

2018

Green Fees: The Challenge of Pricing Externalities under State Law

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Recommended Citation

Erin Adele Scharff, *Green Fees: The Challenge of Pricing Externalities under State Law*, 97 Neb. L. Rev. 168 (2018)

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Erin Adele Scharff*

Green Fees: The Challenge of Pricing Externalities Under State Law

ABSTRACT

Policymakers at the state and local level are increasingly interested in using market-based pricing mechanisms as regulatory tools. For example, at the state level, several states have recently considered state-level carbon pricing, while at the local level, municipal governments are increasingly turning to stormwater remediation fees to pay for the treatment of municipal runoff required by the Clean Water Act.

These regulatory programs are inspired by the insight of English economist Arthur Pigou, who suggested governments could price social costs into market transactions by imposing a tax. Such policies, however, are frequently subject to state court litigation challenging them as unlawful taxes. State law restricts both state and local governments' ability to enact taxes, but similar restrictions are often not in place to limit the enactment of regulatory actions or user fees. Unfortunately, state courts have struggled to appropriately classify these fees under existing state law doctrines.

Such legal instability makes state and local governments less likely to adopt such policies, even when there are strong arguments for doing so. This Article takes a critical look at current state law governing the distinction between user fees and taxes. This Article then argues that Pigovian levies do not fit neatly into either legal category under the definitions in place in most states. As a result, this Article proposes reforms to state user fee definitions that would bring needed clarity to user fee doctrine. Specifically, this Article suggests state courts recognize separate categories of user fees. One such category, price-based regulatory tools, would allow governments to impose Pigovian charges as user

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* Associate Professor, Sandra Day O'Connor College of Law, Arizona State University. Many thanks to Joe Bankman, Adam Chodorow, Heather Field, Dan Hemel, Kathleen Delaney Thomas, Tessa Davis, Cliff Flemming, David Kamin, Sanne Knudsen, Ormi Marion, Goldburn Maynard, Shannon Weeks McCormack, Elizabeth Porter, Katie Pratt, Troy Rule, Ted Seto, Gladriel Shobe, Kirk Star and [people from UW], as well as participants in the Junior Tax Scholars Workshop, the Northern California Tax Roundtable, the Sustainability Conference of American Legal Educators, the Global Conference on Environmental Taxation, the Loyola, BYU and Irvine Tax Policy Colloquia, and the University of Washington Faculty Colloquium. Special thanks to Henry Ordower, Darrien Shanske, and Hugh Spitzer for being especially generous with their time. I am also grateful for the research assistance of Lane Conrad, Hayden Hilliard, and Dan Peabody, as well as the able library assistance of Tara Mohr. All errors are, of course, my own.

fees so long as the charge was roughly commensurate with the externality costs or with the governments' expenses in abating the externality.

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I. INTRODUCTION

State and local lawmakers are increasingly experimenting with regulations that seek to change behavior through market mecha-

nisms.¹ In other words, governments are attempting to increase the price for engaging in behaviors that they want to discourage and charge people for the ways their behavior contributes to shared problems. At the same time, governments are also increasingly looking for non-tax revenue.²

As such policies become more commonplace, state courts increasingly struggle to characterize these policies under existing state law. Stormwater remediation fees, put in place to allow municipal sewage systems to meet Clean Water Act standards, have been repeatedly challenged as illegal taxes.³ In Missouri and Michigan, state courts have struck down such fees, leaving local governments with significant infrastructure costs and limited financing options.⁴ Ongoing litigation challenges California's carbon auction as an illegal tax under California law.⁵ Philadelphia's soda tax recently survived a challenge claiming that it conflicted with Pennsylvania's sales tax.⁶ This legal instability makes state and local governments less likely to adopt such policies, even when there are strong arguments for doing so.

Whether such charges are treated as taxes or user fees depends on state law tests constructed to deal with more traditional types of fees and taxes.⁷ I will provide more detail on how states define the difference between taxes and user fees later in this Article, but for now, some simple examples will help illustrate these two categories. Property taxes, like income taxes and sales taxes, are treated—unsurprisingly—as taxes. Business or occupation licensing charges measured by gross receipts are also treated like taxes. However, flat business or

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1. See Jonathan S. Masur & Eric A. Posner, *Toward a Pigovian State*, 164 U. PA. L. REV. 93, 93–98 (2015); Victor Fleischer, *Curb Your Enthusiasm for Pigovian Taxes*, 68 VAND. L. REV. 1673, 1676 (2015).
 2. Economists often call such policies “Pigovian taxes,” inspired by the insights of British economist Arthur Pigou. A century ago, Pigou commented on the potential efficiency gains of taxing “externalities”—the costs that a market transaction imposes on third parties. N. GREGORY MANKIW, *ESSENTIALS OF ECONOMICS* 203 (Jack W. Calhoun et al. eds., 6th ed. 2012). The classic example of a Pigovian tax is an emissions tax, which charges polluters for the costs their emissions impose on society as a whole. However, a range of other state and local policies, ranging from soda taxes to fees imposed to pay for municipal Clean Water Act compliance, have Pigovian elements.
 3. See *infra* section III.B.
 4. See *Bolt v. City of Lansing*, 587 N.W.2d 264, 266 (Mich. 1998) (finding stormwater user charge was a tax and not a fee); *Zweig v. Metro. St. Louis Sewer Dist.*, 412 S.W.3d 223, 248–49 (Mo. 2013) (finding stormwater user charge was a tax rather than a fee). *But see, e.g., Teter v. Clark County*, 704 P.2d 1171, 1181 (Wash. 1985) (upholding stormwater charge as a fee).
 5. *Cal. Chamber of Commerce v. State Air Res. Bd.*, 216 Cal. Rptr. 3d 694, 700 (Ct. App. 2017) (holding that the carbon auction was not a tax and thus did not violate Proposition 13's supermajority requirement).
 6. *Williams v. City of Phila.*, 164 A.3d 576, 583 (Pa. Commw. Ct. 2017) (holding that the beverage tax was not duplicative of the current sales tax).
 7. See *infra* section II.C.

licensing charges levied to recoup the cost of regulating a specific industry are treated as fees, as are charges a government collects to pay for water usage, trash collection, and other municipally-provided services. Traditionally, user fees are payments for benefits (either goods or services) provided by a government.

Many charges do not fit neatly into either category. For example, a toll is traditionally thought of as a user fee. Paying a toll confers a benefit: the right to use a particular roadway. However, technology increasingly allows for variable pricing in tolls. Variable pricing “charg[es] the customer based on how much he or she values the service, instead of the cost to provide the service.”⁸ Such a pricing model may allow governments to generate revenue for “general transportation needs and a range of other benefits,” and if the revenue serves this greater purpose, a toll can be converted to a tax.⁹

In many states, stormwater remediation fees are treated as user fees just like any other sewer-related charge; in Missouri and Michigan, such charges are taxes.¹⁰ These legal classifications matter for a number of reasons. In many states, there are procedural hurdles for imposing taxes that do not apply to user fees¹¹ and in most states, local governments have less authority to impose taxes than user fees.¹²

In many cases, courts will treat regulatory pricing as a tax, not a user fee.¹³ This is true for several reasons. First, the benefit the payor

8. URBAN LAND INST. WHEN THE ROAD PRICE IS RIGHT 5 (2013), uli.org/wp-content/uploads/2013/03/When-the-Road-Price-is-Right_web_F.pdf [<https://perma.url.edu/UZR7-H8YR>].

9. *Id.* at 6.

10. *See Vandergriff v. City of Chattanooga*, 44 F. Supp. 2d 927, 941 (E.D. Tenn. 1998) (upholding fee); *Church of Peace v. City of Rock Island*, 828 N.E.2d 1282, 1286 (Ill. App. Ct. 2005) (upholding fee); *McCleod v. Columbia County*, 599 S.E.2d 152, 156 (Ga. 2004) (upholding fee); *Bolt v. City of Lansing*, 587 N.W.2d 264, 266 (Mich. 1998) (finding stormwater user charge was a tax and not a fee); *Zweig v. Metro. St. Louis Sewer Dist.*, 412 S.W.3d 223, 248–49 (Mo. 2013) (finding stormwater user charge was a tax rather than a fee); *State v. City of Charleston*, 513 S.E.2d 97, 97 (S.C. 1999) (upholding fee); *Smith v. Spokane County*, 948 P.2d 1301, 1312 (Wash. Ct. App. 1997) (upholding fee); Substitute Brief of the Nat’l Assoc. of Clean Water Agencies, et al. as Amici Curiae in Support of Defendant-Appellant/Cross-Respondent the Metro. St. Louis Sewer Dist. at 13, *Zweig v. Metro. St. Louis Sewer Dist.*, 412 S.W.3d 223 (Mo. 2013) (No. SC92581), 2012 WL 7861293, at *12 (“However, the majority trend is for the state appellate courts to find charges like MSD’s to be a fee and not a tax.”).

11. *See infra* Part III.

12. Erin Adele Scharff, *Powerful Cities?: Limits on Municipal Taxing Authority and What to Do About Them*, 91 N.Y.U. L. REV. 292, 296 (2016).

13. For example, in most jurisdictions, plastic bag fees have been enacted under the jurisdiction’s taxing authority. *See e.g.*, Assemb. B. A08479A, 2015 Gen. Assemb., 238th Leg. Sess. (N.Y. 2015) (“An Act to amend the tax law, in relation to imposing a tax on plastic and paper shopping bags . . .”). Similarly, most carbon pricing proposals are proposed under the taxing authority. *See infra* section III.B.

receives is not a typical user fee benefit. Rather, the benefit conferred could be characterized as the ability to harm a public good. Think about garbage fees: if a garbage fee just reimburses a government for providing trash hauling and disposal, it is clearly a user fee. The government provides a waste management benefit. However, if the government seeks to recover not just the direct costs of garbage disposal but also the indirect costs of trash collection (land contamination or emissions from garbage incineration), these are costs not borne directly by the person who created the trash or the government hauling it away. Rather, society as a whole bears the costs of this kind of garbage-based pollution. If we are to say that the government is charging the user for a benefit, it is for the license to create these problems. Second, the relationship between the size of the benefit to the user and the cost of providing the benefit (or allowing the harmful behavior) is more complicated than that of a typical user fee. In the classic user fee context, the user fee charged reflects dollars that a government spends directly. In the regulatory context, however, the government may not bear the cost of the harm directly. For example, a driver who adds traffic congestion harms other drivers, but the government does not incur any direct additional costs by virtue of that congestion.¹⁴ (Of course, there may be indirect costs if congestion leads local residents to advocate additional lanes and other roadway improvements.)

This Article discusses how courts determine—and how courts should determine—whether a charge is a user fee or a tax. I argue, first, that courts should be more precise in recognizing the diversity of government charges encompassed by the user fee doctrine. Second, I argue that state courts, consistent with their interpretive authority, should include in the definition of user fees those charges that are levied to offset the costs expended by a government in combatting an externality or levied directly in proportion to the estimated costs of an externality.

This argument proceeds in the following parts. Part II explores current state law frameworks governing the distinction between taxes and user fees. Part III provides a brief primer on Pigovian taxation and considers how current frameworks treat various Pigovian policies. Part IV offers suggestions for reforming the current frameworks. Part V concludes.

14. Scharff, *supra* note 12, at 318–20.

II. USER FEES V. TAXES

The popularity of regulatory pricing at the state and local level should not be surprising.¹⁵ State and local governments rely on a more diverse set of revenue sources than the federal government, which is heavily reliant on income taxes.¹⁶ While sales and income taxes are still the primary source of revenue at the state level and property taxes are the primary type of revenue at the local level,¹⁷ reliance on user fees has increased at both levels over the past three decades.¹⁸ This trend seems likely to continue.¹⁹ Further, many special districts (the numerical majority of local governments) are funded largely or exclusively by user fees.²⁰

To some degree, this differentiation is consistent with the recommendations of economists, particularly those economists focused on the problem of tax assignment: how government at different levels should raise revenue and which level of government should tax what activities.²¹ Because opportunities for exit are greater the smaller the jurisdiction, sub-federal entities should avoid taxing more mobile items (like income).²² Thus, the tax assignment literature often recommends local governments raise revenue by taxing land, an immobile asset.

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15. In their article on Pigovian taxes, Eric Posner and Jonathan Masur note that much of the action on Pigovian taxation has happened at the state and local level. *See generally* Masur & Posner, *supra* note 1. Victor Fleischer's survey of Pigovian policies accords with this view. Fleischer, *supra* note 1. Fleischer is skeptical that Pigovian theory can justify many non-carbon pricing models because of the significant heterogeneity in externalities. As I discuss in subsection IV.C.4, measuring externalities accurately may be a difficulty with my proposal, but I am willing to entertain pricing that allows either for some targeting or some imperfections in modeling.
 16. Ellen Kant & Liz Malm, *The Sources of State and Local Tax Revenues*, TAX FOUND. (Jan. 28, 2013), <http://taxfoundation.org/article/sources-state-and-local-tax-revenues> [<https://perma.unl.edu/ZVV9-GLHC>].
 17. *Id.* Revenue here means own-source revenue, i.e. the revenue a government raises by imposing its own taxes rather than revenue received through intergovernment transfers.
 18. Kriston Capps, *Why City Fees Keep Rising Instead of Taxes*, CITYLAB (June 4, 2015), <http://www.citylab.com/work/2015/06/why-city-fees-keep-rising-instead-of-taxes/394844/> [<https://perma.unl.edu/R7ZG-FJD7>].
 19. Mike Maciag, *The Current State of State Budgets*, GOVERNING (June 16, 2014), <http://www.governing.com/topics/finance/gov-nasbo-state-budget-report.html> [<https://perma.unl.edu/PGK2-E58G>].
 20. *See infra* subsection III.A.2 (discussing revenue raised by the Bay Area Air Management Quality District).
 21. Charles E. McLure Jr., *The Tax Assignment Problem: Ruminations on How Theory and Practice Depend on History*, 54 NAT'L TAX J. 339, 339 (2001).
 22. Richard M. Bird, *Fiscal Federalism*, in THE ENCYCLOPEDIA OF TAXATION AND TAX POLICY 147, 147 (Joseph J. Cordes et al. eds., 2005) (discussing the different roles for federal government compared with state and local government in taxation).

