer receives.⁵⁹ Second, equity refers to considering the distribution of the cost of government and it is evaluated by examining the user's ability to pay compared to other users. There are two aspects of the ability-to-pay principle: horizontal equity and vertical equity. Horizontal equity is the concept that two individuals who have the same ability to pay should pay the same amount. Vertical equity is when the burden of payment should be higher for those who have a greater ability to pay.⁶⁰ When the financial burden of a service falls more heavily on higher income households, it is referred to as progressive; this is generally the favoured policy direction. When the opposite happens, that is the financial burden falls more heavily on lower income households, the policy is regressive and goes against equity principles.⁶¹ This section examines user fees with respect to both the benefit principle and the ability-to-pay principle, explains a critique that is developing within the literature, and offers a recommendation with respect to design and implementation of user fees when addressing equity concerns.

The benefits received principle provides that where an individual receives a benefit, it is fair if that individual pays for the cost of the benefit.⁶² Duff articulates the reason that user fees support the benefits received rationale, arguing that user fees work on the basic principle of

⁵⁹ Rosen et al, *supra* note 49 at 45.

⁶⁰ *Ibid.*

⁶¹ Duff, "Benefit Taxes and User Fees in Theory and Practice", *supra* note 51 at 403.

⁶² Rosen et al, *supra* note 49 at 328.

fairness because you pay for what you get.⁶³ All users, regardless of income are paying for the cost of the good or service. Duff provides an example of municipal charges for water, sewage or the disposal of solid waste as user fees which are based on the charge relating to an individual's consumption of the good or service.⁶⁴

In terms of the ability to pay principle, the most frequent, and likely the strongest argument against user fees, is that they are argued to be a regressive policy instrument.⁶⁵ This means that the cost of user fees is a heavier burden on lower income individuals because the fee will take up more of their income relative to a higher income individual. This critique was offered by the Official Opposition in response to a federal government initiative to increase user fees, "NDP Treasury Board critic Alexandre Boulerice said user fees discriminate against the poor because unlike income taxes, they are not geared to income."⁶⁶ The debate as to the regressive incidence of user fees continues in the economic literature and some economists have developed arguments rebutting this generally held belief and conducted studies to discern if the claim that user fees are regressive can be supported with evidence.

The literature offers some rebuttals to the presumption of regression in user fees. This research has not been generalized, but rather establishes that some user fees, in some circumstances, did not have the anticipated regressive impact. In one paper, the authors simulated a user fee implementation of a congestion charge, a user fee to use roads at certain times of day, in three towns and found that it was possible for the user fee to have varying impacts. In one town the user fee was found to have a neutral impact and in another town the

⁶³ Duff, "Benefit Taxes and User Fees in Theory and Practice", *supra* note 51 at 396.

⁶⁴ *Ibid* at 394.

⁶⁵ Althaus, Tedds & McAvoy, *supra* note 21 at 552.

⁶⁶ Bill Curry, "Ottawa Embraces higher user fees, holds no tax hikes", *The Globe and Mail* (13 June 2011), online: *The Globe and Mail* <<http://www.theglobeandmail.com/news/politics/ottawa-embraces-higher-user-fees-holds-to-no-tax-hikes/article2052045/>>.

user fee was found to be progressive.⁶⁷ While this research considering the regressive nature of user fees has not been widely conducted, the authors demonstrate that not all user fees will be found to be regressive and through economic modelling, the impact of implementing a user fee can be studied. Other research by Ecola and Light reviews equity with respect to congestion charges across a number of different studies of specific congestion charges.⁶⁸ The studies they reviewed varied on the level of complexity that was examined with respect to equity. In the studies that only considered the payment of fees, the general conclusion was that congestion charging is slightly regressive, but no less so than other forms of taxation, including property tax. When other factors, such as an individual's value of time, are taken into consideration through a more complex equity analysis, it was found that lower-income individuals are worse off than a status quo policy because they face more constraints in their travel time flexibility and are more affected by a congestion charge.⁶⁹ Ecola and Light also suggest that accommodation for equity concerns may be possible outside of pricing modifications, by, for example making operational changes. For example, where it may not be possible to purchase a pass for an individual trip using the road with the congestion charge, but only for a week or a month long pass this may be considered inequitable to those with lower incomes who cannot afford to make such a large purchase at one time.⁷⁰

Bird offers another counter-argument to the argument that user fees are regressive, writing that “the income profile of the consumers of a large range of government services suggests that the upper-income households sometimes benefit disproportionately from the consumption of

⁶⁷ Georgina Santos and Laurent Rojey, “Distributional Impacts of Road Pricing: the truth behind the myth” (February 2004), 31(1) *Transportation* 21 at 31-32.

⁶⁸ Lllsa Ecola & Thomas Light, *Equity and Congestion Charging: A Review of the Evidence* (2009), online: The Rand Corporation <http://www.rand.org/pubs/technical_reports/TR680.html>.

⁶⁹ *Ibid* at 16.

⁷⁰ *Ibid* at 31.

free, or low cost, public services.”⁷¹ Bird is suggesting that when taxed, the units of a good or service are not individually measured or charged for, and compared to circumstances where upper income households must pay for each unit of a good or service consumed, the upper income household is using more of the service and not paying for the amount they are using. Furthermore, using the benefits received principle, user fees also allow low income consumers to adjust consumption to save money. That is, low income consumers have the option to pay for the public goods and services they deem most necessary in their lives. In a municipal context, the alternative that may be used is a property tax, which may also have a regressive incidence if income growth is less than the real estate valuation growth.⁷² This is because property taxes are based on the value of the plot of land rather than tied to an individual’s income, so if a person’s income does not grow at the same rate as their property value, they have less ability to pay for a good or service than the property value represents. These arguments set out by represent the main rebuttals to the argument that a user fee is a regressive policy instrument.

Aside from the debate as to the regressive nature of user fees, there is another significant issue in the economic literature with respect to the equity principle. An underlying criticism of the study of the equity condition in economics is that when studying equity, all elements which may affect the equity condition are not considered. Duff writes,

[I]n evaluating any tax policy *reform* [...] it is important to consider not only the incidence of the levy alone but the incidence of any other tax or taxes that might be reduced at the same time and the incidence of the publicly provided goods and services to which any increase in total revenues is devoted.⁷³

⁷¹ Bird & Tsiopoulos, *supra* note 44 at 50; see also Enid Slack, *Financing Large Cities and Metropolitan Areas* (December 2010), online: Institute on Municipal Finance and Governance, Munk School of Global Affairs, University of Toronto

<http://www.munkschool.utoronto.ca/imfg/uploads/73/financing_large_cities_and_metropolitan_areas.pdf> at 6.

⁷² Ecola & Light, *supra* note 68 at 16.

⁷³ Duff, “Benefit Taxes and User Fees in Theory and Practice”, *supra* note 51 at 404 [emphasis in original].

Examination of the equity concerns of user fees is an important aspect of the user fee design stage and the equity assessment must be comprehensive to ensure a full understanding of the affects of the user fee on other correlated levies and goods and services.⁷⁴ Duff expands the analysis of proposed policy to include consideration by public administrators of other areas affecting equity between users which may be affected.

An example that occurs frequently in the literature demonstrating a need for a broad understanding of equity considerations is the location of the service relative to the potential consumers. For some user fees, location may increase costs in the distribution of good and services because it will be more expensive to serve outlying populations. Likewise, location can also affect the use of the service because certain populations may have to travel farther distances to reach a destination. Nallathiga notes that the socio-economic conditions of the outlying populations may differ,

Location also affects costs—it is costlier to supply to outlying areas because of the conveyance costs involved but recovery of which needs to be carefully worked out. If wealthy groups choose to live on plots away from the city, they should bear the heavy costs of pumping water. However, if the poor live on the outskirts because the housing in city is unaffordable, burdening them further with above-average unit costs may not be justifiable. Charging has to be made with respect to affordability of groups.⁷⁵

Location is an example of a condition that may affect the equity of a user fee, beyond an analysis that is limited to considering a regressive incidence of a user fee based on income.

Given both the lack of conclusive information regarding the regressive impact of user fees and the critique that equity may not necessarily consider all relevant factors, one of the challenges facing public administrators is deciding how to include equity considerations in the

⁷⁴ *Ibid* at 406-407.

⁷⁵ Ramakrishna Nallathiga, *User Charge Pricing for Municipal services: Principles, fixation, process and guidelines*, online: < http://www.cgg.gov.in/workingpapers/User_charge_levy_paper.pdf > at 4; see also Slack, *supra* note 71 at 5-6.

public policy analysis process and particularly for municipal public administrators as it may be argued that it is not within their mandate or policy tools to deal with equity issues. The economic literature is unsettled in its guidance with respect to this issue. There are some economists who argue that income distribution concerns should not be addressed initially in a user fee design structure or should not be included at all.⁷⁶ Where equity considerations are included, in a user fee context they will likely be a subsidy or discount on the price of the user fee to certain classes of consumers. Adjusting a user fee structure for income distribution is the process of including a measure in the user fee design to adjust for the perceived regressive nature of the user fee. That is, a built-in adjustment to alleviate the financial burden on low income consumers. The rationale against these types of adjustments appears to be three-fold; first, some of the subsidies provided make little economic sense in terms of efficiency. An example is the discounts made available for seniors and students on publicly provided bus services. The consumer, whether a senior or a student, is consuming the same amount of the bus service. The second rationale is that a subsidy may alter the demand function of the consumer, which is contrary to the economic objectives because it makes it more difficult to determine allocative efficiency. The third argument against subsidizing user fees for certain groups to achieve equity is put forward by Kitchen, who argues it is not the responsibility of local government to ensure appropriate income distribution because of the limited revenue sources and authorities at the municipal level.⁷⁷ Bird and Slack elaborate on this point, explaining that because labour mobility at the local level more readily facilitates

⁷⁶ Bird & Tsiopoulos, *supra* note 44 at 58; Harry Kitchen, *Municipal Revenue and Expenditure Issues in Canada* (Toronto, Canadian Tax Foundation, 2002) at 123 [Kitchen, *Municipal Revenue and Expenditure Issues in Canada*]; Kitchen, "Pricing of Local Government Services", *supra* note 4 at 139; Bird & Slack, *Urban Public Finance in Canada*, *supra* note 48 at 81.

⁷⁷ Kitchen, "Pricing of Local Government Services", *supra* note 4 at 158.

movement between jurisdictions, offsetting the redistribution policies is easier.⁷⁸ Recall, however, that Ecola and Light suggest that operational changes may also be made to address equity issues. Municipalities may be able to consider these types of operational changes to adjust for equity concerns rather than looking strictly to financial adjustments for equity concerns.

On the other hand, there are some economists who disagree and argue that equity concerns should be included in the policy design of a user fee. As demonstrated by Nallathiga in the location example above, when she writes, “[c]harging has to be made with respect to affordability of groups”,⁷⁹ there is not a consensus among economists that income distribution concerns should always be excluded. Gillette and Hopkin agree on a similar position, writing that considerations for fairness may warrant differential fees based on ability to pay.⁸⁰ Bird also acknowledges the importance of distribution in when making policy decisions,

[A]nalysis that assumes distributional considerations are either unimportant or can easily be accommodated by (usually unspecified) adjustments somewhere else in the tax-transfer system simply does not resonate in the policy context of most countries. Distributional issues matter in tax policy.⁸¹

However, for public administrators, the practical point at which equity concerns override the benefit-based principle of user fees, where a user or beneficiary is to receive a discount on the full cost of the good or service, is unclear.

There appears to be some middle ground that can be found between the two positions on user fees as to incorporation of distributional concerns. Bird and Tsiopoulos write that distribution concerns should not be taken into account *initially* in deciding the appropriate

⁷⁸ Bird & Slack, *Urban Public Finance in Canada*, *supra* note 48 at 17-18.

⁷⁹ Nallathiga, *supra* note 75 at 4.

⁸⁰ Clayton P Gillette & Thomas D Hopkins, “Federal User Fees: An Economic and Legal Analysis” (1987) 67 BUL Rev 795 (Heinonline) at 801.

⁸¹ Bird, *Tax System Change and the Impact of Tax Research* (2009), *supra* note 22 at 19.

structure of user fee pricing.⁸² However, there is little economic literature that speculates as to what tips the scales to include distributional elements in the pricing, aside from public administration concerns. Ungemah writes, concerning congestion charging, that “[p]ublic opposition rather than a technical evaluation of equity has been the overriding factor in tolling projects that have failed to come to implementation.”⁸³ This illustrates the lack of understanding by economists of the pressures on public administrators. Setting user fee pricing in a vacuum, without considering that public administrators are likely going to be required to adjust pricing for distributional concerns without any guidance in the literature as to how to accomplish this task, even if it goes against economic advice, does not assist the policy administrator.

To summarize, the equity condition considers both the benefits received principle and whether a user fee will have a regressive impact, meaning whether it will cost a lower income household a greater proportion of their income compared to a higher income household. The regressive incidence of a user fee is a controversial and unsettled point in the economic literature. Furthermore, the general presumption of a regressive incidence of user fees is the general argument against user fees, however some research has demonstrated that user fees may have a neutral or positive impact. A second criticism underlying the literature is that the study of equity does not consider all potentially relevant factors; the prominent example in the literature is location of the good or service relative to the user. One of the major deficiencies in the literature is providing any sort of guiding principles to public administrators who will be implementing user fees, specifically as to whether subsidies should be introduced and if so, when. The best

⁸² Bird & Tsiopoulos, *supra* note 44 at 58 [emphasis added].

⁸³ David H Ungemah, “This Land Is Your Land, This Land Is My Land: Addressing Equity and Fairness in Tolling and Pricing” (2007) 2013 *Transportation Research Record* 13 at 14.

recommendations to public administrators that can be established from the literature are to examine equity broadly and that each potential user fee will require its own analysis.

3.3.3 Administration and Compliance Cost

The third evaluative criteria used to determine the economic rationale of a levy is consideration of the administration and compliance costs. Rosen et al. define this criterion as the costs that are imposed to comply with the levy, especially enforcement costs, and to operate the user fee collection system. The objective is to create policies which minimize these costs.⁸⁴ Alm states that revenue generating tools, such as taxes and user fees, should be simple, both to administer and comply with. His rationale is that a complicated system wastes the resources of both the administrators and the individuals paying the taxes and fees.⁸⁵ This section considers the limited literature that is available on administrative and compliance costs with respect to user fees and draws some conclusions related to this condition from related research.

Unfortunately, there is not significant discussion on the issue of user fee administrative and compliance costs in the economic literature. Gillette and Hopkins write that a minimal objective of implementing user fees should be only in situations where revenues generated will be well in excess of fee compliance costs.⁸⁶ Arguably, a properly set user fee will ensure the compliance costs are included and paid for; however it is noteworthy that the compliance costs be included. Dewees also notes with respect to public administration considerations that user pay programs will involve additional costs for communications, publicity, and interaction with the public.⁸⁷ Given that adopting a user fee model will at the very least require establishing the price, administering the system, and ensuring payment, it may be assumed that there are costs when

⁸⁴ Rosen et al, *supra* note 49 at 47.

⁸⁵ Alm, *supra* note 52 at 15.

⁸⁶ Gillette & Hopkins, *supra* note 80 at 820.

⁸⁷ Dewees, *supra* note 50 at 591.

implementing a user fee and these figures should be compared to the alternative potential policy solutions.

There are general design and implementation criteria related to administration and compliance cost which may be drawn from specific experience reported in the literature. A study of the collection of user fees of the City of Milwaukee was undertaken because Milwaukee was experiencing late payments in the processing of user fees.⁸⁸ The researchers were asked to identify the causes of the late payments and make recommendations as to a potential resolution. The impact of the problem was described,

Any delay in payment is costly to the City, which must devote scarce resources to the process of collecting fees. To the extent that delinquencies are not budgeted, the City may have to undertake additional short-term borrowing. The city incurs the real costs of debt service, foregone revenue and outsourced collections, as well as costs associated with the time and resources of city staff dedicated to tracking and monitoring unpaid charges.⁸⁹

Many of these consequences experienced by the City of Milwaukee would be similar to the consequences experienced by a Canadian municipality, though the nature of the prohibitions on deficits may be different for Canadian municipalities.⁹⁰ The researchers identified a number of factors that assisted in higher collection rates, including issuing multiple invoices rather than a single invoice⁹¹ and made final policy recommendations to mail all invoices with due dates for all fees, issue late penalties for all unpaid fees, and to offer credit card payment options for all fees.⁹² The overriding issue that was made clear in this report is the discrepancy of practices between different departments administering user fees and that the departments were not sharing

⁸⁸ Melissa Berger et al, *City of Milwaukee, The Collection of Municipal User Fees* (2011), online: Robert M LaFollette School of Public Affairs, University of Wisconsin-Madison <<http://www.lafollette.wisc.edu/publications/workshops/2011/fees.pdf>>.

⁸⁹ *Ibid* at 1.

⁹⁰ For further discussion of the limitation of municipal deficits, see text accompanying notes 7 and 8.

⁹¹ Berger et al, *supra* note 88 at 4.

⁹² *Ibid* at 34-35.

best practices with each other. Indeed, administrative and compliance costs are sure to be sacrificed if the user fees, which provide the revenue to continue to fund the service, are not paid.

An additional simple, if obvious observation that may be drawn from the Milwaukee experience is the difficulty in administering multiple user fees. Each department required a collections structure to ensure the fees were appropriately monitored, invoiced, payments were received, and overdue payments were tracked. In contrast to a property tax, which would require these same processes to be conducted, but only once for the tax rather than by multiple departments, the user fee can add additional administrative and compliance costs.

The literature on administrative and compliance costs for user fees is not as extensive as other conditions of public welfare in this chapter. However, the literature provides some guidance that compliance, and one may infer administration, costs should not be in excess of the revenue generated by the user fee. Additionally, where comparing user fees and other common means of revenue generation by municipalities, such as property taxes, it is likely that multiple user fees will generate significant administrative and compliance costs, as was seen in the Milwaukee study, especially if administrative policies are inconsistent and late payments are not penalized. Property taxes are likely to be easier to administer and monitor compliance than user fees.

3.3.4 Visibility

The fourth condition is the visibility of a levy, which refers to the consumer's knowledge as to the amount they are paying. An extension of this definition is also the consumer's knowledge of the service they are receiving. For example, public services such as schools, are highly visible. Other regulations, such as the inspection of food, may be considered less visible, because though the consumer eats the food, few consumers would read through the regulations

on how it is inspected.⁹³ The preference of economists is to ensure and promote visibility of the policy and its payment structure because it assists individuals in discerning the amount being levied and for what purpose.

Interestingly, both property tax and user fees are considered to be visible levies by economists, but user fees are generally favoured because consumers are less likely to react negatively to the imposition of user fees and because the cost and benefits of specific service are more visible when paid by a user fee than through a property tax. Property tax is highly visible and is subject to political influence because raising the property taxes is often politically unpalatable. User fees are generally considered to be visible because benefits of which allow consumers to see their costs and the benefits derived from the service more clearly. Visibility is closely related to the other conditions of efficiency and accountability, as visibility in user fees allows beneficiaries to see costs more clearly, choose spending habits that reflect their desired level of cost and service, and judge the appropriateness of user fees, increasing the degree of accountability.⁹⁴ While both user fees and property taxes may be considered visible, the politicized nature of the property tax is what makes the user fee favoured by economists.

3.3.5 *Accountability*

Accountability, the fifth condition used to assess the economic rationale for policy decisions, is frequently referred to by proponents of user fees. When examining these economic conditions, visibility and accountability are sometimes conflated into the same evaluation because they are both related to the general awareness of the consumer. For the purposes of this thesis, accountability is distinguished from visibility because of the implication that

⁹³ This example is drawn from Bird & Tsiopoulos, *supra* note 44 at 45.

⁹⁴ Kitchen, *Municipal Revenue and Expenditure Issues in Canada*, *supra* note 76 at 123.

accountability will make an indication as to consumer preferences, to which government should react, while visibility refers to the level of awareness of the consumer of exactly where their money is going.

Accountability is enhanced when there is a close link between the quantity consumed and the price per unit of consumption.⁹⁵ For example Dewees writes in the context of using user fees for new infrastructure, that “if capital costs are paid through user fees, capital investments may be made when the utility can persuade the public that the investment is necessary for the public interest.”⁹⁶ By increasing consumer awareness of the goods and services they are paying for, consumers can further their preferences which can indicate to public administrators the overall public preference for services or goods. User fees also have more frequent feedback that is provided to government to guide adjustments to goods and services more regularly and quickly than the alternative indicator, which is a general election every four to five years.⁹⁷ Furthermore, it is worth expanding this point to note that consumers are able to indicate preferences for specific public goods or services through user fees, rather than by voting on a comprehensive election platform which may or may not target their interests.

Accountability is also a consideration in the revenue collection of user fees. User fees are collected in specific revenue streams and reinvested back into the good or service. This form of ‘earmarking’ allows for increased accountability because it is clearly known what is collected and spent on a specific service. However, an objection sometimes raised by economists in the realm of user fees is the principle of public finance theory that says tax revenue should not be constrained to certain expenditure patterns. This is because government priorities can change

⁹⁵ Kitchen, *Municipal Finance in a New Fiscal Environment*, *supra* note 58 at 5.

⁹⁶ Dewees, *supra* note 50 at 589-590.

⁹⁷ Duff, “Benefit Taxes and User Fees in Theory and Practice”, *supra* note 51 at 401.

over time and separating revenue streams allocating specific funds to finance specific services will decrease the flexibility in government budgets.⁹⁸ This consideration is further discussed in the revenue management section below.

3.3.6 Summary

Economists rely on certain economic conditions to evaluate finance policy, including allocative efficiency, equity, administration and compliance costs, visibility, and accountability. These conditions can be used evaluate financial policy and are not limited to user fees; however, the objective of this section was to apply the factors to user fees and provide property tax comparisons where available. Allocative efficiency is one of the objectives of a policy decision because it means that no individual can be made better-off without making another person worse-off. Allocative efficiency is supported by user fees because user fees are able to indicate consumer preference through unit-based pricing. Equity refers to ensuring that services are accessible based on a consumer's ability to pay and is a condition that is generally cited by opponents of user fees as it is believed user fees are regressive. However, the literature demonstrates that some user fees may in fact be neutral or progressive, and advocates for the study of a specific user fee as to how it affects equity rather than labelling all user fees as regressive. Administration and compliance costs are likely to be increased when user fees are implemented, because multiple user fees require systems of billing, tracking, and collecting. Visibility, the knowledge by the consumer as to the cost they are paying and the service received, is promoted by user fees as a consumer can find a direct correlation between the amount paid and the service they receive. Finally, accountability is also promoted because consumers will be able to indicate their preferences more clearly and regularly than through a property tax.

⁹⁸ Althaus, Tedds & McAvoy, *supra* note 21 at 547.

Based on the evaluative criteria discussed in the context of allocative efficiency, equity, administration and compliance costs, visibility, and accountability, advocates of user fees are likely to rely on allocative efficiency and accountability arguments most strongly. While not widely discussed as a separate objective of user fees in the economic literature, and perhaps relating to the condition of visibility, user fees can be put in place not just to generate sufficient revenue for the good or service, but to curb demand and influence consumer preferences. Opponents to user fees are likely to rely on the position that a user fee is a regressive levy and can bolster this argument by noting that the economic literature advocates for alternative subsidies from other programs, rather than within the user fee design itself, likely increasing administration costs in program design. An additional factor that opponents may rely upon is that the user fee is likely to impose more significant administrative and compliance cost burdens than a property tax. Figure 3.1 summarizes the design stage considerations in this section.

| PUBLIC POLICY ANALYSIS CRITERIA | |
|---------------------------------|---|
| | ECONOMICS |
| DESIGN | <p>Conditions of Public Welfare</p> <p><i>Allocative Efficiency:</i> Does the instrument support efficient allocation of resources? → User fees: consumers are aware of the cost per unit and can adjust consumption according to preferences.</p> <p><i>Equity:</i> What is the incidence of the instrument (regressive, neutral, positive)? → User fees: Generally thought to be regressive, requires case by case analysis.</p> <p><i>Administration and Compliance Costs:</i> Are the costs of the instrument overly cumbersome; will the revenue generated be in excess of costs? → User fees: Likely requires administrative and compliance structure for each fee.</p> <p><i>Visibility:</i> Is the consumer aware of the amount they are paying? → User fees: Yes, highly likely.</p> <p><i>Accountability:</i> Is there a close link between quantity of the good or service consumed and price per unit? → User fees: Yes, consumers can readily indicate preferences, steady feedback loop, does not rely on election cycles.</p> |

Figure 3.1: User Fee Design Stage Considerations, Conditions of Public Welfare

3.4 *User Fee Design Stage Considerations from the Economic Literature: Features of the Good or Service Supporting the Implementation of User Fees*

Section 3.3 examined five general economic principles: allocative efficiency, equity, administration and compliance costs, visibility, and accountability, and gave consideration as to

how user fees apply to these principles. Evaluating user fees against these general economic principles is one part of the comparison between alternative potential policy solutions found in the design stage. This section adds a second component to this aspect of the design stage and examines the features of a municipal good or service that would make it appropriate for a user fee. Some goods or services have economic characteristics that are favourable to the application of user fees. Bird and Tsiopoulos identify six characteristics of public sector activities that are relevant to determining if a user fee is an appropriate revenue generating model to apply: publicness, excludability, economies of scale, sunkness of costs, externalities, and social and political objectives. The public administrator is also advised, when examining these characteristics, to consider both the nature of the good or service and nature of its market as some characteristics may affect both the good or service and its delivery to market.⁹⁹ This section describes these characteristics, discusses the features of a good or service which best allow for a user fee to be implemented, and notes circumstances where user fees would be inappropriate. As in Section 3.3, an explanation of the characteristic is provided and then user fees are evaluated against the identified characteristic.

Publicness refers to the level of competition, or ‘rivalry’, for the use of the good or service. The two extremes of publicness in relation to goods and services are ‘public goods’ and ‘private goods’. A pure public good is one in which one person’s consumption of the good does not prevent anyone else from consuming the good.¹⁰⁰ A common example is national defence, where the benefits of national security are generally shared, “without resorting to artificial

⁹⁹ Bird & Tsiopoulos, *supra* note 44 at 39-42.

¹⁰⁰ Rosen et al, *supra* note 49 at 38.

presumptions regarding the manner in which these benefits are distributed.”¹⁰¹ A private good may be understood by the fact that an individual’s use of the good limits the ability of another individual to use it and that people can be prevented from using the good altogether. An example of a private good is food; if one individual eats an apple, another individual cannot eat the same apple.¹⁰²

Bird and Tsiopoulos state that the less public a service or good, the more desirable it is to impose a user fee because it becomes easier to distinguish the units of the good or service and the direct benefits to the consumer.¹⁰³ This suggests that there is a range of “publicness” with respect to publicly provided goods and services. Indeed, Althaus, Tedds, and McAvoy characterize the publicly provided good, highways, as a quasi-public good in the case of the proposed Halifax Peninsula congestion charge.¹⁰⁴ A highway may be characterized as a quasi-public good because it only becomes rivalrous when the amount of cars trying to access the road space exceeds the supply of the road space, normally measured in terms of traffic flow or volume of cars.¹⁰⁵ This example demonstrates that a service or good does not have to be considered in a constant state as a rivalrous public good in order for a fee to be levied and that there may only be certain times or instances when it is appropriate to levy a fee.

Excludability, the second condition, is closely related to publicness. Both publicness and excludability characteristics refer to the nature of services in terms of consumption.

Excludability considers the feasibility of restricting the consumption of a service. A non-

¹⁰¹ David G Duff, *The Social Contract Revisited: Tax Fairness and the Tax Mix*, online: The Foundation for Law, Justice and Society <<http://www.fljs.org/uploads/documents/Tax%20Fairness%20and%20the%20Tax%20Mix.pdf>> at 3.

¹⁰² Bird & Tsiopoulos, *supra* note 44 at 40.

¹⁰³ *Ibid* at 40.

¹⁰⁴ Althaus, Tedds & McAvoy, *supra* note 21 at 542.

¹⁰⁵ *Ibid* at 542.

excludable good or service is when it is not plausible to prevent consumers from using the good or service. Bird and Tsiopoulos write, “[t]he publicness of an activity determines to some extent whether pricing [a user fee] is desirable; its excludability determines whether pricing is feasible.”¹⁰⁶ Police and fire services are generally considered non-excludable services because individuals who do not pay for the service are not prevented from accessing those services. An example of an excludable activity is a toll highway, where users who do not pay the toll are not permitted to make use of the road. Publicness and excludability are not necessarily inherent features of a publicly provided good or service, but may be dependent on the service delivery.¹⁰⁷ For instance, keeping with the highway example, a highway mechanism that takes a photo of a licence plate and levies the user fee through a mailed billing after the use has taken place is less excludable than a highway that will not allow a user on the road unless the fee is paid. As with publicness, user fees are best applied to a good or service in which people who choose not to pay the user fee can be easily excluded from use. The reason for this is self-evident; in order for a user fee to be effectively imposed, individuals who choose not to use the good or service must not be able to access it without having paid the required fee.

The third and fourth conditions, economies of scale and sunk costs, are features which refer to the production of a good or service. Economies of scale refers to circumstances where the cost of producing a unit of the good or service falls as the output of the good or service increases.¹⁰⁸ Sunkness of costs is the difference between the long-term and short-term costs of providing an additional unit of service.¹⁰⁹ Costs will be considered more sunk when a longer

¹⁰⁶ Bird & Tsiopoulos, *supra* note 44 at 40.

¹⁰⁷ *Ibid* at 40.

¹⁰⁸ Michael Parkin & Robin Bade, *Microeconomics: Canada in the Global Environment*, 7th ed (Toronto: Pearson, 2010) at 243.

¹⁰⁹ Bird & Tsiopoulos, *supra* note 44 at 41.

term is required to pay the costs. Bird and Tsiopoulos explain that, if the unit costs decrease as the scale increases (achieving economies of scale), the efficient private sector provision of a service can be difficult to achieve, making the case for public sector intervention. Additionally, the less sunk the costs are, the easier it is to apply economically efficient charges.¹¹⁰

The fifth characteristic for consideration is the externalities of the good or service. Externalities are circumstances in which an individual's behaviour affects the welfare of another individual in a way that markets do not fully account for in the pricing of a good or service.¹¹¹ There are both positive and negative externalities in relation to goods and services. An example of a positive externality is the benefit that is gained by the neighbours in the form of beautification and potentially increased property values when a homeowner keeps up their lawn and garden. An example of a negative externality is air pollution as the by-product of industrial activity. Economists are consistent in their opinions, if not adamant, that user fees must include the cost of externalities, meaning generally that the cost of the user fee must incorporate the broad production and consumption costs of the good or service.¹¹² The costing of externalities is discussed in the next section because the method of costing externalities is one of the significant debates in the economic literature on user fees and requires a full section for explanation.

In the context of application of user fees to a good or service, there may be instances in which society places high value on the externality, warranting below cost pricing of the good or service or that user fees are not preferable because they are perceived as a barrier to access. A common example of this circumstance is schools. Society benefits from a well-educated population and places significant value on this service. Though schools may fit other criteria for

¹¹⁰ *Ibid* at 41.

¹¹¹ Rosen et al, *supra* note 49 at 38.

¹¹² Bird & Tsiopoulos, *supra* note 44 at 41.

user fees to be imposed (an example of excludability is that students could be excluded by having guards at classroom doors to ensure payment), the value of the positive externality of education overrides the full cost of the externality being included and provides a rationale for schools to be funded through taxes. Considering the effect of externalities also relates back to the nature of the policy package being considered for implementation and the potential effect of the user fee in other areas.

The last characteristics of a good or service under discussion are the social and political objectives of the good or service. Generally, these characteristics refer to whether there is an underlying value that the public has expressed in terms of providing access to the good or service because it is seen to benefit society. In contrast to the critiques offered of the economic literature in Section 3.3, these characteristics demonstrate that the economic literature acknowledges that public administrators may have to incorporate certain values, even if they go against the guidance provided in the literature.

Primarily, the social and political objectives relate back to the issues of equity in the provision of a good or service in Section 3.3.2 and the debate over whether a user fee is an appropriate policy tool for issues of income redistribution. The concern of those who argue against including discounted user fees for certain users is because adjustments to the user fees will make it difficult to find the point of allocative efficiency and ensure that municipalities are using their resources in the best possible manner. The economic literature does not provide a consensus on the issue of income redistribution, though the main themes emerging from the literature are that equity must be considered broadly (for example, to include location access) and that income redistribution measures, such as discounts, should be considered later in the policy design.

This section set out design stage considerations with respect to the nature of the good or service that can be used to evaluate whether a user fee is appropriate against the other potential policy solutions available to municipalities. The economic literature suggests user fees are appropriate for policy problems where the good or service is “less public” and practically, where non-users may be excluded. The complementary feature of the good or service is that the beneficiaries or consumers can be readily identified. When costs are “less sunk”, that is the costs related more to the short-term rather than long-term costs, the user fee will be more likely to be efficient. Externalities are to be included in the costing of a user fee, as will be discussed in detail in Section 3.5. Last, user fees should consider social and political objectives and whether a user fee will allow these objectives to be fully addressed. These considerations show that the nature of the good or service can influence the type of revenue generating device that should be applied.

Figure 3.2 summarizes the features of a good or service which support a user fee.