More broadly, the tax assignment and fiscal federalism literatures are skeptical about local efforts to implement progressive revenue or spending programs, fearing the richest residents will simply leave the jurisdiction.²³ Under the classic Tiebout model—describing local government decisions to raise and spend revenue—the ease of exit allows local residents to preference-sort based on the package of taxes and local benefits they prefer.²⁴

Despite the many persuasive critiques of the model,²⁵ Tiebout's basic insights continue to inform the way scholars think about local revenue and spending decisions. As a result, even as the public and scholars generally support a federal tax burden that reflects taxpayers' ability-to-pay, there is theoretical support at the local level for a tax system that reflects the benefits theory of taxation.²⁶ Under the benefits theory, tax payments should reflect the benefits (goods or services) that a particular level of government provides. This is in contrast to the federal and state income tax systems, which focus on ability-to-pay as the criterion of tax fairness.²⁷ User fees, which are charged for benefits conferred, are obviously consistent with this benefits theory. As a result, user fees may allocate government services more efficiently than general revenue taxation. As Clayton Gillette and Thomas Hopkins have observed, "there are many situations in which a user fee can successfully ration limited supplies of currently available goods and services to more highly valued uses, signal whether particular output levels should increase or decrease, avert wasteful usage, and encourage use of more suitable substitutes."²⁸

Of course, local governments are increasing their reliance on user fees for reasons other than economic efficiency. First, numerous studies suggest that the tighter the connection between government benefits and government revenue, the easier it is for governments to raise revenue.²⁹ In this context, governments may find that user fees are

23. *Id.*

24. Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956).

25. See Gladriel Shobe, *Disaggregating the State and Local Tax Deduction*, 35 VA. TAX REV. 327, 361–62 (2016) (summarizing some of the "extreme" assumptions of the Tiebout model).

26. Darien Shanske, *Interpreting State Fiscal Constitutions: A Modest Proposal*, 69 RUTGERS U. L. REV. 1331 (2018). Shanske's paper addresses the important question of how a court should evaluate a fee structure. As he notes, by setting a charge too high, a government can convert a user fee into a tax. *Id.* at 1331. But how does a court know whether the fee is set too high? Shanske argues courts should evaluate such fee setting procedurally rather than substantively. *Id.* at 1335.

27. AJAY K. MEHROTRA, *MAKING THE MODERN AMERICAN FISCAL STATE* (2013).

28. Clayton P. Gillette & Thomas D. Hopkins, *Federal User Fees: A Legal and Economic Analysis*, 67 B.U. L. REV. 795, 805 (1987).

29. See Shobe, *supra* note 25, at 25–26 (reviewing such studies).

simply more popular than taxes. Second, many states now subject tax increases to supermajority requirements and other procedural hurdles. For example, California's Proposition 13, the grandfather of contemporary tax limitation measures, requires a two-thirds majority for tax increases.³⁰ Such limitations have made raising taxes more difficult at the local level, and local governments have sought to substitute fees for tax revenue.³¹ Third, some of the increased reliance on user fees stems from the increased use of services traditionally associated with user fees, like public hospitals and universities.³²

In this section, I first provide some background on how states and local governments currently use their user fee authority. I then explore what is at stake in the distinction between user fees and taxes. Finally, I look at judicial efforts to distinguish taxes from user fees.

A. The Variety of User Fees

Most tax revenue is from a few major sources: income, sales, and property taxes.³³ The term "fee," however, describes a wide variety of exactions, ranging from library fines and municipal court fees to municipal water bills and public recreation fees. State law definitions of user fees, however, do not always craft distinctions between these different types of fees. Thus, the Massachusetts Supreme Court consid-

30. See, e.g., STATE OF WIS. LEGIS. AUDIT BUREAU BEST PRACTICES REPORT: LOCAL GOV'T USER FEES, LEG. 96, 9–11 (2004), <http://legis.wisconsin.gov/lab/reports/04-0userfeesfull.pdf> [<https://perma.unl.edu/89CR-QSGU>] (discussing the ability of Wisconsin municipalities to impose user fees more easily than taxes). At the local level, the benefits principle of taxation (i.e., the idea that taxes represent a payment by a resident for a bundle of public goods) plays a much greater role in policy design than it does at the state and federal levels, where the "ability to pay" principle has generally carried the day. See JOEL SLEMROD & JON BAKIJA, TAXING OURSELVES 227–29 (4th ed. 2008) (providing overview of both theories); see also MEHROTRA, *supra* note 27, at 193–96 (providing a historical account of rise of the "ability to pay" principle at state and federal levels). Nevertheless, many scholars have criticized increasing reliance on user fees as taking the benefits principle too far. See Suellen M. Wolfe, *Municipal Finance and the Commerce Clause: Are User Fees the Next Target of the "Silver Bullet"?*, 26 STETSON L. REV. 727, 785 (1997) (expressing concern that user fees may be targeted for constitutional scrutiny).

31. It is less clear if support for tax increases has changed over time. While certainly all else equal, voters would prefer lower taxes, "voters are as likely as not to vote for a state tax increase." VANESSA S. WILLIAMSON, READ MY LIPS: WHY AMERICANS ARE PROUD TO PAY TAXES xiii (2017).

32. Dick Netzner, *Differences in Reliance on User Charges by American State and Local Governments*, 20 PUB. FIN. Q. 499, 503 (1992).

33. The federal government and state and local governments also raise some revenue via excise taxes. Excise taxes are paid on purchases of a certain good or on a certain activity, generally included in the price of the good. A common example is gasoline. See generally *Excise Tax*, INTERNAL REVENUE SERV., <https://www.irs.gov/businesses/small-businesses-self-employed/excise-tax> [<https://perma.unl.edu/XQ2L-DKN5>] (last updated Nov. 20, 2017).

ers both the payments required of sex offenders to the state's sex offender registry and tolls paid by drivers on the Massachusetts Turnpike under similar doctrinal tests.³⁴

In considering Washington State's definition of a user fee, Hugh Spitzer has suggested four categories of user fees: (1) commodity charges, (2) burden offset charges, (3) regulatory fees, and (4) special assessments.³⁵

Commodity charges comprise the classic type of user fees. As Spitzer observes, these fees are "[i]mposed to pay for the provision of commodities or services of direct benefit to consumer[s],"³⁶ such as utilities or tickets to a municipal museum.³⁷ Such fees are calculated by considering both marginal costs of providing the service and the capital costs that need to be recouped from consumers.³⁸ To the extent the municipality offers a private good in a competitive market place, governments may sometimes use private market pricing as a benchmark.³⁹

Regulatory fees are assessed to recoup the cost of administering regulations.⁴⁰ Fees charged by state licensing boards are typically regulatory fees, designed to recoup the cost of regulating the licensed industry. Similarly, fees charged by a municipal department to inspect residential buildings for code compliance are regulatory fees. These fees are designed to recover the cost of code enforcement. While these fees partly benefit the payor, they also benefit the entire community by ensuring that a business is properly regulated.⁴¹

State courts rarely acknowledge the ways regulatory fees differ in purpose from commodity fees. Instead, they focus on the relationship

34. *Compare Doe v. Sex Offender Registry Bd.*, 947 N.E.2d 9, 19 (Mass. 2011) (stating that regulatory fees are set to cover costs of participating in regulation), *with* *Murphy v. Mass. Tpk. Auth.*, 971 N.E.2d 231, 239–40 (Mass. 2012) (allowing toll fees to pay for improvements on roads other than the ones producing revenue). As discussed in section II.C, the Massachusetts Supreme Court does tweak the requirements of voluntariness for "regulatory fees"—a category that includes the sex offender registry registration fee.

35. Hugh D. Spitzer, *Taxes vs. Fees: A Curious Confusion*, 38 GONZ. L. REV. 335, 364 (2003). Spitzer's insightful work explores the tax versus fee distinction under Washington state law and likewise concludes that courts would benefit by explicitly recognizing multiple types of user fees.

36. *Id.*

37. *See generally* 16 TEX. ADMIN. CODE § 25.344(f) (2008); 16 TEX. ADMIN. CODE § 25.451 (2008).

38. *See* Spitzer, *supra* note 35, at 345. Darien Shankse's recent work explores the complexities of these calculations. As he observes, "No fee is perfect; they are only average prices and not perfectly calibrated to the user." Shankse, *supra* note 26, at 1340.

39. Spitzer, *supra* note 35, at 364.

40. *Id.*

41. *See* Gillette & Hopkins, *supra* note 28, at 815–16 (discussing the pricing of user fees when benefits accrue to nonpayers).

between the charge paid by the business and the regulation, and they focus on enforcement costs the government bears as a result of its activities.

Special assessments are another kind of user fee. These assessments are typically levied on property and are thought to pay for the capital costs of public infrastructure that increase property value.⁴² Property law scholars have paid particular attention to such fees, especially development impact fees, which have been the subject of several Supreme Court challenges. Development impact fees charge developers for public costs associated with developing land (like increased infrastructure and public school costs), and they condition permit approval on paying such fees. Developers challenged these fees as unlawful takings, arguing that they impose restrictions on private land use in violation of due process. In those cases, the Supreme Court has held that rough proportionality must be found between the payment required and the benefit to the property owner.⁴³

Pigovian charges differ from development impact fees in several ways. First, they are not charges collected as part of a permit approval process. Second, they are often levied based on activity level rather than as an incident of property ownership and development.⁴⁴ Third, and finally, the Takings Clause jurisprudence on impact fees looks at the relationship between the benefit government services provide to the property owner and the costs that the government incurs as a result of development.⁴⁵ Pigovian charges, on the other hand, are levied in relationship to the harm the payor causes the public.

Spitzer's fourth category of user fees overlaps with Pigovian charges. Spitzer terms this subset of user fees "burden offset charges," which he defines as payments to cover the cost of externalities imposed by the payor's activities.⁴⁶ Spitzer cites sewer rates, garbage rates, and stormwater remediation fees as examples of these burden-offset charges, which, at least under Washington law, could be considered user fees.⁴⁷ He does not, however, analyze pollution taxes. Nor is it clear that sewer and garbage rates are payments for externalities.

42. See Laurie Reynolds, *Taxes, Fees, Assessments, Dues, and the "Get What You Pay For" Model of Local Government*, 56 FLA. L. REV. 373, 397 (2004).

43. *Dolan v. City of Tigard*, 512 U.S. 374 (1994).

44. 7 NORMAN WILLIAM JR. & JOHN M. TAYLOR, *AMERICAN LAND PLANNING LAW* § 167:1, at 530 (Rev. ed. 2003) (describing the trend of localities to "raise revenue by imposing fees upon new development, with the fee usually being due and payable at the time of building permit issuance").

45. *Dolan*, 512 U.S. at 391 ("No precise mathematical calculation is required, but the city must make some sort of individualized determination that the required dedication is related both in nature and extent to the impact of the proposed development.").

46. See Spitzer, *supra* note 35, at 364.

47. *Id.*

Payors certainly benefit directly from having their trash removed from their property and their sewage treated far away from their property.

Further, while state courts have not limited the category of user fees to fees paid for the direct consumption of government services, most state courts have done so by stretching the definition of a “benefit” rather than directly grappling with how to categorize government pricing of externalities.⁴⁸ As a result, state law in this area remains unsettled and unpredictable.

Spitzer suggests that Washington’s user fee doctrine would be more coherent if its state courts recognized the multiplicity of user fees that governments impose.⁴⁹ Spitzer’s critique, however, applies more broadly. While some states have crafted more specialized tests for special assessments (or, more limitedly, impact fees), state law often fails to distinguish between benefit fees, regulatory fees, and burden offset charges when evaluating whether a particular extraction is a “fee” or a “tax.” Before turning to the doctrine, it is useful to spend some time thinking about the differences between fees and taxes.

B. Legal Differences Between Taxes and User Fees

A state court might be called upon to classify a given policy as a tax or a user fee for a number of reasons. First, state courts may need to determine whether an extraction was subject to state political process requirements (such as supermajority approval) that affect taxes but not user fees. Second, a state court may be called upon to determine whether a local government extraction is a valid user fee or an invalid tax. Third, state courts may be asked to evaluate whether an extraction is subject to state constitutional requirements of equal apportionment not applicable to user fees. Fourth, a tax-exempt entity may try to claim a tax exemption, and the government may counter that the entity is not exempt because the levy is a user fee. Finally, under the Tax Injunction Act (and its variants) as well as sovereign immunity doctrines, federal courts sometimes need to distinguish taxes from fees. While my argument focuses on state law definitions of these terms, federal law has influenced a number of state interpretations. Consequently, I briefly touch upon selected federal cases at the end of this section.

48. *See, e.g.*, subsection III.B.2 (discussing the Michigan Supreme Court’s decision in *Bolt v. City of Lansing*, 587 N.W.2d 264 (Mich. 1998), holding that Lansing’s stormwater remediation fees were taxes rather than fees).