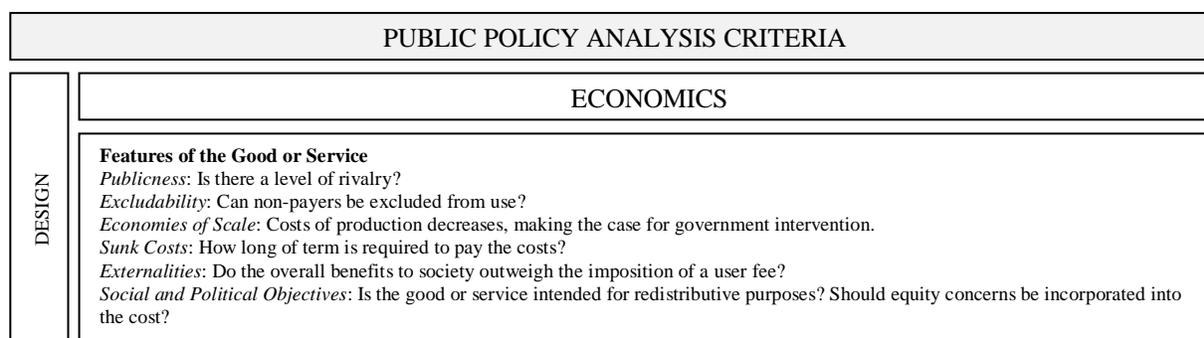


Figure 3.2: User Fee Design Stage Considerations, Nature of the Good or Service

3.5 *User Fee Design Stage Considerations from the Economic Literature: Calculating the Cost of a User Fee*

A crucial element in the design stage is establishing the cost of the service and the amount individuals will be charged. The purpose of accurate costing is two-fold. The first reason is to generate sufficient revenues to fund the good or service. The second reason, related to the

first, is to ensure that the units of the good or service are correctly measured so as to best find the point of allocative efficiency of the good or service. This topic has been divided into two sections that consider user fee design; the first examines how the cost of the good or service is set, and the second section discusses the proposed options for payment by consumers. Arguably, the first section considers the design principles of the user fee, such as the factors the cost will include, and the second section considers the implementation principles of how the costing will be applied, including the payment scheme for consumers. The line between design and implementation on these aspects is blurry and they are likely to inform each other's development. The costing structures examined in this section are marginal cost pricing, average pricing, and average incremental pricing.

Marginal cost pricing is the approach consistently recommended by the economic literature when designing user fees because it is most likely to achieve allocative efficiency. In principle, marginal cost pricing achieves allocative efficiency by setting a pricing structure where the user fee is equal to the cost of producing the last unit of output.¹¹³ In other words, the extra cost of producing each unit of output is measured by the marginal cost.¹¹⁴ Bird describes this amount as, “[i]n deciding whether to produce an extra unit of some good or service our concern is with what we give up in terms of not producing some other good. The relative cost is therefore measured by the additional or marginal cost of producing the extra unit [...]”¹¹⁵ Consequently, when the cost of producing a good or service is decreasing, the marginal cost of that good or service will also decrease, representing that each additional unit is costing less to produce.

¹¹³ Kitchen, “Pricing of Local Government Services”, *supra* note 4 at 145.

¹¹⁴ Kitchen, *Municipal Revenue and Expenditure Issues in Canada*, *supra* note 76 at 122.

¹¹⁵ Bird, *Charging for Public Services*, *supra* note 2 at 33.

As discussed in Section 3.3.1, allocative efficiency is the objective sought by economists when setting public policy because it ensures that the best possible use is made out of all resources so that no one could possibly be better-off without making another person worse-off. Economists argue for user fees set by marginal cost pricing because it accounts for both financial costs and economic costs. Financial costs are the costs generally associated with developing a user fee, such as administration and infrastructure and are generally considered to be readily calculable. Economic costs include societal costs, externalities, and opportunity costs, which are much more difficult to calculate than financial costs. Externalities are physical effects that do not involve a market transaction¹¹⁶ or for which a market has not yet been developed and opportunity costs are the value of a scarce resource in its next alternative use.¹¹⁷ Typically, financial costs are accounted for when user fees are developed, but economists argue that economic costs should be also be included in the pricing process. Without the full cost of the good or service considered with respect to economic costs, economists argue that the revenues generated will not meet the full cost of the good or service, leading to insufficient revenues. As marginal cost pricing accounts for the full cost of the good or service, it provides the most accurate measure of efficient allocation of the pricing structures.

As an example of financial costs in a municipal context, the Federation of Canadian Municipalities (FCM) outlines some of the financial costs that should be included when considering implementing water and sewer fees. FCM identifies three cost categories: capital works, operations, maintenance, and administration, and financial. Capital works includes the costs associated with expansion, upgrades, rehabilitation, and replacement. The FCM

¹¹⁶ Dewees, *supra* note 50 at 589.

¹¹⁷ *Ibid* at 589.

recommends using an asset management system with a complete infrastructure inventory and valuation, condition assessments, and repair, replacement, and refurbishment plans. Operations, maintenance, and administration covers the costs related to staffing, annual operational contracts, material, equipment, and energy costs for day-to-day operations of the service. Financial costs are the costs related to short-term and long-term debt, such as interest expenses and associated legal costs.¹¹⁸ Marginal cost pricing is said to include both the financial and economic costs, and FCM provides an example of the financial costs that should be considered in relation to water and sewage fees.

It is well-accepted that economic costs included in the marginal cost are exceedingly difficult to calculate. Kitchen writes that there is an inability or difficulty to define units of output for many public goods, combined with inaccessibility of cost data and problems assigning costs.¹¹⁹ Other costs must also be included to set the correct marginal cost, such as the opportunity-cost of land, but Dewees comments, “[c]onceptually, the most difficult part of this calculation is the opportunity cost of space.”¹²⁰ Given the variety of difficulties faced, marginal cost pricing is rarely if ever a viable way for a municipality to cost a service.¹²¹ The alternative approach generally pursued is to only use financial costs.

When only the financial costs are taken into account in the user fee pricing design, it is known as calculating the ‘average cost’. Average cost pricing is the ‘typical’ way user fees are set because of the difficulties found in setting user fees which include financial and economic

¹¹⁸ FCM, *Water and Sewer Rates: Full Cost Recovery*, *supra* note 29 at 24.

¹¹⁹ Harry M Kitchen, *Local Government Finance in Canada* (Toronto: Canadian Tax Foundation, 1984) at 266 [Kitchen, *Local Government Finance in Canada*].

¹²⁰ Dewees, *supra* note 50 at 593.

¹²¹ Marginal cost pricing may also be inappropriate for a municipality to charge because many services that a municipality provides are natural monopolies. Natural monopolies are subject to decreasing costs. When marginal cost pricing is applied to a natural monopoly, the provider will produce a smaller output and charge a higher price which would be inefficient (see Rosen et al, *supra* note 49 at 37-38; Parkin & Bade, *supra* note 108 at 306).

costs in their costing. The average cost estimates the total financial cost and divides it by the number of units currently provided to obtain the user charge.¹²² In average cost pricing, unlike marginal cost pricing, the incremental cost of providing a service to specific properties or individuals is not calculated. Each consumer is charged based on the adding up the total cost of the service and dividing by the total number of units used in entire community.¹²³ The major detriment of average cost pricing is that only takes financial costs into account, rather than financial and economic costs. The danger to a policy design only employing average costing is that the government is unlikely to recover the full cost of the service. While the simplicity of the average cost model may be attractive, it is also to its detriment.

The significant issue that critics of average cost pricing raise is that it is not an economically efficient user fee. Because of the economies of scale that attract user fees, the cost of the unit is likely to decrease as more units are produced. The average cost curve must fall above the marginal cost curve when the marginal cost curve is declining and conversely falls below the marginal cost curve when the marginal cost curve is rising. Essentially, this means that depending on the circumstances, marginal costs can be above or below average costs.¹²⁴ If there are diseconomies of scale, in that the cost of the unit increases as unit output increases, the result is too much output at a price that is too low.¹²⁵ This essentially means that where the marginal cost is the ideal cost to charge to achieve allocative efficiency, where there are economies of scale in the provision of the good or service and the cost of the fee is set through average cost pricing, the user fee will be too high. Conversely, where there are diseconomies of scale in the provision of the good or service, and average cost pricing is used, the user fee will be too low.

¹²² Bird & Tsipoulous, *supra* note 44 at 55-56.

¹²³ Kitchen, "Pricing of Local Government Services", *supra* note 4 at 146.

¹²⁴ FCM, *Water and Sewer Rates: Full Cost Recovery*, *supra* note 29 at 15.

¹²⁵ Kitchen, *Municipal Revenue and Expenditure Issues in Canada*, *supra* note 76 at 126.

Where the aim of user fees to promote economic efficiency, average cost pricing is unlikely to meet that objective as well as marginal cost pricing. Average cost pricing is however, favoured by public administrators in user fee design because of the simplicity of its structure.

Between the overly complex, if not feasible in reality, marginal cost pricing, and the economically inefficient average cost pricing, is the second best alternative. In economics, the second best alternative is exactly what it purports to be; when the best option is unavailable because of practical concerns, in this case marginal cost pricing, the second best alternative looks to achieve the most efficient outcome given practical realities.¹²⁶ The general theory of second best also states that in any given set of conditions, there may be more than one second best optimum.¹²⁷ In context of cost calculations for user fees, the second best alternative supported by the literature is costing through average incremental pricing.

Average incremental pricing encourages the inclusion of social costs and externalities where possible. However, the main feature that makes it attractive as a second best alternative is that average incremental pricing allows for calculation of the cost of providing the service to an additional user.¹²⁸ The average incremental cost is calculated by dividing the cost of providing an increasing unit by the anticipated number of additional users. Each user is charged the average of the total incremental costs.¹²⁹ Kitchen writes, “[t]his approach does not amount to marginal-cost pricing in the strict sense, which refers to the additional cost for each user, but for many services it may be as close as one can get in practice.”¹³⁰

¹²⁶ *Ibid* at 128; see also Richard G Lipsey & Kelvin Lancaster, “The General Theory of Second Best” (1956) 24 *Review of Economic Studies* 11 at 11.

¹²⁷ Lipsey and Lancaster, *supra* note 126 at 13, n 1.

¹²⁸ Kitchen, *Municipal Revenue and Expenditure Issues in Canada*, *supra* note 76 at 127.

¹²⁹ *Ibid*.

¹³⁰ *Ibid*.

In the context of considering policy design alternatives, once the user fee tool has been selected to solve the policy problem, the economic literature suggests that average incremental cost pricing be used. The objective of setting the cost is to achieve efficiency by using the best information available to set the marginal cost pricing. Given that economists agree that establishing the marginal cost is a difficult, if not impossible task, there is concurrence in the literature that the second best alternative, that is average incremental cost pricing should be the approach pursued.¹³¹

| | |
|---------------------------------|--|
| PUBLIC POLICY ANALYSIS CRITERIA | |
| DESIGN | ECONOMICS |
| | <p>Calculating the Cost of a User Fee <i>Marginal Cost Pricing:</i> Incorporates economic and financial costs, exceedingly difficult to calculate. <i>Average Cost Pricing:</i> Strictly financial costs, inaccurate and does not promote allocative efficiency. <i>Average Incremental Cost Pricing:</i> Incorporates marginal cost concerns as best as possible. Closest realistic method of calculating marginal cost pricing. Advocated by literature.</p> |

Figure 3.3: User Fee Design Stage Considerations, Calculating the Cost of a User Fee

3.6 User Fee Implementation Stage Considerations from the Literature: Deciding on the Type of User Fee

Once it has been decided that a user fee is the policy solution that will be selected, the public administrator must consider how users of the good or service will be charged for their use and how much they will be charged. These questions fall into the implementation stage of the policy analysis process, as the tool and costing measure have been selected, it now rests on how the revenue is going to be assessed and collected. However, as discussed in Chapter 2.0, it is anticipated that the implementation stage and design stage will inform each other and public administrators may revert back to design stage considerations to inform implementation; notably,

¹³¹ The economic literature does not specifically address how a benefit that is accrued by the municipality may be set-off against the costs of providing the good or service. For example, if the municipality charges a user fee to collect compostable goods and is able to use the compost as soil for municipal flower beds, a savings for the municipality has been created. This section does not account for how that savings may be considered within the costing of the user fee.

for user fees, the design of the costing of the user fee. The first implementation stage concern is setting the price of the user fee, but there are also a number of ways in which the fees can be charged. Various forms of fees exist which will be discussed in this section, including flat rate charges, volume-based pricing, and rate mixing pricing.¹³²

Flat rate charges are charges in which the rate varies but the variation is unrelated to consumption. An example of a flat rate charge is a flat rate that has variation by the type of customer, such as an industrial rate and a residential rate for water consumption. While flat rate charges are easier to administer than some of the other types of charges, the rate of consumption is based on an assumption of the use of the user, not the actual amount of the product or good used. For instance, charging a water rate by the number of faucets in the house may not reflect water conservation efforts by the residents.¹³³

Volume-based pricing calculates the amount of the fee based on the amount of the product or good consumed. This type of pricing includes constant unit prices, declining block rates, increasing block rates, humpback block rates, seasonal rates, and excess use rates.¹³⁴ Constant unit rates are an equal charge applied for each unit of consumption. This is different from a flat rate because each unit is still being charged, whereas a flat rate is one amount no matter how many units are consumed. An example of a constant unit rate is a user fee for each bag of garbage that is set out for pick-up; whereas a flat rate may charge a certain amount for garbage pick-up over the course of a month, no matter how many garbage bags were set out for

¹³² Not considered in this thesis is how the forms of fees link to the pricing models described in Section 3.5: *User Fee Design Stage Considerations from the Economic Literature: Calculating the Cost of a User Fee*. Note that some fees structures may not be appropriate for pricing models; for example, decreasing block fees are not consistent with marginal cost pricing because this form of fee would not account for the marginal cost of providing the next unit of a good or service.

¹³³ Kitchen, *Local Government Finance in Canada*, *supra* note 119 at 269.

¹³⁴ Kitchen, *Municipal Revenue and Expenditure Issues in Canada*, *supra* note 76 at 130-137.

pick-up. A declining block rate is a charge where there is a decrease in the charge as the volume increases. An example of a declining block rate is where the user fee applied to a unit of water decreases after a certain number of water units are consumed. When applied to some goods or services which have related environmental objectives, such as water, the declining block rate has been criticized as it fails to promote conservation of the resource. Increasing block rates are the inverse to a declining block rate, where a charge increases as the volume of units consumed increases. Humpback rates combine increasing and decreasing block rates with the intention of encouraging conservation but allowing large industrial users to have declining block rates reflecting economies of scale.

Two other types of volume-based pricing are seasonal rates and excess use rates. Seasonal rates are adjusted to increase when there is peak demand, or to accommodate a decline in resources which encourages conservation. Prices correspondingly decline in the off-season. Using water as an example, in the summer unit prices would be higher as there is less rainfall and more water use (for example, by watering lawns, washing cars, filling pools), while prices would be lower than summer rates in the rest of the year. Excess use rates are rates that are set on consumption during peak times, for instance during the days, after a threshold amount has been reached. Kitchen writes, concerning these types of charges,

[T]he difference between the base charge and the excess-use charge must be large enough to give consumers a strong incentive to save water. One way in which to achieve a large seasonal charge is to recover all capital costs for expansion from the peak-season charge. The problem with this approach is that it increases the risk that cost recovery will be inadequate, since peak-season demand tends to be more variable than demand during the balance of the year.¹³⁵

¹³⁵ *Ibid* at 136. “

The final type of user fee is multi-part tariffs, which combine a flat rate with an additional charge, often based on volume.¹³⁶ A common example of rate mixing are telephone systems, where a flat rate is charged to have access to the network and a volume-rate is added on depending on how many calls you make or how long you talk.

An additional consideration may be a surcharge applied for specific users. Kitchen offers an example of sewage treatment which would add an additional fee to the sewage of industrial waste. The justification for such a charge is that it is more dense and contains a more damaging discharge and is therefore more expensive to treat.¹³⁷ Likewise, one of the benefits user fees offer is being able to charge all users for the use of the service, including consumers from other jurisdictions. An example of price discrimination for these individuals is charging a user fee, or an increased user fee, for library services.¹³⁸

3.7 User Fee Implementation Stage Considerations from the Literature: Managing Revenue Generated from User Fees

Following the payment structure of the user fee, the last consideration in the implementation criteria is how government accounts for and spends the revenues generated from the user fee. This section discusses the practice of earmarking government revenues. Earmarking is defined as “the practice of designating or dedicating specific revenues to the financing of specific public services” and may also be referred to as “special funds” or “dedicated revenues”.¹³⁹ As the definition implies, earmarking can take place outside of a user fee context and refers to any situation in which funding is set aside from general revenues for a specific purpose.

¹³⁶ Bird & Tsiopoulos, *supra* note 44 at 57.

¹³⁷ Kitchen, “Pricing of Local Government Services”, *supra* note 4 at 154.

¹³⁸ Kitchen, *Municipal Revenue and Expenditures in Canada*, *supra* note 76 at 150.

¹³⁹ James Buchanan, “The Economics of Earmarked Taxes” (1963), 71 *Journal of Political Economy* 457 at 457-458.

In the user fee context, earmarking refers to revenues generated from a specific good or activity which are re-applied to continue the funding a particular good or activity. Generally the revenues are re-invested in the same program, limiting the potential of the revenue to be allocated to the production of other goods or services.¹⁴⁰ When managing how government revenue is collected and allocated, earmarking is controversial because it limits the discretion and ability of government to spend public finances as specific amounts are allocated for particular purposes and cannot be shifted to other purposes.¹⁴¹ However, the practice of earmarking in a user fee context receives support because it assists in cost-recovery for goods and services where charging a price has been determined to be feasible.¹⁴² This is an application of the benefit theory of taxation, in which the beneficiaries, the “users” of government services, pay for the goods or services used.¹⁴³ Additionally, the practice of earmarking with respect to user fees is supported because the consumption of the good or service sends a clear demand signal to the government about how much should be supplied.¹⁴⁴ This application becomes more difficult when revenues are allocated to a general revenue account, which is why earmarking has led to more controversy in that practice.

Economists describe earmarking as taking place on a spectrum. A weak earmark does not see the amount of the expenditure reduced if the revenue falls, nor is it correspondingly increased if the revenues increase; the weak earmark receives subsidies if it is underfunded. A strong earmark sees the complete revenue, and only that revenue, spent for an indefinite period of time

¹⁴⁰ Bird, *Charging for Public Services*, *supra* note 2 at 23.

¹⁴¹ Elizabeth Deran, “Earmarking and Expenditures: A Survey and a New Test” (1965) 18 *National Tax Journal* 354 at 357; see also William McCleary, “The Earmarking of Government Revenue: A Review of Some World Bank Experience” (1991) 6 *World Bank Research Observer* 81 at 84.

¹⁴² McCleary, *supra* note 141 at 87.

¹⁴³ *Ibid* at 82.

¹⁴⁴ Bird, *Tax System Change and the Impact of Tax Research* (2009), *supra* note 22 at 24.

on a good or service that does not benefit those who are paying the tax.¹⁴⁵ Therefore, a strong earmark will be significantly impacted by a correctly calculated user fee and if an inappropriate pricing structure has been applied the correct amount of revenue will not be generated to fund the program or service. Likewise, earmarking can be wide, covering the entirety of a spending program, or narrow, in which only a particular aspect of the scheme is funding.¹⁴⁶ A user fee is most likely to fall on the narrow, strong earmarking end of the spectrum because there is a direct link between the supply of the good or service and the demand.¹⁴⁷ An interesting drawback of a weak earmark is noted by Berger et al. in the City of Milwaukee municipal user fee review.

Berger et al. write,

One of the reasons that so many user fees remain unpaid and end up on the property rolls is that some fee-issuing city departments appear to have little incentive to ensure fees are collected. For departments such as Neighborhood Services and Public Works, which receive funding primarily through appropriations, the City pays for services provided even if property owners initially do not.¹⁴⁸

In practicality, Berger et al. found that the effect of the weak earmark reduces the incentive to collect user fees because the shortfall in funding will be made up from other sources.

As discussed in Section 3.3.5 which considered the negative impacts of user fees, earmarking notably constraints revenue distribution, especially when government adaptation for changing conditions is required. However, earmarking does support allocative efficiency and equity principles, the basis of user fee support.¹⁴⁹ Deran also identifies that earmarks may be justified because they assure a minimal level of spending for certain government goods and

¹⁴⁵ Bird, *Charging for Public Services*, *supra* note 2 at 23; Margaret Wilkinson, "Paying for Public Spending: Is there a role for earmarked taxes?" (2005) 15(4) *Fiscal Studies: The Journal of Applied Public Economics* 119 at 125-126.

¹⁴⁶ Wilkinson, *supra* note 145 at 119.

¹⁴⁷ *Ibid* at 132.

¹⁴⁸ Berger, *supra* note 88 at 4.

¹⁴⁹ Bird, *Charging for Public Services*, *supra* note 2 at 27.

services, which avoids recurring lobbying for support, reducing the inefficient use of resources in other areas.¹⁵⁰ Accountability is also supported as consumer signals can affect the reallocation of scarce resources quickly and accurately. McCleary writes in support of user fee earmarking,

Cost recovery, the argument goes, makes more sense if the monies raised are retained for particular public goods or services in the same sector of the economy. Beneficiaries will be more willing to pay if they know their money will be used for activities that directly benefit them. Officials who provide the good or service will be encouraged to enforce the collection of fees if they know that their clients will benefit or that more and better services will be provided.¹⁵¹

McCleary also notes that voters and legislators will be unwilling to vote for additional taxes without assurances about how the money will be spend and that earmarking reinforces a tie-in which ensures that taxes will be used for certain purposes and the relationship will be stable over time.¹⁵² Buchanan applies the accountability criteria to voting practices, arguing that earmarking allows an individual to make individual choices on each service and to participate in each spending decision, either individually or through a legislative representative.¹⁵³ While earmarking is a controversial topic in the realm of public finance, there is much less controversy with respect to the practice of earmarking applied to user fees.

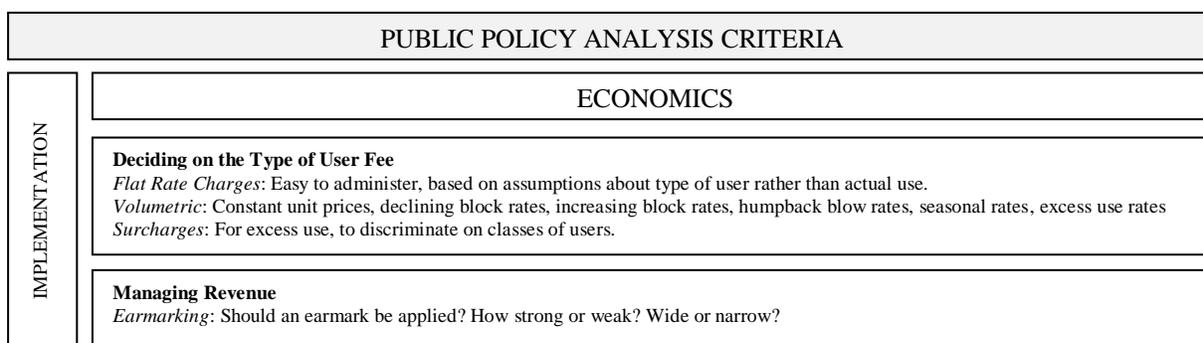


Figure 3.4: User Fee Implementation Stage Criteria

¹⁵⁰ Deran, *supra* note 141 at 357.

¹⁵¹ McCleary, *supra* note 141 at 87.

¹⁵² *Ibid* at 86.

¹⁵³ Buchanan, *supra* note 139 at 458-459; see also Wilkinson, *supra* note 145 at 123.

3.8 *Critique of the Economic Literature on User Fees*

One of the objectives of a literature review is to offer critique of the body of literature on a topic. The purpose of this section is to provide additional considerations which were found to be absent from the economic literature. In particular, this section provides three critiques: first, on the number of contributors to the economic literature; second, the practical reality of excluding distributional objectives from user fee costing and pricing; and third, the inconsistency in reinforcing that user fees must be revisited to ensure allocative efficiency is maintained.

As was seen in this chapter, the economic literature is fairly consistent on the economic rationale for user fees, advocating their use to promote allocative efficiency and accountability. One of the reasons for this consistency, though it is seemingly sound and well-reasoned, is the lack of authors on this topic. Bird, Slack, and Kitchen dominate the Canadian municipal and local government finance literature and frequently cite each other for support. While this is not an easily resolvable criticism, and indeed other authors such as Duff and Dewees also contribute to the body of literature, the main bodies of work are written and updated by a few key authors. The result may be a lack of divergent views on some of the key issues identified in the user fee debate.

The second criticism offered of the literature is the lack of practical consideration on the condition of equity and the feasibility of public administrators to include or exclude distribution objectives. Distribution objectives are argued to be inefficient because they create a distortion on the user fee, making it more difficult to determine when allocative efficiency has been reached. However, exemplifying the underpinnings of this thesis, the economic literature fails to taken into significant consideration the public administrator's practical situation when assessing equity. Discounts are commonly given for differentiated users and it will be a significant task to

convince decision-makers and the public to eliminate these so-called distortions. While the literature can assume for an ideal situation, much as with the marginal cost pricing, the practicality of implementation should also be considered.

A final consideration in respect of the economic literature on user fees is that it is often phrased as a point in time decision. While some of the benefits of user fees allow for adjustments to meet allocative efficiency, generally the process of modifying or evaluating a user fee, and whether it is meeting its objective, is not discussed. Bird notes with respect to user fees that allocations established by earmarking could become unsuitable over time and therefore should be subject to periodic review.¹⁵⁴ However, overall the economic literature gives little guidance to public administrators in terms of amount of time before modifications are made, the type of modifications that could be used, and how to generally undertake an adjustment period. Moreover, it may be anticipated that the amount generated will vary from when a user fee is first introduced as consumers decide to alter their behaviour to save money. The economic literature provides little information on continuing user fees past the initial implementation.

3.9 Summary

In this chapter, the economic rationale for user fees, the conditions supporting a user fee, and the pricing model for a user fee were considered in the design stage of public policy analysis. The implementation stage considered the payment structure to be applied in the user fee and the management of the revenue generated by the user fee.

The economic rationale behind user fees is that they promote the efficient allocation of resources, especially in comparison with property taxes, which are likely to be the other primary policy alternative for municipalities. Opponents to user fees argue they are regressive and impact

¹⁵⁴ Bird, *Charging for Public Services*, *supra* note 2 at 29.

lower income users more heavily, going against the economic principle of equity. Other factors supporting user fees are that they are visible and provide accountability. Accountability is promoted because users can indicate more frequently and with more accuracy as to their use of the government provided good or service.

There are some specific conditions of a good or service that make it more conducive to having a user fee imposed. A degree of rivalry in the publicness of the good makes it easier to exclude those who do not pay. A good or service with decreasing economies of scale indicates a rationale for government intervention. Finally, the fewer externalities produced by the good or service make it easier to impose a user fee.

The pricing of the user fee is highly important to the success of generating the appropriate amount of revenue. Marginal cost pricing is the ideal pricing strategy because it includes financial and economic costs. Average cost pricing is unfavoured by economists as it has the potential to endanger the revenues required to maintain the good or service. However, because marginal cost pricing is so difficult to accurately determine, economists favour alternative cost pricing, which essentially accounts for as much as possible of the economic costs.

In terms of implementation, several payment structures are available to public administrators. Flat rate charges and volumetric charges are the two main categories. Public administrators in selecting the payment structure of the levy should be aware of the type of behaviour they are seeking to influence. Finally, the last implementation consideration is the allocation of revenue and the strength of earmarking that will be imposed. Figure 3.5 compiles the economic criteria in the design and implementation stages of public policy analysis.

| PUBLIC POLICY ANALYSIS CRITERIA | |
|---------------------------------|--|
| ECONOMICS | |
| DESIGN | <p>Conditions of Public Welfare</p> <p><i>Allocative Efficiency:</i> Does the instrument support efficient allocation of resources? → User fees: consumers are aware of the cost per unit and can adjust consumption according to preferences.</p> <p><i>Equity:</i> What is the incidence of the instrument (regressive, neutral, positive)? → User fees: Generally thought to be regressive, requires case by case analysis.</p> <p><i>Administration and Compliance Costs:</i> Are the costs of the instrument overly cumbersome; will the revenue generated be in excess of costs? → User fees: Likely requires administrative and compliance structure for each fee.</p> <p><i>Visibility:</i> Is the consumer aware of the amount they are paying? → User fees: Yes, highly likely.</p> <p><i>Accountability:</i> Is there a close link between quantity of the good or service consumed and price per unit? → User fees: Yes, consumers can readily indicate preferences, steady feedback loop, does not rely on election cycles.</p> |
| | <p>Features of the Good or Service</p> <p><i>Publicness:</i> Is there a level of rivalry?</p> <p><i>Excludability:</i> Can non-payers be excluded from use?</p> <p><i>Economies of Scale:</i> Costs of production decreases, making the case for government intervention.</p> <p><i>Sunk Costs:</i> How long of term is required to pay the costs?</p> <p><i>Externalities:</i> Do the overall benefits to society outweigh the imposition of a user fee?</p> <p><i>Social and Political Objectives:</i> Is the good or service intended for redistributive purposes? Should equity concerns be incorporated into the cost?</p> |
| | <p>Calculating the Cost of a User Fee</p> <p><i>Marginal Cost Pricing:</i> Incorporates economic and financial costs, exceedingly difficult to calculate.</p> <p><i>Average Cost Pricing:</i> Strictly financial costs, inaccurate and does not promote allocative efficiency.</p> <p><i>Average Incremental Cost Pricing:</i> Incorporates marginal cost concerns as best as possible. Closest realistic method of calculating marginal cost pricing. Advocated by literature.</p> |
| IMPLEMENTATION | <p>Deciding on the Type of User Fee</p> <p><i>Flat Rate Charges:</i> Easy to administer, based on assumptions about type of user rather than actual use.</p> <p><i>Volumetric:</i> Constant unit prices, declining block rates, increasing block rates, humpback blow rates, seasonal rates, excess use rates</p> <p><i>Surcharges:</i> For excess use, to discriminate on classes of users.</p> |
| | <p>Managing Revenue</p> <p><i>Earmarking:</i> Should an earmark be applied? How strong or weak? Wide or narrow?</p> |

Figure 3.5: Summary of User Fee Economic Design and Implementation Stage Criteria

4.0 Jurisprudence

Just as there are a number of economic factors to consider when implementing a user fee, there are an abundance of legal factors that must be taken into account in both the design and implementation stages. The legal requirements set out in this chapter are relevant to a municipality regardless of the good or service to which the user fee is to be applied or is already applied. Municipal public administrators must be aware of these requirements so the appropriate steps can be taken in the design and implementation stages to ensure that a user fee, when applied, will not be ruled invalid by a court if challenged.

This chapter fulfills two objectives related to the purposes of this thesis. First, it provides clarity with respect to the principles developed in the jurisprudence on the topic of user fees, particularly from a municipal implementation perspective. These principles inform the interpretation of municipal legislation. The research into the legal literature and case law revealed that there are no legal academic papers that address the topic of user fees directly. While some authors address related taxation issues,¹⁵⁵ the user fee has not been individually studied. Moreover, the case law on user fees still leaves many legal questions unsettled, making it difficult for public administrators adhere to the specific requirements that must be met in order to implement user fees. The likely result is significant uncertainty for public administrators when attempting to design and implement user fees. The first objective of this chapter is to provide information that contributes to filling this identified gap in the legal literature.

The second objective of this chapter is to contribute to the development of user fee design and implementation stage criteria for municipal public administrators. The analysis of

¹⁵⁵ See for example Gerard V La Forest, *The allocation of taxing power under the Canadian Constitution*, 2d ed (Toronto: Canadian Tax Foundation, 1981); Nathalie J Chalifour, “Making Federalism Work for Climate Change: Canada’s Division of Powers over Carbon Taxes” (August 2008), 22 NJCL 119.

jurisprudence follows the economic literature review because many of the legal factors are relevant to implementation stage concerns, while the economic literature lent itself to design stage considerations. In contrast to Chapter 3.0, which identified the economic issues in the design and implementation stages, this chapter sets out the full legal tests that will be relevant for municipal public administrators before identifying the components of the tests that will be relevant in the design and implementation stages. The law on user fees is complex, not definitive, and a full understanding of the legal user fee framework is necessary before the design and implementation stage criteria can be identified.

The first three sections of this chapter are provided to ensure the chapter is accessible to public administrators who do not have a legal background. The first section sets out the research methodology for this chapter. The second section generally explains how legal research is conducted and provides key terms that are relevant in the analysis that follows. The third section provides an overview of the constitutional background of municipal law. This section is particularly relevant because the authority granted to municipalities, both for goods and services they can offer their communities and the means by which they can fund those services, are founded in the *Constitution Act, 1867*¹⁵⁶ [*Constitution Act*].

The following three sections consider user fee case law and discuss the distinction between taxes and user fees and the tests set forth by the Supreme Court of Canada. Case law from lower level courts that demonstrates elements of the tests in practice is provided. These sections provide the basis of the user fee tests and the user fee tests are evaluated.

¹⁵⁶ *Constitution Act, 1867*, 30 & 31 Victoria, c 3 (UK) [*Constitution Act*]. Note that there is a 1982 version of the *Constitution Act*, but it did not amend these sections.

The remaining sections consider a significant issue in the jurisprudence, which is the distinction between user fees and regulatory charges. In these sections, regulatory charges and licence fees are discussed and the similarities with user fees are evaluated. The final section concludes the chapter by summarizing the legal tests for user fees, applying the legal tests to the design and implementation stages in public policy analysis, and discussing the unresolved issues plaguing the user fee tests.

4.1 *Research Methodology*

The starting point for legal research on a question is to determine if there is legislation on the matter. This is particularly important in the area of municipal law as municipalities may only exercise the authorities granted by the province or territory, therefore all the actions that a municipality may conduct are found in legislation. However, where interpretation of a particular term or concept in legislation is required, such as the application of a user fee, the general principles may not be written in the legislation and further legal research is required. As the focus of this thesis is to establish general principles of user fee interpretation as developed in the jurisprudence, further legal research is required.

The first step in legal research is to consult textbooks on the subject matter in order to locate the relevant cases. Treatises such as Hogg's *Constitutional Law of Canada*¹⁵⁷ and Rogers' *Municipal Corporations of Canada*¹⁵⁸ were used to provide appropriate background information. Additionally, as the research subject was generated as a result of the work of Althaus, Tedds, and McAvoy,¹⁵⁹ some of the leading cases in the field had been identified. Following identification of these leading cases, the legal research database WestlaweCarswell was searched to find all the

¹⁵⁷ Peter W Hogg, *Constitutional Law of Canada*, 5th ed, loose-leaf (consulted on November 5, 2011) (Toronto: Thomson Reuters, 2007), c 31.

¹⁵⁸ Rogers, *supra* note 1.

¹⁵⁹ Althaus, Tedds & McAvoy, *supra* note 21.

cases that cited these cases as precedent. Through this method, over 300 cases were identified that cited the leading cases. These cases were reviewed to determine if their holdings were relevant to municipalities, user fees, or direct or indirect taxation. Additionally, searches on WestlaweCarswell also retrieved academic legal literature that cites the leading cases, and the few legal papers related to the user fees were retrieved in this manner.¹⁶⁰

Additional searches were conducted on WestlaweCarswell, Quicklaw, and Canlii, the three primary legal research databases, using terms including, ‘user fee’, ‘user charge’, ‘levy’, and ‘municipal’. This was done to ensure that the review of the case law was accurate and to find any cases that may have been decided without reference to the leading cases. As expected, these searches retrieved many of the same cases previously identified. To extend the academic legal literature search, the same search terms were used in Heinonline, a legal literature database. However, determining relevant cases is not sufficient; cases must be assessed together to provide a full understanding of the state of the law. This analysis is conducted using legal research techniques as are discussed in the next section.

4.2 Legal Research Techniques and User Fee Legal Research Methodology

When conducting legal analysis, several factors must be weighed to provide the sound reasoning. Legal research integrates a number of elements to determine the current law. In some instances, legislation will guide the type of analysis that needs to take place. This is the case in municipal law as the legislation always must be considered to confirm appropriate statutory authority for municipal activities. In other cases, particularly where there is no relevant legislation, lawyers and researchers turn to previous cases decided on the issue to assess the state of the law. These factors include the level of the court, the date of the decision, and how the

¹⁶⁰ See for example Chalifour, *supra* note 155.

decision has been subsequently treated. The analysis leads to an opinion by the lawyer as to the ‘weight’ that a court will give to their argument. If the fact pattern is similar or analogous to the facts in the jurisprudence and the outcome is favourable to the outcome that is sought, a case will be argued to have more ‘weight’ and be more persuasive.

The level of court refers to whether the decision was made at a trial level court or at an appellant level court. Each province and territory has a court system that includes lower level courts and an appellate level court, though they are named differently and may be split into different subsections. Cases will be introduced at the lower level court and a trial judge’s decision can be appealed to an appellate level court. For example, in British Columbia, a trial may take place at the British Columbia Supreme Court and would be appealed to the British Columbia Court of Appeal. A further appeal would be to the Supreme Court of Canada (SCC). The SCC is the highest court in Canada and decides on cases appealed from provincial or territorial courts of appeal. SCC decisions are considered binding, meaning that they will be followed if relevant. There are also separate federal courts at the trial and appellant level, which deal with specific areas under federal jurisdiction, including tax. Finally, boards and tribunals are established by provincial or federal legislation to decide on specific issues, for example, the British Columbia Human Rights Tribunal considers claims of discrimination based on identified human rights grounds in British Columbia. Decisions of a board or tribunal may be appealed to a level of court as designated by the enacting legislation. Decisions made in the same jurisdiction (that is, province or territory) are considered binding in that jurisdiction. Likewise, decisions made by the Supreme Court of Canada are binding across the country.

Legal analysis also depends on the persuasiveness of the case law authorities. Supreme Court of Canada cases will have significant weight and be considered highly persuasive.

Appellate level decisions are generally considered to be more persuasive than trial level decisions. Generally, courts give boards and tribunals deference as experts in their field, but when used for general research purposes an administrative decision may be less persuasive than a court because they are not binding. Another relevant factor will be the dates of the decisions, as the most recent decisions based on similar facts are usually more persuasive. However, sometimes recent decisions from the SCC or other appellate level courts have received little judicial interpretation so it is more difficult to be informed as to their meaning. Another reason the date of a decision is important is that the outcomes may have been altered or affected by a later decision, especially of a higher court, or changes in legislation.

The system of law in Canada, with the exception of Québec, which operates under a civil code, is common law and is a system relying on precedents, meaning that past decisions are binding upon future decisions. That is, where a similar issue has been before the courts, the court is to follow the reasoning that was applied in the previous case. In making arguments, lawyers will make analogies and find similarities between cases to persuade the court of the strength of their argument. It can also be understood therefore that the date of a decision will also be relevant when considering the weight of cases to an overall argument or position. Older decisions should not be discounted, especially, as will be seen, when the decision sets the foundation test in an area of law. More recent decisions are likely to be persuasive because they have incorporated the sum of the jurisprudence. However, in some cases new high level court decisions will not have been interpreted by trial level courts in application, leaving more room for interpretation by the trial level court. It is important in legal research to look at how a case has been treated since its publication, as often there will be facts and evidence that distinguish the case, allowing for arguments that the decision is not binding on a future case.

The level of court also indicates the number of judges who will hear the case and make a decision. Generally, at the lower level court there will be one judge. Courts of appeal usually have three judges sitting to hear a case. The SCC will usually have either seven or nine judges hearing a case. A case will list the judge(s) who presided over the hearing. This is relevant information because the judges do not always agree and in cases where there are multiple judges, a judge may disagree with the decision of the majority and write a dissent. Dissents are not considered binding, but may still be relevant to the development of the law and may be adopted as the majority decision in a subsequent case.

The person hearing the case, usually a judge but possibly a member of a tribunal or a panel of judges, will generally give a final decision after examining a specific question and reviewing the evidence and hearing arguments on that question. The answer to the question asked to the court is the *ratio decidendi*, also known as the *ratio*, of the decision. This is the binding element that is carried forth to be applied in other cases. A court may also set out principles and discuss other areas that are relevant to the case. While this information is informative, it is not binding upon future courts as precedent. This information is known as *obiter dictum*, or *obiter*, in the decision. *Obiter* may be persuasive, but this largely depends on the nature of the case before the court.

It is noteworthy at this juncture to address the limitations in this research. In order to render a decision, courts are provided with evidence supporting the arguments of both parties. One way to present evidence is through testimony in court, where a witness is examined and cross-examined on their particular knowledge. The difficulty that may be present in some cases is that courts provide limited information in the written decision from the evidence. This limitation is arguably overcome as the evidence that is relied upon in the written decision is the

most persuasive to the judge and thus the most pertinent to this analysis. However, it is important to acknowledge that these evidentiary limitations may lead to limitations in the research in terms of the information made available to the researcher. The limitations of evidence are relevant where this thesis uses examples of evidence provided on municipal financing and the figures were cited by the court from the evidence provided during the hearing. It is likely that the information provided is only a fraction of what was presented to the court, which limits the principles that can be taken from the case, but at the same time, it is important to note that this selection of financial information was the most relevant to the court in making the decision.

An overriding consideration in the field of municipal law is the deference that the courts offer to municipalities. Deference refers to the presumption that the municipality has significant expertise in their decision-making capacity and that a court will take that specialized experience into account and not interfere with municipal activity lightly. In a recent decision on the ability of the court to overturn municipal taxation bylaws in *Catalyst Paper Corp v North Cowichan (District)*¹⁶¹ [*Catalyst*], the SCC affirms this position in writing, “[t]he case law suggests that review of municipal bylaws must reflect the broad discretion provincial legislators have traditionally accorded to municipalities engaged in delegated legislation.”¹⁶² This means there is a high threshold to meet for a court to find that a municipality’s policy or decision is verging on improper law. The SCC also comments in *Catalyst* on this point, “the power of the courts to set aside a municipal bylaw is a narrow one [...]”¹⁶³ In the cases that follow, this issue is less likely to arise as the nature of the questions tend to revolve around jurisdiction and ensuring appropriate authority exists for municipalities to exercise their fee-setting authority as they have.

¹⁶¹ 2012 SCC 2, 2012 CarswellBC 17 (*Catalyst* cited to WL Can).

¹⁶² *Ibid* at para 19.

¹⁶³ *Ibid* at para 9.

In addition to *ratio* and *obiter*, there are a few other legal terms that are used frequently in this jurisprudence. The term ‘pith and substance’ refers to an interpretation technique. The essence of the pith and substance analysis is to look beyond the direct effects of a piece of legislation to examine the social or economic purpose which the law was designed to achieve.¹⁶⁴ Related to pith and substance, is the term ‘colourability’, used to describe circumstances where a policy or legislative scheme aims to achieve an outcome that it would not otherwise be entitled to achieve.

The case law on user fees dates back to 1931 and is complicated to interpret. There are a few reasons for this, one of which is because the terminology around user fees is not consistent and other similar words, such as ‘levy’, ‘charge’, ‘fee’, and ‘licence’ are used interchangeably. Whenever possible, the wording in this chapter is kept consistent and explained where words are replaced or assumptions are made. In this chapter, the term ‘levy’ is used to refer to the general process of collecting revenue by government, whether in the form of a tax, a fee, or a charge. This is not consistent in the case law, but the term is unaffiliated with the remaining terms. Therefore, ‘tax’, ‘user fee’, and ‘regulatory charge’ are all types of ‘levies’.

Many of the leading cases concerning user fees do not deal with municipal user fees. User fees may be imposed by the federal, provincial or territorial, and municipal (if appropriately delegated) levels of government. The test for user fees remains the same without concern to the level of government imposing the user fee, unless there is legislation governing the user fee, therefore cases that challenge user fees imposed by other levels of government can be used by way of analogy to inform municipal user fee cases.

¹⁶⁴ [1996] 2 SCR 929, 137 DLR (4th) 449, 1996 CarswellOnt 3403 [*Ontario Home Builders*] (*Ontario Home Builders* cited to WLeC) at para 117.

The factors discussed above, the level of court, date of the case, and relevant precedence are important to consider when reading the remaining portion of this chapter. Lawyers will analyze these factors to construct a legal opinion as to how a court may decide a case. One of the reasons the facts are important to understand is because they are often relied upon so that lawyers may find analogies that support their position in a new case. Finally, a disclaimer: while legal analysis is based on an informed opinion, different perspectives may be taken on the same issue, especially where an area of the law is unsettled and the weight accorded between cases may be difficult to analyze. The next section in this chapter continues to build on the understanding established in the general research methodology by providing a framework to understand municipal law.

4.3 Framework: Understanding Municipal Law

An understanding of the jurisdictional responsibilities and authorities of federal, provincial and territorial, and municipal governments is fundamental to the discussion on user fees. This is because municipalities are only allowed to exercise the powers that are delegated to them by the provinces or territories, so it is important to understand where provinces get the authority to delegate and what powers may be delegated. This section provides an overview of the constitutional framework in which these levels of government operate, making reference to the relevant constitutional provisions that explain these questions of the source of authority and what powers may be delegated. The question of authority to provide a good or service and to charge a user fee for that good or service are the first questions that should be asked by the municipal administrator in the design stage. To guide this discussion, the section first discusses the division of powers between federal and provincial governments. After establishing the powers and authorities of these levels of government, the section explains how powers are given

to municipal governments and where they may be found. This section concludes with specific information about the revenue raising abilities of municipalities, leading to the discussion on user fees.

The *Constitution Act* is the legislation that sets out the division of powers between federal and provincial governments. These powers are found in sections 91 and 92 of the *Constitution Act*. The federal and provincial governments are only able to pass laws on the matters for which they are given authority. If a law is outside of the jurisdiction of a government, that is, the government is not given constitutional authorization to govern in that area, it is deemed to be *ultra vires*; if it is within the jurisdiction of a government, it is *intra vires*.

Provincial governments have jurisdiction, pursuant to the *Constitution Act*, s 92(8) for municipalities. This is why municipalities are known to be “creatures of the province”. Municipal governments are not recognized in the *Constitution Act* as having separate jurisdiction or authority over any areas or matters and consequently they are limited to exercising only the powers that are delegated to them by the provinces.¹⁶⁵ As such, it is important to understand that provinces exercise these powers in different ways, meaning that all municipalities across Canada will not have the same authority. In relation to user fees, this means that a municipality in one province may be able to enact a user fee for a particular public good or service, while a municipality in another province is not permitted to enact the same user fee. Careful examination of the provincial or territorial authority is required to establish the authority given to municipalities to charge user fees and if there are any legal limitations on those authorities in the law.

¹⁶⁵ Felix Hoehn, *Municipalities and Canadian Law: Defining the Authority of Local Governments* (Saskatoon, SK: Purich Publishing, 1996) at 1.

In addition to provincial authority to charge user fees, the *Constitution Act* has specific provisions concerning revenue raising methods that are granted to different levels of government. The broadest revenue raising powers are provided to the federal government. The relevant provision in the *Constitution Act* that explains the federal government's revenue generation authority is s 91(3), which reads,

s 91. [...] it is hereby declared that (notwithstanding anything in this Act) the exclusive Legislative Authority of the Parliament of Canada extends to all Matters coming within the Classes of Subjects next hereinafter enumerated; that is to say,
 (3) The raising of Money by any Mode or System of Taxation.

The revenue raising powers of provinces are more limited than those of the federal government. Section 92(2) governs the raising of revenue in a province, while s 92(9) authorizes licences and has been found to also provide for the levying of fees in relation to those licences. This authority has been broadened in its interpretation to also include regulatory charges. These sections read,

s 92. In each Province the Legislature may exclusively make Laws in relation to Matters coming within the Classes of Subjects next hereinafter enumerated; that is to say,

(2) Direct Taxation within the Province in order to the raising of a Revenue for Provincial Purposes.

[...]

(9) Shop, Saloon, Tavern, Auctioneer, and other Licences in order to the raising of a Revenue for Provincial, Local, or Municipal Purposes.

Section 92(2) has been interpreted to include the legislative power to impose a “fee or charge”, meaning that s 92(2) provides the provincial authority for the charging of both direct taxes and user fees.¹⁶⁶ In summary, the federal government has unrestricted powers to charge any form of levy it chooses, including direct and indirect taxes as well as user fees. Provincial governments are limited to direct taxes and licence fees, as provided for in the *Constitution Act*. Furthermore,

¹⁶⁶ *Ottawa v Elec Ry* (1929) 64 OLR 537 at 543 (while this case describes the authority to charge a “fee or charge” as a direct tax, given subsequent case law, it would appear that regulatory charges are authorized under s 92(9) rather than s 92(2)).

provinces may only delegate to municipalities the authorities within their jurisdiction.

Municipalities are limited to only exercising authority that is specifically delegated to them through provincial authorizing legislation. In general under s 92(2), user fees and property taxes are the two main forms of direct taxes that are devolved to municipalities. Across Canada, municipalities are generally granted the authority to charge property taxes and user fees and these authorities generally found in provincial legislation entitled *Community Charter*, *Municipal Act*, or Charter Acts for individual cities.¹⁶⁷

This thesis does not provide a detailed summary of the municipal and local government provisions that enable the application of user fees, as the focus of this thesis is on the general principles that have been interpreted from decisions considering user fees. However, as discussed in Chapter 1.0, it is fundamental that a municipality consider the legislation that governs its ability to levy user fees and whether any additional constraints or limitations are placed on the municipality as a result. To provide an example of the legislation that should be reviewed, this thesis examines the Ontario *Municipalities Act*¹⁶⁸ and the British Columbia *Community Charter*.¹⁶⁹

The Ontario *Municipalities Act* provides in Part XII, s 391(1) the general parameters for an Ontario municipality to charge a user fee.

- 391.** (1) Without limiting sections 9, 10 and 11, those sections authorize a municipality to impose fees or charges on persons,
- (a) for services or activities provided or done by or on behalf of it;
 - (b) for costs payable by it for services or activities provided or done by or on behalf of any other municipality or any local board; and
 - (c) for the use of its property including property under its control.

¹⁶⁷ See for example, *Vancouver Charter*, SBC 1953, c 55.

¹⁶⁸ *Municipal Act*, SO 2001, c 25.

¹⁶⁹ *Community Charter*, SBC 2003, c 26.

(2) A fee or charge imposed for capital costs related to services or activities may be imposed on persons not receiving an immediate benefit from the services or activities but who will receive a benefit at some later point in time.

(3) The costs included in a fee or charge may include costs incurred by the municipality or local board related to administration, enforcement and the establishment, acquisition and replacement of capital assets.

In the same Part XII of the Ontario *Municipalities Act*, limitations are placed on the ability of an Ontario municipality to levy a fee or charge.

394 (1) No fee or charge by-law shall impose a fee or charge that is based on, is in respect of or is computed by reference to,

(a) the income of a person, however it is earned or received, except that a municipality or local board may exempt, in whole or in part, any class of persons from all or part of a fee or charge on the basis of inability to pay;

(b) the use, purchase or consumption by a person of property other than property belonging to or under the control of the municipality or local board that passes the by-law;

(c) the use, consumption or purchase by a person of a service other than a service provided or performed by or on behalf of or paid for by the municipality or local board that passes the by-law;

(d) the benefit received by a person from a service other than a service provided or performed by or on behalf of or paid for by the municipality or local board that passes the by-law; or

(e) the generation, exploitation, extraction, harvesting, processing, renewal or transportation of natural resources.

(2) Nothing in clause (1) (b) prevents the imposition of a fee or charge that is based on, is in respect of or is computed by reference to the location of the property, the physical characteristics of property, including buildings and structures on the property, or the zoning of property or other land use classification.

It is also important to note that under the Ontario *Municipal Act* scheme, s 400(b) the Minister has the ability to make regulations that pertain to conditions or limitations on the power of the municipality to impose fees or charges. This means that for Ontario municipalities, the regulations should also be examined to ensure that there are no specific constraints on user fees.

Ontario *Municipal Act*, Regulation 584/06¹⁷⁰ pertains to fees and charges and has specific

¹⁷⁰ *Fees and Charges*, O Reg 584/06.

limitations such as a prohibiting classification of the Crown as a sole class of persons¹⁷¹ and prohibiting imposition of fees or charges to for the processing of planning applications.¹⁷²

In British Columbia, municipal and local governments are governed under the *Community Charter* and the *Local Government Act*.¹⁷³ The statutes inform each other's interpretation; the provinces is divided into regional districts which are governed under the *Local Government Act* and where residents have chosen to incorporate under the *Local Government Act* to form a municipality, the municipality is also governed under the *Community Charter*. Buholzer describes this relationship, “[b]ecause the *Community Charter* does not apply in its entirety to regional districts, the core enabling provisions in the *Local Government Act* continue to be required for British Columbia’s regional districts.”¹⁷⁴ Both statutes provide for financial management of a municipality including the levying of fees and charges, however, only the relevant provisions of the *Community Charter* are provided below. The authority to charge fees for municipalities incorporated under the *Community Charter* is provided in s 194.

- 194** (1) A council may, by bylaw, impose a fee payable in respect of
- (a) all or part of a service of the municipality,
 - (b) the use of municipal property, or
 - (c) the exercise of authority to regulate, prohibit or impose requirements.
- (2) Without limiting subsection (1), a bylaw under this section may do one or more of the following:
- (a) apply outside the municipality, if the bylaw is in relation to an authority that may be exercised outside the municipality;
 - (b) base the fee on any factor specified in the bylaw and, in addition to the authority under section 12 (1) [variation authority], establish different rates or levels of fees in relation to different factors;
 - (c) establish fees for obtaining copies of documents that are available for public inspection;

¹⁷¹ *Ibid* at s 1(a).

¹⁷² *Ibid* at s 3.

¹⁷³ *Local Government Act*, RSBC 1996, c 323.

¹⁷⁴ William A Buholzer, *Local Government Under the Community Charter*, 3rd ed (Vancouver, BC: The Continuing Legal Education Society of British Columbia, 2009) at 32.

- (d) establish terms and conditions for payment of a fee, including discounts, interest and penalties;
- (e) provide for the refund of a fee.
- (3) As exceptions, a council may not impose a fee under this section
 - (a) in relation to Part 3 [Electors and Elections] or 4 [Other Voting] of the Local Government Act, or
 - (b) in relation to any other matter for which this or another Act specifically authorizes the imposition of a fee.
- (4) A municipality must make available to the public, on request, a report respecting how a fee imposed under this section was determined.
- (5) A municipality may not impose a highway toll unless specifically provided by a Provincial or federal enactment.

Unlike Ontario, in the British Columbia *Community Charter* there are specific provisions that deal with the removal of soil and deposit.

- 195** (1) A council may, by bylaw, do one or both of the following:
- (a) impose rates or levels of fees for a permit required under a municipal bylaw for
 - (i) the removal of soil from, or
 - (ii) the deposit of soil or other material on
 any land in the municipality or in any area of the municipality;
 - (b) impose rates or levels of fees for the activities referred to in paragraph (a).
- (2) Without limiting section 12 (1) [*variation authority*], fees under subsection (1) may vary according to the quantity of soil removed or the quantity of soil or other material deposited and may be different for different areas of the municipality.
- (3) A bylaw under subsection (1) has no effect until it is approved by the minister.

Note as well that the British Columbia only discusses the imposition of “fees” and not “charges”.

This is dealt with in the definitions section of the statute which provides that “‘fee’ includes a fee by any name, including a charge”.¹⁷⁵

The purpose of this section is to situate the constitutional authority for municipal revenue sources, particularly for property taxes and user fees. In application to the design stage of user fees, in advance of all of the economic design stage criteria described in Chapter 3.0, the first question a municipality must consider is whether the appropriate authority is delegated from the

¹⁷⁵ *Community Charter*, *supra* note 169, Schedule, Definitions and Rules of Interpretation, s 1.

province. As this section described, this question originates because each action a municipality takes must be based on authority provided by the province, resulting from the powers delegated to the provinces in the *Constitution Act*, s 92(8).

One of the main legal challenges user fees are faced with is the argument that the enacting body, often a municipality, has acted outside of the authority that has been delegated to them by the province. Typically this argument is shaped such that the challenging party argues that the user fee is an indirect tax, which is *ultra vires* the jurisdiction of a province, so cannot be delegated to a municipality. Provinces are only allowed to charge direct taxes and licence fees, pursuant to the *Constitution Act*, ss 92(2) and (9). Therefore, in order to understand the legal parameters of a user fee, the discussion begins with the determinants of what is a tax.

Case Study: Smithton, British Columbia, Canada

The purpose of this fictitious case study is to provide a better understanding of the legal principles applied to user fees. Smithton is a municipality incorporated under the British Columbia *Local Government Act* and is a part of the Mountain Regional District. The Mountain Regional District has a Solid Waste Management Plan (SWMP) that was developed in accordance with the British Columbia *Environmental Management Act*.¹⁷⁶ The SWMP does not provide for pick-up and disposal of municipal solid waste, but rather allows municipalities to decide whether they will offer a solid waste disposal service and how that service will be funded. However, the SWMP does detail how solid waste is to be disposed of in the Mountain Regional District if solid waste is picked-up by a municipal service. Smithton operates a municipal solid waste pick-up service and is concerned about both increasing pressure on its budget and reducing the amount of solid waste that it is producing. The elements of the municipal solid waste pick-up and disposal service include waste diversion and public education regarding suitable goods for residential solid waste pick-up. Suzie is a municipal public administrator in Smithton. Suzie has been asked to consider the legal general principles for user fee implementation.

Suzie has determined, knowing that Smithton municipalities are only allowed to do what is provided to them in their governing legislation, she must ensure that Smithton can charge a user fee. The relevant sections that Suzie understands to be important are:

Community Charter

8 (2) A municipality may provide any service that the council considers

¹⁷⁶ *Environmental Management Act*, SBC 2003, c 53.

necessary or desirable, and may do this directly or through another public authority or another person or organization.

(3) A council may, by bylaw, regulate, prohibit and impose requirements in relation to the following:

[...]

(h) the protection and enhancement of the well-being of its community in relation to the matters referred to in section 64

12 (1) A municipal bylaw under this Act may do one or more of the following:

(a) make different provisions for different areas, times, conditions or circumstances as described by bylaw;

(b) establish different classes of persons, places, activities, property or things;

(c) make different provisions, including exceptions, for different classes established under paragraph (b).

64 The authority of a council under section 8(3)(h) [...] may be exercised in relation to the following:

(d) refuse, garbage or other material that is noxious, offensive or unwholesome;

(e) the use of waste disposal and recycling services;

194 (1) A council may, by bylaw, impose a fee payable in respect of

(a) all or part of a service of the municipality,

(2) Without limiting subsection (1), a bylaw under this section may do one or more of the following:

(a) apply outside the municipality, if the bylaw is in relation to an authority that may be exercised outside the municipality;

(b) base the fee on any factor specified in the bylaw and, in addition to the authority under section 12 (1) [...], establish different rates or levels of fees in relation to different factors;

[...]

(d) establish terms and conditions for payment of a fee, including discounts, interest and penalties;

(e) provide for the refund of a fee.

Schedule: Definitions and Rules of Interpretation

1(1)

“**fee**” includes a fee by any name, including a charge;

“**municipality**” means, as applicable,

(a) the corporation into which the residents of an area are incorporated as a municipality under Part 2 [*Incorporation of Municipalities*] of the *Local Government Act* or under any other Act

Suzie has determined that s 8(3)(h) includes waste disposal services as provided for under s 64(d). According to s 94(1)(a), a municipality can establish fees payable in respect of a service of the municipality and s 12 allows for those fees to vary based on classes, so for instance, Suzie

can make different fees for different amounts of solid waste. In light of both of the major concerns of Smithton, Suzie is considering recommending a volumetric user fee where a base amount is charged for all households and an increased amount above the base is charged for every additional bag of residential solid waste set out for pick-up.

4.4 Determination of a Tax

The first concern in determining the municipal power to levy a user fee is to ensure that the levy is in fact a user fee. There are two steps in conducting this analysis. This section deals with the first step, which is to establish that the levy is not a tax and may be found to be a user fee. The second step, described in Section 4.5, if the levy is found not to be a tax, is to meet the requirements for the levy to be found to be a user fee. As discussed in the previous section, municipalities may only raise revenue through the instruments delegated to them by their respective provincial government and the provincial government may only authorize powers that it is delegated under the constitution.

*Lawson v Interior Tree Fruit and Vegetable Committee of Direction*¹⁷⁷ [Lawson] provides the starting point for the analysis distinguishing fees and taxes by setting out the legal test to determine if a levy is a tax.¹⁷⁸ *Lawson* considers the authority granted by the Province of British Columbia to a committee to impose levies on any product marketed, but it is not explicitly made clear if the rates are flat rates or volumetric rates.¹⁷⁹ The plaintiff, Lawson, a fruit rancher and shipper of fruit, alleged that the authority to impose this levy was outside the jurisdiction of the Province and the levy was therefore unconstitutional. The question before the SCC was whether the levy fell under provincial jurisdiction, pursuant to the *Constitution Act, 1867*, ss 92(2) or (9).

¹⁷⁷ [1931] SCR 357, 1930 CarswellBC 129 [Lawson] (*Lawson* cited to WL Can).

¹⁷⁸ *Ibid* at para 10.

¹⁷⁹ In *Lawson, ibid*, the authority given by the Province to the Committee included: “Shippers of car-load lots may be classified with reference to the quantity of product marketed and the fee may vary accordingly, but shall not in any case exceed twenty dollars; and in the case of other shippers the fee shall not exceed five dollars” (para 6). The reference to the quantity of product marketed appears to indicate that this is a volumetric fee.

Sections 92(2) and (9) are the provisions discussed above and respectively allow for direct taxation and granting licences to raise revenue for provincial, local, or municipal purposes.

In *Lawson*, the Supreme Court stated that a levy will be a tax if it meets all of the following four criteria.

- First, that a tax is enforceable by law;
- Second, that a tax is imposed under the authority of the legislature;
- Third, that a tax is imposed by a public body; and
- Fourth, that the levy is made for a public purpose.

Therefore, in future cases applying *Lawson* to assess whether a levy is a tax, a levy being challenged will be evaluated against each of these elements. This is the test that continues to be applied to determine if a levy is a tax since *Lawson* was decided.

In *Lawson*, the Court found that the levy met all the elements of being a tax. The levy was enforceable because it could be sued for; a certificate demonstrated the amount owed and failure to pay was an offence. The levy was imposed by the authority of the legislature through a public body. It was demonstrated that the Committee was a public body because the Committee Chairman was appointed by the Lieutenant-Governor in Council, had wide powers of regulation over an extensive territory, and was constituted by and acted according to statute. The Court also stated that the levy is made for a public purpose, which it found support for by considering that the Committee that imposed the levy was a public body and that the levy affected a wide territory and number of people. The Court concluded in *Lawson* that the tax is an indirect tax because it related to the trade of commodities, “which have always been regarded as indirect taxes”¹⁸⁰ and was therefore *ultra vires* the jurisdiction of the province. As discussed above, pursuant to s 92(2), provinces are not allowed to charge indirect taxes.

¹⁸⁰ *Ibid* at para 10.

Subsequent case law provides additional information on each of the four *Lawson* criteria. The Alberta Electric Utility Board decided *Grand Prairie (City)*¹⁸¹ [*Grand Prairie*] and considered the first *Lawson* criterion, which requires a levy to be enforceable by law in order to be a tax. In this case, the City of Grand Prairie and its natural gas provider, ATCO Gas, reached an agreement that increased a contractual fee ATCO was required to pay for the provision of natural gas to the City from 10% of all revenues to 34.75% of the delivery portion of ATCO rates. The fee, known as a franchise fee, is imposed on the utility for its use of municipal property and for the grant of exclusive rights in the municipality.¹⁸² This arrangement was challenged by Mr. Logan, who argued that the fee constituted an indirect tax because it was related to the manufacturing of a commodity, as in *Lawson* where the trade in commodities was held to constitute an indirect tax, and was thus outside the jurisdiction of the municipality.

The Board concluded that the fee was not a tax because it was imposed through an agreement and not required by law. The Board was persuaded that the arrangement did not meet the first element of *Lawson* because the levy was not enforceable by law as the arrangement for payment was negotiated between the parties in the agreement. The Board further held that the “fee is not compulsory or enforceable by law in the sense that it is charged pursuant to a freely negotiated agreement between the City and ATCO Gas.”¹⁸³ Therefore, while the authorizing legislation permitted the City to enter into the agreement with ATCO gas, the City was not required to enter into the agreement or to charge a fee and therefore the fee was not enforceable by law and did not meet the first *Lawson* criterion in order to be found to be a tax.

¹⁸¹ 2003 CarswellAlta 2132 (EUB) [*Grand Prairie*] (*Grand Prairie* cited to WL Can).

¹⁸² *Ibid* at para 38.

¹⁸³ *Ibid* at para 24.

The Board was also persuaded by the argument that the contract stated that the fees are in lieu of a tax, reasoning that the fee cannot be a tax if it is paid instead of a tax.¹⁸⁴ One of the arguments made to uphold the fee was that it was a regulatory charge made under the licensing authority of province, pursuant to the *Constitution Act*, s 92(9). The Board found that a regulatory charge is normally imposed where a payment is not exchanged for a service received and that the franchise fee did not fit this model. Concluding that the fee was neither a tax nor a regulatory charge, the Board relied on the presumption of constitutionality of statutes, which provides that statutes are presumed to be written in accordance with the *Constitution Act*, to uphold the fee.¹⁸⁵ The proposition that the fee was a user fee was not considered by the Board. *Grand Prairie* is useful to demonstrate a levy that fails on the first *Lawson* element, that when a levy is not compulsory but rather arranged by negotiation it will not be found to be a tax. This was the only case found which demonstrates this principle. However, caution should be used in citing *Grand Prairie* for any of its additional findings as subsequent case law, as will be discussed, has clarified a number of the terms and tests that the Board used.

The first element of *Lawson*, requiring that a tax is enforceable by law, was also discussed by the British Columbia Supreme Court in *Cariboo College v City of Kamloops*¹⁸⁶ [*Cariboo College*]. Cariboo College was seeking a declaration that it was not required to pay development cost charges to the City of Kamloops on the basis that the charges were taxes and were *ultra vires* the jurisdiction of the City. In this case, development cost charges were levies imposed for the purpose of providing the municipality with funds to assist in the capital costs of

¹⁸⁴ *Ibid* at para 30.

¹⁸⁵ *Ibid* at para 45, citing Peter Hogg, *Constitutional Law of Canada* at 57-15.

¹⁸⁶ 133 DLR (3d) 241, 36 BCLR 133, 1982 CarswellBC 81 (SC) [*Cariboo College*] (*Cariboo College* cited to WL Can).

building sewers, water, drainage, highways, and public open space.¹⁸⁷ The Court stated that Cariboo College was not obliged to obtain a building permit from the City unless it chose to construct a new building, and if it chose to do so it must pay the development cost charges to defray the City's capital cost of providing the services.¹⁸⁸ The Court concluded, using the fact that the College made a choice that it would incur the fee as one of the grounds, that the development cost charge was not a tax¹⁸⁹ and it appears that the Court characterized the levy as a charge, though did not explicitly hold that it was a regulatory charge authorized under s 92(9).¹⁹⁰ From *Grand Prairie* and *Cariboo College*, it may be discerned that where a body, be it a utilities provider or a post-secondary institution, chooses to enter into a situation where it will be required to incur a fee, it is likely that the fee will not be found to meet the first element of the *Lawson* test, in that it is not mandatory as a tax would be.