49. *Id.*

1. *Political Process Restrictions*

Fee payors often challenge government extractions as “hidden” or “disguised” taxes. Payors argue these taxes are invalid because they are put in place without the various political process requirements that circumscribe the enactment of new taxes or the increase of existing taxes. Some states require supermajorities to increase taxes, at least in some instances.⁵⁰ Other states require voter approval through a referendum process, at least at the local level.⁵¹

While some states enacted tax restrictions in the nineteenth century, passage of such restrictions accelerated in the later part of the twentieth century.⁵² Of the forty-six states with tax restrictions, seventeen added restrictions between 1970 and 1976, and “nearly half (48%) of those currently in existence were adopted after 1977.”⁵³ Michigan’s Headlee Amendment imposed overall limits on state tax collection and required voter approval for new local taxes,⁵⁴ while Missouri’s Hancock Amendment requires voter approval for both state and local tax increases.⁵⁵

Perhaps the best-known of these taxing restrictions is California’s Proposition 13.⁵⁶ Proposition 13 focused on limiting California’s property taxes, reducing the property tax rate to one percent, and limiting the rate at which property tax assessments could grow to two percent

50. *Policy Basics: State Supermajority Rules to Raise Revenue*, CTR. ON BUDGET & POL’Y PRIORITIES, <http://www.cbpp.org/sites/default/files/atoms/files/PolicyBasics-StateSupermajorities-4-22-13.pdf> [<https://perma.unl.edu/PR32-2ZXR>] (last updated Feb. 5, 2018).

51. *See, e.g.*, COLO. CONST. art. X, § 20.

52. Daniel R. Mullins & Bruce A. Wallin, *Tax and Expenditure Limitations: Introduction and Overview*, 24 PUB. BUDGETING & FIN. 2, 3–6 (2004).

53. *Id.* at 6; *see also* Stephen Diamond, *The Death and Transfiguration of Benefit Taxation: Special Assessments in Nineteenth-Century America*, 12 J. LEGAL STUD. 201, 268 n.160 (1983) (discussing limits on special assessment both by frequency and in relation to property value).

54. Kevin C. Kennedy, *The First Twenty Years of the Headlee Amendment*, 76 U. DET. MERCY L. REV. 1031, 1031–33 (1999).

55. Rhonda C. Thomas, *The Hancock Amendment: The Limits Imposed on Local Governments*, 52 UMKC L. REV. 22, 22 (1983).

56. *See* ARTHUR O’SULLIVAN ET AL., PROPERTY TAXES AND TAX REVOLTS: THE LEGACY OF PROPOSITION 13, at 6 (1995) (exploring how Proposition 13 radically reduced the ability of local governments to set property tax rates within their district); Michael R. Johnson et al., *State Constitutional Tax Limitations: The Colorado and California Experiences*, 35 URB. LAW. 817, 817 (2003) (discussing implications of restrictions on local government’s ability to tax, specifically in regards to Colorado’s TABOR and California’s Proposition 13); *Policy Basics: Taxpayer Bill of Rights (TABOR)*, CTR. ON BUDGET & POL’Y PRIORITIES, <http://www.cbpp.org/cms/index.cfm?fa=view&id=2521> [<https://perma.unl.edu/B5YS-ND34>] (last updated Aug. 13, 2015) (defining TABOR as constitutional Taxpayer Bill of Rights measure meant to tie growth of state and local revenues to inflation rate and population change of state).

annually until the property owner sells the property.⁵⁷ Proposition 13 also added a new restriction that affected all state taxes and special purpose local taxes: a supermajority requirement.⁵⁸ Special purpose local taxes require approval from two-thirds of voters, while state tax increases require a two-thirds majority of both the California Assembly and Senate.⁵⁹

All told, sixteen states have supermajority requirements,⁶⁰ and an additional three states require voter approval for tax increases.⁶¹

2. *Restrictions on Local Taxing Authority*

Fee payors also challenge user fees imposed by local governments as invalid taxes under state law. In the vast majority of states, local governments have greater authority to impose user fees than taxes.⁶² Traditionally, states have granted local governments very limited revenue-generating authority, even as compared to other home rule powers.⁶³

While some jurisdictions, like California and Ohio, grant taxing authority to charter or home rule jurisdictions, many states do not.⁶⁴ As a result, cities may lack authority to enact meaningful tax reform, including reform to the most important local tax, the property tax. In New Orleans, elected officials had to win a state constitutional amendment simply to allow its residents to vote on their own property tax increases. In Texas, mayors worry that proposed state-level cuts to

57. *What is Proposition 13?*, CAL. TAX DATA, <http://www.californiataxdata.com/pdf/Prop13.pdf> [<https://perma.unl.edu/A2FL-VCGE>].

58. CAL. CONST. art. XIII A, § 3(a).

59. Noah Glyn & Scott Drenkard, *Prop 13 in California, 35 Years Later*, TAX FOUND. (June 6, 2013), <http://taxfoundation.org/blog/prop-13-california-35-years-later> [<https://perma.unl.edu/A9B7-AZ4J>]. As will be discussed in the next section, subsequent ballot initiatives expanded the supermajority requirements at the local level and minimized some of the differences between taxes and user fees, thus expanding the scope of Proposition 13. Most recently, California voters eliminated the supermajority requirement at the state level.

60. Bert Waisanen, *State Tax and Expenditure Limits—2010*, NAT'L CONF. ST. LEGISLATURES, <http://www.ncsl.org/research/fiscal-policy/state-tax-and-expenditure-limits-2010.aspx#typesoflimts> [<https://perma.unl.edu/7SAA-FT5N>].

61. *Id.*

62. DALE KRANE, PLATON N. RIGOS & MELVIN B. HILL, *HOME RULE IN AMERICA* (2001).

63. See Richard Briffault, *Foreword: The Disfavored Constitution: State Fiscal Limits and State Constitutional Law*, 34 RUTGERS L.J. 907, 915 (2003) (“The vast majority of state constitutions impose some limitation on the ability of their state and local governments to incur debt.”).

64. See OHIO CONST. art. XVIII, § 3 (Home Rule Amendment); CAL. GOV'T CODE § 23027 (West 2003) (uniform application of special taxes); CAL. GOV'T CODE § 37100.5 (West 2003) (voter approval of city levies); *Cincinnati Bell Tel. Co. v. City of Cincinnati*, 693 N.E.2d 212, 214 (Ohio 1998) (giving taxation authority to locality); *Cal. Fed. Sav. & Loan Ass'n v. City of Los Angeles*, 812 P.2d 916, 924 (Cal. 1991) (finding taxation to be rightly within the power of the locality).

their property tax rates will hinder their ability to provide municipal services.⁶⁵

But property taxation is not the only area where state authority has blocked municipal tax reform. The New York State Legislature blocked both of New York City Mayor Michael Bloomberg's efforts to establish a congestion pricing system and stalled Mayor Bill de Blasio's proposed municipal income tax reforms.⁶⁶ When Brookfield, Illinois, tried to impose a tax on amusement activities, the Brookfield Zoo lobbied the state legislature to prohibit the tax.⁶⁷

In contrast, local governments have more expansive authority to impose user fees.⁶⁸ State law has long construed user fees as an exercise of the local government's general police power, which is broad, rather than its taxing power, which is narrow.⁶⁹

3. *State Law Requirements of Tax Uniformity*

Many state constitutions include tax "uniformity" requirements. St. Paul, Minnesota, levied a "special assessment" on property owners to fund road maintenance during the winter months as well as other routine road repairs. Property owners paid St. Paul based on their frontage—the length of their property that faces a public way. However, the city charged residential property owners and commercial owners different rates. Commercial property owners sued, claiming the assessment was actually a tax imposed in violation of a number of

65. *Louisiana Orleans Parish Tax for Fire and Police Protection, Amendment 6 (2014)*, BALLOTPEDIA, [http://ballotpedia.org/Louisiana_Orleans_Parish_Tax_for_Fire_and_Police_Protection,_Amendment_6_\(2014\)](http://ballotpedia.org/Louisiana_Orleans_Parish_Tax_for_Fire_and_Police_Protection,_Amendment_6_(2014)) [<https://perma.unl.edu/M3JJ-EV5A>]; Mike Ward, *Big City Mayors to Lege: Don't Mess with Taxes*, HOUS. CHRON. (Feb. 16, 2015), <http://www.chron.com/news/politics/texas/article/Big-city-mayors-to-Lege-Don-t-mess-with-taxes-6083909.php> [<https://perma.unl.edu/4HDF-C9JQ>].

66. See Ross Barkan, *Bill de Blasio Says New Congestion Pricing Plan 'Has to Be Taken Seriously'*, OBSERVER (Feb. 19, 2015), <http://observer.com/2015/02/bill-de-blasio-says-new-congestion-pricing-plan-has-to-be-taken-seriously/> [<https://perma.unl.edu/PT5Y-TRAY>] (describing de Blasio's comments that it was important to find long-term solution for MTA finances); Nicholas Confessore, *Congestion Pricing Plan Dies in Albany*, N.Y. TIMES (Apr. 7, 2008, 3:01 PM), http://cityroom.blogs.nytimes.com/2008/04/07/congestion-pricing-plan-is-dead-assembly-speaker-says/?_r=0 [<https://perma.unl.edu/VE7H-KEXP>] (describing New York State Assembly Speaker Sheldon Silver's decision not to hold vote authorizing Bloomberg's congestion pricing plan).

67. Victoria Pierce, *Bill to Block Zoo Tax Clears Legislature*, CHI. TRIB. (Jan. 9, 2011), http://articles.chicagotribune.com/2011-01-09/news/ct-met-zoo-tax-0110-20110107_1_brookfield-zoo-amusement-tax-zoo-officials [<https://perma.unl.edu/G79U-8XCW>].

68. See generally Scharff, *supra* note 12.

69. Ronald Rosenberg, *The Changing Culture of American Land Use Regulation: Paying for Growth with Impact Fees*, 59 SMU L. REV. 177, 218 (2006) (discussing that state courts generally inquire whether a local government's fee is a valid exercise of police power).

legal requirements, including uniformity. In 2016, the Minnesota Supreme Court sided with property owners, labeling the assessment an exercise of the city's taxing authority because the general public benefitted as much (or more) from these services as the property owners.⁷⁰ The Court remanded the case to determine whether the design of the fee presented problems of uniformity or other constitutional issues.

4. *Tax-Exemptions*

State law often exempts certain non-profit and governmental entities from sales and property tax liability. However, such entities are typically subject to user fees. As a result, local governments sometimes carefully design charges as user fees to ensure that large, non-profit landowners and governmental entities pay. For example, Ithaca touted as one of the advantages of its stormwater remediation fee that Cornell University would also pay the fee.⁷¹ As a result of payments from non-profits, city analysis suggested that residents of the city would actually see their overall payments to the city go down once the stormwater remediation fee was added to their bills.⁷² Accordingly, disputes can arise between a non-profit and a governmental entity over whether a levy is a tax or a user fee.

5. *Federal Law*

Federal law also requires courts to determine whether state and local governments are levying taxes or charging fees. The Tax Injunction Act (TIA) limits federal authority to hear challenges to state and local taxes.⁷³ The TIA, originally passed in 1937, prohibits federal district courts from “enjoin[ing], suspend[ing] or restrain[ing] the assessment, [and prohibits the] levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State.”⁷⁴ The law allows “state courts to be the final arbiters of the meaning of their own tax statutes.”⁷⁵ Without the TIA, non-re-

70. *First Baptist Church v. City of St. Paul*, 884 N.W.2d 355, 365 (Minn. 2016) (finding the assessment to be a tax subject to constitutional restrictions on taxing authority).

71. CITY OF ITHACA, STORMWATER TASK FORCE FACT SHEET (2013) (on file with author).

72. *See id.*; *Why Isn't Funding for the Stormwater Program Just Included in My Property Taxes?*, CITY OF ITHACA, <https://www.cityofithaca.org/Faq.aspx?QID=184> [<https://perma.unl.edu/PVA7-9C72>].

73. *See generally* 28 U.S.C. § 1341 (2012).

74. *Id.*

75. Clark R. Calhoun & Timothy L. Fallaw, *Avoiding the TIA: Not Impossible but Close*, ST. TAX NOTES, Nov. 8 2010, at 425. Passed in the middle of the Great Depression, the TIA prevented multi-state corporations from tying up state tax disputes with federal proceedings, a litigation strategy that denied states much

sidents could invoke diversity jurisdiction to sue in federal courts to block tax enforcement, but state residents might only be able to sue in state court.⁷⁶ The Act prevents federal courts from disrupting state revenue collection.⁷⁷

The TIA, however, does not apply to user fees.⁷⁸ As a result, a federal court must determine whether a particular levy constitutes a tax or a user fee. For example, Illinois required three casinos to make payments to a greyhound-racing track, a somewhat unusual regulatory/fiscal regime. When the casinos tried to challenge these payments in federal court, the court needed to determine whether such payments constituted fees or taxes.⁷⁹

Sovereign immunity also invites federal courts to determine whether a particular levy is a tax or a user fee. Tribes and the federal government are immune from state and local taxes, but not from user fees. While the Constitution does not explicitly limit state authority to tax the federal government, the principal of federal sovereign immunity from state taxation was ensconced in the early years of the republic, when Chief Justice Marshall famously declared in *McCulloch v. Maryland* that the “power to tax involves the power to destroy.”⁸⁰ Though most constitutional law professors do not stress this point, the admonition does not apply to user fees. *McCulloch* does not mean that “the United States cannot be charged reasonable fees related to the cost of governmental services provided, such as payment for metered water usage.”⁸¹

Similarly, the Supreme Court has held that state taxes do not apply to tribes and tribal members for on-reservation activities.⁸² Thus, tribal members who live and work on a reservation are immune from state income taxes.⁸³ But like the federal government, tribal governments and tribal members can be responsible for user fees reasonably

needed revenue and that gave such multi-state corporations a procedural advantage over their purely local counterparts. See Note, *Clarifying Comity: State Court Jurisdiction and Section 1983 State Tax Challenges*, 103 HARV. L. REV. 1888, 1892–93 (1990) [hereinafter “*Clarifying Comity*”].

76. *Clarifying Comity*, *supra* note 75; see also Robert F. Williams, *The Tax Injunction Act and Judicial Restraint: Property Tax Litigation in Federal Courts*, 12 RUTGERS L.J. 653, 661–62 (1981) (discussing congressionally enacted restrictions on the federal judiciary). The TIA does not apply to Indian Tribes or to the United States. 28 U.S.C. § 1362 (2012); Calhoun & Fallaw, *supra* note 75.