*Antigonish (Town) Waste Disposal Charges Bylaw*¹⁹¹ [*Antigonish*] also considered *Lawson* elements. In *Antigonish*, St. Francis Xavier University made an application to quash a newly enacted waste disposal charges by-law for being *ultra vires* the municipality's jurisdiction. *Antigonish* passed a by-law imposing a waste disposal charge on land owners, but made an exemption for residents who were paying the waste disposal charge in their property tax from making payments under the new bylaw. The result was that the charge only applied to tax-exempt entities, which were not paying property tax, such as the University. The University used its own equipment and personnel to remove solid waste from its property.¹⁹²

¹⁸⁷ *Ibid* at 13.

¹⁸⁸ *Ibid* at para 27.

¹⁸⁹ *Ibid* at para 30.

¹⁹⁰ *Ibid* at para 43.

¹⁹¹ 7 MPLR (3d) 165, 181 NSR (2d) 68, 1999 CarswellNS 413 (SC) [*Antigonish*] (*Antigonish* cited to WL Can).

¹⁹² *Ibid* at para 2.

The Court undertook a detailed analysis of all four *Lawson* criteria. As to the first element, that the levy is enforceable by law to be a tax, the Court found that the charges would bear interest if they are outstanding, they may be registered as a lien, and may be sued for and collected by the Town.¹⁹³ The Court concluded that this was sufficient to meet the first *Lawson* element.¹⁹⁴ The second element of *Lawson*, requiring that the levy is imposed under the authority of the legislature to be a tax, was fulfilled by examining the authorizing legislation which allowed for the creation of by-laws on the amount and manner of payment of any fees and charges to be paid for the deposit of solid waste at a solid waste management facility.

The third element of *Lawson*, requiring that the levy is imposed by a public body, is rarely considered in any depth as it is generally obvious that the imposing body is a public body. In *Antigonish*, the Court summarized its conclusion that the municipality was a public body by stating, “[a] municipal corporation is the body politic and corporate constituted by the incorporation of the inhabitants of a city or town for the purpose of local government.”¹⁹⁵ Two additional sources are cited to support this position. First, the Court cites Rogers in *The Law of Municipal Corporations* who writes, “a municipality can also be described as a ‘public corporation created by the government for political purposes and having subordinate or local powers of legislation.’”¹⁹⁶ Second, the Court cites the 1911 case of *Dugas v Macfarlane*, (1911), 18 WLR 701 (YT Terr Ct) in which Craig J. describes municipal corporations as “miniature parliaments, institutions by which the people’s will is expressed through elected

¹⁹³ *Ibid* at para 18.

¹⁹⁴ *Ibid* at para 19.

¹⁹⁵ *Ibid* at para 21.

¹⁹⁶ *Ibid* at para 21 citing Rogers, *The Law of Municipal Corporations* (2d ed) (Toronto: Carswell, 1999).

representatives.”¹⁹⁷ The Court held that the third *Lawson* element, that the levy is imposed by a public body, was met based on these reasons.

The last element of *Lawson* is to establish that the levy is intended for a public purpose. The municipal by-law in *Antigonish* included a purpose statement, which is referred to by the Court. Cacchoine J. wrote, “[i]t is obvious that the By-law was enacted as a means of helping to defray the costs associated with the use of waste processing facilities.”¹⁹⁸ The conclusion the Court reached was that there was a two-fold public purpose; first, to reduce the tax burden on Town tax payers, and second, to increase the Town’s revenue.¹⁹⁹ The court found that the by-law was a tax and not a user fee and was inconsistent with the legislative scheme that created tax-exempt institutions. Had the by-law levy been found to be a user fee, it would have been applicable to the tax-exempt institutions. In other words, the Town of Antigonish was attempting to tax the tax-exempt University. Consequently, the challenged by-law was held to be invalid.

In summary, in 1931 *Lawson* provided four elements for a court to consider when determining if a levy was a tax. First, that the levy is enforceable by law. Second, that the levy is imposed under the authority of the legislature. Third, that the levy is imposed by a public body. Fourth, that the levy is generated for a public purpose. Subsequent case law has elaborated on these elements in a municipal context. In *Grand Prairie*, the Board held that the first *Lawson* element was not met because the charges were not compulsory, as they were negotiated between the parties. *Cariboo College* also found that the development cost charges for new buildings were not compulsory because it was optional for the College to construct new facilities. *Antigonish* provided significant analysis and background for the remaining three *Lawson*

¹⁹⁷ *Ibid* at para 22 citing *Dugas v Macfarlane* (1911), 18 WLR 701 (YT Terr Ct).

¹⁹⁸ *Ibid* at para 25.

¹⁹⁹ *Ibid* at para 29.

elements, particularly in establishing that a municipality is a public body (a principle for which this case is often cited), holding that the waste disposal fees were indeed taxes. The following Figure 4.1 summarizes the test in *Lawson* to determine if a levy is a tax or is not a tax.

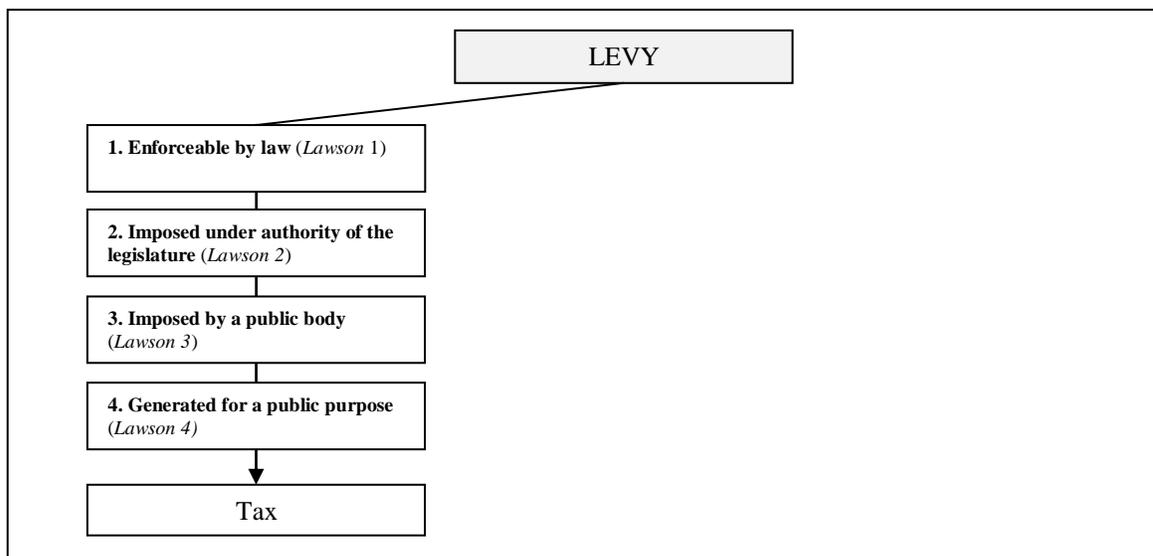


Figure 4.1: Lawson Tax Criteria

The purpose of this section was to discuss the first step in a user fee analysis, which is to determine whether or not the levy is a tax. If the levy is found to be a tax, after having been evaluated against the *Lawson* criteria, it cannot be a user fee. To be found to be a user fee, the levy must meet the second step of the user fee analysis, which is discussed in the next section.

Case Study: Smithton, British Columbia, Canada

Given the decision in *Lawson*, Suzie has to consider how the four tests in *Lawson* apply to her proposed solid waste pick-up and disposal user fee. Under the first *Lawson* element, the user fee will be enforceable by law because it will be written in a municipal by-law. Under the second *Lawson* element, the user fee is imposed under the authority of the municipality, and according to *Antigonish*, a municipality is a public body, meeting the third *Lawson* element. Finally, Suzie has to ensure that the user fee revenue is generated for a public purpose. After looking at the cases interpreting *Lawson*, Suzie has determined that the user fee revenue should be earmarked in a special account for solid waste pick-up and disposal to administer, operate and inform consumers about the service.

4.5 Determination of a User Fee; the Lawson and Eurig Criteria

In 1998, the Supreme Court of Canada rendered a decision in *Eurig Estate (Re)*²⁰⁰ [*Eurig*] which added a further element to the *Lawson* test to distinguish a tax from a user fee. The issue in *Eurig* was not related directly to municipal law, but rather to the probate fees authorized by the Province of Ontario to obtain letters probate. Thus, the service considered in this case was the issuing of letters probate. Nonetheless, this is the element for the application of all user fees and will be applied to evaluate municipal user fees in a legal context.

The issue in *Eurig* was that the appellant, the executrix of an estate not wishing to pay approximately \$5,000 in probate fees, argued that the fee was an indirect tax and was therefore *ultra vires* the province's authority. If the probate fee was found to be direct tax, it would be *intra vires* the province's authority. In summary, the executrix argued that the levy be found an indirect tax so she would not have to pay the probate fee and the province argued that the levy was either a direct tax or a validly enacted fee.

The first step for the Court in making a decision as to whether a levy is a user fee is to determine if it is actually a tax. To do so, the Court evaluated the probate fee against the four *Lawson* elements. On the first *Lawson* element, which requires that for the levy to be a tax it must be enforceable, the SCC found that the probate fee was compulsory and enforceable by law. The Court wrote on this point “[a] practical compulsion usually exists for the executor to obtain probate in order to comply with his or her legal obligations.”²⁰¹ The Court examined the second element of *Lawson*, requiring that the charge is imposed under the authority of the legislature, after looking at the first three elements and deciding that the levy was a tax. In this

²⁰⁰ [1998] 2 SCR 565, 1998 Canlii 801 [*Eurig*] (*Eurig* cited to Canlii).

²⁰¹ *Ibid* at para 17.

case, the authority was delegated to the Lieutenant-Governor in Council to set the amount of the fee, and because the levy was held to be a tax, it was found that there was not sufficient authority.²⁰² As to the third *Lawson* element, which requires that the levy be levied by a public body to be a tax, the Court found it was fulfilled as the probate fees are levied by the Ontario Court (General Division) which was a public body.²⁰³ The fourth *Lawson* element, that the levy is raised for a public purpose, was supported by an Ontario Law Reform Report which stated that the fee appeared to be regarded as a “suitable vehicle for raising revenue”.²⁰⁴

With respect to the fourth element, requiring that the levy be for a public purpose, it is notable that in *Eurig* the nature of “public purpose” had shifted. Previously, as seen in *Antigonish*, the accounting of the revenue from a user fee may not have been considered; rather the court was concerned with whether the revenue was fulfilling a “public purpose”. In *Eurig* the SCC considered the account where the revenue generated by the levy will be held in order to evaluate public purpose. The Court wrote,

[P]robate fees do not “incidentally” provide a surplus for general revenue, but rather are intended for that very purpose. The revenue obtained from probate fees is used for the public purpose of defraying the costs of court administration in general, and not simply to offset the costs of granting probate.²⁰⁵

This point continues to be reiterated as the delegation of the revenues generated from fees to either a general revenue or specific revenue account becomes the most frequently examined factor by the Court in making determinations on whether the levy is intended for a public purpose. Given that the term “public purpose” appears to be ill-defined in the case law, and that most, if not all, government levies could be found to have some sort of purpose that served the

²⁰² *Ibid* at para 36.

²⁰³ *Ibid* at para 18.

²⁰⁴ *Ibid* at para 19.

²⁰⁵ *Ibid* at para 20.

public, the shift to determining if the levy was collected for a public purpose and used for that purpose directly by allocating revenues to a specific revenue account is helpful.

The seminal point in *Eurig* was a new consideration the SCC introduced to conduct the user fee analysis. The Court wrote at paragraph 21, “[a]nother factor that generally distinguishes a fee from a tax is that a nexus must exist between the quantum charged and the cost of the service provided in order for a levy to be considered constitutionally valid.”²⁰⁶ In relation to setting the price of user fees the Court stated,

In determining whether that nexus exists, courts will not insist that fees correspond precisely to the cost of the relevant service. As long as a reasonable connection is shown between the cost of the service provided and the amount charged, that will suffice.²⁰⁷

The Court relied on the evidence provided to determine that there was no correlation between the cost of the service provided (the service being the issuing of the letters probate) and the amount charged by the province. The Court found that the levy was tied to the value of the estate, but the cost for issuing letters probate did not increase or decrease depending on an estate’s value. As a result, the SCC found there was no nexus between the cost of the service and the levy charged.²⁰⁸

The Court held that the levy is a tax and is *ultra vires* the jurisdiction of the province.

Presently, the test to determine if a levy is a user fee, pursuant to the existing jurisprudence, is the following. First, the levy is evaluated against the criteria established in *Lawson*: that the levy is (1) enforceable by law; (2) imposed under the authority of the legislature; (3) imposed by a public body and; (4) for a public purpose. If a levy meets these elements, it will be found to be a tax. An additional element was introduced by *Eurig*, which provides that if there is a nexus between the cost of the service and the fee, then the levy is a user

²⁰⁶ *Ibid* at para 21.

²⁰⁷ *Ibid* at para 22.

²⁰⁸ *Ibid* at para 22.

fee. There must be a reasonable connection between the cost of the service and the amount charged, but it does not have to be exact.²⁰⁹ While these tests may appear straightforward, questions arise when it comes to being able to apply each element of the tests. Figure 4.2 provides a summary of the *Lawson* and *Eurig* tests.

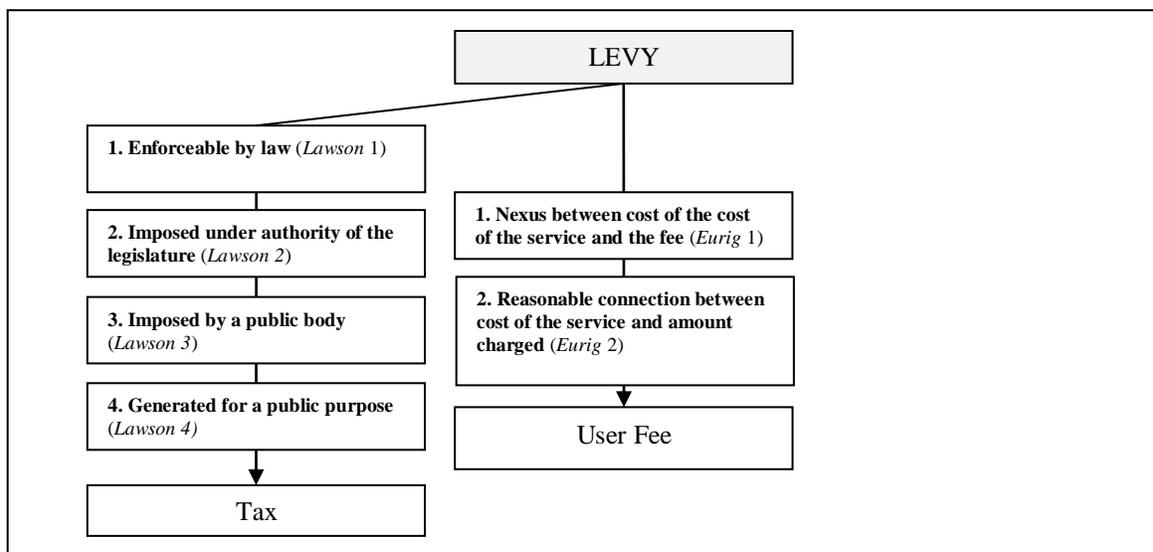


Figure 4.2: Lawson and Eurig User Fee Tests

Case Study: Smithton, British Columbia, Canada

Suzie has already determined under the *Lawson* test that the revenue generated from the municipal user fee on the will go to a specific revenue account. Therefore, Suzie is able to meet the first test in *Eurig*, that there is a nexus between the cost of the service and the fee. However, Suzie now needs to consider the amount that will be charged for the user fee. Suzie needs to ensure that the amounts generated do not exceed the cost of providing the service. Suzie will need to discuss the costing with a number of people who work for Smithton in order to determine the cost of the service and how the user fee will be applied and that there will not be a surplus generated from the user fee. Suzie is aware that there is some flexibility because the courts have recognized that it can be difficult to figure out how much to charge without running a surplus.

4.6 Evaluating the User Fee Test

Two questions result from the *Lawson* and *Eurig* test that are unanswered in the jurisprudence. First, is it possible for a user fee to meet all the *Lawson* criteria, implying that the

²⁰⁹ One could argue that these two elements in *Eurig* are in fact one requirement for a “reasonable cost nexus”; however, it appears that the interpretation to have two elements is also sound and for the purposes of this thesis facilitates integration with the economic elements in subsequent chapters.

levy would be a tax, and still meet the *Eurig* criteria, and then be found to be a user fee? There does not appear to be a case in which a court states whether or not the entire *Lawson* test must be completed before the *Eurig* step can be examined. Second, and in relation to the first question, though the dates of the cases seem to establish the order in which the tests are applied, is this the most appropriate method to evaluate a user fee given the nature of the elements of the tests? It appears that re-ordering of the *Lawson* and *Eurig* elements when applying the tests to determine if a levy is a user fee would be appropriate. This section argues that by suggesting that the public policy element, that is the fourth element in the *Lawson* test, which states that a levy will be found to be a tax if it is levied for a public purpose, should be the starting point for a user fee analysis. By answering the questions posed in this section, clarity is provided with respect to the state of the law on user fees.

A 2001 decision from the Ontario Court of Appeal applied the *Lawson* and *Eurig* test to a user fee analysis, which demonstrated how the *Lawson* and *Eurig* tests were applied and why re-ordering the test would be appropriate. In *Urban Outdoor Trans Ad v Scarborough (City)*²¹⁰ [*Urban Outdoor*], the Scarborough City Council passed a by-law to limit the number of outdoor signs being erected.²¹¹ Under the by-law there were two fees imposed; first, a fee for a new sign permit, depending on the size of the sign face. This fee was not disputed. Second, an annual fee for each third-party billboard sign of \$100 per face for ground-mounted signs and \$200 per face for roof-mounted signs.²¹² This was the fee that was contested. The sign companies launched an action, arguing that the fees were indirect taxes and *ultra vires* the jurisdiction of the

²¹⁰ 52 OR (3d) 593 (Eng), 196 DLR (4th) 304, 2001 CarswellOnt 187 (CA) [*Urban Outdoor*] (*Urban Outdoor* cited to WL Can).

²¹¹ *Ibid* at para 1.

²¹² *Ibid* at para 12.

municipality.²¹³ The Court held that the levy met the test in *Eurig* and did not meet some of the elements of the *Lawson* test, making the levy a user fee, which was *intra vires* the municipality's jurisdiction.

Only two *Lawson* elements were at issue; first, the first *Lawson* element, that the fees were not enforceable by law and second, the fourth *Lawson* element, that the fees were not intended for a public purpose. The Court of Appeal found that the annual fee was enforceable by law as the business of the sign companies was the erection and maintenance of billboards and the sale of space. The Court held that even if the sign companies 'voluntarily' chose not to sell the space, they would be required to pay the annual fee.²¹⁴

As to the second issue in *Urban Outdoor*, which is the issue of primary concern, the Court held that the annual fee was not intended for a public purpose. As this case was an appeal, the Court relied on the trial judge's decision and review of the evidence, which the Court of Appeal summarized,

He [the Judge] relied upon the fact that the funds raised from the annual fees are directed in their entirety to the administrative costs of the Sign Section [the governing body] and do not go into the City's general revenues.²¹⁵

The Court relied on the fact that the funds generated by the fee are not being deposited into a general revenue account and concluded that the funds are not intended for a public purpose.

Urban Outdoor is an example of the application of the shift in the *Lawson* element which appears to examine only the accounting of the revenue when evaluating whether the fee is levied for a "public purpose". Recall that this shift was previously discussed in Section 4.5 when the same element was considered in *Eurig*. This discussion noted that the examination of the third

²¹³ *Ibid* at para 1.

²¹⁴ *Ibid* at para 30.

²¹⁵ *Ibid* at para 33.

Lawson criteria, which required that the levy was collected “for a public purpose” has shifted from a consideration of why the funds were being collected, to potentially serve the common good, to where the funds were being allocated, that is a specific or the general revenue account.

The Court in *Urban Outdoor* then moved on to consider the *Eurig* element, because the levy did not meet all four the *Lawson* elements, that there is a nexus between cost of service and the fee. The Court found a nexus between the cost of the service provided and the fee levied, but the Court distinguished the sign fee in *Urban Outdoor* from the probate fee in *Eurig*. Recall that in *Eurig*, the levy was found to be a tax because there was no nexus between the cost of the service and the fee. However, in *Urban Outdoor*, the Court found a nexus existed,

The probate levy considered in *Eurig, Re* varied directly with the value of the estate although the cost of granting letters probate did not vary with the value of the estate. The result was an absence of a nexus between the levy and the cost of the service, indicating that the levy was a tax and not a fee. The fees imposed by the by-law in this case are entirely different and do not vary depending on the value of the particular sign locations.²¹⁶

One criticism of the Court’s reasoning is that the Court does not discuss the rationale behind an increased annual fee for a roof-mounted sign. The fees were applied differently depending on whether the signs were ground-mounted or roof-mounted. So while the fees did not vary depending on the value of the sign locations, they did vary, without apparent reason, depending on the type of sign mounted. However, the levy in *Urban Outdoor* was held to be a fee rather than a tax, and was therefore *intra vires* the power of the municipality and was not an indirect tax.²¹⁷

²¹⁶ *Ibid* at para 35 [references omitted].

²¹⁷ A second criticism of *Urban Outdoor* is that it did not explain or state that the Court was considering a “user fee” specifically; it was implied because of the tests that were argued for application. The only reference to distinguishment is from support for the conclusion on public purpose cited from P. Hogg in *Constitutional Law of Canada*, where the Court states, “the author explains that levies such as licence fees and registration fees can be supposed as fees rather than taxes, ‘if they bear a reasonable relation to the cost of providing the service.’ Such

It appears, from both *Eurig* and *Urban Outdoor*, that the public purpose element in *Lawson* is determined by establishing whether the revenue generated goes to a general revenue account or a specific account that funds the service. The Court in *Eurig* was persuaded that the levy was for a public purpose because the monies levied from the fee were used as surplus in general revenue accounts rather than to directly offset the costs of probate.²¹⁸ If the levy is intended for a public purpose, as in *Eurig*, the revenues from the levy are designated towards general revenues. In contrast, the allocation of the levy to the specific fund that funds the service provided is an indicator that the revenues are not intended for a public purpose, as in *Urban Outdoor*. Additional support may be found in *Urban Outdoor* for the proposition that revenues are designated for a specific account may be used for administrative activities associated with the service. To this end, it also becomes clear that it should not be possible to meet all the *Lawson* criteria and the *Eurig* criteria. The *Eurig* element requires that there is a reasonable connection between the cost of the service and the fee. It is implied that the service can only be costed if there is a specific revenue fund for the service. A levy will not be able to be raised for a public purpose and go to general revenues (where it would likely be found to be a tax) and go to specific revenues (where it would likely be found to be a user fee). The fourth element of *Lawson* requires that for a levy to be a tax, it must be allocated to general purposes and the nexus requirement in *Eurig* requires that the levy be allocated to a specific revenue account.²¹⁹

charges are not taxes ‘because their purpose is to defray expenses, not to raise revenue.’” (at para 31). Therefore, while this case is helpful in clarifying the public purpose criteria, it is not likely to be helpful to distinguish user fees and licence fees.

²¹⁸ *Eurig*, *supra* note 200 at para 20.

²¹⁹ Most recently, the *Lawson* and *Eurig* criteria were restated in the 2008 SCC decision *620 Connaught Ltd v Canada (Attorney General)* 2008 SCC 7, [2008] 1 SCR 131, 2008 CarswellNat 399, which dealt with a question of whether a levy on liquor licences on restaurants operating in Jasper National Park was a regulatory charge or a tax. It was not argued that the levy constituted a user fee. In this case, the SCC provided guidance with respect to the assessment process of determination of fees, using the *Eurig* criteria. The court states, “A user fee, by definition, is a fee charged by the government for the use of government services or facilities. In the case of user fees, as stated by

The jurisprudence does provide some answers to the questions posed in this section. The first question posed was whether it was possible for a user fee to meet all of the *Lawson* elements and still be found to be a user fee. It does not appear to be possible, primarily because of the fourth *Lawson* element, which is to determine whether the levy is for a public purpose. The second question was if, as a result of the answer the first question, there is a more logical way of re-ordering the *Lawson* and *Eurig* tests. While the jurisprudence has not taken this step, this section suggests that manipulating the *Lawson* and *Eurig* criteria to allow for a clearer application of the user fee test would seem appropriate. The first factor to consider should be how the revenues are designated; if the revenues go to a general revenue account, the remaining *Lawson* criteria should be applied to determine if the levy is a tax. If the revenues go to a specific revenue account that is designated for the cost of the service, the *Eurig* test to find a nexus should be applied. The user fee analysis, while clearly articulated in terms of the elements required, leaves gaps in terms of the ordering of the test and which elements must be fulfilled to move onto the next stage. Providing a clear procedure would allow parties to make clearer arguments to a court and for the court to ensure it is considering all factors appropriately. Figure 4.3 provides a summary of the proposed test.

this Court in *Eurig*, there must be a clear nexus between the quantum charged and the cost to the government of providing such services or facilities. The fees charged cannot exceed the cost to the government of providing the services or facilities. However, “courts will not insist that fees correspond precisely to the cost of the relevant service. As long as a reasonable connection is shown between the cost of the service provided and the amount charged, that will suffice” (citing *Eurig*). *620 Connaught* demonstrates that the *Lawson* and *Eurig* test is still “good law”.

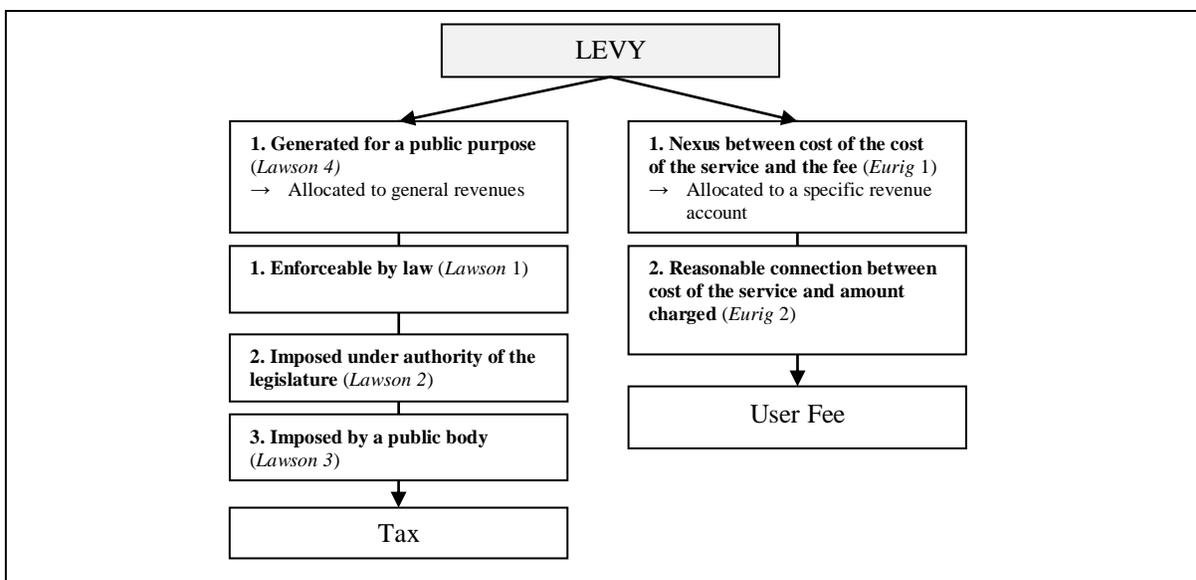


Figure 4.3: Suggested Ordering of *Lawson* and *Eurig* Criteria

4.7 Direct and Indirect Taxes

The finding that a levy is a tax, under the *Lawson* test, does not automatically mean that the tax is *ultra vires*. Provinces, and if properly authorized, municipalities, have the authority to charge direct taxes pursuant to the *Constitution Act*, s 92(2). One of the most common challenges that a user fee faces is for the plaintiff to argue that the user fee is *ultra vires* the jurisdiction of the governing body; this was the case in *Eurig*, where the executrix successfully argued that the probate fee (the user fee) was in fact an invalid tax. Following the *Lawson* test analysis, there is another step to determining if a tax is valid, which rests on the determination of whether the incidence of the tax is direct or indirect. Generally, the law relies on an economic understanding of direct and indirect taxation, primarily the definition provided by John Stuart Mills, which simply put says that a direct tax cannot be shifted from the person intended to pay the levy, while an indirect tax can be shifted.²²⁰ A common example of a direct tax is a property tax; while an example of an indirect tax is where goods are taxed when they cross a border, but the cost of

²²⁰ La Forest, *supra* note 155 at 78-79.

those taxes are shifted to the consumer. In *Eurig*, it was found that the tax was indirect, and was therefore *ultra vires*. However, as will be seen in other cases, finding that the fee is in fact a direct tax, will allow the fee to be upheld.

The finding that a levy is an indirect tax is not necessarily the final fatal blow to the levy. If an indirect tax is found to be ancillary or adhesive to a regulatory scheme, it may be saved as a regulatory charge, which provinces may charge pursuant to the *Constitution Act*, s 92(9).²²¹ If properly authorized, municipalities will also be able to implement regulatory charges. Regulatory charges are an alternative charging method to user fees, but as will be further discussed there are overlapping features and similarities between a regulatory charge and a user fee.

To begin this discussion, recall the explanation of municipal authorities according to the *Constitution Act*, in Section 4.3. There are two sections of the *Constitution Act* which pertain to the revenue raising authorities that provinces may delegate to municipalities. The first section is s 92(2) which allows provinces to impose direct taxation to raise revenue for provincial purposes. This is the authority that is generally used for property taxation. The other section is s 92(9) which allows for licence fees to be imposed for municipal purposes. The s 92(9) licence fees are the levies under consideration in this section. As will be seen, the term “licence fees” becomes synonymous with “regulatory charges” over the course of the jurisprudence; these terms may be read interchangeably.

Lawson also provides the starting point for the discussion on direct and indirect taxation. In addition to providing the four criteria used to establish a tax, discussed in the previous section,

²²¹ “Ancillary or adhesive” refers to the purpose of the levy. If the dominant purpose of the provincial or municipal levy is to charge an indirect tax, then it will be held invalid because this is not permitted under the *Constitution Act*, s 92(9). However, if the indirect tax is ancillary or adhesive to a regulatory scheme, meaning that it is not the dominant purpose but something that may be thought of as an effect of the dominant purpose, (it may also be called a “regulatory charge”) then it will be held valid, according to the interpretation of the *Constitution Act*, s 92(9).

the Court in *Lawson* held that the jurisdiction of the provincial government, which is limited in the *Constitution Act*, s 92(2) to impose direct taxes, does not carry over to s 92(9) with respect to licence fees. According to the *Constitution Act*, s 91(3), only the federal government can charge indirect taxes. However, *Lawson* implies that licence fees may be charged as indirect taxes. It is succinctly stated in the subsequent *Allard Contractors Ltd v Coquitlam (District)*,²²² [*Allard Contractors*] that there are limitations on the amount that may be recovered by licence fees, “[w]hile *Lawson* [...] gave a reading to s. 92(9) which opened up the possibility for indirect taxation within that section, it did so in the context of language suggesting that the possibility would be limited to the recouping of regulatory expenses.”²²³ In summary, *Lawson* has been interpreted to mean that licence fees may be charged for both direct and indirect taxes, but the amount of the fee is limited to the costs of regulation. However, because provinces have authority to charge any form of direct tax, the licence fee exemption is only relevant where a levy has been found to be an indirect tax and must be saved. The levy can be found valid if it is a licence fee.

The situation may arise as such: a provincial or municipal levy is challenged and is found to be a tax. If it is a direct tax, it is a valid because (assuming the proper statutory authority), both levels of government can charge direct taxes. If the levy is an indirect tax, it is invalid unless it is found to be a regulatory charge because the province and the municipality cannot charge indirect taxes, but can charge licence fees, which can be indirect taxes. The issue that arises is what the distinction is between a regulatory charge and a user fee. However, to get to this point, there has to be a foundation for understanding the distinction between a direct and an indirect tax. This

²²² [1993] 4 SCR 371, 85 BCLR (2d) 257, 1993 CarswellBC 317 [*Allard Contractors*] (*Allard Contractors* cited to WL Can).

²²³ *Ibid* at para 58.

section considers the distinction between direct and indirect taxes and is followed by a discussion of regulatory schemes and regulatory charges.

The courts often cite John Stewart Mills for the definition of direct and indirect taxation.

This commonly recited quotation reads,

Taxes are either direct or indirect. A direct tax is one which is demanded from the very person who, it is intended or desired, should pay it. Indirect taxes are those which are demanded from one person in the expectation and intention that he shall indemnify himself at the expense of another, such as the excise or customs.²²⁴

While this is the frequently relied upon and cited definition, Alaire and Bird comment that the “distinction between what constitutes a direct tax and what constitutes an indirect tax has been a frequently contested one that has given rise to sporadic and inconsistent treatment by the courts.”²²⁵

La Forest writes that the distinction should be viewed in light of the “general understanding of men”, meaning that an economic understanding of the incidence of taxation may not necessarily align with what an individual would commonly expect and that the individual’s expectation should not be discounted. La Forest’s principle of interpretation was cited with approval by the Ontario Superior Court of Justice in *Hudson’s Bay Co v Ontario (Attorney General)*²²⁶ [*Hudson’s Bay*], a complicated case which provides significant detail as to the background of direct and indirect taxation and the *Constitution Act, 1867*.