77. See *Empress Casino Joliet Corp. v. Balmoral Racing Club, Inc.*, 651 F.3d 722, 726 (7th Cir. 2011) (“During the pendency of the federal suit the collection of revenue under the challenged law might be obstructed . . .”).

78. Calhoun & Fallaw, *supra* note 75.

79. *Empress Casino Joliet Corp.*, 651 F.3d at 726–27.

80. *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 431 (1819).

81. *Novato Fire Prot. Dist. v. United States*, 181 F.3d 1135, 1139 (9th Cir. 1999) (citing *United States v. City of Huntington*, 999 F.2d 71 (4th Cir. 1993)).

82. *Okla. Tax Comm’n v. Chickasaw Nation*, 515 U.S. 450 (1995).

83. *McLanahan v. Ariz. State Tax Comm’n*, 411 U.S. 164 (1974).

related to services provided to the tribe or its members on the reservation.⁸⁴

The Supreme Court has not provided a definition of tax for purposes of either federal or tribal sovereign immunity. Federal courts have generally looked to the relationship between the amount of the levy and the particular service provided to determine its character.⁸⁵ Finally, as a general matter, taxes are deductible from federal income taxes, while fees generally are not.⁸⁶

In addition to the law requiring federal courts to characterize state charges, federal law sometimes requires characterization of payments to foreign countries and payments to the United States. Federal tax law distinguishes between taxes and other kinds of charges because only income taxes paid to foreign governments can be offset with the Foreign Tax Credit.⁸⁷ Treasury has promulgated regulations for defining income taxes for this purpose.⁸⁸ Under these regulations, a payment is not a tax when the payor “receives (or will receive), directly or indirectly, a specific economic benefit”⁸⁹ Generally speaking, the courts have not considered this regulatory definition of a tax outside the context of Foreign Tax Credit cases, in part because the foreign tax credit does not apply to consumption taxes and other types of taxes that may be similar to user fees.

Parallel to the Tax Injunction Act, the Anti-Injunction Act prohibits federal courts from hearing pre-assessment challenges to federal taxation.⁹⁰ In *NFIB v. Sebelius*, however, the Court held that its Anti-Injunction Act precedent was not relevant for defining Congress’s taxing power for purposes of Article I, Section Eight, Clause One.⁹¹ Like the jurisprudence surrounding the Foreign Tax Credit, the Court’s

84. *Gila River Indian Cmty. v. Waddell*, 967 F.2d 1404 (9th Cir. 1992).

85. *See, e.g., Novato*, 181 F.3d at 1138–39 (9th Cir. 1999) (discussing relevant Supreme Court law and law of other circuits).

86. I.R.C. § 164; *see also* Gladriel Shobe, *Disaggregating the State and Local Tax Deduction*, 35 VA TAX REV. 327, 340 (2016) (discussing the complexities involved in determining whether various property assessments are properly deductible as taxes). Shobe suggests that some property tax assessments paid by businesses for property improvements may also be capitalized. Pigouvian levies will often be deductible for businesses as a cost of doing business, but will not be similarly deductible for individuals. When facing a carbon price, however, businesses may choose to make various improvements to reduce carbon emissions. Such improvements would likely be capitalized rather than deductible, even though the carbon price itself is likely deductible.

87. 26 U.S.C. § 901(b)(1) (allowing credits for the amount of “income, war profits, or excess profits tax” paid to a foreign country). I thank Shannon McCormick for reminding me of my federal income tax roots.

88. 26 C.F.R. § 1.901-2 (2017).

89. *Id.* § 1.901-2(a)(2)(i).

90. 26 U.S.C. § 7421(a) (2012).

91. *Nat’l Fed’n of Indep. Bus. v. Sebelius*, 567 U.S. 519, 545–46 (2012).

constitutional understanding of the federal taxing power has not significantly impacted state court doctrine.⁹²

C. The Doctrine Does Not Readily Distinguish Taxes from User Fees

As discussed, whether a given levy is categorized as a tax or a user fee often determines whether the levy is valid.⁹³ Unfortunately, the law distinguishing taxes from user fees is far from clear.⁹⁴

No one would characterize a property tax as a user fee, even though higher property tax rates often support better public services.⁹⁵ The receipt of these benefits is simply not contingent on the payment of a property tax. Nor would anyone question whether a green fee at a local golf course constitutes anything other than a user fee.

The clarity at the ends of these categories, however, masks much confusion in the middle. Across the country, state courts have struggled to define these boundaries. As the Georgia Supreme Court has observed, “it is frequently difficult to discern whether a given enactment provides for a regulatory fee or authorizes simply a tax.”⁹⁶

States have taken a variety of approaches to distinguishing these two categories. In this section, I develop a typology of common approaches taken by state law, and I also take a detailed look at California’s repeated efforts to disentangle taxes from fees through the initiative process.⁹⁷

92. Of the fifty-one state court cases citing the *NFIB* decision, only a handful deal with state tax issues. The opinion has been cited to support the general proposition that taxes can serve a regulatory purpose. *See, e.g.*, *Garwood v. State*, 77 N.E.3d 204, 225 (Ind. Ct. App. 2017), *aff’d in part, vacated in part* 84 N.E.3d 624 (Ind. 2017) (“Furthermore, the use of tax as a means to nontax ends is allowed today and is nearly as old as taxation itself. (citing *Sebelius*, 567 U.S. 519 (2012))). However, even in these opinions the citation is not central to the court’s holding.

93. *See supra* section II.B. (discussing the ways in which the distinction between user fee and tax matters for the legal validity of the tax).

94. *See Spitzer, supra* note 35, at 342–44. As Hugh Spitzer observes, historically the question of whether a charge was a fee or a tax turned on whether the revenue supported “public goods” or “private goods.” *Id.*

95. Higher property taxes might be supported on a benefits theory of taxation, but the benefits theory of taxation is a theory, not a legal test. JOEL SLEMROD & JON BAKIJA, *TAXING OURSELVES* 62–63 (2008) (discussing the “benefit principle” and why it is hard to apply in the context of taxation).

96. *McLeod v. Columbia County*, 599 S.E.2d 152, 154 (Ga. 2004) (citing *Hadley v. City of Atlanta*, 502 S.E.2d 784 (Ga. 1998)).

97. Two other papers have looked at the ways states generally distinguish between taxes and fees. Joseph Henchman explores the question in *HOW IS THE MONEY USED?: FEDERAL AND STATE CASES DISTINGUISH TAXES AND FEES* (2013). Henchman’s paper, however, explores this doctrine with an eye toward narrowing the definition of user fees under state law to ensure broad applicability of tax limita-

The first set of state law approaches, which I call the single-factor approaches, places significant weight on a single characteristic of the charge. Unsurprisingly, the second approach, the “multi-factor” approach, looks at a range of factors. The third approach, adopted by California voters, is a narrow definition of user fees that categorizes many types of extractions as taxes. Finally, federal circuit courts have adopted multi-factor tests that differ in focus from the tests developed independently by state courts. In this section, I consider each of these approaches in turn.

1. *Single-Factor Approaches*

Some state courts rely primarily on a single defining characteristic to determine whether a particular charge is a user fee or a tax. For example, some state courts focus on how the funds are to be spent. If the money raised from the charge supports general public spending, called “general revenue,” it is a tax. If the money is segregated for a specific purpose related to the charge, it is a user fee. For example, in South Dakota, if the revenue only “cover[s] the cost and expense of supervision or regulation” it is a fee, but if it exceeds those costs, it is a tax.⁹⁸

Other courts focus on the intentions of those enacting the charge. In Texas, for example, the distinction between a tax and a user fee turns entirely on whether the purported fee is imposed for regulatory or revenue purposes.⁹⁹

2. *The Multi-Factor Approach*

Many states use a variety of factors in making the tax/user fee determination. Factors include the statute’s purpose (sometimes as reflected in its plain language), voluntariness, and proportionality to the benefit conferred.¹⁰⁰ Charges enacted for the purpose of raising revenue are taxes, whereas charges enacted for other purposes (like regulatory purposes) may be user fees.¹⁰¹ In looking at the voluntariness of the charge, courts consider how much flexibility payors have in avoiding the charge.¹⁰² Obviously, a charge for the use of the municipal golf

tions. Jasper Cummings has also looked at these issues, but his work blends federal and state law. JASPER L. CUMMINGS JR., *USER FEES VERSUS TAXES* (2011).

98. *Valandra v. Viedt*, 259 N.W.2d 510, 512 (S.D. 1977).

99. *See County of Harris v. Shepperd*, 291 S.W.2d 721, 723 (Tex. 1956) (“A charge or fee which has regulation for its purpose is imposed under the police power. On the other hand, if for the purpose of raising revenue, it is a tax and levied under taxing power.”); *Prudential Health Care Plan, Inc. v. Comm’r of Ins.*, 626 S.W.2d 822, 828 (Tex. Ct. App. 1981).

100. *See HENCHMAN*, *supra* note 97, at 16–97.

101. *Id.*

102. *See, e.g., infra* notes 117–20 and accompanying text (discussing Michigan’s approach to voluntariness).

course is completely voluntary. At the other extreme, property owners cannot avoid a property tax except by selling their property. If the amount of the charge is close to the economic benefit conferred on the payor (or the cost to the government providing the service) then that charge is more likely to be a user fee.¹⁰³

Of course, each state's specific factors are different. In Michigan, the court evaluates a user fee under three criteria: (1) whether the fee serves a regulatory or a revenue-raising purpose; (2) whether the fee is proportional to the benefit conferred; and (3) whether the fee is voluntary.¹⁰⁴ Massachusetts has similar criteria.¹⁰⁵

It is helpful to consider a specific example of how the multi-factor test works. Courts in Arkansas look to the fee's relationship to the benefit conferred, who the payor is, how the funds will be used, and how the fees compare to similar private services. In *Harris v. City of Little Rock*, the plaintiff challenged Little Rock's decision to raise user fees at its recreational facilities in order to pay for the building of a new presidential park that would house the Clinton Presidential Library.¹⁰⁶ The court upheld these fees, noting the trial court's finding that only park users pay the fee and that the fees were segregated from the city's general revenue and put into a special enterprise fund supporting municipal parks.¹⁰⁷ The court also noted that the city's recreational fees were competitively priced when considering the market.¹⁰⁸

State courts frequently look to decisions in sister jurisdictions in choosing which factors to consider and how to apply them. Georgia, for example, originally adopted a single-factor, general revenue approach.¹⁰⁹ Later cases, however, emphasize that voluntariness is also an important feature of user fees,¹¹⁰ and recently the state supreme court has looked to the multi-factor test of Florida for guidance.¹¹¹

103. *See Spitzer* note 35, at 348.

104. HENCHMAN, *supra* note 97 (citing *Bolt v. City of Lansing*, 587 N.W.2d 264 (Mich. 1990)).

105. *Id.* at 50; *Easthampton Sav. Bank v. City of Springfield*, 21 N.E.3d 922, 935–37 (Mass. 2014).

106. *Harris v. City of Little Rock*, 40 S.W.3d 214, 216 (Ark. 2001).

107. *Id.* at 221–22.

108. *Id.* at 222.

109. *Gunby v. Yates*, 102 S.E.2d 548, 550–51 (Ga. 1958).

110. *McLeod v. Columbia County*, 599 S.E.2d 152, 155 (Ga. 2004) (“Whether a charge is voluntary is also a factor since, if it is not mandatory, it cannot be a tax.”); *Luke v. Dep’t of Nat. Res.*, 513 S.E.2d 728, 729 (Ga. 1999) (“[T]he essential characteristics of a tax are that it is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to legislative authority.” (internal citation omitted)).

111. *McLeod*, 599 S.E.2d at 155 (citing *Sarasota County v. Sarasota Church of Christ*, 667 So. 2d 180 (Fla. 1995)).

The multi-factor approach seems to be more common in jurisdictions with more litigation challenging user fees. For example, Georgia originally adopted a general revenue approach, but has developed a multi-factor test over time.

Courts have exercised their interpretative authority in analyzing whether a particular levy satisfies a relevant factor. For example, courts have significant leeway in determining whether the user fee is proportional to the cost of providing the benefit. Most courts, rather than declaring mathematical certainty as the standard, look for a reasonable relationship.¹¹² As the Michigan Court of Appeals describes its requirement, “[t]he test is whether the fee is proportional, not whether it is equal, to the amount required to support the services it regulates.”¹¹³ The proportionately requirement is satisfied as long as the fee is not “wholly disproportionate.”¹¹⁴

The courts also have leeway in determining what government costs can be considered. In *Murphy v. Massachusetts Turnpike Authority*, the Massachusetts Supreme Court considered a challenge to the Authority’s use of tolls to pay for infrastructure costs on both tolled and non-tolled roads, tunnels, and bridges. The plaintiffs presented evidence that 58% of the toll revenue supported other infrastructure. Nevertheless, the court held that the tolls were user fees, finding that

[w]here, as here, a public authority manages an integrated system of roadways, bridges, and tunnels, and chooses to impose tolls on only some of the roadways and tunnels in an amount sufficient to support the entire integrated system, its purpose does not shift from expense reimbursement to revenue raising simply because the toll revenues exceed the cost of maintaining only the tolled portions of the integrated system.¹¹⁵

In other words, the court did not require tolls to support exclusively the upkeep of the roadways from which the tolls were taken, or even to support tolled roadways in general. The tolls could provide financial support for all roadways.

In those states where “voluntariness” is a relevant factor, courts have been even more malleable in their analysis. Voluntariness can often be a matter of perspective. As scholar Laurie Reynolds has noted, at the right level of abstraction, even income and sales taxes are voluntary.¹¹⁶ No one requires that you earn income or buy goods

112. *Dawson v. Sec’y of State*, 739 N.W.2d 339, 355 (Mich. Ct. App. 2007).