Hudson’s Bay considered in detail the incidence of indirect and direct taxation. The Province of Ontario attempted to implement a taxation structure in which mall anchor tenants were charged a different tax scheme at a higher rate. Anchor tenants are companies such as the

²²⁴ La Forest, *supra* note 155 at 78; *Allard Contractors*, *supra* note 222 at para 47.

²²⁵ Benjamin Alarie & Richard M Bird, Tax Aspects of Canadian Fiscal Federalism (30 September 2009), online: Social Science Research Network <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1689311>12.

²²⁶ 49 OR (3d) 455, 17 MPLR (3d) 15, 2000 CarswellOnt 2058 (Sup Ct Jus) [*Hudson’s Bay*] (*Hudson’s Bay* cited to WL Can).

Bay, which are considered to be more important to the success of the shopping centre.²²⁷ The tax scheme made it so the anchor tenants were, in effect, subsidizing other tenants' tax payment.

Hudson's Bay sought a decision that the tax scheme was *ultra vires* the province and argued that the scheme imposed an indirect tax.

The Court in *Hudson's Bay* provided a potential rationale for Mill's test to be re-evaluated, or at the very least, include supplementary considerations when making a decision on the incidence of a tax. The Court wrote,

The historical general tendency for property taxes, which has its roots in Mill's formulation, is anachronistic. In Mill's agrarian economy, landlords could not pass on tax increases to their tenants. In our society, landlords regularly pass on part of their property tax burdens to their tenants. Nonetheless, the conclusion that property taxes are a direct form of taxation has not been overturned by our contemporary courts and still has the same vigour.²²⁸

There are two approaches to determining indirect and direct taxation for the purposes of arguing a case. The first approach is the categories approach which accepts that there are certain types of taxes that have been regarded as direct since before confederation.²²⁹ In this approach, once the court has identified the category of taxation, the court relies on its established precedent in holding whether the tax is direct or indirect.²³⁰ The second approach is the legal incidence approach, which advocates a purposive analysis through an examination of the pith and substance to determine the legal incidence of a tax, as followed in *Ontario Home Builders*²³¹. *Ontario Home Builders* dealt with education development cost charges (EDCs), similar to the

²²⁷ *Ibid* at para 2.

²²⁸ *Ibid* at para 76.

²²⁹ The Court in *Hudson's Bay*, *ibid* at para 22, cites *Halifax (City) v Fairbanks Estate*, [1927] 3 WWR 493, [1927] 4 DLR 945 (PC) as the originating case of the categories approach.

²³⁰ *Hudson's Bay*, *supra* note 226 at paras 21-22.

²³¹ *Ontario Home Builders*, *supra* note 164.

development cost charges in *Cariboo College*,²³² where a levy was imposed on developers for new school infrastructure and the Court had to determine if the incidence of EDCs was direct or indirect. The Court found that the EDCs were an indirect tax, despite the fact that it was a land-based tax.²³³ This purposive analysis would be conducted by “identify[ing] the primary aspect of the impugned provisions by analyzing the language used in the statute, its surrounding context, and the legislation’s purpose.”²³⁴

The categories and legal incidence approaches, arguably, are not likely to be mutually exclusive, as a pith and substance analysis can rely on past distinctions to inform the present case. This may be especially true if arguments are made based on analogies to traditional taxes.

The Court in *Hudson’s Bay* wrote,

While the categories approach is quite useful in assessing more traditional kinds of taxes, it may not be as helpful in determining whether more innovative taxation schemes, which could not have been within the reasonable contemplation of the British Legislature when it enacted the *Constitution Act, 1867*, are a form of direct or indirect taxation.²³⁵

This statement is perhaps an indication that the Court is anticipating new revenue generating models and would tend to work through the legal incidence approach but be open to considering the categories approach as well. Though the categories approach may be useful, it appears that the direction of the court is towards the legal incidence approach that is informed by a categories analysis.

Ontario Home Builders is also a key case in this line of jurisprudence because it uproots the traditional categories approach and demonstrates how the legal incidence approach may include categorical considerations. Taxes on land are perhaps the most notable category and even

²³² *Cariboo College*, *supra* note 186.

²³³ *Ontario Home Builders*, *supra* note 164 at paras 46-48.

²³⁴ *Hudson’s Bay*, *supra* note 226 at para 21.

²³⁵ *Ibid* at para 23.

through the legal incidence approach are likely to be found as direct taxes. In *Ontario Home Builders* the incidence of the EDCs was at issue, and in particular if they were a tax on the developed land (a direct tax) or were going to be passed on by the developer to the future property owners (an indirect tax). In *Ontario Home Builders*, Iacobucci, J. wrote for the majority,

I agree that in the incidence of a land tax, in the traditional sense, will be direct. The hallmarks of a land tax are that the tax is, of course, imposed on land against the owner of the land, and that the tax is assessed as a percentage of the value of the land, or as a fixed charge per acre. The tax may be an annual, recurring assessment, or a one-time charge. In some cases, the tax may be enforced through the sale of the land. Although land owners, like everyone, may wish to pass on their tax burden to someone else or otherwise to avoid taxation, this desire or ability does not transform the direct nature of the tax into an indirect one. I also accept that the case law reveals that land taxes are generally direct taxes; but I do not believe the case law prevents a tax on land by itself from being treated as an indirect tax.²³⁶

The last sentence in this quotation indicates that a legal incidence analysis will be required for each tax to determine its incidence no matter how the incidence on similar taxes had been decided in the past. It is also noteworthy that the SCC was divided on the question of the incidence of taxation in *Ontario Home Builders*, which indicated uncertainty as to the approach that should be used in determining direct and indirect taxation.

Additional information regarding the categorical approach and the characterization of the incidence of taxation has been decided. In *Allard Contractors*, the Court cites *Bank of Toronto v Lambe* for the proposition that a flat fee constitutes a form of direct taxation and is therefore valid pursuant to s 92(2).²³⁷ *Allard Contractors* is an SCC decision that required the Court to rule on the validity of a gravel removal fee. The fee was based on the amount of gravel removed,

²³⁶ *Ontario Home Builders*, *supra* note 164 at para 46.

²³⁷ *Allard Contractors*, *supra* note 222 at para 44, citing *Bank of Toronto v Lambe* (1887), 12 App. Cas. 575 (PC).

therefore it was a volumetric fee, rather than a licence to remove gravel, which was called a flat fee. However, in *Allard Contractors* the Court further cautioned,

Whereas *Lambe* [...] determined the general tendency of a flat fee is direct, in the case of a variable fee, no automatic conclusion as to the general tendency can be drawn. Each case must be examined to determine whether a variable fee calculated according to the number of value of a licensee's transactions is direct or indirect in its general tendency.²³⁸

The SCC in *Allard Contractors* found further authority that a “tax measured with reference to a marketable commodity is usually indirect in its general tendency” and stated the test as “is the tax related or relatable, directly or indirectly, to a unit of the commodity or its price, imposed when the commodity is in the course of being manufactured or marketed?”²³⁹ Thus, *Allard Contractors* provides authority that a flat fee is likely to constitute direct taxation, while a variable fee attached to a commodity may constitute indirect taxation.²⁴⁰

This test was applied in *Grand Prairie (City)*, where the Board was considering the validity of a proposed fee. The Board stated, “[i]f a tax is related or relatable, directly or indirectly, to a unit of a commodity or its price, imposed when the commodity is in course of being manufactured or marketed, then the tax is indirect.”²⁴¹ The Board found the fee was not a tax and commented that the fee was related to the delivery charges, rather than the units of the commodity or the price.²⁴² This may be analogous to other municipal services which are similar to a gas utility and are delivered to a home, such as water.

²³⁸ *Ibid* at para 45.

²³⁹ *Ibid* at para 50.

²⁴⁰ The outcome in *Allard Contractors* is discussed in the next section, Section 4.7: *Regulatory Schemes and Regulatory Charges*.

²⁴¹ *Grand Prairie*, *supra* note 181 at para 7.

²⁴² *Ibid* at para 33.

In another case considering the incidence of a tax on land, *Carson's Camp Ltd v Amabel (Township)*²⁴³ [*Carson's Camp*], the Court had to determine the incidence of taxation in relation to a campground. After determining that the levy was a tax and not a fee or a charge, the Court reiterated that in order to be valid, the tax must be direct.²⁴⁴ Using *Ontario Home Builders* as precedent, the Court found that the incidence of the tax was indirect.²⁴⁵ The Court wrote,

Here, the levy imposed by Amabel is to defray the costs of providing general services to the public, including the users of campsites. Its collection scheme is linked to land, but it is not the ownership of the land *qua* land that is the object of the tax. The object of the tax is to recoup the added cost of providing general services in the Township associated with the additional use of those services by campers. And the general tendency will clearly be to pass the levy on to the seasonal campsite occupants. Carson's has indicated so in its material.²⁴⁶

In *Carson's Camp*, the Court found that the levy was *ultra vires* the authority of the municipality.²⁴⁷ As a result of this case, campsites may be found analogous to other private uses of land in a municipality where the land itself is not being taxed, but rather the additional use of land is costing money and the revenue is recuperating that cost.

In summary, if a levy is found to be a tax under the *Lawson* test, it may still be authorized depending on the nature of the authorizing legislation and the incidence of the tax. The provinces and, with appropriate authority, municipalities, may charge direct taxes pursuant to the *Constitution Act, 1867*, s 92(2). However, a finding that a levy is an indirect tax may still see the indirect tax upheld if it is related to a regulatory scheme. This summary is represented in Figure 4.4 below.

²⁴³ 159 DLR (4th) 180, 47 MPLR (2d) 31, 1998 CarswellOnt 1852 (Ct of Jus, Gen Div) [*Carson's Camp*] (*Carson's Camp* cited to WL Can).

²⁴⁴ *Ibid* at para 22.

²⁴⁵ *Ibid* at para 27.

²⁴⁶ *Ibid* at para 25.

²⁴⁷ *Ibid* at paras 26-27.

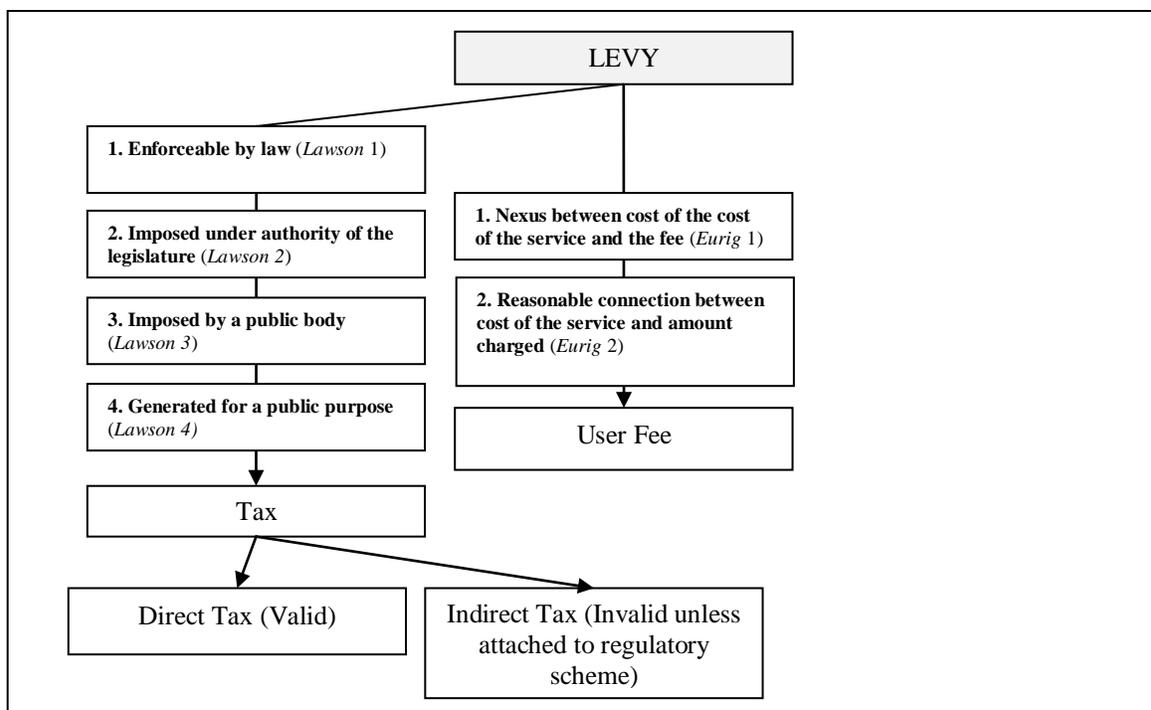


Figure 4.4: Summary of Lawson and Eurig Criteria with Indirect and Direct Taxation Considerations

This section considered the categories and legal incidences approaches employed by the court to determine if a tax is direct or indirect. The conclusion is that there is no certainty with respect to a decision on the incidence of a tax and the court is likely to undertake the legal incidence approach through a pith and substance analysis. This analysis may be informed by past cases using the categorical approach. Ultimately, the most important point in this section is that there is significant uncertainty in the determination of the incidence of a tax, which caused controversy in the SCC decision in *Ontario Home Builders*. The next section considers how an indirect tax may be saved by being attached to a regulatory scheme.

4.8 Regulatory Schemes and Regulatory Charges

When a levy is found to be a tax, fulfilling the four elements of *Lawson*, it must then be determined if the incidence of the tax is direct or indirect, as discussed in the previous section. If the incidence is direct, such as property tax, it is *intra vires* the province's authority pursuant to

the *Constitution Act*, s 92(2) and, with appropriate authority granted to the municipalities, may also be *intra vires* the municipality's authority. However, if the levy is found to have an indirect incidence, it will be found to be *ultra vires* the province's or a municipality's jurisdiction and will be found invalid. There is, however, an exception to the invalidation of an indirect tax. If the indirect tax is found to be "ancillary or adherent to a regulatory scheme" pursuant to the interpretation of the *Constitution Act*, s 92(9), it will be held as *intra vires* and will be found valid. Given the appropriate authorizing legislation, a regulatory scheme can have a very similar appearance to a user fee. This section sets out the development of the test for regulatory schemes and describes the test presently in place.

The case law concerning regulatory schemes has reached the Supreme Court of Canada on a number of occasions, each time receiving additional clarity. Tracing the decisions reveals modest changes in the test and the tone of the court. The first notable case concerning regulatory charges and schemes is *Coquitlam (District) v LaFarge Concrete Ltd*²⁴⁸ [*LaFarge Concrete*], a 1972 decision of the British Columbia Court of Appeal. LaFarge Concrete Ltd. and other respondents to the appeal operated businesses extracting and removing gravel from a site in Coquitlam. The gravel was removed using Coquitlam's roads and highways, which were subjected to heavy use. The Court described the use in detail, "the extent to which is shown when 470 loaded 10-ton trucks were counted leaving the quarries or pits on one day alone."²⁴⁹ Coquitlam amended a by-law from charging a flat annual rate of \$50 for a licence fee to remove soil to 15 cents per cubic yard of soil removed. The Court notes, "[i]t was common ground that the effect of the amending by-law was to increase the fee to a considerable sum, which, the

²⁴⁸ 32 DLR (3d) 459, 1 WWR 681, 1972 CarswellBC 267 (CA) [*LaFarge Concrete*] (*LaFarge Concrete* cited to WL Can).

²⁴⁹ *Ibid* at para 2.

respondent alleges, it proposes to pass on to its customers by adding it to the price of its commodity.²⁵⁰ It is important to note that the design of the permit fee changed from a flat fee to a volumetric fee, meaning that the fee was based on the amount of soil removed, and that the incidence was alleged to be passed on to the customers.²⁵¹ Consequently, the fee was alleged to be a form of an indirect tax, and as discussed in Section 3.7, would therefore be outside the municipality's jurisdiction to impose.

The trial judge found that the levy was an indirect tax yet still *intra vires* the municipality and laid the foundation for the test for a regulatory scheme that would save an indirect tax that was a regulatory charge. There were three judgments written by the Court of Appeal, all upholding the appeal which partially overruled the trial judge's decision that the levy was an invalid tax and *ultra vires* the powers of the municipality.²⁵² Bull, J.A. wrote,

It appears to me that the principle that emerges from the authorities is that taxation which can be characterized as other than direct, and hence not falling within the ambit of provincial legislation by s. 92(2) of the B.N.A. Act [*Constitution Act, 1867*], may still be within the scope of provincial competency if contemplated by, and fairly authorized under, another head such as here—s. 92(9). In my view, the key lies in the question as to what is the primary and real purpose, or pith and substance, of the legislation—is the levy or tax (whether direct or indirect by nature) merely ancillary, or adhesive to the licensing scheme of regulating or prohibiting trade, or is it essentially a fiscal imposition, or taxation, under a form of disguise or colourable concept?²⁵³

Bull J.A. undertook a pith and substance analysis to determine if the by-law was a form of indirect taxation that had been disguised and was therefore invalid, or if the by-law was ancillary to a regulatory scheme, in which case it would be valid. The facts relied upon were that the removal of the gravel both raised concerns by the citizens of Coquitlam and was likely to cost

²⁵⁰ *Ibid* at para 4.

²⁵¹ These facts are very similar to the facts in *Allard Contractors*, discussed at notes 12 and 222.

²⁵² *Lafarge Concrete*, *supra* note 248 at para 6.

²⁵³ *Ibid* at para 14.

taxpayers for road provision and regulatory expenses and further that the 15 cents imposed by the permit fee created a heavy burden on the industry and greatly increased their costs of business.²⁵⁴ Bull, J.A. concluded that,

The bylaw being amended constitutes a complete and detailed code for the regulation of the gravel and soil extraction and removal trade, including the provision of performance bonds and operation plans and surveys, obviously directed to safety and environmental control.²⁵⁵

This was sufficient to render the levy as ancillary or incidental to the regulatory licensing of a trade or business, despite the cost of the fee.²⁵⁶ It may be argued that *LaFarge Concrete* laid a foundation for a regulatory scheme test to be adopted by the Supreme Court of Canada, as the Supreme Court uses some of the same language of *LaFarge Concrete* in the regulatory charge test. However, the conclusion of the British Columbia Court of Appeal was questioned but not resolved in a subsequent case.

In *Kirkpatrick v Maple Ridge*²⁵⁷ [*Maple Ridge*], the municipality enacted a by-law requiring a permit to remove soil. The fee set was a volumetric fee based on the amount of soil removed. However, the authorizing legislation in the British Columbia *Municipal Act*, s 930(d) provided that the municipality was only allowed to “fix a fee for the permit”.²⁵⁸ The question before the SCC was whether the fee was valid under the municipality’s authority or whether it was a tax. The SCC’s decision held that the municipality did not have the authority to charge a volumetric fee as the authorizing legislation limited the levies to flat fees because the wording “fix a fee” was interpreted to mean only a flat fee could be imposed.²⁵⁹ This case is relevant as

²⁵⁴ *Ibid* at para 17.

²⁵⁵ *Ibid* at para 18.

²⁵⁶ *Ibid* at para 18.

²⁵⁷ [1986] 2 SCR 124, 30 DLR (4th) 431, 1986 CarswellBC 257 [*Maple Ridge*] (*Maple Ridge* cited to WL Can).

²⁵⁸ *Ibid* at paras 4, 10.

²⁵⁹ *Ibid* at para 10.

both a reminder that the correct wording has to be given in the provincial authorizing legislation for municipalities and because gravel and soil removal and volumetric and flat rates as user fees had reached the SCC on a number of occasions and form a significant portion of the body of law on user fees. While amendments had taken place to the British Columbia *Municipal Act* between the 1972 *LaFarge Concrete* decision at the British Columbia Court of Appeal and the 1986 *Maple Ridge* SCC decision, changing the relevant section numbering, the wording of the provision remained the same. The SCC in *Maple Ridge* did not rule on the validity of *LaFarge Concrete*, so these cases have not been reconciled for their inconsistency. As a result of the conflicting authorities and because subsequent decisions have clarified the test for regulatory charges, these cases would likely not be relied upon except for the points that, first, *LaFarge Concrete* introduces some of the wording of the regulatory charge test and, second, *Maple Ridge* indicates that close examination of enabling legislation is required. The regulatory charge test established in *LaFarge Concrete* was not considered by the SCC in *Kirkpatrick*, because the municipality was found not to have the authority to charge a volumetric fee in the authorizing legislation.

In 1993, a constitutional challenge reached the Supreme Court in *Allard Contractors*,²⁶⁰ which the Court introduced as, “another chapter in the apparently ongoing saga of constitutional litigation concerning sand and gravel excavation.”²⁶¹ *Allard Contractors* was discussed above, in the section dealing with direct and indirect taxation. Once the SCC determined that the volumetric fee for the removal of gravel was an indirect tax, the Court considered the question in *Allard Contractors*, “can the variable fees be supported as ancillary or adhesive to a valid

²⁶⁰ *Allard Contractors*, *supra* note 222.

²⁶¹ *Ibid* at para 1.

provincial regulatory scheme?”²⁶² Because the variable fees were found to be a form of indirect taxation, in order to be valid under provincial and municipal authority, they had to be connected to a regulatory scheme.

The Court found that there was a sufficient regulatory scheme based on a number of provisions found in the by-law, which the Court described as,

A general prohibition against removal subject to removal by permit is found in s. 4. Section 20 provides for inspection. Section 3 requires the by-law to be interpreted in a manner consistent with the *Mines Act* [...], and s. [sic] 5(e) and (f) require proof of approved mining systems and reclamation plans. The volumetric fee is set out in s. 13(a) and calculations provisions are located in ss. 14 to 18. Section 23 establishes an offence for violation.²⁶³

This paragraph is cited to provide an example of the depth of the regulatory scheme that the Court found sufficient. The Court cited *LaFarge Concrete*, and in particular the description provided by Bull, J.A. of a “complete and detailed code for the regulation of gravel and soil extraction and removal trade.”²⁶⁴ In application to the regime established by Coquitlam in this case (to which the regime in *LaFarge Concrete* is related), Iacobucci, J. wrote for the majority, “I am also satisfied that the fee provisions are related to these regulatory by-laws.”²⁶⁵ *Allard Contractors* upholds the finding in *LaFarge Concrete* that indirect taxation can be valid when ancillary or adherent to a valid regulatory scheme.

Another argument is made in *Allard Contractors* in an attempt to invalidate the regulatory scheme. The Court wrote that the line of cases that has developed on indirect taxes have developed a standard that the power of indirect taxation through a regulatory scheme can only be

²⁶² *Ibid* at para 69.

²⁶³ *Ibid* at para 77.

²⁶⁴ *Ibid* at para 78.

²⁶⁵ *Ibid* at para 78.

used to defray the costs of regulation.²⁶⁶ The appellants argued that there was nothing in the statute or by-laws that limited the amount of revenue from licensing to the actual costs of the scheme. The appellant's objective with this argument is to demonstrate that there is potential for surplus to be generated that goes beyond the cost of the regulatory scheme, invalidating the regulatory charge.²⁶⁷ The Court responded to this argument by stating,

[I]t is not for this Court to undertake a rigorous analysis of a municipality's accounts. A surplus itself is not a problem so long as the municipalities made reasonable attempts to match the fee revenues with the administrative costs of the regulatory scheme, which is what occurred in this case. It is easy to imagine reasons for the existence of a so-called "surplus" at any given time. For example, changes in forecasted prices might lead to road repair being over-budgeted, or a municipality might choose not to repair a certain road in order to undertake more extensive repairs or reconstruct at a later date.²⁶⁸

Recall that the *Eurig* test for user fees requires that there is a "nexus" between the cost of the service and the fee and that there is a reasonable connection between the cost and the fee, which is to say that the revenues generated by the fee cannot exceed the costs of the service. To this point in the *regulatory scheme* analysis, the term "nexus" has not been used, however the same principle is emerging with respect to regulatory charges in that they must be reasonably connected to the cost of the service.

The next case at the SCC considering regulatory charges was *Ontario Home Builders*²⁶⁹ in 1996. While not associated with gravel, this case is still in the municipal law realm as it dealt with education development charges (EDCs), which were analyzed as "regulatory charges". The purpose of the EDC scheme was to permit school boards to raise revenue for the local portion for new school construction where there was new development, when that development created the

²⁶⁶ *Ibid* at para 63.

²⁶⁷ *Ibid* at para 70.

²⁶⁸ *Ibid* at para 83.

²⁶⁹ *Ontario Home Builders*, *supra* note 164.

need for new schools.²⁷⁰ The EDCs were authorized by the Ontario *Development Charges Act*.²⁷¹ The question before the Court was whether the *Development Charges Act*, which authorized public and separate school boards to impose EDCs, was *ultra vires* the Province of Ontario because it authorized the imposition of an indirect tax contrary to s 92(2) of the *Constitution Act*.²⁷² The direct and indirect nature of the EDC was discussed above in Section 4.7, which considered the distinction between indirect and direct taxation. Resolution of this question, that the EDCs were an indirect tax, inherently led to a discussion of the regulatory scheme and in turn a reformulation and clarification of the regulatory charge that was developing.

The majority in *Ontario Home Builders* found that the EDCs constituted an indirect tax.²⁷³ The Court wrote on this point,

In a sense, EDCs are imposed in the course of manufacture on the commodity to be sold, that is, the new house or building. Most of the charge payers, the majority of whom are developers, intend to trade in the commodity, that is to sell the newly constructed buildings. It follows, in my view, that EDCs cling as a burden to new buildings when they are brought to market. Accordingly, EDCs constitute indirect taxation and are *ultra vires* provincial competence under s. 92(2).²⁷⁴

Therefore, in order for the EDCs to be held constitutionally valid and *intra vires* the province, it had to be demonstrated that they were ancillary to a valid regulatory scheme. The scheme under consideration was the provision of educational facilities as a component of land use planning.²⁷⁵

The methodology of conducting the pith and substance analysis received additional information in *Ontario Home Builders*. The majority wrote in review of *LaFarge Concrete* that the pith and substance analysis was intended to convey that the validity of the by-law in question

²⁷⁰ *Ibid* at para 3.

²⁷¹ *Ibid* at para 1.

²⁷² *Ibid* at para 1.

²⁷³ *Ibid* at paras 2, 46-48.

²⁷⁴ *Ibid* at para 49.

²⁷⁵ *Ibid* at para 50.

was linked to the costs of regulation.²⁷⁶ The SCC furthers this point by summarizing the decision in *Allard Contractors*,

[I]n so far as the power pursuant to s. 92(9) comprehends indirect taxation, this power is to be strictly limited “such that it can only be used to defray the costs of regulation”. Any power of indirect taxation extending beyond regulatory costs would indeed render s. 92(2) meaningless. Such a result is clearly undesirable, and is avoided, in my view, as long as the province is limited to recoupment of only the actual costs of regulation.²⁷⁷

The Court conducted a thorough review of the by-law in question in *Ontario Home Builders* in the introduction of the facts, and again to demonstrate that the regulatory scheme does not elicit a concern of excessive recovery and therefore, impliedly, that it was not an indirect taxation scheme.

Regulation 268, which sets out the mechanism for the calculation and disbursement of EDCs, is meticulous in its detail, and clearly operates so as to limit recoupment to the actual costs involved in providing educational facilities occasioned by new development [...] the fees are based on specific estimates of costs based on detailed and comprehensive calculations [...] The construction cost and cost of site figures used in calculating EDCs are to be approved by the Minister of Education [...]. It is important to note that EDCs can only be directed toward education capital costs made necessary by new residential development. EDC revenue cannot be used to defray capital costs associated with existing schools; this is another indication that the scheme is properly limited to the actual costs of regulation.²⁷⁸

The Court held that the regulatory scheme was sufficient and the EDCs were properly adhesive to the province’s planning and development regime, therefore the regulatory charges were *intra vires* the Province’s jurisdiction.²⁷⁹ Notable in the annotation to this case is the comment on future applicability,

It appears clear that the reasoning of both the majority and the minority decisions of the court with respect to the issues of direct/indirect taxation, and whether the

²⁷⁶ *Ibid* at para 51.

²⁷⁷ *Ibid* at para 53.

²⁷⁸ *Ibid* at para 55.

²⁷⁹ *Ibid* at para 67.

charges are imposed pursuant to a provincial regulatory scheme, would be equally application if not more so, to municipal development charges.²⁸⁰

While an annotation does not provide persuasive authority, nor is it a binding ruling, it is an indication of how this case may be applied in the future.

The next regulatory scheme considered by the Supreme Court was in *Westbank First Nation v British Columbia Hydro & Power Authority*, [1999] 3 SCR 134, 176 DLR (4th) 276, 1999 CarswellBC 1929²⁸¹ [*Westbank*]. There is a constitutional provision, s 125 of the *Constitution Act, 1867*, which prohibits one level of government from taxing another level of government. In this case, Westbank First Nation was attempting to assess and impose a levy on BC Hydro, an agent of the provincial Crown. If the court found that the taxation regime was in fact a tax, it would be invalid because of the prohibition in s 125. However, if the regime was not found to be a tax, but rather some other form of regulation, then s 125 would be inapplicable, meaning that Westbank First Nation could continue to charge BC Hydro. Therefore, the question before the Court was whether the levy was a regulatory charge or a tax. The levy was found to be a tax and was therefore inapplicable to BC Hydro. Notably, in this case it is irrelevant whether the tax had a direct or indirect incidence, because both would be invalid pursuant to s 125.

The SCC first sets out the *Lawson* criteria and the *Eurig* additional criteria, as discussed above in Section 4.5. The Court makes an interesting comment concerning *Eurig*, “[t]his was a useful development, as it helps to distinguish between taxes and user fees, as a subset of ‘regulatory charges’.”²⁸² The Court cites no specific authority for orienting a user fee as a subset of a regulatory charge. As will be seen in the most recent case on regulatory charges, this sentence does not make a re-appearance where it would have been appropriate, so it is possible

²⁸⁰ *Ibid*, annotation.

²⁸¹ [1999] 3 SCR 134, 176 DLR (4th) 276, 1999 CarswellBC 1929 [*Westbank*] (*Westbank* cited to WL Can).

²⁸² *Ibid* at para 22.

that this was a deliberate choice and that the Court no longer perceives user fees to be a subset of regulatory charges.

Westbank is the cumulative case that summarizes the features of regulatory schemes and reformulates the previously identified characteristics into a test to identify a regulatory scheme.

The SCC wrote,

Certain indicia have been present when this Court has found a “regulatory scheme”. The factors to consider when identifying a regulatory scheme include the presence of: (1) a complete and detailed code of regulation; (2) a specific regulatory purpose which seeks to affect the behaviour of individuals; (3) actual or properly estimated costs of the regulation; and (4) a relationship between the regulation and the person being regulated, where the person being regulated either causes the need for regulation or benefits from it. This is only a list of factors to consider; not all of these factors must be present to find a regulatory scheme. Nor is this list of factors exhaustive.²⁸³

The Court then considers whether the *Westbank* assessment and taxation scheme is in fact a regulatory scheme and concludes that it does not meet any of the factors that it has set forth,

The appellant has also not demonstrated that these charges form a nexus with any regulatory costs such as to bring it into the type of charge contemplated by *Allard [Contractors]* and *Ontario Home Builders*. The charge forms no part of a regulatory scheme. Although the *Indian Act* is legislation in relation to Indian land, this is insufficient to meet the requirements for a “regulatory scheme” in the constitutional sense. There is insufficient evidence demonstrating that the charge is attached to any “complete and detailed code”; nor can it be said that this forms part of a “complex regulatory framework”. There are no costs of a regulatory scheme identified. *Westbank* does not seek to alter B.C. Hydro’s behaviour in any way. B.C. Hydro has not caused the need for any regulation, to which the charges adhere. Nor does it benefit from any regulation provided. In summary, these charges do not “regulate” in any sense of the word, and they are not attached to any scheme which does.²⁸⁴

²⁸³ *Ibid* at para 24.

²⁸⁴ *Ibid* at para 38 [references omitted].

In this paragraph, the court cross-pollinated the *Eurig* user fee test and the regulatory scheme test established in *Westbank* by using the term “nexus”. However, the Court emphasized that they are separate forms of levies.

Although in today’s regulatory environment, many charges will have elements of taxation and elements of regulation, the central task for the court is to determine whether the levy’s primary purpose is, in pith and substance: (1) to tax, i.e., to raise revenue for general purposes; (2) to finance or constitute a regulatory scheme, i.e., to be a regulatory charge or to be ancillary or adhesive to a regulatory scheme; or (3) to charge for services directly rendered, i.e. to be a user fee.²⁸⁵

In summary, to this point *LaFarge Concrete*, *Allard Contractors*, and *Ontario Home Builders* had provided context for a regulatory charge. Where an indirect tax may be held invalid because it is *ultra vires* pursuant to s 92(2), it may be upheld as valid if attached to a regulatory scheme pursuant to s 92(9). *Westbank* provided a summary of the regulatory scheme elements and integrated *Eurig* by stating that a user fee was a subset of a regulatory charge.

The most recent SCC case to consider the issue of regulatory charges is *620 Connaught Ltd v Canada (Attorney General)*, 2008 SCC 7, [2008] 1 SCR 131, 2008 CarswellNat 399²⁸⁶ [620 Connaught]. The issue in *620 Connaught* relates to the licence fees that were charged at Jasper National Park to serve liquor. The Minister of Canadian Heritage was only permitted to charge fees pursuant to the governing legislation. Therefore, if the licence fee was in fact found to be a tax, it would be *ultra vires* the Minister’s jurisdiction to impose. The Court concluded that the fee was a regulatory charge and was validly imposed.²⁸⁷

There was no suggestion that the levy in this case is a user fee for the provision of government services or facilities. Rather the question was whether in pith and substance the levy

²⁸⁵ *Ibid* at para 30.

²⁸⁶ 2008 SCC 7, [2008] 1 SCR 131, 2008 CarswellNat 399 [620 Connaught] (620 Connaught cited to WL Can).

²⁸⁷ *Ibid* at para 3.

was a tax or a regulatory charge.²⁸⁸ However, the SCC still took occasion to distinguish a user fee and a regulatory charge. This distinction affirmed that these forms of levies are indeed still considered to be different, despite relying on similar elements. The Court wrote,

It will be useful to first differentiate a regulatory charge from a user fee. A user fee, by definition, is a fee charged by the government for the use of government services or facilities. In the case of user fees, as stated by this Court in *Eurig*, there must be a clear nexus between the quantum charged and the cost of the government of providing such services or facilities. The fees charged cannot exceed the cost to the government of providing the services or facilities. However, “courts will not insist that fees correspond precisely to the cost of the relevant service. As long as a reasonable connection is shown between the cost of the service provided and the amount charged, that will suffice” [citing *Eurig*].

By contrast, regulatory charges are not imposed for the provision of specific services or facilities. They are normally imposed in relation to rights or privileges awarded or granted by the government. The funds collected under the regulatory scheme are used to finance the scheme or to alter individual behaviour. The fee may be set simply to defray the costs of the regulatory scheme. Or the fee may be set at a level designed to proscribe, prohibit or lend preference to a behaviour, e.g. “[a] per-tonne charge on landfill waste may be levied to discourage the production of waste [or a] deposit-refund charge on bottles may encourage recycling of glass or plastic” [citing *Westbank*].²⁸⁹

Notably, this was an opportunity for the SCC to integrate the *Westbank* analysis that a user fee is a subset of a regulatory charge. The SCC does not restate that user fees are a subset of regulatory charges, but rather distinguishes the two levies without stating any connection between them.

This case is also noteworthy because the SCC appears to open the door to regulatory charges that explicitly have the objective of incentivizing consumer behaviour with less regard for matching costs.

After the Court set aside the user fee concerns, it proceeded with the regulatory scheme analysis. First, the SCC helpfully restated another consideration that was put forth in *Westbank*,

²⁸⁸ *Ibid* at para 17.

²⁸⁹ *Ibid* at paras 19-20 [references omitted].

which is “that the government levy would be in pith and substance a tax if it was ‘unconnected to any form of regulatory scheme’.” The Court restates the criterion as “[t]his fifth consideration provides that even if the levy has all the other indicia of a tax, it will be a regulatory charge if it is connected to a regulatory scheme.”²⁹⁰ This holding makes good sense as it removes the consideration of direct or indirect incidence of a tax from the initial assessment. Recall the controversy in *Ontario Home Builders* concerning the direct or indirect incidence of taxation and the murky test with which to undertake the legal incidence analysis. The parameters of a regulatory scheme are, for the most part, clearer than the legal incidence test and less controversial than those attempting to define an indirect and direct tax. The overall order of the regulatory scheme test is therefore reversed; the four *Lawson* elements comprising the test to determine if a levy is a tax will still apply and the fifth element will be to determine if there is an ancillary regulatory scheme. If there is no regulatory scheme and the levy is found to be a tax then a direct and indirect analysis will follow.

The regulatory scheme analysis was restated from *Westbank* in *620 Connaught*. First, the court must consider if the levy has the attributes of a tax (pursuant to the four *Lawson* criteria). Second, the court must consider if the levy is connected to a regulatory scheme which will first require an evaluation of the relevant regulatory scheme to determine if it is sufficient and second to consider the relationship between the levy and the regulatory scheme.²⁹¹ In application, the Court found that the business licence fees required by the Minister of Heritage to sell liquor in Jasper National Park met all the attributes of a tax. The Court also found that the four criteria to

²⁹⁰ *Ibid* at para 24.

²⁹¹ *Ibid* at para 28.

determine a regulatory scheme in *Westbank* are met. Figure 4.5 summarizes the current state of the law regarding taxes, user fees, and regulatory charges below.

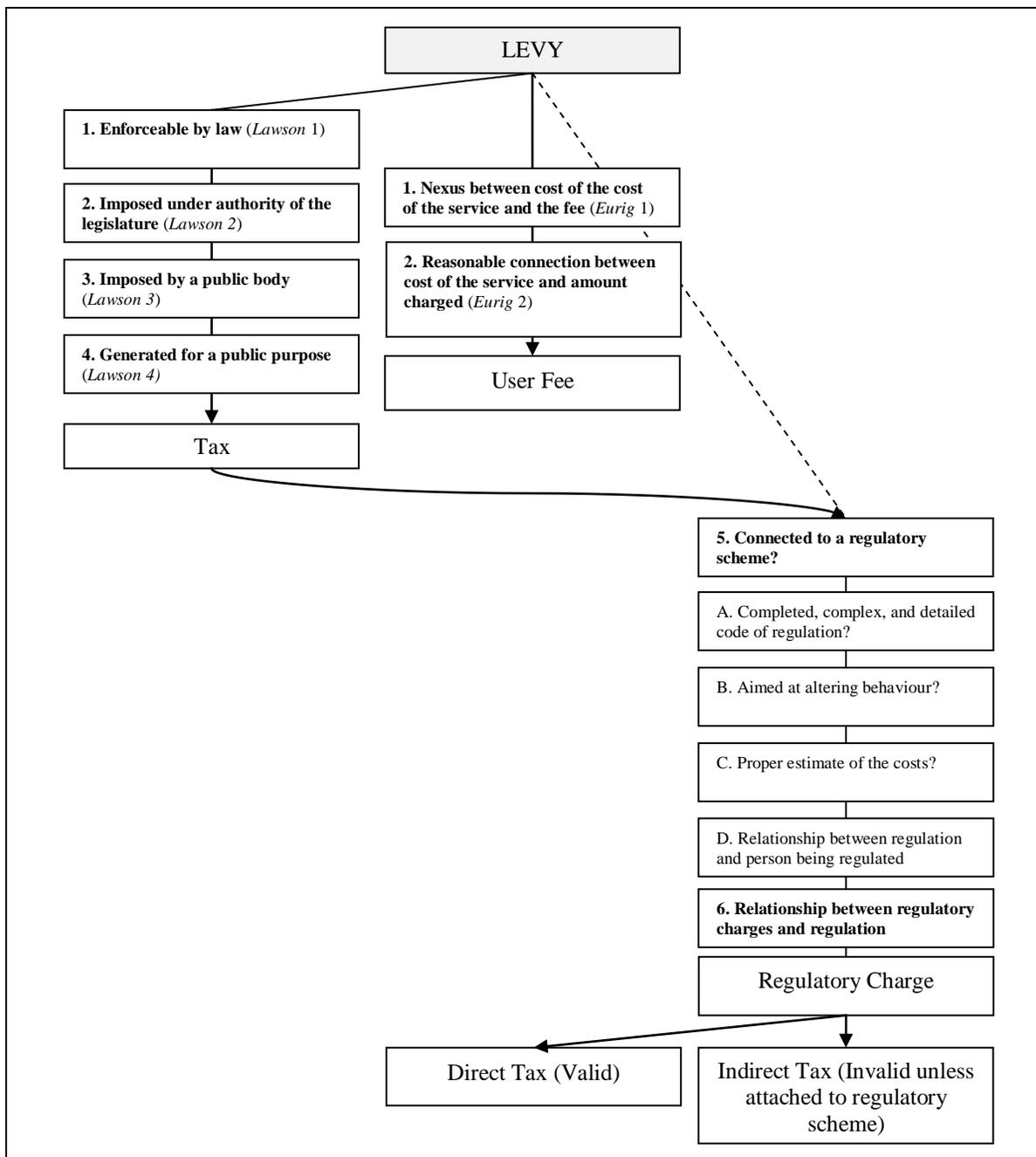


Figure 4.5: Summary of the Current State of the Law

Case Study: Smithton, British Columbia, Canada

Suzie has determined that the user fee she is developing for Smithton's municipal solid waste pick-up and disposal will meet the requirements of a user fee. However, Suzie's research into the legal principles of user fees has led her to the decisions in *Westbank* and *620 Connaught*, which gives the example of a volumetric charge on landfill waste that may be levied to discourage the production of waste. Remembering that one of Smithton's objectives in developing the solid waste pick-up and disposal user fee was to discourage the production of waste, Suzie is concerned that the user fee she is designing and planning to implement is in fact a regulatory charge.

Suzie looks back to her governing authority and determines that the term "fee" includes a fee by any name, including a charge. Therefore, Suzie determines that if her user fee is a regulatory charge, she still has authority under the *Community Charter*.

Next, Suzie looks to the regulatory charge test that has been established in *Westbank* and *620 Connaught*. First, she attempts to determine if there is a relevant regulatory scheme. Suzie thinks that because the *Environmental Management Act* mandates that Mountain Regional District develop a Solid Waste Management Plan, and that the plan includes information that has details like how solid waste is to be disposed of, the plan is complex enough to meet this requirement. Suzie also thinks that the regulatory scheme also has the intent of altering behaviour, because it is trying to reduce the amount of solid waste output of Smithton by imposing a fee to deter Smithton residents from putting out solid waste for pick-up and disposal. Suzie has talked to several people who work for Smithton and has developed an estimate of the costs of the service and the amount of the levy. Suzie is also confident there is a relationship between the solid waste pick-up and disposal regulatory scheme and an individual living in Smithton because the regulatory scheme will determine how much that individual has to pay for a municipal service.

Suzie is pretty sure that the solid waste pick-up and disposal plan could be a regulatory scheme, so she looks at the next step in the regulatory charges test, which is to determine if there is a relationship between the regulatory charges and the regulation. Suzie has based the levy on the amount required to administer and run the solid waste pick-up and disposal service in Smithton, so she also thinks that the levy meets this test.

In this case, Suzie is fairly certain that because her governing legislation allows both fees and regulatory charges and that she meets both tests her levy will be upheld as a user fee or a regulatory charge if it is challenged. However, Suzie is also now aware that if the governing legislation did not provide for "charges" or that she could not meet all the elements of a "regulatory charge" test, her levy may be in trouble.

Another distinction not carefully drawn out by the court but that becomes apparent when comparing user fees and regulatory charges is the court's treatment of the fourth element in the *Lawson* test, that is that to be a tax the levy will be intended for "public purposes". In the user fee context, it was suggested that this was a significant element that distinguished user fees from

taxes and suggested a re-ordering of the *Lawson* and *Eurig* test to first consider whether the revenues generated from a user fee were accounted for in general revenues or in a specific revenue fund. The Court did not consider the *Lawson* elements individually in *620 Connaught*, but rather stated, “[t]hese characteristics [referring to the *Lawson* elements] will likely apply to most government levies.”²⁹² It is unclear what affect this could have on the “public purpose” element of *Lawson*, but a prudent argument would be to consider both the general public purpose and the revenue accounting when examining this element.

Returning to the regulatory scheme analysis, the second step as described in *620 Connaught* is to discern the relationship between the business licence fees and the regulation of Jasper National Park. The Court states, “in order for a regulatory charge intended to defray the costs of a regulatory scheme to be ‘connected’, the fee revenue must be tied to the costs of the regulatory scheme.”²⁹³ The regulatory charge may comprise two separate intentions, as the Court initially described when distinguishing the regulatory charge from the user fee when the Court said, “[t]he fee may be set simply to defray the costs of the regulatory scheme. *Or* the fee may be set at a level designed to proscribe, prohibit or lend preference to a behaviour [...]”²⁹⁴ The first intention, to match the costs of regulation, seems analogous to there being a nexus between the costs of the service. The second intention, whether separate or in tandem with the first, opens the door to increased revenue beyond the costs of the service if it is meant to alter behaviour. This is a significant shift in the jurisprudence and is discussed in the next section.

²⁹² *Ibid* at para 23.

²⁹³ *Ibid* at para 38.

²⁹⁴ *Ibid* at para 20 [emphasis added].

4.9 *The Suggestion of a New Type of Regulatory Charge*

This section discusses the potential exemption to the reasonable connection or nexus requirement, found as a testable element in both user fees and regulatory charges. The limitation on revenue to the cost of the service appears to be lifted when a regulatory charge is implemented to alter behaviour, pursuant to the decision in *620 Connaught*. However, this section suggests that this exemption is likely only available when found under a federal regulatory scheme. This is a recent development in the law, arising from *620 Connaught*, though alluded to in *Westbank*, and has yet to be challenged or interpreted. This section begins by discussing the intricacies of the development, as found in *620 Connaught* and then considers the rationale behind this exemption being only available to the federal government.

The issue before the Supreme Court of Canada in *620 Connaught* was whether the liquor licence fees charged to the providers of liquor in Jasper National Park are part of a regulatory scheme or if they are a tax. If the levy was found to be a regulatory charge, it would be *intra vires* the jurisdiction of the Minister of Heritage. The Court comments outside the scope of regulatory fees and taxes and includes a section to distinguish between regulatory charges and user fees. When Rothstein J. described regulatory charges for the Court, he wrote,

[R]egulatory charges are not imposed for the provision of specific services or facilities. They are normally imposed in relation to rights or privileges awarded or granted by the government. The funds collected under the regulatory scheme are used to finance the scheme or to alter individual behaviour. The fee may be set simply to defray the costs of the regulatory scheme. *Or* the fee may be set at a level designed to proscribe, prohibit or lend preference to a behaviour.²⁹⁵

This is a significant clarification to the case law. The Supreme Court not only suggested, but nearly advocated the possibility that a regulatory charge be set at a level to influence

²⁹⁵ *Ibid* at para 20 [emphasis added].

behaviour, rather than be measured by the standard that is the test for user fees and the *other* type of regulatory charge, which is to defray the costs of the regulatory scheme. This phrasing suggested that there are two types of regulatory schemes, one in which costs are defrayed for the administration of a service (“revenue raising”), the other which attempts to influence behaviour through financial incentives (“behaviour modifying”).

Two other paragraphs in *620 Connaught* further this proposition. First, at paragraph 48 the Court reinforces its position when Rothstein J. stated that a behaviour modifying regulatory scheme is not being considered in *620 Connaught*,

Whether the costs of the regulatory scheme are a limit on the revenue generated, where the purpose of the regulatory scheme is to proscribe, prohibit or lend preference to certain conduct, is not an issue before the Court in this case, and it is not necessary to answer that question here.²⁹⁶

Second, the Court cited *Westbank* directly when describing the test for regulatory fees, writing, “[t]his is only a list of factors to consider; not all of these factors must be present to find a regulatory scheme. Nor is this list of factors exhaustive.”²⁹⁷ *620 Connaught* demonstrates that the Court is opening a door for regulatory schemes to have a charging component that is not tied to the cost of the service; though the contours of such a scheme are yet to be decided. It would be wise to consider though that the second step in the regulatory charge test is titled ‘the relationship between the licence fees and the regulation’. The title suggests that while the costs do not have to be related to the charges, a ‘reasonable relationship’ is still required in which the regulator would likely have to demonstrate how the behaviour modifying regulatory charges are intended to modify behaviour.

²⁹⁶ *Ibid* at para 48.

²⁹⁷ *Ibid* at para 26, citing *Westbank*, *supra* note 281 at para 24.

It is possible, however, that there is a limitation on this behaviour modification regulatory scheme. This limitation comes by way of constitutional jurisdiction and suggests that the behaviour modification regulatory scheme is only available to federal regulatory schemes. Referring back to the basis of the constitutional discussion, the federal government is allowed to charge both direct and indirect taxes, pursuant to the *Constitution Act, 1867*, s 91(3). However, the provinces are only allowed to charge direct taxes, pursuant to s 92(2) and licence fees, pursuant to s 92(9). If the behaviour modification regulatory scheme were to be available to the provinces, it has the potential to allow indirect taxation without the limitation of cost recovery. Limiting the amount that could be recovered was the rationale for the origin of the cost recovery principle, as the Supreme Court sought to find a way for ss 92(2) and 92(9) to interact without creating redundancies. Section 92(2) allows for revenues to be raised without limitation. Section 92(9) allows cost recovery methods for indirect taxation, if ancillary to a regulatory scheme. However, if s 92(9) were to be read so as to allow behaviour-modifying regulatory schemes, it could render s 92(2) redundant as the same privileges would be available to both direct and indirect taxation.

This constitutional quandary was contemplated by Prof La Forest (as he then was) in *The allocation of taxing power under the Canadian Constitution*,²⁹⁸ which is cited with approval by Iacobucci J. writing for the majority in *Ontario Home Builders*. Prof La Forest wrote,

If section 92(9) is limited to direct taxation, it adds nothing to the section. 92(2), for there is no doubt that direct taxation may be raised under section 92(2) even though it is framed in the form of a licence. On the other hand if section 92(9) permits a province to levy indirect taxation by means of a licence, there would seem to be no limit on provincial taxing power (there being no restriction of the types of licences falling within the section) so long as a tax is framed in the form of licensing provisions. Yet the British North America Act [now the *Constitution*

²⁹⁸ La Forest, *supra* note 155.

Act, 1867] appears to contemplate that indirect taxation should be within the sole competence of the federal Parliament.²⁹⁹

It would therefore appear that to avoid the constitutional redundancy created by the behaviour modifying regulatory scheme, provinces and the authorities they authorize to municipalities, should be limited to cost recovery regulatory schemes. A potential counter-argument to this point is that the behaviour modification regulatory scheme still requires a relationship to be established between the charge and the regulatory scheme. So while a behaviour modification regulatory scheme is likely not limited to cost recovery, there are limitations in place in terms of justifying the relationship. It is likely to be difficult to discern this costing mechanism from indirect taxation which may have an alternative purpose or effect that is invalid, though on the face appears to be valid, which may be referred to as a “colourable scheme”.³⁰⁰

The Supreme Court in *620 Connaught*, appears to clearly open a door for behaviour modifying regulatory schemes. This type of scheme sets aside the cost-recovery foundation of the user fee test and the regulatory charge test described in *Westbank* and appears to allow for charging so long as a relationship may be established with the regulatory scheme. It is likely as well that this charging will require some evidence as to the consideration and reasonability of the charge. Additionally, the behaviour modifying regulatory scheme may only be available to the federal government, as it could be considered that it imposes a redundancy on the constitutional interpretation of ss 92(2) and 92(9). With that disclaimer, it would certainly be available for a bold municipality to attempt to implement this type of regulatory scheme as a test case.

²⁹⁹ *Ontario Home Builders*, *supra* note 164 at para 52 citing *La Forest*, *supra* note 155 at 155-56.

³⁰⁰ The term “colourable” was also discussed in Section 4.2: *Legal Research Techniques and User Fee Legal Research Methodology*.

4.10 *Discerning and Distinguishing User Fees and Regulatory Charges*

There are similarities between user fees and regulatory charges and distinguishing the two levies will be necessary for the public policy analysis process. Some examples elucidate this point. In *620 Connaught*, the definition of a user fee is a fee charged by government for the user of government services or facilities; a fairly clear example is if a municipality owns a recreational facility and charges users a certain fee to use the facility. *620 Connaught* also defines a regulatory charge as being imposed for in relation to rights or privileges awarded or granted by government; one example that has been upheld of a regulatory charge is the right to remove gravel because the municipality does not own the gravel pit facility but the services it provides (such as roads) are affected. An example that muddies the user fee and regulatory charge waters is a levy imposed on landfill waste. A municipally provided service charging a levy on landfill waste may be analogized to a recreation facility and appear to be a user fee. However, the SCC writes that “a per-tonne charge on landfill waste may be levied to discourage the production of waste” as a direct example of a regulatory charge.³⁰¹

When working through the public policy analysis on a new problem, a public administrator, given the information provided above, will likely be able to design and implement a policy that reflects the objective of government, whether to raise revenue or modify behaviour, according to the relevant tests in *Lawson*, *Eurig*, and *620 Connaught*. This section approaches the question of how to determine what the type of levy is when it is already in place. Municipalities may have already implemented “user fees” for some services, but upon integration of the economic and legal information, there may now be less certainty with respect to the design of the levy.

³⁰¹ *620 Connaught*, *supra* note 286 at 20.

An additional concern may emerge if a user fee is challenged in court. The court challenges in the jurisprudence thus far generally had a plaintiff business arguing that the levy was a user fee or a regulatory charge was *ultra vires* and the defendant government arguing that the levy was a tax and was therefore *intra vires*. There has not been a case in which it has been before the court to decide whether a levy was a user fee *or* a regulatory charge. Such a challenge may be claimed, for example, if the municipality has authority to impose user fees but not regulatory charges and a business that is unhappy paying the levy argues that the user fee is a regulatory charge and is therefore *ultra vires*. I propose two methods the court is likely to use in attempting to distinguish a user fee from a regulatory charge.

This section first reviews the tests established for user fees and regulatory charges respectively before attempting to provide some ways to deal with discerning what kind of levy has been enacted. *Eurig* upheld the *Lawson* test which sets out four elements to determine if a levy is a tax. A levy will be found to be a tax if it meets all four of the *Lawson* elements which are, (1) that it is enforceable by law, (2) that it is imposed under the authority of the legislation, (3) that it is imposed by a public body, and (4) that it is levied for a public purpose. *Eurig* clarified the user fee test by adding that a levy will be a user fee if there is a nexus between the service and the fee and fee is reasonably equal to the costs of the provision of the service.

It was suggested in Section 4.6 that it is unlikely that a levy will meet both the standard to be a tax and a user fee because the public purpose provision relates to the accounting of the revenue generated by the user fee. If the revenue is accounted for in general revenues, it will be held as a tax for a public purpose. If the revenues are set aside in special account, it will not be found to be a public purpose, but rather for a specific purpose. It was also suggested that when considering the *Eurig* evaluation for a user fee, it would be sensible to reverse the order of the

Lawson criteria and first consider the public purpose element. If there is a special account designated, the analysis should proceed to the *Eurig* test for a user fee.

The Supreme Court has also set out the test to establish if a levy is a regulatory charge. As traced through *LaFarge Concrete*, *Allard Contractors*, *Ontario Home Builders*, *Westbank*, and *620 Connaught*, the SCC has established a regulatory scheme test. This test establishes that if a levy is ancillary or adhesive to a regulatory scheme, it is a regulatory charge and therefore bypasses the direct or indirect taxation analysis because both a direct and indirect regulatory charge would be valid under provincial authority. The regulatory charge test was first applied in *Westbank* and was subsequently upheld in *620 Connaught*.

The regulatory scheme tests were set out in *Westbank* and more clearly stated in *620 Connaught*. The first step is to determine the existence of a relevant regulatory scheme by examining the following factors (described as “loose” by the Court): (1) the presence of a complete, complex and detailed code of regulation; (2) whether the regulatory scheme is aimed at altering behaviour; (3) the presence of a proper estimation of the costs; and (4) the existence of a relationship between the regulation and the person being regulated. If this step is satisfied by a court determining that a regulatory scheme does exist, the second step is to establish the relationship between the regulatory charges and the regulation. The charges may be either imposed to defray the costs of the regulatory scheme *or*, as alluded to in *620 Connaught*, to alter behaviour. In both cases it was suggested that the fees must be tied to the costs of the regulatory scheme.

There is a lack of clarity about *how* the tests interact with each other. It is not clear as to whether the levy has to meet all the requirements of being a tax and therefore becomes a regulatory charge if it there is a regulatory scheme found, or if it does not meet all the elements

of a tax and it is matched to the cost, then it could be a user fee. This point is of further concern as the SCC commented in *620 Connaught* that all government levies are likely to meet the *Lawson* tax criteria.³⁰²

While the Supreme Court distinguished user fees from regulatory schemes explicitly in *620 Connaught*, there has not been a case in which a levy is challenged and it is determined whether the levy is a user fee or a regulatory charge. This leaves a gap in the jurisprudence, complicated by the definitions provided to distinguish user fees from regulatory charges have some similarities. In *620 Connaught*, the Supreme Court wrote that a user fee is paid based on the cost of the provision of a government good or service. The Supreme Court further said that a regulatory charge may either be (this is indicated by the use of the word ‘or’ in the description) based on an assessment of the cost of regulation or for the purposes of influencing behaviour.³⁰³

From a public policy analysis perspective, it is possible to see the difficulties arising for public administrators in distinguishing a user fee from a regulatory scheme. If a levy is already implemented and is called a user fee, the name of the levy is insufficient to determine which test should be applied to determine the validity of the levy. This section suggests that a court could undertake two analyses to distinguish between user fee and regulatory charges. The first analysis is to review the authorizing legislation that will reveal what types of levies are permitted. The second analysis to distinguish the levies is through a ‘pith and substance analysis’, which is a judicial interpretation method designed to reveal the underlying purpose and incidence of a levy. In the absence of a case that offers distinction between a user fee and a regulatory charge, my suggestion of the analysis a court will conduct may be supported through existing case law.

³⁰² *620 Connaught*, supra note 286 at para 23.

³⁰³ *Ibid* at para 20.

4.10.1 Authorizing Legislation Influencing the Court's Interpretation

Authorizing legislation refers to both the provincial legislation, likely found in laws entitled the *Community Charter* or the *Municipal Act*, and the municipal by-laws. The provincial legislation delegates and 'authorizes' specific authorities to municipalities. The municipality, as a 'creature of the province', may only implement by-laws based on those authorities provided. The by-laws, in turn authorize policy decisions made by municipal council. Both levels of law will be relevant to the discussion on authorizing legislation and certainly require scrutiny at the beginning of the policy design stage to ensure that the municipal council is permitted to pursue the proposed course of action.

My argument is that the authorizing legislation informs the type of levying scheme that is developed. That is, the specific words in the by-law or the provincial law, as applicable, are the basis for which the parties arguing before the court have suggested the appropriate tests to be applied and, in turn, form the basis for the court's application of either the user fee test or the regulatory charge test. While this argument may seem simplistic (of course a municipality would only pursue what it was authorized to do by law), one must bear in mind the similarities in the definitions of user fees and regulatory charges. The similarities are such that in some cases either test could be applied. It could be suggested that, in some circumstances, rather than the authorizing legislation informing the interpretation of the levy, the details of the levy are informing the interpretation of the authorizing legislation. Four cases demonstrate how the wording of the levy informs the interpretation of the legislation.

In the 2008 Supreme Court of Canada decision, *620 Connaught*, the authorizing legislation provided that the Minister of Canadian Heritage was authorized to "fix the fees or the manner of calculating fees in respect of the products, *rights or privileges* provided by the [Parks

Canada] Agency.”³⁰⁴ *620 Connaught* was a case based on the ability of the Minister of Canadian Heritage to prescribe the charges for liquor licences in Jasper National Park. The Supreme Court specified in its definition that “regulatory charges are not imposed for the provision of specific services or facilities. They are normally imposed in relation to *rights or privileges* awarded or granted by the government.”³⁰⁵ A liquor licence was perceived to be a right or privilege, rather than a service provided by government. Neither party in this case made an argument that the ‘fee’ that was authorized was in fact a user fee.³⁰⁶ Noticeably, the wording in the legislation is reflected in the definition of the regulatory charge. Additionally, it should be noted that it may not be simply ‘fee’ or ‘charge’ that are the words found in the authorizing legislation, but that scrutiny is required to determine the appropriate test.

Additional support for this hypothesis is found in the decision rendered in *Maple Ridge*.³⁰⁷ In this case, the Supreme Court of Canada was considering the constitutionality of a volumetric fee on the removal of sand and gravel. The enabling bylaw granted the power to “*fix a fee* for the permit” and because the fee was volumetric and therefore varied with the amount of soil removed, the Supreme Court disallowed the bylaw.³⁰⁸ The fixed fee could only be applicable to a flat fee; a variable fee was not permitted. Consequently, the by-law was struck down.

After the decision in *Maple Ridge* there were attempts made to reconfiguring the municipal by-law to allow for volumetric fees and the by-law was amended again, which was finally successful in being found to grant the appropriate variable rate volumetric permit fee,

³⁰⁴ *620 Connaught*, *supra* note 286 at para 1 [emphasis added].

³⁰⁵ *Ibid* at para 20 [emphasis added].

³⁰⁶ *Ibid* at para 17.

³⁰⁷ *Maple Ridge*, *supra* note 257.

³⁰⁸ *Ibid* at para 10.

which was then considered by the Supreme Court of Canada.³⁰⁹ This fee was considered to be a permit fee, analogous to a licence fee under s 92(9). Once again, this series of amendments demonstrates the necessity of careful examination of governing legislation.

A more recent example is the 2008 British Columbia Court of Appeal decision in *Greater Vancouver Sewage & Drainage District v Ecowaste Industries Ltd*³¹⁰ [*Greater Vancouver*]. The Court in *Greater Vancouver* was considering the validity of a waste disposal scheme and whether a disposal fee was a regulatory charge or an unconstitutional tax. The authorizing legislation provided,

Whereas [...]

C. Greater Vancouver Sewage and Drainage District is operating under a Solid Waste Management Plan which defines *a regulatory scheme* for the management of all privately operated municipal solid waste and Recyclable Material operations. The goal of *the regulatory scheme* is to ensure proper management of privately operated facilities by specifying operating requirements so as to protect the environment and public health, to protect the region's land base in accordance with the host municipality's zoning and land use policies, to ensure that regional and municipal facilities and private facilities operate to equivalent standards and to achieve the objectives of the Solid Waste Management Plan.³¹¹

As such, the Court delves into the regulatory scheme analysis from *Westbank* and *620 Connaught* and does not consider the disposal fee, despite its name, under the user fee analysis but rather considered it as a regulatory charge.

Some cases do not elucidate this point as carefully, though, as discussed in the legal research methodology component, these cases are more out of date and thus are likely to be given less weight. In the 1999 Nova Scotia Supreme Court decision in *Antigonish (Town) Waste Disposal Charges Bylaw, Re*, the governing legislation in the relevant *Municipal Government*

³⁰⁹ *Allard Contractors*, *supra* note 222 at para 12.

³¹⁰ 2008 BCCA 126, 79 BCLR (4th) 298, 2008 CarswellBC 565 [*Greater Vancouver*] (*Greater Vancouver* cited to WL Can).

³¹¹ *Ibid* at para 31 [emphasis added].

Act provides for the Council to make decisions regarding “the amount and manner of payment of any fees or charges to be paid for the deposit of solid waste at a solid waste-management facility” and for by-laws to set fees or charges for the removal of solid waste.³¹² The respondent municipality attempts to frame the levies as user fees. This is the only option in this case, as the case considered potential tax liability of tax exempt institutions. Therefore, any finding of a tax, whether direct or indirect, would result in the bylaw being invalid. In this case, it is possible the governing legislation could have been interpreted as either a user fee or a regulatory charge; however, the municipality had no choice but to advocate the levy as a user fee, which was dismissed by the Court.

The 2001 Ontario Court of Appeal decision in *Urban Outdoor* demonstrates how a court may choose to deal with interpreting authorizing legislation. In this case, the Court found that the *Municipal Act* authorized the annual fee in place, levied against sign companies for each third-party billboard sign at a cost of \$100 per face for ground-mounted signs and \$200 per roof-mounted signs.³¹³ The relevant sections of the *Municipal Act* provided,

220.1(2) Despite any Act, a municipality and a local board may pass by-laws imposing fees or charges on any class of persons,

- (a) for services or activities provided or done by or on behalf of it;
- (b) for costs payable by it for services or activities provided for done by or on behalf of any other municipality or local board; and
- (c) for the use of its property including property under its control.

[...]

(6) A by-law under this section may provide for,

- (a) *fees and charges* that are in the nature of a direct tax for the purpose of raising revenue;

[...]

- (d) *fees and charges* that vary on any basis the municipality or local board considers appropriate and specifies in the by-law, including the

³¹² *Antigonish*, *supra* note 191 at para 10.

³¹³ *Urban Outdoor*, *supra* note 210 at para 12.

level or frequency of the service or activity provided or done, the time of day or of year the service or activity is provided and whether the class of persons paying the fee is a resident or non-resident of the municipality;³¹⁴

It should be noted for clarity that the *Municipal Act*, in this case, authorized both fees and charges. Urban Outdoor Trans Ad (the plaintiff) argued that the levy was an indirect tax and therefore the municipality was unauthorized to levy the tax. The City argued that the levy was a fee and was therefore within the authority of the municipality, pursuant to the governing legislation. While the term ‘user fee’ was not explicitly used, the Court considered the *Eurig* analysis and held that the levy was indeed a fee. *Urban Outdoor* demonstrates a possible approach a court could take with a levy to determine if it is a user fee or a regulatory charge, by only applying the test that is suggested by the parties, in this case the *Lawson-Eurig* test for a user fee though arguably, given the governing legislation, both tests could have applied.

With an existing levying scheme, or where a scheme is being proposed but it is unclear as to whether it is a user fee or a regulatory charge, courts will have to decide which test to apply to determine the validity of the levy. To this point, there has not been a case where the court has had to distinguish between a user fee and a regulatory charge, therefore opinions must be discerned from the existing case law as to how a court may proceed with this analysis. This section suggests that it is in fact the wording in the delegated legislation that has informed the court as to the test that should apply. In *620 Connaught*, the Court used identical wording from the legislation imposing the regulatory charge to inform the definition of a regulatory charge. In *Maple Ridge*, the gravel removal by-law was held invalid because it was based on the volumetric amount rather than a flat fee. *Antigonish*, though slightly outdated, had to be argued that the by-

³¹⁴ *Ibid* at para 15 [emphasis added].

law imposed a user fee rather than a tax and therefore the user fee test was applied. Lastly, in *Urban Outdoor*, where both a fee and a charge were authorized by the provincial legislation, the Court applied the user fee test. The policy implication of this argument is that by-laws should state clearly what type of levy they intend to apply and ensure the scheme is developed in accordance with the appropriate test. This issue is highly relevant to the implementation stage as the municipal by-law will have to be drafted accordingly.