113. *Id.* at 352 (quoting *Westlake Transp., Inc. v. Pub. Serv. Comm’n*, 662 N.W.2d 784 (Mich. Ct. App. 2003)).

114. *Id.*

115. *Murphy v. Mass. Tpk. Auth.*, 971 N.E.2d 231, 239–40 (Mass. 2012) (“Nor must every road, bridge, and tunnel in an integrated system of roadways, bridges, and tunnels be tolled to enable the tolls collected to support the expenses of the entire integrated system without being deemed taxes.”).

116. Reynolds, *supra* note 42, at 412.

and services, and if you don't earn or consume, you don't owe these taxes.

State court decisions on the voluntariness factor sometimes push toward abstractions. Michigan courts have been especially willing to adopt an expansive definition of voluntariness. In one Michigan case, a developer challenged an increase in a water line tap-in connection fee.¹¹⁷ The developer argued that the municipal fee was an unconstitutional tax under Michigan's Headlee Amendment because the city imposed the increase without a popular vote.¹¹⁸ The state court of appeals rejected this argument, noting that the plaintiff "need not pay the tap-in fee unless it decides to install a home site in a particular location. It has the ability to choose whether to use the service at all."¹¹⁹ In other words, the developer could always choose to leave the property undeveloped and thereby avoid the tax. Another Michigan case found a two dollar charge assessed on pawnshop transactions to be voluntary because

[b]y the plain language of the city ordinance, the reporting requirements and attendant regulatory fee only apply to an individual or business that chooses to enter into secondhand transactions of a certain volume within a given period of time. The decision to engage in secondhand transactions at all, and the number of transactions in which to engage, is a purely voluntary decision within the complete control of an individual or business.¹²⁰

Thus, the court concluded that the fee was voluntary because the pawnshop owners could choose to do less business and thereby avoid the fee.

Other courts have simply limited the class of user fees for which voluntariness is required. For example, Florida courts only require voluntariness when the user fee is not authorized by statute.¹²¹ Similarly, Massachusetts does not require voluntariness when analyzing what it terms regulatory fees, which are imposed to cover the administrative costs of participating in a regulated activity.¹²²

While the multi-factor approach appears to offer more nuanced guidance to courts and policy makers than the general revenue approach, in practice parties may find the multi-factor approach no more predictable than the single-factor tests.

117. *Mapleview Estates, Inc. v. City of Brown City*, 671 N.W.2d 572, 573 (Mich. Ct. App. 2003).

118. *Id.*

119. *Id.* at 575.

120. *USA Cash #1, Inc. v. City of Saginaw*, 776 N.W.2d 346, 360 (Mich. Ct. App. 2009) (internal quotations omitted).

121. *City of Gainesville v. Florida*, 863 So. 2d 138, 146 (Fla. 2003).

122. *See Silva v. City of Attleboro*, 908 N.E.2d 722, 727 (Mass. 2009). "This court subsequently recognized in *Silva* that voluntariness is not an essential characteristic of all fees and, in particular, is not 'relevant in the regulatory fee context.'" *Doe v. Sex Offender Registry Bd.*, 947 N.E.2d 9, 19 (Mass. 2011) (quoting *Silva*, 908 N.E.2d at 727-28).

3. *The California Approach*

California takes a unique approach to defining user fees and taxes as a result of the frequent interplay between California's courts and voters. Historians and other scholars often trace the beginning of the "tax revolt" of the 1970s to California's Proposition 13.¹²³ While there is significant scholarly debate about what actually caused Proposition 13,¹²⁴ there is widespread agreement that it was successful in limiting property tax growth in California.¹²⁵ The proposition amended the California constitution to limit property valuation growth for current property owners, limited the property tax rate, and required a supermajority of voters to approve increases to other taxes and special assessments.¹²⁶

California's local governments immediately felt the pinch of these tax limits and sought other sources of revenue.¹²⁷ Municipalities seeking additional revenue to replace reductions in property taxes turned to user fees, many times replacing property taxes with user fees associated with the ownership of property.¹²⁸ They also turned to special property assessments, which are "compulsory charge[s] placed by the state upon real property within a pre-determined district, made under express legislative authority for defraying in whole or in part the ex-

123. See William V. Roth Jr., *The "Malmanagement" Problem: Finding the Roots of Government Waste, Fraud, and Abuse*, 58 NOTRE DAME L. REV. 961, 961 n.2 (1983).

124. See William A. Fischel, *How Serrano Caused Proposition 13*, 12 J.L. & POL. 607, 624 (1996) (discussing multiple theories on the impetus of Proposition 13).

125. See *S.S. Silberblatt Inc. v. United States*, 888 F.2d 829, 830 (Fed. Cir. 1989) (stating Proposition 13 limited property taxes to one percent of the property's value); *Howard Jarvis Taxpayers Ass'n v. City of Riverside*, 86 Cal. Rptr.2d 592, 595 (Ct. App. 1999) (explaining that Proposition 13's intent was to reduce property taxes and describing its methods for doing so); *Sonoma Cty. Org. of Pub. Emps. v. County of Sonoma*, 591 P.2d 1, 3 (Cal. 1979) (Proposition 13 "placed significant limitations upon the taxing power of local and state government").

126. CAL. CONST. art. XIII A, § 1(a) (limiting ad valorem tax on real property to one percent of the property's assessed value); *id.* § 2(b) (limiting, in part, the inflation rate for property value to two percent in a year's time); *id.* § 3(a) (requiring a 2/3 majority in both houses to change statutes to increase taxes and preventing imposition of new ad valorem and property taxes); *id.* § 3(b) (defining tax and exceptions); *id.* § 4 (permitting cities, counties, and special districts to impose taxes other than property taxes by a 2/3 majority); *County of Los Angeles v. Sasaki*, 29 Cal. Rptr. 2d 103, 108 (Ct. App. 1994) ("[Proposition 13's] effect was to drastically cut property tax revenue, and thereby sharply reduce the funds available from that source to local governments, and also schools." (citations omitted)); *Sonoma County*, 591 P.2d at 3.

127. *S.S. Silberblatt*, 888 F.2d at 830 ("Many taxing authorities responded by instituting alternative methods of generating revenue, such as through special assessments and service charges.").

128. *Isaac v. City of Los Angeles*, 77 Cal. Rptr. 2d 752, 758-59 (Ct. App. 1998).

pense of a permanent public improvement.”¹²⁹ The California Supreme Court held that special assessments were not special taxes under Proposition 13, and therefore could be imposed without meeting the supermajority requirements.¹³⁰

Voters in California pushed back, passing Proposition 218 in 1996.¹³¹ Proposition 218 restricted the ability of local governments to use assessments in lieu of property taxes and also limited their ability to impose property-related user fees.¹³²

Even after Proposition 218, state and local governments continued to impose a variety of non-property-related fees that were not subject to Proposition 13 limits.¹³³ One such regulatory fee required businesses involved in lead pollution to contribute to a fund to pay for the health care costs associated with lead poisoning.¹³⁴ In *Sinclair Paint Company v. State Board of Equalization*, the California Supreme Court upheld this regulatory fee against a challenge asserting that it was a disguised tax passed without the supermajority required under Proposition 13.¹³⁵

The *Sinclair* court distinguished taxes and fees by stating that taxes generally “are imposed for revenue purposes, rather than in return for a specific benefit conferred or privilege granted,” and are “compulsory rather than imposed in response to a voluntary decision to develop or to seek other government benefits or privileges.”¹³⁶ Summarizing prior case history, the court held that three types of levies did not constitute special taxes under the California constitution.¹³⁷ The first were “special assessments on property or similar business charges, in amounts reasonably reflecting the value of the benefits conferred by improvements” such as those on businesses for downtown promotion or street construction.¹³⁸ The second category consisted of

129. *San Marcos Water Dist. v. San Marcos Unified Sch. Dist.*, 720 P.2d 935, 939 (Cal. 1986) (quoting *Spring St. Co. v. City of Los Angeles*, 148 P.217 (Cal. 1915)), *superseded by statute*, CAL. GOV'T CODE § 54999 (West 2010).

130. *Knox v. City of Orland*, 841 P.2d 144, 150–52 (Cal. 1992), *superseded by constitutional amendment*, CAL. CONST. art. XIID, § 3.

131. *Howard Jarvis Taxpayers Ass'n v. City of Riverside*, 86 Cal. Rptr. 2d 592, 595 (Ct. App. 1999).

132. *Id.*

133. *See, e.g., Sinclair Paint Co. v. State Bd. of Equalization*, 937 P.2d 1350, 1351 (Cal. 1997).

134. *Id.* at 1352.

135. *Id.* at 1358.

136. *Id.* at 1354 (internal citations omitted).

137. *Id.* at 1353–56.

138. *Id.* at 1354 (emphasis omitted) (citing *Evans v. City of San Jose*, 4 Cal. Rptr. 2d 601, 605–08 (Ct. App. 1992) (“assessments on businesses for the purposes of general downtown promotion”)); *see also J.W. Jones Cos. v. City of San Diego*, 203 Cal. Rptr. 580, 583–89 (Ct. App. 1984) (“facilities benefit assessments”); *City Council v. South*, 194 Cal. Rptr. 110, 118 (Ct. App. 1983) (special assessments on real property); *County of Fresno v. Malmstrom*, 156 Cal. Rptr. 777, 783 (Ct. App.

“development fees exacted in return for building permits or other governmental privileges” if the fee amount is reasonable in light of the community’s costs and the developer’s gains.¹³⁹ The third were regulatory fees that “do not exceed the reasonable cost of providing services necessary to the activity for which the fee is charged and which are not levied for unrelated revenue purposes.”¹⁴⁰

The court found that regulatory fees are permissible even when the payors are unable to reap a tangible benefit,¹⁴¹ noting that “if regulation is the primary purpose of the fee measure, the mere fact that the measure also generates revenue does not make the imposition a tax.”¹⁴² The court viewed these fees as an exercise of the police power, not the taxing power.¹⁴³ The *Sinclair* court held that the lead pollution fee in question was a permissible regulatory fee.¹⁴⁴ The court found that the same policing authority which permitted the operation of the companies and businesses could reasonably regulate and expect them to contribute to the “cleanup” of the lead problem.¹⁴⁵ Further-

1979) (special assessments for construction of streets) *superseded by constitutional amendment*, CAL. CONST. art. XIII A, § 4.

139. *Sinclair*, 937 P.2d at 1354 (emphasis omitted) (citing *Shapell Indus., Inc. v. Governing Bd.*, 1 Cal. Rptr. 2d 818 (Ct. App. 1991) (“school facilities fee”)); *see also Bixel Assocs. v. City of Los Angeles*, 265 Cal. Rptr. 347, 349 (Ct. App. 1989) (“fire hydrant fees”); *Cal. Bldg. Indus. Ass’n. v. Governing Bd.*, 253 Cal. Rptr. 497, 510–11 (Ct. App. 1988) (school development fees); *Russ Bldg. P’ship v. City of San Francisco*, 246 Cal. Rptr. 21, 24–26 (Ct. App. 1987) (“transit impact fee”) *aff’d in part, rev’d in part*, *Russ. Bldg. P’ship v. City of San Francisco*, 750 P.2d 324 (Cal. 1988); *Beaumont Inv’rs v. Beaumont-Cherry Valley Water Dist.*, 211 Cal. Rptr. 567, 571–73 (Ct. App. 1985) (new facilities water hookup fees); *Trent Meredith, Inc. v. City of Oxnard*, 170 Cal. Rptr. 685, 689–91 (Ct. App. 1981) (fees as precondition for building permits); *Mills v. County of Trinity*, 166 Cal. Rptr. 674, 676–78 (Ct. App. 1980) (“fees for county services in processing subdivision, zoning, and other land use applications”); *Ehrlich v. Culver City*, 911 P.2d 429, 458–59 (Cal. 1996).
140. *Sinclair*, 937 P.2d at 1355 (citing *City of Oakland v. Superior Court*, 45 Cal. App. 740 (1996) (upholding charges on alcohol sales licenses to support a project addressing public nuisances associated with alcohol sales as regulatory fees)); *see also Kern Cty. Farm Bureau v. County of Kern*, 23 Cal. Rptr. 2d 910, 914–17 (Ct. App. 1993) (upholding landfill assessment based on land use to reduce illegal waste disposal); *City of Dublin v. County of Alameda*, 17 Cal. Rptr. 2d 845, 855–58 (Cal. Ct. App. 1993) (upholding waste disposal surcharge imposed on waste haulers); *San Diego Gas & Elec. Co. v. San Diego Cty. Air Pollution Control Dist.*, 250 Cal. Rptr. 420, 428–31 (Ct. App. 1988) (upholding emissions-based formula for recovering direct and indirect costs of pollution emissions permit programs); *United Bus. Comm’n. v. City of San Diego*, 154 Cal. Rptr. 263, 269–72 (Ct. App. 1979) (upholding fees for inspecting and inventorying on-premises advertising signs).
141. *Sinclair*, 937 P.2d at 1355.
142. *Id.* at 1358 (citing *United Bus. Comm’n.*, 154 Cal. Rptr. 263).
143. *Id.* at 1356.
144. *Id.* at 1358.
145. *Id.* at 1356.

more, the court asserted that fees could regulate behavior by deterring future manufacturing and sale of lead products.¹⁴⁶

In the wake of *Sinclair Paint*, California voters further restricted user fees.¹⁴⁷ Proposition 26, which voters approved in 2010, added a new definition of user fees to the California constitution that was much narrower than that offered by the court.¹⁴⁸

Proposition 26 defines a tax as “any levy, charge, or exaction of any kind imposed by the State” unless the levy, charge, or exaction falls into five narrow exceptions.¹⁴⁹ The exceptions include (1) charges where only the party that pays receives a specific benefit or privilege from the State and are not greater than the State’s reasonable costs in conferring that benefit or granting the privilege; (2) charges where only the party that pays receives a specific service or product from the state and which are not greater than the State’s reasonable costs in providing the service or product; (3) charges related to administrative and regulatory costs the State incurs in issuing permits or undertaking inspections and audits; (4) charges connected with use of state property; and (5) fines and penalties imposed by the judiciary for legal violations.¹⁵⁰

In *Schmeer v. County of Los Angeles*, the court upheld a county ordinance that banned stores from providing plastic bags and imposed a ten-cent-per-bag charge on paper bags because the stores, rather than the county, collected and kept the proceeds from the charge.¹⁵¹ The *Schmeer* court limited the definition of “any levy charge, or exaction of any kind imposed by a local government” to those paid to the government.¹⁵² Courts have continued to interpret the Proposition 26 exceptions to include a variety of charges.¹⁵³

146. *Id.*

147. *Schmeer v. County of Los Angeles*, 153 Cal. Rptr. 3d 352, 361 (Ct. App. 2013).