4.10.2 Pith and Substance

It is foreseeable that a levy will be challenged and the court must determine if the levy is a user fee or a regulatory charge in order to apply the appropriate test. It has been established that user fees and regulatory charges are indeed different forms of levies and that while they have been described in case law, the court has not faced a case in which it was required to establish a means of distinguishing the two forms of levies. As discussed in Section 4.10.1, one strategy to determine which test should be applied is to carefully review the authorizing legislation. However, the authorizing legislation may not be clear as to the nature of the levy, as in *620 Connaught*, or may authorize both fees and charges, as in *Urban Outdoor*. In a situation where a court is faced with deciding which test to apply, another method that the court will likely pursue is a pith and substance analysis. This section begins by attempting to forecast the types of challenges that may be anticipated by municipalities and then proceed to describe the pith and substance analysis process. The section concludes by discussing the application of pith and substance analysis in the case law previously reviewed and discerning the features the courts may rely upon for a user fee and regulatory charge pith and substance analysis.

It is possible to forecast circumstances that may arise in which a user fee and a regulatory charge must be distinguished by a court. In addition to the type of attack that has been seen in the

jurisprudence to this point, that is, that the levy is *ultra vires*, future challenges may come in the form of insufficient authorizing legislation, not meeting the requirements of the test, or not meeting an aspect of either test. Both user fees and regulatory charges are vulnerable to attacks on costing, as this is a key feature in the tests, though as will be discussed below, does not have a significant threshold to overcome. It is also possible that a challenge may involve arguing that a user fee is a regulatory charge, but does not have the authorizing legislation to permit that possibility. Given the decision in *620 Connaught* which arguably authorizes two forms of regulatory charges, for either revenue raising or behaviour modification purposes, a court will not likely be satisfied with simply reading the imposing legislation and may also apply a pith and substance analysis.

A pith and substance analysis is a legal interpretation technique, often used in constitutional analysis. The technique was described in the dissent in *Ontario Home Builders*, but is a commonly used tool and the dissent cites Supreme Court of Canada approval of the technique from another case. La Forest J. wrote,

The identification of the pith and substance of a law involves an analytical process conducted according to the approach carefully described by Sopinka J. in *R. v. Morgentaler*. As he explained, the analysis “necessarily starts with looking at the legislation itself, in order to determine its legal effect”, but courts also “will look beyond the direct legal effects to inquire into the social or economic purposes which the statute was enacted to achieve”, its background and the circumstances involving its enactment and, in appropriate cases, will consider evidence of the second form of ‘effect’, the actual or predicted practical effect of the legislation.³¹⁵

This description points to the use of the legislation to help determine the legal effect of a law but also describes a second level analysis. This second level refers to the incidence of the legislation and the purposes it was intended to achieve. It is likely that a court would undertake both a

³¹⁵ *Ontario Home Builders*, *supra* note 164 at para 117 [references omitted].

careful reading of the legislative authority and a pith and substance analysis if the pith and substance analysis is a method of analysis the court determines to be appropriate.

While not previously used in the context of discerning user fees and regulatory charges, the pith and substance analysis has been used in the broader context of the user fee case law. The test was used by the British Columbia Court of Appeal in the 1972 case of *LaFarge Concrete*, when the Court considered whether the volumetric fee on gravel was ancillary to a regulatory scheme or a form of taxation disguised as a regulatory scheme. The Court wrote,

[T]he key lies in the question as to what is the primary and real purpose, or pith and substance, of the legislation—is the levy or tax (whether direct or indirect by nature) merely ancillary, or adhesive, to the licensing scheme of regulating or prohibiting a trade, or is it essentially a fiscal imposition, or taxation, under a form of disguise or a colourable concept?³¹⁶

In order to make a decision in *LaFarge Concrete*, the Court examined the rationale for the imposition of the fee. One of the main reasons for the fee increase was because a new road was required for the trucks hauling gravel to be diverted around the neighbourhood.³¹⁷ The Court also considered the nature of the legislation, in that there was a detailed regulatory scheme enacted which involved safety and environmental controls.³¹⁸ As a result of these features, the Court determined that the levy was not a form of disguised indirect taxation but was rather ancillary to the regulatory scheme.³¹⁹

The Supreme Court of Canada makes a strong indication in *620 Connaught* that the pith and substance analysis may be employed to distinguish between user fees and regulatory charges. This is demonstrated by the Supreme Court's use of this method to distinguish between a tax and a regulatory charge. The Court wrote,

³¹⁶ *Lafarge Concrete*, *supra* note 248 at para 14.

³¹⁷ *Ibid* at para 17.

³¹⁸ *Ibid* at para 18.

³¹⁹ *Ibid* at para 18.

In summary, if there is a regulatory scheme and it is found to be relevant to the person being regulated under step one, and there is a relationship between the levy and the scheme under step two, the *pith and substance will be a regulatory charge and not a tax*. In other words, the dominant features of the levy will be its regulatory characteristics.³²⁰

The language of the Supreme Court in *620 Connaught* suggests that the test to determine if a regulatory scheme exists is the test that should be applied to determine if the levy is in pith and substance a regulatory scheme.

4.11 Summary

The public policy analysis process requires that public administrators must consider both economic and legal parameters in the policy design and implementation stages. User fees are a policy instrument that may be considered by public administrators for revenue raising or behaviour modification purposes as a user fee can raise funds to supply government provided goods and services or can alter consumer habits. Chapter 3.0 provided a description of the economic criteria for the design stages and the options for implementation stage of user fees with respect to pricing and accounting of revenue generated. The purpose of this chapter was to understand the legal standards for the design and implementation stages in the public policy analysis process when considering user fees as a policy instrument.

In summary, the criteria for a user fee are found in *Lawson* and *Eurig* and upheld in *620 Connaught*. It was suggested that the *Lawson* criteria be re-organized as it is seemingly impossible to meet both the test in *Lawson* and in *Eurig*. Therefore, it was proposed that the first consideration should be whether the levy is made for a public purpose, meaning discerning whether the revenues raised go to general or specific revenues. If the revenues are allocated to general revenues, the remaining elements of the *Lawson* test should be applied to determine if

³²⁰ *620 Connaught*, *supra* note 286 at 28 [emphasis added].

the levy is a tax. They are (1) that the levy is enforceable by law; (2) that the levy is imposed by the authority of the legislature; (3) that the levy is imposed by a public body. If the revenues raised by the levy go to specific revenue, the *Eurig* criteria should be applied. First, determining if there is a nexus between the costs of the user fee and the revenue and, second, if the cost of the provision of the service and the fee are reasonably connected.

If the levy is found to be a tax, it may still be saved if it is either a direct tax or if it is an indirect tax that is ancillary or adhesive to a regulatory scheme, also known as a licence fee or a regulatory charge. The SCC determined that the first step to determine whether the levy could be saved is to establish if there is a regulatory scheme. There are four elements to determine if there is a regulatory scheme, though the SCC notes these are not limited. The four elements are: (1) if there is a complete, complex, and detailed code of regulation; (2) if there is a regulatory purpose that seeks to affect some behaviour; (3) if there is a presence of the actual or properly estimated costs of the regulation; and, (4) if there is a relationship between the person being regulated and the regulation. The second step is to establish if the costs of the fee revenue is tied to the costs of the regulatory scheme. There is a limitation that the fee generated cannot exceed the costs of the scheme.

As discussed, the jurisprudence is complex in this area and two unsettled questions emerged as a result. The first question is whether there was an opening for a particular type of regulatory charge to be developed. *620 Connaught* strongly suggests that there is a possibility for a regulatory scheme to be imposed that is intended to proscribe, prohibit, or lend preference to a behaviour and that such a charge is to be tied but not limited to the costs of the regulatory scheme. It was suggested that this opening is likely only available for the federal government. The second question considered, with high relevancy to municipalities, is the question of how to

determine that a user fee is indeed a user fee from the outset. This question appears to find resolution by close examination of the enabling legislation and such a challenge will also likely include a pith and substance analysis. However, as will be discussed below, municipalities can design and implement the enabling by-law and policy structure so as to clearly indicate the type of policy instrument imposed.

The following Figure 4.6 summarizes the current state of the law, as represented in Figure 4.5 and supplements these tests with the additional legal criteria drawn out in this chapter. These sections are re-ordered and applied to the design and implementation stage criteria in the public policy analysis framework. The consideration of regulatory charges was excluded from the design and implementation stage criteria, as the objective of this thesis is to guide municipalities in developing user fees; however, as this chapter demonstrates, there are a number of background issues that must be considered in the legal analysis. The methodology of deciphering which elements fit into design stage and implementation stage criteria was informed by the summary of the key elements of each stage in Chapter 2.0 and how the economic criteria aligned at the conclusion of Chapter 3.0. As represented, the first question in the design stage is to determine the legal authority of the municipality. The design stage also includes consideration of the first three *Lawson* elements; these are likely to be integrated into the considerations of determining the authority of the municipality. The final legal requirement component in the design stage is the second element of *Eurig*, which is to establish if the user fee is set at a “reasonable cost”. The implementation stage concerns include the question of where revenue is designated and if a nexus can be established. The design and implementation stage criteria established in the economic literature review and the jurisprudence are integrated in the subsequent two chapters.

| PUBLIC POLICY ANALYSIS CRITERIA | | | |
|---|---|---------------------------|---|
| LAW | | | |
| Legal Criteria | Current State of the Law | Design and Implementation | |
| <p>Legislative Authority Does the municipality have delegated authority from the province for:</p> <ul style="list-style-type: none"> → The good or service it wishes to charge for; and → Implementing a user fee (or regulatory charge). | <p>User Fee Test <i>Is the Levy a Tax?</i> (if so, it cannot be a user fee):</p> <ol style="list-style-type: none"> (1) Enforceable by law (2) Imposed under the authority of the legislature (3) Imposed by a public body (4) For a public purpose <p>→ Does the revenue go to general revenue or specific revenue? If general revenue then tax.</p> <p><i>If not a tax, then is the levy a user fee?</i></p> <ol style="list-style-type: none"> (1) Nexus between cost of service and user fee. → Does the revenue go to general revenue or specific revenue? If specific revenue then user fee. (2) Reasonable cost of user fee. → Does not generate surplus (not rigorous analysis) <p><i>If a tax, then can it be a regulatory charge?</i></p> <ol style="list-style-type: none"> (1) Connected to a regulatory scheme? → A regulatory scheme may have the following elements (loose test): (A) Complete, complex, and detailed code of regulation? (B) Aimed at altering behaviour? (C) Proper estimate of the costs? (D) Relationship between regulation and person being regulated? (2) Relationship between regulatory charges and regulation. <p><i>If not a regulatory charge, then a direct tax?</i></p> <ul style="list-style-type: none"> → Apply legal incidence or categories approach | DESIGN | <p>Legislative Authority Does the municipality have delegated authority from the province for:</p> <ul style="list-style-type: none"> → The good or service it wishes to charge for; and → Implementing a user fee (or regulatory charge). |
| | | DESIGN | <p>User Fee Test <i>Is the Levy a Tax?</i> (if so, it cannot be a user fee):</p> <ol style="list-style-type: none"> (1) Enforceable by law (2) Imposed under the authority of the legislature (3) Imposed by a public body |
| | | DESIGN | <p>User Fee Test <i>Is the Levy a Tax?</i> (if so, it cannot be a user fee):</p> <ol style="list-style-type: none"> (2) Reasonable cost of user fee. → Does not generate surplus (not rigorous analysis) |
| | | IMPLEMENTATION | <p>User Fee Test <i>Is the Levy a Tax?</i> (if so, it cannot be a user fee):</p> <ol style="list-style-type: none"> (4) For a public purpose <p>→ Does the revenue go to general revenue or specific revenue? If general revenue then tax.</p> <p><i>If not a tax, then is the levy a user fee?</i></p> <ol style="list-style-type: none"> (1) Nexus between cost of service and user fee. → Does the revenue go to general revenue or specific revenue? If specific revenue then user fee. |

Figure 4.6: Legal Tests Applied to Design and Implementation Criteria

5.0 Discussion: Design Stage Criteria

Municipal public administrators must consider a range of factors in their policy design, including economic and legal criteria. In the public policy analysis process, set out in Chapter 2.0 this thesis, the design stage comes after the problem definition has been clearly identified and the policy analysis has moved to the process of deciphering which policy instrument to select and apply to the policy problem. The economic and legal standards were set forth in the previous chapters, which explained how each influences user fee design. However, as emphasized in the introduction, examining these standards individually does not provide the necessary guidance to the municipality. This chapter integrates the economic and legal research to support municipal public administrators with information from both disciplines in the user fee design stage.

This chapter contains three sections which discuss different aspects of the design stage. The appropriate sections were determined by assessing the individual criteria generated by both the economics literature in Chapter 3.0 and the jurisprudence in Chapter 4.0 and deciphering where both disciplines had criteria that affected the design stage of the user fee. The first two sections consider where the economics literature and the jurisprudence overlap with each other and attempts to reconcile the disciplines to provide coherent guidance to municipal public administrators. The first section cautions public administrators to clearly communicate their objectives to ensure the appropriate objectives are being met. The second section is the most significant case of overlapping criteria in the design stage and considers the “reasonable cost” element that appears in both the user fee and regulatory charge legal tests in conjunction with the economic recommendation to cost user fees according to average incremental cost pricing. As may be discerned, there are areas in which the economics literature and jurisprudence do not overlap. Given the nature of the disciplines, the economics literature features more prominently

in the design stage criteria. The third section is a residual section that considers the information that economists provide to the design stage that the courts are unlikely to consider.

5.1 Speaking the Same Language

The terminology around user fees is complicated and inconsistent in both disciplines. As a result, it is imperative that the policy analysis process clearly indicate the underlying objectives of the levy. This strategy relates back to having a clear problem definition with the available policy options articulated. The danger in communicating using only the terminology of user fees and not considering the policy objective is that the implementation will not accurately reflect the intention of the policy analysis process and will leave the levy open to legal challenges.

Economists appear to have a broad understanding of the term ‘user fee’. User fee is used by economists in the context where an individual or business is charged according to their use of a public good or service and must pay the government for the use. It does not appear that a distinction is made between regulatory charges, licence fees, or user fees. Moreover, at times there may not be distinctions made between taxes and the terms listed above. This was not the approach taken in this thesis, but it must be understood that it is an approach that may be employed by economists.

The legal understanding of a user fee is fairly simple and in alignment with the economic definition used in this thesis, in that a user fee is a levy for a good or service provided by government. However, when attempting to draw a distinction between a regulatory charge and a user fee, the practical terms of what constitutes either can be difficult to discern. As discussed in Section 4.10, guidance may be found in the authorizing legislation. In particular, if the legislation limits the policy analysis to one or the other (user fee or regulatory charge) then this must be communicated at the outset of the design stage. This is a legislative limitation and if the levy that

is subsequently developed does not adhere to the legal requirements identified, it may be found invalid. If the options are not limited because the legislation provides that both user fees or regulatory charges may be imposed, then the policy design should indicate the tool selected so as to ensure the appropriate legal considerations are evaluated.

Economists recognize that all taxes and user fees have the capability of modifying behaviour. This is relevant because it is not what the law assumes. For some policy problems, modification of behaviour is the desired solution. For example, if the policy objective was to produce less garbage, an increase in the amount it costs for an individual to dispose of garbage would likely influence that individual's behaviour to produce less garbage so as to incur less cost. In other cases the modification of behaviour is not the desired objective, but may be a by-product of the policy. For example, if a municipality decides to raise revenue for garbage services through a user fee, the change in cost is still likely to alter consumer behaviour. Economists do not generally distinguish between which policies are likely to modify behaviour, as it is accepted that it will be the result of most revenue generating devices; but the extent to which behaviour is modified is often in question.

The law appears to be aligning with the economics literature on this point, though it is not possible to provide certain criteria as these are recent developments in the case law. As discussed in Section 4.9, *620 Connaught* appears to indicate that two types of regulatory charges exist; one for which revenues are collected strictly to offset the cost of the service and the other suggestions that there may be revenues collected to incentivize a particular type of behaviour. While still evolving, the case law seems to indicate that it may be possible to have a regulatory charge with the primary intention of modifying behaviour, acknowledging, at least in one type of levy, that behaviour may be influenced by a levy.

Public administrators must communicate clearly with respect to their objectives and not rely on generally accepted terminology because the terminology within each discipline is unclear. Relying strictly on the words without describing the underlying objective runs the risk of imposing a user fee that does not comply with certain legal requirements and may not withstand a legal challenge. This consideration is the first design stage element that integrates the economics literature and jurisprudence.

5.2 *The Cross-over Costing Elements*

As has been previously stated, *620 Connaught* upheld the clarification in *Westbank* that there are three types of levies: user fees, regulatory charges, and taxes. The previous chapter discussed the issue of discerning user fees from regulatory charges and how a court is likely to undertake that process should an appropriate challenge arise. This section takes a different perspective and looks to the element that is similar, if not identical, in the respective tests for user fees and regulatory charges. This element is the requirement that the cost must be reasonably related to the cost of the service or regulation. The purpose of this section is to demonstrate that despite being identified as separate types of levies, user fees and regulatory charges rely on the same methodology to determine this reasonable cost relationship element. By establishing that the reasonable cost relationship element is based on the same test, jurisprudence from both tests can be used to inform public administrators' understanding of this element. This section establishes the foundation for Section 5.3, which discusses the interplay between economic and legal analysis and how courts deal with challenges to reasonable cost. This section will first review the user fee and regulatory charge tests, with specific attention to the costing elements. This section will then examine a case where the tests are conflated with respect to

reasonable cost, demonstrating both that the tests are sufficiently similar and an example where the test are used to inform each other.

The test to determine a user fee and the test to determine a regulatory charge are both defined in the jurisprudence. The *Eurig* element is the key feature in the user fee test, and provides that “[a]nother factor that generally distinguishes a fee from a tax is that a nexus must exist between the quantum charged and the cost of the service provided in order for a levy to be considered constitutionally valid.”³²¹ This point was added to in the next paragraph when the Court wrote, “[i]n determining whether that nexus exists, courts will not insist that fees correspond precisely to the cost of the relevant service. As long as a reasonable connection is shown between the cost of the service provided and the amount charged, that will suffice.”³²² This test has been re-stated and upheld in *620 Connaught*, where the Court wrote “there must be a clear nexus between the quantum charged and the cost to government of providing such services or facilities. The fees charged cannot exceed the cost to the government of providing the services or facilities.”³²³

The test for regulatory charges is most clearly established in *Westbank*, though as the jurisprudence reveals, the elements were fairly consistently contemplated throughout the development of the case law and *Westbank* was the case in which the information was compiled and organized into a more applicable format. There are two elements in the regulatory charge test which consider the costing elements. The main steps in the regulatory charge analysis are first, the identification of a regulatory scheme, and second, establishing the relationship between the charges and the regulatory scheme. The first element that considers cost is a sub-test under the

³²¹ *Eurig*, *supra* note 200 at para 21.

³²² *Ibid* at para 22.

³²³ *620 Connaught*, *supra* note 286 at para 19.

first step. In order to identify a regulatory scheme, the test is likely to require “actual or properly estimated costs of the regulation.”³²⁴ The Court elaborated on this element in writing,

Regulatory schemes usually involve expenditures of funds on costs which are either known, or properly estimated. In the indirect tax cases, evidence was provided demonstrating how the revenues would be used and how the regulatory costs of the scheme were estimated. In *Ontario Home Builders*, the charge levied was “meticulous in detail” and “clearly operate[d] so as to limit recoupment to the actual costs”. In *Allard [Contractors]*, evidence was led by city officials demonstrating the actual costs of annual road repair, based on estimates from similar repairs in the municipality. In both cases, there was a fairly close “nexus” between the estimated costs and the revenues raised through the regulatory scheme.³²⁵

It is interesting to note that the Court, in its explanation of this sub-element of the test draws attention to the ‘nexus’ relationship, especially because it is not explicitly mentioned in the summarized wording of the test. This summarized wording only appears to require that the costs are estimated, though this is likely because this element ties in so closely with the second step.

The second step in the regulatory charge test is to determine that the regulatory scheme is indeed “adhesive” to the charge, which the Court says in *Westbank* will exist when, “the revenues are tied to the costs of the regulatory scheme, or where the charges themselves have a regulatory purpose, such as the regulation of certain behaviour.”³²⁶ In *Westbank* the second step did not receive as much attention because the regulatory scheme in question failed to meet the four sub-elements required to satisfy the first step. However, in *620 Connaught*, where the regulatory scheme was upheld, the Court provided additional elaboration,

[T]he government needs to be given some reasonable leeway with respect to the limit on fee revenue generation. While a significant or systematic surplus above the cost of the regulatory scheme would be inconsistent with a regulatory charge and would be a strong indication that the levy was in pith and substance a tax, a small or sporadic surplus would not, as long as there was a reasonable attempt to

³²⁴ *Westbank*, *supra* note 281 at para 24.

³²⁵ *Ibid* at para 27 [references omitted].

³²⁶ *Ibid* at para 44.

match the revenues from the fees with the cost associated with the regulatory scheme.³²⁷

The similarity in the costing elements of the tests barely requires explanation, as the point is fairly self-evident. There are two concepts which are almost identically replicated between the tests for a user fee and a regulatory charge. First, that there is a “nexus” or “connection” between the fee or the charge and the cost of the government provided service. Notably, while the term “nexus” seems to be specifically related to *Eurig* and the user fee analysis, the broader description of the element the Court is searching for as evidence is identical. The second concept is that the regulatory charge is limited to the cost of the service, and that there is a reasonable attempt to match the cost of the service with the charge.

If the similarities in language and test design were insufficient to be fully persuasive, consider that the tests are in fact both based from and reference *Allard Contractors*. In *Eurig*, immediately after prescribing the “nexus” requirement, the Court supports its position by writing, “[t]his nexus was also considered relevant to determining the nature of a municipal charge in *Allard Contractors*. In that case the Court engaged the question of whether an indirect tax levied by a province was validly enacted as incidental to a matter of provincial jurisdiction.”³²⁸ Likewise, in *Westbank*, the Court held in relation to the costing element of the first step, “[i]n *Allard [Contractors]*, evidence was led by city officials demonstrating the actual costs of annual road repair, based on estimates from similar repairs in the municipality. In both cases, there was a fairly close ‘nexus’ between the estimated costs and the revenues raised through the regulatory scheme.”³²⁹

³²⁷ 620 *Connaught*, *supra* note 286 at para 40.

³²⁸ *Eurig*, *supra* note 200 at para 21 [references omitted].

³²⁹ *Westbank*, *supra* note 281 at para 27 [references omitted].

This section demonstrates the similar, if not identical, nature of the costing element in the user fee test and the regulatory charge test. This similarity is important to set the stage for the future discussion in the next section, which discusses the standards of economists and the courts in evaluating reasonable costs. This section demonstrates that both tests use similar language with the hope of relying on similar evidence to render a decision. As such, the following discussion on reasonable cost is likely to be directly applicable to both tests.

5.3 “Reasonable Cost” and “Alternative Incremental Cost Pricing”

The reasonable cost element is important to consider at the policy design stage for two reasons. The first reason is because if the costing is not properly determined economically, the government may be in a position where the revenues generated do not equal the costs of the good or service and could potentially sustain a loss. The second reason is because, legally, in addition to an argument that the levy is *ultra vires*, both user fees and regulatory charges are vulnerable to attacks that their costing is unreasonable, which, if established, is likely to result in the levy being held invalid. The reasonable cost element sees significant interplay between the economic and legal standards as both fields make specific commentary to this point.

The economic literature does not consider the legal parameters under which municipalities operate with respect to the *Lawson* and *Eurig* tax and user fee tests. Meanwhile, the case law has provided indications of what would be considered in a costing analysis and also indications of who may be relied upon to provide this evidence. This section will first set out a summary of the economic literature and the principles set forth and will then proceed to review the tests set out in the case law. Detailed notes from the case law on costing will be set forth, to demonstrate the considerations that are generated by the evidence and acknowledged by the

court as persuasive. Finally, the section concludes with a discussion on how the economic standards and legal standards may find alignment.

The economic literature review (Chapter 3.0) demonstrated that economists, with few exceptions, advocate marginal cost pricing for user fees. Marginal cost pricing includes all potential costs, including opportunity costs that should be considered when cost setting is developed. Economists also acknowledge that marginal cost pricing suffers from some significant limitations in practical application, primarily in costing so-called “economic costs” such as opportunity-costs, and therefore that a second best alternative should be used. An alternative method of costing discussed by economists is average cost pricing, where average costs are established by adding up the sum total and dividing by the number of users. Average cost pricing is not favoured by economists as it leads to inaccurate pricing, distorting the information that may be gleaned from user fees as to a consumer’s preferences. As a result of the preference but impracticality of marginal cost pricing and the detriment of average cost pricing, economists advocate for the second-best solution, which is alternative cost pricing. Alternative cost pricing includes the financial costs and the best estimates that can be made of the economic costs of a publicly provided good or service.

As discussed above in Section 5.2, the legal standard for the reasonable cost of user fees and regulatory charges has been articulated differently, but is similar, if not identical, for both standards. The legal standard for a user fee must demonstrate that there is a reasonable connection between the cost of the service provided and the amount charged. Challenging this requirement is difficult. There is a presumption of validity of municipal by-laws and the burden of proof, or the onus, will be on the party challenging the invalidity of the by-law. The

Saskatchewan Court of Queen's Bench wrote in a case where the reasonable cost of a municipal licence for commercial photography business was challenged, that

[I]n light of the presumption in favour of the validity of bylaws, it becomes clear that the onus in the case at bar is on [the party challenging the bylaw] to prove that the fees are set at a level which exceeds the cost to the municipality for the administration and regulation of the activity. He has failed to meet that onus. His only evidence was that the City did not know if the costs of the business licenses exceeded the costs of administering them. There was no onus on the City to prove that their fees do not exceed the costs of administration.³³⁰

Perhaps because challenging a user fee on this ground is so difficult, there has been relatively little case law that establishes the parameters of a 'reasonable connection' of a user fee.

However, the regulatory charge analysis most recently found in *Westbank* and *620 Connaught* can inform the reasonable cost analysis which this thesis argued pertains to both user fees and revenue raising regulatory charges.

An example of a regulatory scheme fulfilling the reasonable cost requirement may be found in *Ontario Home Builders*. The SCC, following their decision in *Allard Contractors*, stated that the province is limited to recoupment of only the actual costs of regulation.³³¹ After an assessment of the evidence provided to determine if the regulatory scheme met this standard, the Court wrote,

Regulation 268, which sets out the mechanism for the calculation and disbursement of EDCs [Education Development Charges], is meticulous in its detail, and clearly operates so as to limit recoupment to the actual costs involved in providing educational facilities occasioned by new development [...] the fees are based on specific estimates of costs based on detailed and comprehensive calculations. The construction cost and cost of site figures used in calculating EDCs are to be approved by the Minister of Education. It is important to note that EDCs can only be directed toward education capital costs made necessary by new residential development. EDC revenue cannot be used to defray capital costs

³³⁰ *Prince Albert (City) v Atkinson*, 2003 SKQB 475, 45 MPLR (3d) 148, 2003 CarswellSask 818 at 28 [*Atkinson*] (*Atkinson* cited to WL Can).

³³¹ *Ontario Home Builders*, *supra* note 164 at para 53.

associated with existing schools; this is another indication that the scheme is properly limited to the actual costs of regulation.³³²

Another case that has tested the reasonable costing analysis of a regulatory scheme is *Greater Vancouver Sewerage & Drainage District v Ecowaste Industries Ltd*³³³ [*Greater Vancouver (SC)*], in which the costing of the regulatory scheme imposed to manage waste disposal was challenged. The British Columbia Court of Appeal upheld the trial judge's analysis at the British Columbia Supreme Court.³³⁴ The trial judge established that a loose evaluation or estimate by the municipality is required and wrote,

[S]ome evidence of actual costs and some intent to match revenues with those costs is all that is required. It is not appropriate to engage in a rigorous analysis of the municipality's records in order to challenge its accounts and accounting practices. In my view, however, this does not mean that a municipality is at liberty to book any costs it chooses, or to disregard accounting rules and procedures, in an attempt to mask a true intent to generate revenue. Some analysis is warranted.³³⁵

The most recent interpretation of *620 Connaught* and the *Westbank* criteria is in *Greater Vancouver*, which relies and upholds the trial judge's analysis. The Court of Appeal summarized,

The trial judge found, at paras. 211-215, that there was evidence the GVSDD had incurred actual costs in implementing and operating the regulatory scheme as well as evidence the GVSDD had engaged in an exercise to match estimated costs to estimated quantities of waste in order to determine the disposal fee.³³⁶

The Court in *Allard Contractors* considers an argument by the appellants that the volumetric fees have potential to raise funds substantially in excess of the cost of regulation. The Court cites the lower level judge who stated that there “is some evidence that considerably more moneys would be received from this volumetric levy than the amount actually required” and further agrees that

³³² *Ibid* at para 55 [references omitted].

³³³ 2008 BCSC 859, 22 MPLR (4th) 98, 2006 CarswellBC 1349 [*Greater Vancouver (SC)*](cited to WL Can).

³³⁴ *Greater Vancouver*, *supra* note 310 at para 80.

³³⁵ *Greater Vancouver (SC)*, *supra* note 333 at para 215.

³³⁶ *Ibid* at para 80.

despite this surplus, it is not the role of the court to “undertake a rigorous analysis of the municipality’s accounts.”³³⁷ The Court continued,

A surplus itself is not a problem so long as the municipalities made reasonable attempts to match the fee revenues with the administrative costs of the regulatory scheme, which is what occurred in this case. It is easy to imagine reasons for the existence of a so-called “surplus” at any given time. For example, changes in forecasted prices might lead to road repair being over-budgeted, or a municipality might choose not to repair a certain road in order to undertake more extensive repairs or reconstruction at a later date.³³⁸

Ultimately, in integrating the two fields, the court appears to have accepted that average cost pricing is an appropriate method to determine reasonable cost. The courts do not appear to have considered marginal cost or average incremental cost pricing in this context so it is not know how these types of costing would be treated. The requirement to demonstrate evidence, as articulated in *Greater Vancouver*, appears require that there is evidence of the actual costs and intent to match the revenues with those costs. Furthermore, a rigorous standard will not be applied when reviewing this intent and municipalities may generate a surplus. The threshold question in this section is if the courts will recognize alternative cost pricing as an appropriate method to determine reasonable cost. This thesis argues that it is likely the court will accept alternative cost pricing if it is presented in a manner in which the merits and estimations are clearly communicated.

It is likely that the courts will recognize alternative cost pricing because of two reasons. First, it is not the role of the court to legislate or to set policy. These governance tasks are the responsibility of the legislature, while the courts have responsibility to ensure that the laws enacted by the legislature are applied correctly. This is reflected in the deference afforded to

³³⁷ *Allard Contractors*, *supra* note 222 at para 83.

³³⁸ *Ibid* at para 83.

municipalities that was affirmed by the SCC in *Catalyst*. Second, given the evidentiary requirement elucidated, it appears that there is not a significant burden on municipalities to demonstrate that the costing of a user fee or regulatory charge has been considered. If a municipality were to integrate the economic principles that were considered in their costing, especially if the recommended average cost pricing was described to the court, it is likely that it would be upheld as fulfilling the reasonable connection. The main question the court seems to consider is whether the municipality is generating a significant surplus through the user fee. If it can be demonstrated that the user fee is not generating sufficient revenue to fund the cost of the service, this is also likely to persuade the court that the fee is reasonable. The counterargument to this point is that the court may have difficulty understanding the economic approach to developing a user fee and perceive that the “economic costs” of the user fee were in fact generating a surplus, as the court’s understanding of the costing seems to be limited to what economists would call “financial costs”.

With respect to the argument that regulatory charges are not limited when they are intended to modify behaviour, the most obvious feature is perhaps that the SCC appears to be indicating that regulatory schemes may take the form of granting certain government rights or privileges or setting up a scheme to regulate the behaviour of individuals. When a scheme is developed with respect to modifying individuals’ behaviour, it appears that it is not necessary that the regulatory charge is reasonably connected to the *cost* of the regulation, though it is still likely that there would have to be a *nexus* between the regulatory charge and the regulation. The Court writes, “the fee may be set at a level designed to proscribe, prohibit or lend preference to a

behaviour.”³³⁹ The Court is also willing to find a relationship between the fee and the regulatory scheme when “the charges themselves have a regulatory purpose, such as the regulation of certain behaviour.”³⁴⁰ It is difficult to evaluate the evidence that would be required to demonstrate that the fee is set at an appropriate level as this is a recent decision and this element of the decision does not appear to have been tested in court. It may be anticipated that economic and public administration analysis would factor more heavily into the evidence required for this regulatory charge, as the court would need to be satisfied that public administrators sufficiently considered what behaviour was to be modified and the amount it would cost to change a consumer’s behaviour to the desired level.