148. *Id.* at 363–64.

149. CAL. CONST. art. XIII A, § 3(b).

150. *Id.* § 3(b)(1–5).

151. *Schmeer*, 153 Cal. Rptr. 3d at 354, 366.

152. *Id.* at 364–65.

153. For example, in *California Building Industry Ass’n v. State Water Resources Control Board*, the court upheld the State Water Resources Control Board’s fee on those who discharged waste that could impact the state’s water quality. 186 Cal. Rptr. 3d 212, 216 (Ct. App. 2015) *superseded by* 352 P.3d 418 (Cal. 2015). Each party who emits such waste discharge was required to file a report and pay a fee to be deposited in the Waste Discharge Permit Fund for use by the State Water Resources Control Board. *Id.* at 216–17. The court found the charges were reasonable because they were not demonstrated to exceed the program’s costs, nor was it proven that “allocation of the fees was unfair or unreasonable.” *Id.* at 216. The court also noted that “the reasonableness of the fee is not measured by the impact on an individual payor,” but by consideration of all cost and all payors. *Id.* at 228 (citing *Cal. Farm Bureau Fed’s v. State Water Res. Control Bd.*, 247 P.3d 112, 124 (Cal. 2011)). *City of San Buenaventura v. United Water Conservation District* involved a district which managed groundwater and a city which pumped

So far, no other state has chosen to follow California's lead in expanding the definition of tax so broadly or offering such precise constitutional guidance about the difference between the two categories of taxes and fees.¹⁵⁴

4. Federal Court Approaches

In addition to these state court approaches, federal courts have created their own tests for distinguishing taxes from user fees. As discussed in section II.A, federal courts must distinguish between state taxes and state user fees in several settings.

The dominant federal law approach is a multi-factor test developed by then-Circuit Court Judge Stephen Breyer in a case brought by San Juan Cellular Telephone Company against the Commonwealth of Puerto Rico.¹⁵⁵ Breyer provided three factors to determine whether the levies imposed by Puerto Rico on cellular providers were taxes subject to the Tax Injunction Act. Those factors are (1) "the entity that imposes the assessment;" (2) "the parties upon whom the assessment is imposed;" and (3) "whether the assessment is expended for general public purposes, or used for the regulation or benefit of the parties upon whom the assessment is imposed."¹⁵⁶

Under the first factor, courts assume that levies imposed by administrative agencies, as opposed to the legislature, are more likely to be user fees.¹⁵⁷ Under the second factor, the courts consider the rela-

the District's water for sale to its residents. 185 Cal. Rptr. 3d 207, 210 (Ct. App. 2015), *petition for review granted*, 351 P.3d 328 (Cal. 2015), *superseded by* 406 P.3d 733 (2017). The District charged a fee for the pumping, assessed by volume and whether the use was agricultural or not. Combinations of separate billing zones led to higher groundwater pumping rates for some and the City objected, alleging, in part, that the increase was contrary to provisions of Propositions 13, 218, and 26. *Id.* at 212–13, 216. The court held the pump fees were not property-related charges, and thus, Proposition 218 was inapplicable. *Id.* at 221. The court also held that fees were not taxes because they fell into the "payor-specific benefits and privileges" exception by granting those who pay the charge the right to use the groundwater. *Id.* at 225–26.

154. LEAGUE OF CALIFORNIA CITIES, PROPOSITION 26 IMPLEMENTATION GUIDE 1–6 (2011) (describing the specific history of California's definition of taxation).
155. *San Juan Cellular Tel. Co. v. Pub. Serv. Comm'n of P.R.*, 967 F.2d 683 (1st Cir. 1992). There is also a line of cases exploring the validity of federal user fees. Gillette and Hopkins, *supra* note 28, at 822–45, discuss such cases brought under the Independent Offices Appropriation Act and other statutory authority. The relevant portion of the Independent Offices Appropriation Act was codified as 31 U.S.C. § 9701 and provides statutory authority for agencies to charge fees for services.
156. *Bidart Bros v. California Apple Comm'n*, 73 F.3d 925, 931 (9th Cir. 1996) (citing *San Juan Cellular*, 967 F.2d at 685).
157. *Id.* At the federal level, it is true that user fees are generally set by agencies. Gillette & Hopkins, *supra* note 28, at 822 ("Congress, however, does not possess the capacity to set individually the myriad fees for the vast array of services that the government provides. That function must, as a practical necessity, be per-

tionship of the party to the assessment,¹⁵⁸ and under the third factor, federal courts look at the relationship between the levy and the benefit conferred.¹⁵⁹ To the extent the levy provides a more generalized public benefit, such as funding public schools, the levy is more likely to be a tax.¹⁶⁰ To the extent the levy imposes a particularized benefit or covers the administrative costs of regulating a particular business activity, it is more likely to be a user fee.¹⁶¹ Justice Breyer's multi-factor approach, however, is subject to many of the same definitional problems as the multi-factor tests developed by state courts. For example, because government revenue is fungible, it is not clear what should turn on whether a particular levy is earmarked for a particularized benefit or a more generalized public benefit.

As described in this section, courts use a variety of tests to determine whether a given government extraction is a tax or a user fee. As I will detail in the next Part, none of these tests are particularly helpful when it comes to classifying Pigovian extractions.

III. PIGOVIAN TAXES V. PIGOVIAN USER FEES

Economists have long called on policymakers to consider an alternative to the traditional income tax base, one that addresses negative externalities, that is, the "uncompensated cost[s] that [people] impose[] on others."¹⁶² Economists call such taxes Pigovian taxes, after the English economist Arthur Pigou, who first developed the idea of imposing a tax equal to the magnitude of the harm caused by the externality.¹⁶³ However, Pigovian pricing can also be considered a variant of user fees, where the payor is paying for the externality costs she imposes on society through her actions.¹⁶⁴

When Arthur Pigou first developed the idea of a compensatory tax, he saw it as an efficient response to a variety of externalities.¹⁶⁵ Pigou was concerned about pollution in rapidly industrializing England, and his discussion of externalities referenced the example of a factory increasing congestion, reducing light, and causing health problems for

formed by the provider of the service, typically an administrative agency within the executive branch."). Of course, this is not always the case at the state or local level.

158. *San Juan Cellular*, 967 F.2d at 685.

159. *Id.*

160. *Id.*

161. *Id.* at 685–86.

162. PAUL KRUGMAN & ROBIN WELLS, *MICROECONOMICS* 437 (2d ed. 2009).

163. *Id.* at 443–44.

164. See Gillette & Hopkins, *supra* note 28, at 803–04 (discussing externalities as a market failure that can be addressed by user fees).

165. See generally ARTHUR C. PIGOU, *THE ECONOMICS OF WELFARE* (4th ed. 1920), http://lf-oll.s3.amazonaws.com/titles/1410/Pigou_0316_EBk_v6.0.pdf [https://perma.unl.edu/M9G6-T8QW].

those living in its neighborhood.¹⁶⁶ But Pigou also considered other types of social harms. For example, he argued that businesses selling alcohol produce net social costs.¹⁶⁷

Pigovian charges can address a variety of externalities, but they have caught hold most deeply in environmental economics as an efficient way to reduce the costs of pollution.¹⁶⁸ Many economists have been enthusiastic about Pigovian approaches because they offer the potential of a “double dividend.” Fans of this approach argue that the collection of this revenue offers the opportunity to improve efficiency. Transactions that don’t happen because of the Pigovian tax are inefficient. Not only does the Pigovian tax produce the desired behavioral response,¹⁶⁹ but, by pricing the externality, it also potentially raises revenue the government can spend for other purposes, hence the double dividend.¹⁷⁰

Of course, the possibility of this double dividend actually being delivered depends on a number of assumptions about the implementation of the tax and the ways it would interact with existing regulations

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166. *Id.* at 108 (“They are rendered, again, when the owner of a site in a residential quarter of a city builds a factory there and so destroys a great part of the amenities of the neighbouring sites; or, in a less degree, when he uses his site in such a way as to spoil the lighting of the houses opposite: or when he invests resources in erecting buildings in a crowded centre, which, by contracting the air space and the playing-room of the neighbourhood, tend to injure the health and efficiency of the families living there. Yet again, third parties—this time the public in general—suffer incidental uncharged disservices from resources invested in the running of motor cars that wear out the surface of the roads.”).
167. *Id.* at 111 (“The private net product of any unit of investment is unduly large relatively to the social net product in the businesses of producing and distributing alcoholic drinks. Consequently, in nearly all countries, special taxes are placed upon these businesses.”).
168. Pigouvian Taxes, *ECONOMIST* (Aug. 19, 2017), <https://www.economist.com/news/economics-brief/21726709-what-do-when-interests-individuals-and-society-do-not-coincide-fourth> [https://perma.unl.edu/Y88A-JYXP].
169. Of course, as Katie Pratt reminded me, the potential behavioral response to the pricing regime will also be affected by the elasticity of the priced goods. Pricing regimes might not work as well as command-and-control regulation if we are very worried about inelastic demand, and if a particular charge doesn’t change behavior, the distributional effects of the charge may be quite regressive. In other words, Pigouvian taxation in and of itself does not necessarily resolve an equity versus efficiency debate. See Don Fullerton & Gilbert E. Metcalf, *Environmental Taxes and the Double-Dividend Hypothesis: Did You Really Expect Something for Nothing?*, 73 *Chi.-Kent L. Rev.* 221, 223 (1998) (“Thus the impact of the reform depends on how it affects relative prices and incentives to work, produce, and pollute.”); see also Katherine Pratt, *A Constructive Critique of Public Health Arguments for Anti-obesity Soda Taxes and Food Taxes*, 87 *TUL. L. REV.* 73, 122–35 (2012) (discussing these distributional effects in the context of taxes designed to curb obesity).
170. See generally DALE W. JORGENSON ET AL., *DOUBLE DIVIDEND: ENVIRONMENTAL TAXES AND FISCAL REFORM IN THE UNITED STATES* (2013) (modeling the possibility of a double dividend).

and taxes.¹⁷¹ Because the Pigovian levy achieves its regulatory purpose no matter how the funds are spent, economists have long suggested that an attractive feature of Pigovian taxation is that it can reduce dependence on inefficient taxation.¹⁷² For example, economist Gilbert Metcalf has proposed a federal carbon tax that would allow Congress to cut payroll tax rates, thereby increasing the progressivity of federal taxation.¹⁷³ There is no obvious relationship between the goals of reducing carbon emissions and increasing federal tax progressivity. Such indifference to the way revenue is spent is at odds, however, with traditional state user fee doctrine, which, as discussed above, focuses on how the revenue is spent.

This Part explores two different policies that could be characterized as Pigovian in nature. The first, an emissions tax, is the classic example of a Pigovian tax. The second, stormwater remediation fees, are often structured as utility fees (like municipal trash and water charges), but have a Pigovian element.

A. Emissions Taxes

1. *Emissions Taxes in Theory*

Pollution has long been a by-product of industrialization. Centuries before scientists noted the dangers of climate change, residents of factory towns complained.¹⁷⁴ Pittsburgh's steel mills made the city dark even during daytime hours.¹⁷⁵ For centuries, no one has wanted to live near a tannery.

The Industrial Revolution demanded a government response to pollution abatement, but crafting statutes that effectively improved the environment was not an easy task.¹⁷⁶ Abandoning classic land use controls like zoning and common law nuisance claims, the modern en-

171. See Fullerton & Metcalf, *supra* note 169, at 223 (“Thus the impact of the reform depends on how it affects relative prices and incentives to work, produce, and pollute.”).

172. *Id.* at 232–38 (discussing literature on double-dividend hypothesis and efforts to simulate the possible efficiency gains from pollution tax revenue).

173. Gilbert E. Metcalf & David Weisbach, *The Design of a Carbon Tax*, 33 HARV. ENVTL. L. REV. 499, 517 (2009) (indicating that revenue generated from a carbon tax could be passed on as savings via cuts to income or payroll taxes); see also N. Gregory Mankiw, *One Answer to Global Warming: A New Tax*, N.Y. TIMES (Sept. 16, 2007), <http://www.nytimes.com/2007/09/16/business/16view.html> (discussing the Metcalf proposal).

174. See Joel Franklin Brenner, *Nuisance Law and the Industrial Revolution*, 3 J. LEGAL STUD. 403, 416–18 (1974).

175. Mark Byrnes, *What Pittsburgh Looked Like When It Decided It Had a Pollution Problem*, CITYLAB (June 5, 2012), <https://www.citylab.com/design/2012/06/what-pittsburgh-looked-when-it-decided-it-had-pollution-problem/2185> [<https://perma.unl.edu/K7LP-K2GF>].