5.4 *Economic Design Principles Unlikely to be considered by the Courts*

The interaction between the court and the government is important to understand in the policy design process. There are certain relevant aspects that the court will not consider or review in relation to the policy, because it is not the role of the court to undertake policy analysis. However, in shaping the policy design it is very important to understand the tests that will be applied to the user fee. This section provides a summary of the aspects of the user fee policy design that the court is highly unlikely to consider and an explanation for this rationale.

The court will not consider the rationale for user fees in the same manner as economists. It is possible the court will consider the background to the policy problem in order to establish the pith and substance of the design. For example, in *Allard Contractors* the Court was informed through the evidence that the change from the flat fee rate to the volumetric charge was because of increased road use in the suburbs and the municipality had decided that a new road devoted to

³³⁹ 620 *Connaught*, *supra* note 286 at para 20.

³⁴⁰ *Ibid* at para 27 citing *Westbank*, *supra* note 281 at para 44.

the hauling of gravel was necessary. However, factors such as the efficient allocation of goods, visibility, and accountability of a user fee are unlikely to be considered. The one economic rationale that the court may consider, but not in a policy analysis manner, only with respect to establishing the costs of a user fee, is the administrative and compliance cost of the user fee.

The court's review of the services to which user fees are applied is highly likely to be limited to the parameters of jurisdictional authority. If the authority is provided in the governing legislation to implement a user fee on the government service, the court is highly unlikely to consider the economic conditions which favour the implementation of user fees. However, the public administrator must be diligent to ensure the governing legislation is applied correctly. Municipal public administrators must be aware of the legislation that governs their authority and any amendments that may change those authorities. For example, in *Maple Ridge*, the user fee was found invalid because it imposed a variable rate and the Supreme Court of Canada held that the authorizing legislation only allowed a flat rate to be charged.

The overriding reason why the courts will not undertake these reviews goes to the fundamental role of the court, which is to apply the law as it is written rather than to create new policy. The economist's role may be perceived to be informing policy design and implementation. The role of the court is to ensure that the policy is designed and implemented according to the law, but not to make strategic decisions about how the policy design is created. While these roles certainly interact with each other, as economic evidence may be heard by the court to inform its decision, there are necessarily some elements that a court is highly unlikely to consider. However, as discussed above, there is a potential opening for the courts to undertake a policy evaluation in more depth. If the indications made by the SCC in *620 Connaught* are pursued in policy, the regulatory scheme which attempts to modify behaviour may involve more

of a policy evaluation component than has been previously seen which will likely have to be explained in evidence to the court if the regulatory charge is challenged.

5.5 *Summary*

In the public policy analysis process, the policy design stage considers the policy instruments available to solve the policy problem. In a municipal context, the policy instruments concerning revenue are constitutionally limited, with the result that municipalities will likely be selecting from property tax or user fee policy instruments. This chapter considered and integrated the economic principles and legal requirements for user fees that should be considered by public administrators at the design stage of the public policy process. Recall, however, that the public policy analysis stages are likely to inform each other, and therefore some of the decisions made in the implementation stage may affect the considerations at the design stage.

One of the fundamental issues for the public administrator to understand is that economists and lawyers do not use the same definitions for taxes and user fees. Economists vary in their terminology, some describing user fees as a subset of taxes, while others distinguish between “user fees” and “user charges”.³⁴¹ The law treats taxes, user fees, and regulatory charges as separate entities, but offers confusing definitions to distinguish between user fees and regulatory charges. Ultimately, it is recommended that the public administrator must make clear what the underlying primary objective of the levy is, whether to raise revenue or to modify behaviour. This will ensure that parties are not misunderstood as to their positions for using a definition that may be different within or outside of their discipline.

This chapter then reviewed the costing element of user fees found in economics and law. The costing element is where there is significant interaction between the two disciplines. It

³⁴¹ For discussion on this point, see note 46.

argued in Section 5.2, that in the legal realm the costing elements in the user fee and regulatory charge tests were essentially identical. The purpose of that argument was to demonstrate that the evidence relied on by the court in a case considering user fees also informed the regulatory charge test. When the two disciplines were integrated in the subsequent section, the position of this thesis was that when the courts consider costing, the municipality is given deference in its policy design; so long as there is some sort of connection that can be found between the cost of the service and the user fee. If a municipality were to introduce economic evidence to the court that it had implemented an average incremental cost for a user fee and how the costs were tied to the service, provided there was not a significant surplus generated, it would likely withstand a legal challenge. Figure 5.1 provides a summary of the integrated criteria in the design stage.

| PUBLIC POLICY ANALYSIS CRITERIA | | | |
|---------------------------------|--|---|--|
| | ECONOMICS | LAW | INTEGRATED |
| DESIGN | <p>Conditions of Public Welfare <i>Allocative Efficiency:</i> Does the instrument support efficient allocation of resources? → User fees: consumers are aware of the cost per unit and can adjust consumption according to preferences. <i>Equity:</i> What is the incidence of the instrument (regressive, neutral, positive)? → User fees: Generally thought to be regressive, requires case by case analysis. <i>Administration and Compliance Costs:</i> Are the costs of the instrument overly cumbersome; will the revenue generated be in excess of costs? → User fees: Likely requires administrative and compliance structure for each fee. <i>Visibility:</i> Is the consumer aware of the amount they are paying? → User fees: Yes, highly likely. <i>Accountability:</i> Is there a close link between quantity of the good or service consumed and price per unit? → User fees: Yes, consumers can readily indicate preferences, steady feedback loop, does not rely on election cycles.</p> | <p>Legislative Authority Does the municipality have delegated authority from the province for: → The good or service it wishes to charge for; and → Implementing a user fee (or regulatory charge).</p> | <p>(1) Legislative Authority Does the municipality have delegated authority from the province for: → The good or service it wishes to charge for; and → Implementing a user fee (or regulatory charge).</p> |
| | <p>Features of the Good or Service <i>Publicness:</i> Is there a level of rivalry? <i>Excludability:</i> Can non-payers be excluded from use? <i>Economies of Scale:</i> Costs of production decreases, making the case for government intervention. <i>Sunk Costs:</i> How long of term is required to pay the costs? <i>Externalities:</i> Do the overall benefits to society outweigh the imposition of a user fee? <i>Social and Political Objectives:</i> Is the good or service intended for redistributive purposes? Should equity concerns be incorporated into the cost?</p> | <p>User Fee Test <i>Is the Levy a Tax?</i> (if so, it cannot be a user fee): (1) Enforceable by law (2) Imposed under the authority of the legislature (3) Imposed by a public body → Elements are likely to be met if legislative authority is properly considered</p> | <p>(2) Conditions of Public Welfare <i>Allocative Efficiency:</i> Does the instrument support efficient allocation of resources? → User fees: consumers are aware of the cost per unit and can adjust consumption according to preferences. <i>Equity:</i> What is the incidence of the instrument (regressive, neutral, positive)? → User fees: Generally thought to be regressive, requires case by case analysis. <i>Administration and Compliance Costs:</i> Are the costs of the instrument overly cumbersome; will the revenue generated be in excess of costs? → User fees: Likely requires administrative and compliance structure for each fee. <i>Visibility:</i> Is the consumer aware of the amount they are paying? → User fees: Yes, highly likely. <i>Accountability:</i> Is there a close link between quantity of the good or service consumed and price per unit? → User fees: Yes, consumers can readily indicate preferences, steady feedback loop, does not rely on election cycles.</p> |
| | <p>Calculating the Cost of a User Fee <i>Marginal Cost Pricing:</i> Incorporates economic and financial costs, exceedingly difficult to calculate. <i>Average Cost Pricing:</i> Strictly financial costs, inaccurate and does not promote allocative efficiency. <i>Average Incremental Cost Pricing:</i> Incorporates marginal cost concerns as best as possible. Closest realistic method of calculating marginal cost pricing. Advocated by literature.</p> | <p>User Fee Test <i>Is the Levy a Tax?</i> (if so, it cannot be a user fee): If not a tax, then is the levy a user fee? (2) Reasonable cost of user fee. → Does not generate surplus (not rigorous analysis)</p> | <p>(3) Features of the Good or Service <i>Publicness:</i> Is there a level of rivalry? <i>Excludability:</i> Can non-payers be excluded from use? <i>Economies of Scale:</i> Costs of production decreases, making the case for government intervention. <i>Sunk Costs:</i> How long of term is required to pay the costs? <i>Externalities:</i> Do the overall benefits to society outweigh the imposition of a user fee? <i>Social and Political Objectives:</i> Is the good or service intended for redistributive purposes? Should equity concerns be incorporated into the cost?</p> |
| | | | <p>(4) Calculating the Cost of a User Fee <i>Average Incremental Cost Pricing:</i> Incorporates marginal cost concerns as best as possible. Closest realistic method of calculating marginal cost pricing. Advocated by literature. <i>Meets Reasonable Costs Test:</i> Does not generate surplus (not a rigorous analysis)</p> |

Figure 5.1: Integrated Design Stage Criteria

6.0 Discussion: Implementation Stage Criteria

In the stages framework of public policy analysis, the implementation stage generally follows the design stage. At this point, the problem has been defined, the design stage considered the policy instruments available as alternatives for the solution and evaluated them, and the policy solution has been identified. Pal wrote, “[a] well-designed policy with good implementation is almost a definition of success: a good idea well executed.”³⁴² Thus, the implementation stage considers the execution of the policy. In the municipal user fee context, the implementation stage considers the structure of fees in terms of the pricing that will be applied, how the revenue generated from the user fee will be accounted for, and some of the legal requirements that public administrators will consider to protect the user fee against legal challenges. The first two sections were identified as having economic and legal components to reconcile based on the economic literature review and the jurisprudence. The third section was identified over the course of reviewing the case law and considering the evidence cited by courts in deciding cases. As previously noted, the implementation stage can inform and overlap with the design stage of the public policy analysis, which is likely to be especially true in the first section of this chapter, considering the structure of fees.

6.1 *The Structure of User Fees*

The previous chapter, Chapter 5.0, considered the costing of a user fee, and in particular how the cost would be determined. From both the economic and legal perspectives, this means evaluating what costs are going to be included in the overall price of the service. The amount that is paid by the user is considered as a separate issue by economists. The law appears to distinguish between the cost of the service and the user fee, establishing the test as there being a

³⁴² Pal, *supra* note 26 at 206.

“reasonable connection” between the two; however, when considering the evidence of the “reasonable connection”, the court appears to focus on the cost of the service and not the amount users are being charged. Similar to the conclusion of Section 5.3, this thesis argues that a court will defer to the municipality’s decision given the evidentiary threshold is met.

As discussed in Section 3.6, there are a number of economic structures which may be implemented to set the amount of the user fee. Flat rate charges are based on a rate that is unrelated to consumption but may still vary based on the type of consumer, for example residential and industrial consumer flat rates. Volumetric rates are based on the amount of the good or service that is consumed and may be adjusted so that the fee increases or decreases for different blocks of consumption, at different times of day, or seasonally.

In the case law on user fees and revenue raising regulatory charges, very little attention has been paid as to how much the consumer is being charged. Generally, the rates are only considered when a policy change has been made and the rate has significantly increased the cost to the consumer. For example, in *LaFarge Concrete*, the Court wrote that the permit fee was being changed from a flat annual rate of \$50 to a rate of \$0.15 per cubic yard of soil.³⁴³ In *620 Connaught*, the Court wrote only that the total forecasted cost of Jasper National Park was \$20.4 million and that the regulatory charges collected would account for \$87,625; the amount of regulatory charge was not even mentioned by the Court.³⁴⁴ Both legal tests for user fees and revenue raising regulatory charges require that there is a “reasonable connection” between the cost of the service and the fee or charge. The reasonable connection appears to rely much more significantly on the overall amount that is being raised and whether that will be in deficit or

³⁴³ *LaFarge Concrete*, *supra* note 248 at para 4.

³⁴⁴ *620 Connaught*, *supra* note 286 at para 8.

surplus to the cost of the service, rather than the amount of fee that is being imposed on individual consumers. In the behaviour modification regulatory charge, this may not necessarily hold, as the price levied on the individual consumer will be intended to change behaviour and it may have to be demonstrated to the court that the amount of the fee is reasonably connected to the objective of the regulatory scheme.

However, this conclusion is difficult to draw with any certainty because where courts have considered user fees with volumetric rates, the rates have been questioned. In *Eurig*, one of the factors weighing in the SCC's decision that the levy was a tax was because there levy on providing a probate letter varied depending on the value of the estate, but the cost of issuing the probate letter did not increase or decrease depending on the value of the estate. Therefore, the SCC found there was no "nexus" between the cost of the service and the levy charged. The result in *Eurig* would indicate that for user fees, a volumetric fee must correlate to an increase or decrease in the cost of providing the service. However, a contrary result was found in *Urban Outdoor*, where the permits issued for ground mounted signs were \$100 per face, and \$200 per face for roof mounted signs. The Ontario Court of Appeal in *Urban Outdoor* wrote, in comparison to *Eurig*, that "[t]he fees imposed by the by-law in this case are entirely different [from *Eurig*] and do not vary depending on the value of the particular sign location."³⁴⁵ The case does not make clear what allowed the distinction between the ground mounted and roof mounted signs. The recommendation that may be drawn is that where the decision is made to impose a volumetric fee by a municipal public administrator, in order to satisfy the "nexus" requirement that the user fee is tied to the cost of the service, there must be a rationale for an increase in pricing for certain classes of consumers. Perhaps a better way to conceive of this is a "specific

³⁴⁵ *Urban Outdoor*, *supra* note 210 at para 35.

nexus requirement” in that for a greater sum to be charged there has to be a nexus between the increase in the user fee and the increase in the cost of provision of the service. It is difficult to reconcile this outcome with the case law on regulatory charges to draw a clear conclusion for public administrators.

One of the main economic objections to the user fee is the potential for a regressive incidence, that is, the fee is more burdensome on lower income users. There are two potential issues that translate to implementation from this concern: first, is it possible for a municipality to create different classes of users, potentially to charge less to lower income users and therefore alleviate equity concerns. The Supreme Court of Canada has held that municipalities cannot discriminate between classes of users unless the municipality is granted authority to do so in the enabling provincial legislation,

The rule that the power to make by-laws does not include that of enacting discriminatory provisions unless the enabling legislation provides the contrary has been observed from time immemorial in British and Canadian public law. It has been and still is applied in municipal law.³⁴⁶

The second issue is whether, without the consideration of classes, the court will evaluate the regressive incidence of a fee. One example of a case where this issue was before the court is *Surrey Citizens Rights Assn v Surrey (City)*³⁴⁷ [*Surrey Citizens Rights*]. In this case, the City of Surrey adjusted the method of charging a flat rate for the provision of water, in response to a policy issue where higher individual rates were being charged because unlicensed or illegal secondary suites had not been included in the overall estimation of the number of users which was established by the number of households.³⁴⁸ The adjusted method was to charge based on the

³⁴⁶ *Fountainhead Fun Centres Ltd c Montréal (Ville)*, [1985] SCR 368, 18 DLR (4th) 161, 1985 CarswellQue 54 at para 99 [*Fountainhead*] (*Fountainhead* cited to WLeC).

³⁴⁷ 1 MPLR (3d) 207, 1999 CarswellBC 487 (SC) [*Surrey Citizens Rights*] (*Surrey Citizens Rights* cited to WLeC).

³⁴⁸ *Ibid* at para 5.

number of dwelling units, defined by having cooking equipment and a bathroom, which added 10,000 units to the base calculation of users.³⁴⁹ One of the arguments advanced by Surrey Citizens Rights Association was that the scheme did not take into account multi-generational family occupancy without two separate family units (such as an elderly mother) or suites that are unoccupied.³⁵⁰ The trial judge was sympathetic to these arguments noting “[concern] about the possibility of individual cases of unreasonable hardship or apparent unfairness—perhaps such as multi-generational families or suits in name which are in fact unoccupied.”³⁵¹ However, the trial judge found that the City of Surrey had the ability to classify users under its enabling legislation and that the bylaw was valid.³⁵² This case demonstrates that arguments about a regressive impact may be heard and be persuasive to a court, but the issue of authority to charge different class rates is likely to be the overriding issue.

The general guidance that may be provided when considering both the economic principles and legal requirements for setting the price of the user fee, that the municipality may implement a fee pricing structure that meets its policy objectives, as long as, under the reasonable connection test, it does not significantly surpass the cost of the service. As discussed in Chapter 5.0, the reasonable connection test is a loose test and the threshold to meet this element is generally to demonstrate that the municipality considered the cost of the service and the fee that would be imposed. Where a municipality is considering a volumetric user fee, it should consider if the cost of the provision of the service varies, in accordance with *Eurig*. Furthermore, where a fee is implemented on different classes of users, the municipality must ensure there is specific authority to designate classes of users in the authorizing legislation.

³⁴⁹ *Ibid* at paras 7-9.

³⁵⁰ *Ibid* at para 10.

³⁵¹ *Ibid* at para 23.

³⁵² *Ibid* at para 20.

6.2 Earmarks

One of the main implementation stage concerns is what happens to the revenue generated by the user fee. This factor is treated with significant importance by the courts and can be determinative in establishing whether a levy is a tax or a user fee. The practice of “earmarking” user fees is discussed in the economic literature in terms of advantages and disadvantages. In law, earmarking is a fundamental implementation feature that must be carefully executed so as to ensure the appropriate indication is made to the court as to the nature of the good or service. The basis of the discussion is in alignment with the legal analysis, however difficulties may arise in the complexities of the analysis.

Economists are agreed that user fees must be applied to the funding of the publicly provided good or service and consider a range of earmarks in relation to the strength of the revenue. Earmarks refer to the designation of the revenue to specific accounts and how the accounts are managed in relation to general revenue. If the revenue is a strong earmark, it will be the only revenue that is used to fund the good or service. If there is a weak earmark, additional funds may be added from general revenue to top up the funding to an appropriate level to provide the good or service.

The legal analysis with respect to user fees requires that funds be directed to specific revenue. As discussed and argued in the jurisprudence chapter, this is the strongest indicator of a user fee in the *Lawson* taxation analysis. A user fee that goes to a specific account will not be considered to be for a public purpose. The court indicates that the specific account must be used to fund the good or service but it appears that should the revenues from the user fee be insufficient, supplementary funds from general revenues may be used without jeopardizing the characterization of “specific purpose”. *Greater Vancouver* is an example of a case that

demonstrates that the pricing and revenues have not met the amount of funding required. In *Greater Vancouver*, the Court of Appeal writes, citing the trial judge,

He began by stating his conclusion [...], “that not only did the GVSDD [Greater Vancouver Sewerage and Drainage District] attempt to match estimated costs with revenues, but it appears to have been operating at a deficit, which defeats [the plaintiff’s] assertion that the disposal fee actually resulted in a surplus.” He then supported his conclusion by reference to two staff reports used by the GVSDD to estimate the costs and the revenues in order to arrive at a disposal fee and by reference to the cross-examination of the author of one of the reports.³⁵³

The finding that the GVSDD was running a deficit may allow the implication to be drawn that additional funds had to be derived from general revenues in order to sustain the provision of the good or service. This finding however was not expressly acknowledged in the case. Another case example where a deficit was found to be supplemented by general revenues is in *Urban Outdoor*. In this case the funds generated from the fees charged with sign permits were insufficient to cover the cost of the branch that issued the permits. The Ontario Court of Appeal wrote, “The [branch] has always operated at a deficit and thus most of the costs of its operation were paid from general revenues.”³⁵⁴ However, besides the “most” condition indicated above, there is no threshold indication in the case law as to how much general revenue would be allowable to supplement the specific revenue in the user fee fund.

With respect to the integration of the economic principles and legal components, it is important for the public administrator to remember that while the economic principles accept that the revenue from a user fee may be allocated to specific revenues, it is likely mandatory by the legal requirements of the user fee test. The interpretation of the “public purpose” element of the *Lawson* test has varied, so this element may be subject to a court’s interpretation, but a user

³⁵³ *Greater Vancouver*, *supra* note 310 at para 81.

³⁵⁴ *Urban Outdoor*, *supra* note 210 at para 10.

fee will most likely be held to be a user fee if the revenues generated are set aside in a specific fund. The courts do not appear to consider the types of services the fund may cover (in the narrow or wide context). It may be anticipated, again with respect to the role of the court, that if the municipality can demonstrate that the policy is well-considered and the services are integrated with the objective (for example increased transit services funded by a congestion charge fee) it will be held to be valid.

6.3 Additional Legal Implementation Criteria

Perhaps the most prevalent concern in the jurisprudence is the confusion about the terminology and tests of user fees and regulatory charges. When considering implementing a user fee or a regulatory charge, one of the issues the public administrator will be challenged with is ensuring the user fee or regulatory charge meets the legal requirements. However, given the similarities between the tests and lack of certainty in knowing which test will be applied if a user fee or regulatory charge is challenged, public administrators can take note of indicators the courts have discussed in the jurisprudence. Section 6.3.1 considers the purpose statement indicator, which has been heavily relied on by the courts to interpret what type of levy is being challenged and what test should be applied. Section 6.3.2 provides advice, based on the jurisprudence, as to the type of evidence the court is likely to consider when applying the tests. With this information, public administrators can be mindful of record-keeping and the individuals that may be called to give testimony.

6.3.1 Drafting the Purpose Statement

A purpose statement is often referred to and relied upon by courts as a rationale for the regulatory scheme. It is generally a section within the by-law or governing legislation. Municipal administrators would be well-advised to instruct drafters to include a purpose statement when

enacting a new policy. However, caution must also be demonstrated to ensure the accuracy of the purpose statement. Courts may undertake a ‘colourability analysis’ to determine the true meaning of the statement. In the jurisprudence, this has been found most frequently in relation to indirect taxation schemes and whether or not there is an ancillary regulatory scheme to uphold the by-law under review. This section will begin with some of the general court commentary on purpose statements, followed by examples where purpose statements are used in support of a policy.

In *Allard Contractors*, the Supreme Court provides helpful commentary directed toward municipal administrators,

I do not wish to be taken to suggest that the position of the municipalities would not improve if the by-laws contained an express reference as to the purpose of the fees. [...] Properly framed, a purpose statement could provide valuable assistance to a court charged with determining whether an otherwise indirect tax could be considered ancillary to a regulatory scheme. On the other hand, this should not be taken as an invitation to insert self-serving statements in by-laws which do *not* contain such regulatory schemes, because it is always possible to look behind such statements as part of a colourability analysis.³⁵⁵

Though the facts in *Allard Contractors* revolve around the determination of the validity of an indirect tax and this statement is tailored to that context, it is possible to see the use and application of a purpose statement in user fee by-law design.

The purpose statement was cited in *Antigonish*, where it read, “[t]his charge is imposed for the purpose of enabling a more equitable distribution of the costs incurred by the Town for making use of the landfill site(s) or other solid waste processing facilities.”³⁵⁶ The purpose statement is later cited in the decision in support of the *Lawson* criteria that the levy is for a

³⁵⁵ *Allard Contractors*, *supra* note 222 at para 82 [emphasis in original].

³⁵⁶ *Antigonish (Town)*, *supra* note 191 at para 3.

public purpose,³⁵⁷ though additional clauses are relied upon for the determination of the revenue allocation. In this case, it appears the judge was acting prudently to include both potential interpretations of the term “public purpose”.

6.3.2 *Preparing for Legal Challenges*

The previous section discussed indicators with respect to guiding the court as to the type of levy that was intended by the municipality, that is, telling the court through a purpose statement what the municipality intended to do. This section considers what type of evidence may be relevant when the court is applying a user fee or regulatory charge test.

Though the decision is outdated relative to the current discussion, the evidence presented in the 1982 case of *Cariboo College* was heavily relied upon by the Court in rendering a decision. The Court concluded that the development cost charges were imposed to offset the cost of services provided by the city to the development covered by the permit. In making that determination, the Court relied upon the following evidence,

An affidavit of the Director of Finance of the city establishes that the city provides water, sewage and drainage, and waste disposal facilities, throughout the city, that the costs of establishing, maintaining and operating the water and sewage facilities are not paid out of general revenue but are borne by the users of these facilities.

The city has established a schedule of charges for all commercial and industrial users of the waste disposal facilities and the users of these facilities are billed for these services on a quarterly basis.³⁵⁸

As *Eurig* had not yet been decided, the cost nexus was not specifically examined in this case. However, *Cariboo College* does demonstrate the use of an affidavit from an authoritative city official to be persuasive when it describes the accounting measures in place and where revenues are directed. This evidence was also supported by the by-law, which required and set out that

³⁵⁷ *Ibid* at para 24.

³⁵⁸ *Cariboo College*, *supra* note 186 at paras 20-21.

revenues were to be deposited into a designated fund.³⁵⁹ The guidance that may be derived is to ensure that all decision-making is recorded clearly and retained so as to provide accurate evidence to the court if necessary.

6.4 *Summary*

The implementation stage in the public policy analysis process is concerned with the execution of the policy design and how the policy gets put into place. The implementation principles considered in this chapter reflect an integration of the economic principles and legal requirements for municipal user fees. With respect to the pricing of a user fee, municipalities are likely to have the ability to set the price of the fee so long as there is a “reasonable connection” to the cost of the service, meaning essentially that the revenues do not generate a surplus. Public administrators should ensure that the revenues generated by a user fee are earmarked and accounted for in a specific revenue account, so as to meet the legal test for user fees. In writing the by-law, public administrators should ensure that a clear purpose statement sets out the objectives of the user fee and describes the levy as a user fee. Figure 6.1 summarizes the implementation stage criteria set forth in this chapter.

³⁵⁹ *Ibid* at paras 11-15.

| PUBLIC POLICY ANALYSIS CRITERIA | | | |
|---------------------------------|---|--|--|
| | ECONOMICS | LAW | INTEGRATED |
| IMPLEMENTATION | <p>Deciding on the Type of User Fee <i>Flat Rate Charges:</i> Easy to administer, based on assumptions about type of user rather than actual use. <i>Volumetric:</i> Constant unit prices, declining block rates, increasing block rates, humpback blow rates, seasonal rates, excess use rates <i>Surcharges:</i> For excess use, to discriminate on classes of users.</p> | <p>User Fee Test <i>Is the Levy a Tax?</i> (if so, it cannot be a user fee): <i>If not a tax, then is the levy a user fee?</i> (2) Reasonable cost of user fee. → Does not generate surplus (not rigorous analysis)</p> | <p>Deciding on the Type of User Fee and Reasonable Cost of the User Fee Flexibility to implement structure to meet policy objectives, revenue does not significantly surpass costs</p> |
| | <p>Managing Revenue <i>Earmarking:</i> Should an earmark be applied? How strong or weak? Wide or narrow?</p> | <p>User Fee Test <i>Is the Levy a Tax?</i> (if so, it cannot be a user fee): (4) For a public purpose → Does the revenue go to general revenue or specific revenue? If general revenue then tax.</p> <p><i>If not a tax, then is the levy a user fee?</i> (1) Nexus between cost of service and user fee. → Does the revenue go to general revenue or specific revenue? If specific revenue then user fee.</p> | <p>Managing Revenue and Specific and General Purposes Revenue must be allocated to specific revenue account and funding may be topped up from general revenues</p> <p>Drafting the by-law Objective of bylaw is included in drafting purpose statement</p> <p>Evidentiary Record Records are kept with respect to decision-making to support defence in court challenges</p> |

Figure 6.1: Integration Stage Criteria Summary

7.0 Conclusion

Municipalities are being confronted with complex policy challenges that place a strain on the fiscal resources of a municipality, including deteriorating infrastructure and devolution of responsibilities from other levels of government. While property taxes and user fees are common sources of revenue, property taxes are highly visible and politically unpalatable to raise. User fees may assist municipalities in generating additional revenue to assist with these complex policy challenges, either by raising additional revenue, shifting the funding of a good or service from property taxes to user fees in order to reallocate those funds, or supporting municipalities to ensure the best use of municipal resources.

When a municipality is deciding to implement a user fee, the policy decision-making process is likely to fall to a municipal public administrator. Public administrators are required to integrate relevant criteria into a decision-making process. This thesis was based on the framework of public policy analysis described by Pal in *Beyond Policy Analysis*. Pal's describes a rational comprehensive framework based on stages, which assist the municipal public administrator in ordering and organizing relevant information. The stages in Pal's framework include the problem definition, policy design, policy implementation, and evaluation.

The issue that formed the basis of this thesis is that public administrators could be required to conduct this process of implementing user fees which will always integrate information from economics and law. The economic and legal literature do not consider how the standards and requirements set by economists and courts apply to the public policy analysis process. Moreover, the economic and law literature does not consider how the disciplines are affected by each other. This makes the process of policy analysis even more difficult for the public administrator, as the disciplines appear to operate in isolation of each other.

This thesis set out three objectives to demonstrate that legal and economic user fee information can be clarified in their respective disciplines and that information can be integrated into a public administration framework to provide guidance for future municipal user fee implementation in Canada. The objectives of this thesis were to:

- (i) propose a public administration policy framework within which literature on user fees can be integrated;
- (ii) conduct a review of the existing economic and legal literature on user fees within this framework; and
- (iii) conclude by developing a set of implementation criteria for user fees, informed by economic and legal literature and the public administration policy framework, to guide the practical implementation of municipal user fees.

The first objective was achieved by identifying and describing Pal's public policy framework as the basis to convey the research generated in this thesis. The second objective was achieved in Chapters 3.0 and 4.0 in generating user fee design and implementation stage criteria that are informed by the existing economic and legal literature. Integration of these criteria, in Chapter 5.0 which examines the design stage and Chapter 6.0, which examines the implementation stage, achieved the third objective.

The economic principles discussed in Chapter 3.0 are more pertinent to the policy design considerations. User fees are advocated by economists because they allow for a more efficient allocation of resources as consumers can better indicate their preferences for goods or services. User fees also promoted the economic conditions of accountability and visibility, in that consumers could be more aware of the costs of a particular service, especially in comparison to an instance where the cost of that service is bundled in a property tax, and communicate

consumer preferences to government based on the use of a particular good or service. One of the main detractors in the economic criteria is that user fees can be implemented inequitably, resulting in a greater burden being placed on lower income consumers. Additionally, implementing multiple user fees is likely to have greater administrative and compliance costs than a property tax.

Certain conditions of a good or service made it more favourable for a user fee to be imposed. The less public a good or service, the more appropriate it is for a user fee to be imposed because individuals who choose not to consume the good or service can more easily be excluded. Where economies of scale may be found, it is also favourable to implement a user fee. One feature of a good or service that makes it generally inappropriate for a user fee is if the objective of the policy is to redistribute income.

One of the key design features of the user fee is the costing of the good or service because it relates to generating sufficient revenue to fund the good or service. Economists prefer marginal cost pricing as the ideal pricing strategy because it includes financial and economic costs. In reality, average cost pricing is often used which is unfavoured by economists as it has the potential to endanger the revenues required to maintain the good or service by only accounting for the financial costs. However, because marginal cost pricing is so difficult to accurately determine, economists favour alternative cost pricing, which essentially accounts for as much as possible of the economic costs.

The economic implementation stage considered the payment structures which may be used for the user fee. Flat rate charges and volumetric charges are the two main categories of payment structures. The payment structure can also affect the policy design, especially if it relates to behaviour modification, which public administrators should consider. Finally, the last

implementation consideration is the allocation of revenue and the strength of earmarking that will be imposed.

Chapter 4.0: *Jurisprudence* considered the legal requirements for user fees by discussing the tests that would be applied by the court to determine if a user fee was valid. Challenges to user fees may be based on both the authority of the municipality to implement a user fee and if the user fee is implemented correctly with respect to revenue. A municipality, provided the appropriate authority is delegated by the province, may charge direct taxes and user fees. A municipal levy that is found to be an indirect tax will be invalid. The tests for a user fee are found in *Lawson* and *Eurig* and upheld in *620 Connaught*. *Lawson* establishes the test to determine if a levy is a tax and *Eurig* adds additional elements which are the key tests for a user fee: that there is a nexus between the costs of the user fee and the revenue and if the cost of the provision of the service and the fee are reasonably connected.

A municipal levy may be saved if it is an indirect tax that that is ancillary or adhesive to a regulatory scheme, because it is a licence fee or a regulatory charge. Again, the municipality must have the appropriate delegated authority by the province for this to be the case. The first step of the regulatory scheme test is to determine if there is a regulatory scheme and the second step is to establish if the costs of the fee revenue is tied to the costs of the regulatory scheme.

This thesis culminates in an integration of economic principles and legal requirements in two discussion chapters. Chapter 5.0: *Discussion: Design Principles* considers two issues in the public policy analysis design stage when considering the user fee as a policy instrument. First, that economists and lawyers do not use the same definitions for taxes and user fees so the public administrators must make the underlying primary objective of the levy clear to ensure that parties do not misunderstand the objective. The second issue is the integration of costing principles and

requirements. Based on the argument that a court considers costing to meet the requirement of a “reasonable connection” between the cost of the service and the user fee, the municipality is given deference in their policy design; so long as there is some sort of demonstrable effort by the municipality to match the cost of the service and the user fee.

The discussion on implementation criteria for municipal user fees in Chapter 6.0 considered three issues. First, the pricing of a user fee, for which the analysis is similar to the costing, in that so long as a “reasonable connection” can be demonstrated by an effort from municipalities, the pricing is not likely to be a significant issue for a court. The second implementation issue is fundamental to the success of a user fee in a court challenge as revenues generated by a user fee should be earmarked and accounted for in a specific revenue account. Third, the court has provided some guidance for implementation considerations and suggests that a clear purpose statement will assist the court in interpreting the intentions of the municipality. This thesis has not addressed other political dimensions to the public policy and administration considerations of designing and implementing successful user fee regimes. On the basis of the fruitful integration of economic and legal information covered in this thesis, it is suggested other additional dimension such as political issues be considered in future research regarding user fees.

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