176. See Brenner *supra* note 174, at 425–28 (discussing early British statutes combating pollution).

vironmental movement first sought to protect the environment by setting emissions levels, banning pollutants, and mandating that businesses use specific technologies to abate pollution.¹⁷⁷

By the late 1970s, a growing number of environmental economists and policymakers began to question this approach, termed the “command-and-control” model of pollution control.¹⁷⁸ These scholars criticized the command-and-control model as “forc[ing] firms to shoulder similar shares of the pollution-control burden, regardless of the relative costs to them.”¹⁷⁹ Such standards failed to incentivize those firms or industries which are able to abate emissions much more cheaply. As a result, command-and-control efforts did not necessarily focus on the cheapest abatement options.¹⁸⁰ Neither did such policies incentivize emissions reductions beyond the required amount, even when such reductions were relatively cheap. As a result, “command . . . and . . . control regulations tend to freeze the development of technologies that might otherwise result in greater levels of control.”¹⁸¹

Armed with the insights of Pigovian theory, scholars critical of command-and-control policies argued that lawmakers should adopt market-based regulations.¹⁸² They argued that such market-based regulations would allow companies to profit from their innovation and focus abatement activity within the firms and sectors where pollution reductions were the most cost-effective.¹⁸³ Command-and-control policies still have a place in ensuring environmental quality, especially for substances for which there is no safe level of use and which can be phased out without significant economic costs. However, the debate about climate change policies has shifted to a market-based approach, in part because carbon-emitting activities are so central to the economy.¹⁸⁴

For example, under an emissions tax, firms pay a per-unit fee for emissions. An ideal emissions tax sets this fee equal to the marginal social cost of producing an additional unit of emissions.¹⁸⁵ In other

177. See, e.g., William D. Ruckelshaus, *Environmental Protection: A Brief History of the Environmental Movement in America and the Implications Abroad*, 15 ENVTL. L. 455, 457–60 (1985).

178. See Rena I. Steinzor, *Reinventing Environmental Regulation: The Dangerous Journey from Command to Self-Control*, 22 HARV. ENVTL. L. REV. 103, 103 n.1, 107 (1998) (discussing the traditional critiques of command-and-control).

179. Robert N. Stavins, *Market-Based Environmental Policies*, in PUBLIC POLICIES FOR ENVIRONMENTAL PROTECTION 32 (Paul R. Portney & Robert N. Stavins eds., 2d ed. 2000).

180. *Id.*

181. *Id.*

182. See, e.g., Bruce A. Ackerman & Richard B. Stewart, *Reforming Environmental Law*, 37 STAN. L. REV. 1333 (1985).

183. *Id.* at 1341–42.

184. THE ECONOMIST, *supra* note 168.

185. KRUGMAN & WELLS, *supra* note 162, at 442.

words, the tax requires the firm to internalize the full social harm that their emissions-producing activities create.¹⁸⁶ Firms that can abate cheaply will do so rather than pay the tax. Firms who cannot afford the abatement cost will either pay the tax or exit the market.

2. Emissions Taxes in Practice

Following the Pigovian model, a handful of countries have implemented a pollution tax on carbon emissions.¹⁸⁷ In the United States, a handful of local governments have imposed climate charges.¹⁸⁸ For example, in 2007, Boulder, Colorado, became the first municipality in

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186. In addition to a Pigovian tax, policymakers also explored another “market” approach to limiting emissions, a cap-and-trade system. Under a cap-and-trade (or marketable permit) system, the government regulates emissions quantity, setting a maximum amount of emissions and then either allocating or auctioning permits that allow companies to emit pollutants up to that quantity. By allowing firms to trade permits, the government creates a situation where firms facing a high cost of abatement can purchase permits from firms with a lower abatement cost. See *Policy Basics: Policies to Reduce Greenhouse Gas Emissions*, CTR. ON BUDGET & POLICY PRIORITIES, (2015), http://www.cbpp.org/sites/default/files/atoms/files/PolicyBasic_CapTrade.pdf (providing a basic description of a cap-and-trade program) [<https://perma.unl.edu/25BD-D3HM>]. Both approaches encourage cost-effective emissions abatement. See OFFICE OF POL’Y, ECON., & INNOVATION, INTERNATIONAL EXPERIENCES WITH ECONOMIC INCENTIVES FOR PROTECTING THE ENVIRONMENT ii–iii (identifying advantages of market-based approaches to pollution control). Whether a permit system or a tax is the optimal policy depends upon case-specific factors. See Luca Taschini et al., *Carbon Tax v Cap-and-Trade: Which Is Better?*, GUARDIAN (Jan. 31, 2013), <https://www.theguardian.com/environment/2013/jan/31/carbon-tax-cap-and-trade> [<https://perma.unl.edu/EB96-35EN>]; see generally Lawrence H. Goulder & Andrew R. Schein, *Carbon Taxes Versus Cap and Trade: A Critical Review*, CLIMATE CHANGE ECON., Nov. 18, 2013, <https://web.stanford.edu> [<https://perma.unl.edu/L6C4-3NE9>].
187. Sweden and Finland adopted such taxes in the early 1990s. *Where Carbon Is Taxed*, CARBON TAX CTR., <http://www.carbontax.org/where-carbon-is-taxed/> [<https://perma.unl.edu/8H7W-CSNJ>]. Ireland implemented a carbon tax in 2010 (and used carbon tax revenue to offset declining income tax revenues during the Great Recession). Frank Convery, *Budget 2013 – Three Cheers for the Carbon Tax*, PUB. POL’Y.IE (Sept. 21, 2012), <http://www.publicpolicy.ie/budget-2013-three-cheers-for-the-carbon-tax/> [<https://perma.unl.edu/TUQ2-GRYZ>]. Two Canadian provinces have also implemented a Carbon Tax. *British Columbia / Canada*, CARBON TAX CTR., <http://www.carbontax.org/where-carbon-is-taxed/british-columbia/> [<https://perma.unl.edu/2VAG-Y7WL>].
188. See Roberta F. Mann, *Federal, State, and Local Tax Policies for Climate Change: Coordination or Cross-Purpose?*, 15 LEWIS & CLARK L. REV. 369, 389 (2011) (“State and local governments will likely be significantly involved in climate adaptation measures, as droughts and floods resulting from climate change have differing impacts across the nation.”); Deborah Salon et al., *City Carbon Budgets: A Proposal to Align Incentives for Climate-Friendly Communities*, 38 ENERGY POL’Y 2032 (2010) (proposing a mechanism to decrease greenhouse gas emissions through city policy changes to encourage greener building and less driving).

the United States to enact a carbon tax,¹⁸⁹ while the Bay Area Air Quality Management District imposed regional carbon pricing in 2008.¹⁹⁰

Boulder's tax, called the climate action plan (CAP) tax raises almost \$2 million in revenue every year. The city uses this revenue to fund "programs and services designed to reduce local greenhouse gas emissions" by "encouraging residents and businesses to reduce energy waste, save money on energy costs over time, and minimize reliance on external energy sources."¹⁹¹ Boulder first implemented its carbon charges in 2007, and voters renewed the tax in November 2015.¹⁹² Boulder levies the tax based on energy usage. For residential electric users, the average tax is only \$21 a year, while for commercial users, the average tax is \$94, and for industrial users, the average tax is \$9,600.¹⁹³ These averages reflect differences in energy use. The tax rate per kilowatt used is highest for residential users.¹⁹⁴ The tax is collected by Boulder's energy company, and consumers who elect to receive a portion of their electricity from wind are not taxed on that portion of energy consumption.¹⁹⁵

Washington, Rhode Island, and Massachusetts have also considered charging for carbon emissions, though those efforts have stalled. In 2016, Washington voters rejected Initiative 732, which would have imposed a statewide carbon tax.¹⁹⁶ Observers blame this, in part, on the inability of carbon tax advocates to agree on a single proposal.¹⁹⁷ Supporters of the tax have vowed to renew their efforts, but a legislative effort to impose the tax died in early 2018.¹⁹⁸ The Rhode Island

189. Nicole Beletsky, *Municipalities Join the Great Debates on Cap and Trade, and Carbon Taxes*, FORDHAM URB. L.J. (Mar. 25, 2014), <http://urbanlawjournal.com/municipalities-join-the-great-debates-on-cap-and-trade-and-carbon-taxes/> [https://perma.unl.edu/6RAM-346D].

190. JENNY SUMNER ET AL., NAT'L RENEWABLE ENERGY LAB., CARBON TAXES: A REVIEW OF EXPERIENCE AND POLICY DESIGN CONSIDERATIONS 17 (2009), <http://www.nrel.gov/docs/fy10osti/47312.pdf> [https://perma.unl.edu/5357-Q253].

191. *Boulder's Climate Action Plan (CAP)*, CITY OF BOULDER, https://www.bouldercolorado.gov/docs/City_of_Boulder_-_Climate_Action_Plan_Handout_2015-1-201508261630.pdf [https://perma.unl.edu/QL2P-XA9C].

192. *Climate Action Tax*, CITY OF BOULDER, <https://bouldercolorado.gov/climate/climate-action-plan-cap-tax> [https://perma.unl.edu/XCC3-DPHM].

193. *Id.*

194. *Id.* (\$0.0049/kWh for residential; \$0.0009/kWh for commercial; and \$0.0003/kWh for industrial electricity users).

195. *Id.*

196. Lewis Kamb, *Washington Voters Reject Initiative to Impose Carbon Tax on Fossil Fuels*, SEATTLE TIMES (Nov. 9, 2016), <https://www.seattletimes.com/seattle-news/politics/carbon-emissions-tax-initiative-732/> [https://perma.unl.edu/YR3C-E7DU].

197. *Id.*

198. *Washington State's Carbon-Tax Bill Dies in Legislature*, SEATTLE TIMES (March 2, 2018), <https://www.seattletimes.com/seattle-news/politics/washington-states-carbon-tax-bill-dies-in-legislature/> [https://perma.unl.edu/RTD6-ZT8X].

and Massachusetts proposals are both legislative efforts, and while there seemed to have been momentum behind both proposals, efforts to enact the legislative proposals have stalled.¹⁹⁹ In addition, Montgomery County, Maryland, briefly attempted to impose a carbon tax on large emitters but repealed the tax when it came under legal attack.²⁰⁰

3. *Emissions Taxes Under State Law*

Most carbon tax proposals assume that such policies need to be enacted pursuant to state or local taxing authority. Boulder, for example, enacted its CAP tax subject to the strictures of Colorado's Taxpayer's Bill of Rights (TABOR).²⁰¹ The CAP tax, as described above, functions as an excise tax on the purchase of electricity generated by carbon. As required by TABOR, the tax was approved by voter initiative. Those implementing the CAP tax chose to seek voter approval to avoid the legal challenges that might have arisen had Boulder's city council adopted the CAP program as a fee.²⁰² Proposals to enact carbon taxes in Washington State assumed that these carbon taxes would be treated as taxes under state law.²⁰³ While news coverage of the Rhode Island proposal called it a carbon tax, the legislative language introduced in the House suggested carbon pricing was, in fact, a fee.²⁰⁴

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199. Alex Kuffner, *Carbon Taxing Proposal Back Before the General Assembly*, PROVIDENCE J. (Feb. 2, 2017), <http://www.providencejournal.com/news/20170202/carbon-taxing-proposal-back-before-general-assembly> [<https://perma.unl.edu/L4DL-6HHA>]; Bruce Gellerman, *A 'Tax' or 'the Cost of Pollution'? Mass. Debates Surcharge on Fossil Fuels*, WBUR (Sept. 19, 2017), <http://www.wbur.org/bostonmix/2017/09/19/massachusetts-surcharge-fossil-fuels> [<https://perma.unl.edu/RHG3-G9C6>].
200. Michael Laris & Michael Birnbaum, *Montgomery County Raises Various Taxes*, WASH. POST (May 20, 2010), <http://www.washingtonpost.com/wp-dyn/content/article/2010/05/19/AR2010051904923.html> [<https://perma.unl.edu/GV8M-RZ5Y>]; Montgomery Cty., Md., Res. 17-484 (July 10, 2012) https://www.montgomerycountymd.gov/council/resources/files/res/2012/20120710_17-484.pdf [<https://perma.unl.edu/9HB6-38TN>].
201. COLO. CONST. Art. X, § 20.
202. CAROLYN BROUILLARD & SARA VAN PELT, A COMMUNITY TAKES CHARGE: BOULDER'S CARBON TAX 7 (2007), <https://www-static.bouldercolorado.gov/docs/community-takes-charge-boulders-carbon-tax-1-201305081136.pdf> [<https://perma.unl.edu/LJU4-ACRL>].
203. Robinson Meyer, *Maybe Blue States Won't Take Serious Action on Climate Change*, ATLANTIC (Mar. 2, 2018), <https://www.theatlantic.com/science/archive/2018/03/carbon-tax-fails-in-washington-blue-states-climate-change/554693/> [<https://perma.unl.edu/6TMF-HK4C>] (describing a Washington state legislative proposal as a tax of \$12 per ton of carbon emissions).
204. Kuffner, *supra* note 199; The Energize Rhode Island: Clean Energy Investment and Carbon Pricing Act of 2017, H. 5369 2017 Gen. Assemb. (R.I. 2017).

Because Massachusetts Governor Charlie Baker opposed tax increases, legislators in that state proposed imposing carbon pricing as a fee.²⁰⁵ Journalists covering the proposal repeatedly noted that, as a legal matter, the program would establish a fee and not a tax. For example, one journalist reported, “The rebate provision ensures that legally, it is a fee, not a tax.”²⁰⁶ Boston’s public radio station observed, “Under Barrett’s proposal, residents would get a check from the proceeds of the carbon fee. Under state law, it’s not a tax because the money would not go to general revenue, but would go directly back to taxpayers.”²⁰⁷

The Massachusetts Senate bill proposed a carbon emissions “charge” of \$10 per ton of CO₂ the first year, which will increase by \$5 each year until it reaches \$40 per ton.²⁰⁸ The revenue would be returned to residents and employers as rebates calculated by the commissioner of energy.²⁰⁹

To date, no state court has considered whether a carbon tax policy could be adopted pursuant to a government’s fee authority. Whether such a claim would be successful depends both on the specifics of the program and on state law. For example, Boulder’s carbon tax was explicitly designed to raise general revenue and in implementing the proposal, city staff considered a wide variety of revenue options. Such legislative history would make it more difficult to pass muster as a fee.

However, to the extent that the goal of carbon pricing is primarily to regulate behavior (and not to raise revenue), and to the extent that revenue is targeted toward efforts aimed at reducing carbon emissions, there is a strong argument under the general revenue approach that carbon pricing is not a tax, but rather a fee imposed pursuant to a regulatory policy.

Many of the factors in the multi-factor approach suggest that a properly designed carbon-pricing program could be considered a fee, depending, as always, on how these factors are interpreted under specific state law. For example, the carbon fee is voluntary to the extent that emitters can also choose to reduce their emissions and lower their tax burden. The choice between reducing emissions and paying a carbon fee is certainly more voluntary than the option faced by Michigan pawnbrokers in *USA Cash #1, Inc. v. City of Saginaw*, who had to

205. S. 1821, 190th Gen. Court, Reg. Sess. (Mass. 2017).

206. Shira Schoenberg, *Environmentalists Push Carbon Fee in Massachusetts*, MASS LIVE (Oct. 27, 2015), http://www.masslive.com/politics/index.ssf/2015/10/environmentalists_push_carbon.html [https://perma.unl.edu/W89D-JR7N].

207. Fred Thys, *With Mass. Off Track on Emissions Goal, Advocates Seek 1st State Carbon Tax*, WBUR (Mar. 12, 2015), <http://www.wbur.org/news/2015/03/12/massachusetts-carbon-tax-proposal> [https://perma.unl.edu/WEG9-NN35].

208. S. 1747, 189th Gen. Court, Reg. Sess. § 3 (Mass. 2015).

209. *Id.*

either pay the challenged tax or reduce their business operations significantly.²¹⁰

The difficulty of classifying carbon pricing as a fee is that, unlike other traditional user fees, carbon taxes can collect significant revenues, and spending this revenue only on areas with an obvious nexus with the program may make little sense. The carbon tax itself may accomplish a significant private-sector shift in greenhouse gas emissions, and spending the majority of dollars raised chasing this same goal may not be a particularly effective use of additional money, especially given the opportunity to reduce other taxes or fund other programs.

Massachusetts's climate advocates, noting this problem, attempted to craft a revenue neutral carbon-pricing program. Under this proposal, carbon-pricing revenues would offset other tax cuts. Consultants suggested that this would make the proposal more fee-like, though the consultants also noted that the carbon-pricing model may require a new category.²¹¹

Recent California litigation suggests that courts may also struggle to categorize other types of carbon pricing policies. The California Chamber of Commerce (among other plaintiffs) challenged California's emissions permit auction as an unlawful tax, put in place without the supermajority support required to impose new taxes under California law.²¹² Both the trial and appeals courts that heard this claim rejected it and the California Supreme Court refused certiorari.²¹³ However, district and appellate courts used strikingly different frameworks for reaching this result and comparing the two opinions suggests the continuing confusion surrounding the definition of "tax." Further, because Proposition 26 was passed after the legislative authorization of the carbon auction, both courts refused to consider the carbon auction under its broad definition of tax.²¹⁴ A closer look at the two court opinions suggests the ways in which the tax versus user fee distinction fails to clarify carbon-pricing policies.

The California district court readily admitted that it found the auction pricing had similarities to both taxes and to fees.²¹⁵ The district

210. *See supra* subsection II.C.2.

211. MARC BRESLOW ET AL., MASS. DEP'T OF ENERGY RESOURCES, ANALYSIS OF A CARBON FEE OR TAX AS A MECHANISM TO REDUCE GHG EMISSIONS IN MASSACHUSETTS 41–42 (2014).

212. Cal. Chamber of Commerce v. Cal. Air Res. Bd., 216 Cal. Rptr. 3d 694, 699–700 (Ct. App. 2017), *cert. denied*, (2017).

213. *Id.* at 719–20; Cal. Chamber of Commerce v. Cal. Air Res. Bd., No. 34-2012-8001313, 2013 WL 12204350 (Sup. Ct. Dec. 2, 2013).

214. Cal. Air Res. Bd., 216 Cal. Rptr. 3d at 719–20; Cal. Air Res. Bd., 2013 WL 12204350, at *18–19.

215. Cal. Chamber of Commerce v. Cal. Air Res. Bd., No. 34-2012-8001313, 2013 WL 12108277, at *5 (Cal. Sup. Ct. Aug. 28, 2013).

court ultimately concluded that under *Sinclair Paint*, the auction was closer to a regulatory fee than a tax since it was seeking to regulate behavior.²¹⁶

The California appellate court, in a split 2–1 opinion, also declined to hold that the auction was an unlawful tax.²¹⁷ The appellate court, however, did not base its decision on *Sinclair Paint*. Rather the court held that while *Sinclair* does distinguish regulatory fees from taxes, it does not provide an exclusive test for determining when the state is using its police power rather than its taxing authority, and as the court noted, the carbon auction was not really a regulatory fee because it was not trying to recoup costs incurred by the state as a result of a payor's activities.²¹⁸

Rather, in determining the auction as something other than a tax, the court held that the hallmarks of a non-tax payment are its voluntariness and the payor's receipt of a benefit.²¹⁹ The court found the payment was voluntary because businesses had many options other than purchasing emissions permits at auction: they could reduce their emissions via investments in improved technology, they could pay emissions permits on the post-auction market, they could bank emissions from prior years, and they could receive emissions credits from reductions in emissions from activities in non-covered sectors.²²⁰ The court also found the emissions permits conferred a benefit on the payors: the license to emit pollutants.²²¹ The court rejected the plaintiff's contention that the permits only conferred on them the ability to do something they already had the legal right to do. As the court noted, the litigants had no vested legal right to continue polluting and that California could have decided to limit pollutants rather than provide for an emissions auction.²²²

In some sense, the appellate court's opinion provides clear guidance to policymakers attempting to craft carbon pricing policies in California going forward: voluntariness is key. Nevertheless, it remains unclear whether such interpretations can survive under Proposition 26.

In part, this confusion stems from the basic mismatch between existing tax and user fee doctrine and Pigovian theory. Government pricing designed as a regulatory tool fits neither the classic definition of a tax nor the classic definition of a regulatory fee since emissions pricing may vastly exceed the cost of implementing the emissions regulatory

216. See *Cal. Air Res. Bd.*, 2013 WL 12204350, at *27.

217. *Cal. Air Res. Bd.*, 216 Cal. Rptr. 3d at 720.

218. *Id.* at 720.

219. *Id.* at 721.

220. *Id.* at 722.

221. *Id.* at 725.

222. See *id.* at 726 (quoting *Bronco Wine Co. v. Jolly*, 17 Cal. Rptr. 3d 180 (Ct. App. 2004)).

regime. Similar conceptual confusion has bedeviled at least two courts considering stormwater remediation fees.

B. Stormwater Remediation Fees

1. Stormwater Remediation Fees in Theory and Practice

After a rainstorm, the air often feels cleaner. The rain absorbs pollutants in the air, washing them out of the sky.²²³ Natural ground cover (a fancy way of saying dirt) absorbs rainwater, and this dirt filters out the pollutants before they enter waterways.²²⁴ Unfortunately, the built environment, including buildings, roads, and parking lots, often reduces this natural ground cover, replacing permeable dirt with impermeable surfaces like asphalt and roofing materials. As a result, rain “washes sediment, pathogens, and metals into surface waters, impairing the nation’s rivers, streams, and coastal shorelines.”²²⁵ This stormwater runoff is the second biggest source of water pollution in the United States.²²⁶

The Clean Water Act required the Environmental Protection Agency (EPA) to regulate stormwater discharge and the EPA implemented this requirement in phases.²²⁷ In 1990, the EPA began Phase I, which required large and medium municipal sewer systems be permitted.²²⁸ In 1999, Phase II brought smaller municipal sewers into the permit system.²²⁹

Traditionally, funding for stormwater management came from local property taxes or a stormwater surcharge on local water bills.²³⁰ But building the infrastructure to comply with the Clean Water Act’s

223. See Jennifer Chu, *Can Rain Clean the Atmosphere*, MASS. INST. TECH. NEWS (Aug. 28, 2015), <http://news.mit.edu/2015/rain-drops-attract-aerosols-clean-air-0828> [<https://perma.unl.edu/4UB3-WFGQ>] (discussing MIT research on the ways rain washes aerosols out of the atmosphere). In fact, the California drought has increased air pollution problems in the state. See *Cal. Air Quality Affected by Lack of Rain*, NPR (Jan. 22, 2014), <http://www.npr.org/2014/01/22/264742844/calif-air-quality-affected-by-lack-of-rain>.

224. See generally DENNIS JURRIES, STATE OF OR. DEPT’ OF ENVTL. QUALITY, BIOPILTERS (BIOSWALES, VEGETATIVE BUFFERS, & CONSTRUCTED WETLANDS) FOR STORM WATER DISCHARGE POLLUTION REMOVAL (2003) (discussing, *inter alia*, ways to decrease pollution in run-off).

225. Samuel L. Brown & Gerard Olson, *Stormwater—The Next Phase*, 30 NAT. RESOURCES & ENV’T, 53, 53 (2016).

226. Avi Brisman, *Considerations in Establishing a Stormwater Utility*, 26 S. ILL. U. L.J. 505, 505 (2002).

227. Water Quality Act of 1987, 33 U.S.C. § 1342(p) (2012).

228. *Stormwater Discharges from Municipal Sources*, EPA, <https://www.epa.gov/npdes/stormwater-discharges-municipal-sources#overview> [<https://perma.unl.edu/8XXJ-5WX5>].

229. *Id.*

230. CTR. FOR AM. PROGRESS ACTION FUND, RAISE NEEDED REVENUE EFFICIENTLY AND FAIRLY 153 (2014), https://cdn.americanprogress.org/wpcontent/uploads/2014/01/COW_05RaiseNeededRevenue.pdf [<https://perma.unl.edu/9QXX-HGBF>].

mandates required local governments to make significant capital investments to manage growth and modernize existing systems.²³¹ To pay for all of this investment, many local governments have turned to an alternate source of financing: stormwater remediation fees.²³² These fees are assessed based on a property's impervious surface area, linking the amount of runoff a property generates to the cost of remediating that runoff.

Many governments treat the stormwater remediation fees much like other utility bills. Local Philadelphia, described as the “the gold standard” for stormwater management,²³³ adds its Stormwater Management Service Charge to properties' water bills—describing the charge as a “utility fee” on its website.²³⁴ Seattle's stormwater management fees are collected as part of a combined water-sewer-garbage charge, and stormwater management is conducted by a combined sewer-stormwater utility.²³⁵ Other local governments have created a separate stormwater utility to manage the problem.²³⁶

2. Stormwater Remediation Fees Under State Law

According to one scholar, lawsuits challenging stormwater fees as disguised taxes are the most common legal obstacle to funding stormwater remediation.²³⁷ The majority of state courts hearing these challenges have upheld stormwater fees as user fees.²³⁸ However, two states have found them to be disguised taxes.²³⁹ At least one federal court has found the fee to be a tax for purposes of tribal sovereign immunity,²⁴⁰ while another found it to be a user fee for purposes of the TIA.²⁴¹ Even courts that upheld remediation fees as user fees have struggled with how to fit them into existing doctrine.

231. *Id.*

232. Brisman, *supra* note 226, at 507.

233. CTR. FOR AM. PROGRESS ACTION FUND, *supra* note 230, at 153.

234. *Residential Stormwater Billing*, CITY OF PHILA., <http://www.phila.gov/water/wu/stormwater/Pages/ResidentialSWBilling.aspx> [<https://perma.unl.edu/RQ98-3SJD>].

235. Wash. Rev. Code §§ 35.67.010; 35.67.331 (2013).

236. See C. Warren Campbell, et al., Western Kentucky University Stormwater Utility Survey (2017) (surveying stormwater utilities by state).

237. Brisman, *supra* note 226, at 520.

238. Substitute Brief of the National Association of Clean Water Agencies et. al., *supra* note 10, at *3.

239. See *Bolt v. City of Lansing*, 587 N.W.2d 264, 266 (Mich. 1998) (finding stormwater user charge was a tax and not a fee); *Zweig v. Metro. St. Louis Sewer Dist.*, 412 S.W.3d 223, 226–27 (Mo. 2013) (finding stormwater user charge was a tax, rather than a fee).

240. *Oneida Tribe of Indians v. Vill. of Hobart*, 732 F.3d 837, 842 (7th Cir. 2013) (finding a stormwater runoff assessment to be a tax, rather than a fee).

241. *Homewood Vill., LLC, v. Unified Gov't of Athens-Clarke Cty.*, 132 F. Supp.3d 1376, 1381 (M.D. Ga 2015) (finding a county stormwater ordinance created a fee rather than a tax for purposes of the TIA).

Utility bills are classic user fees. Consumers of municipal services are paying for the marginal cost of municipally-provided trash collection, electricity, water, or sewer services plus the consumer share of capital costs. Stormwater remediation does not directly benefit a property owner in the same way as trash collection, electricity, water, or sewer connections. While the municipality as a whole benefits from compliance with the EPA's permitting requirements under the Clean Water Act, individual property owners do not benefit from this compliance. In fact, because water drains to the lowest point, the pollutants in stormwater runoff often end up affecting areas outside municipal boundaries.²⁴² This explains the need for federal legislation: adequate stormwater drainage benefits the entire water basin community by ensuring cleaner waterways.

A close look at a successful challenge to a stormwater remediation fee illustrates the ways courts can struggle in applying user fee doctrine. In *Bolt v. City of Lansing*, the Michigan Supreme Court addressed the validity of Lansing's stormwater remediation fees. These fees were designed to be roughly commensurate with the amount of stormwater runoff from the subject property.²⁴³ For commercial parcels, industrial parcels, and residential parcels greater than two acres, the fee was based on the ratio of impervious to pervious surfaces.²⁴⁴ Residential parcels smaller than two acres were charged a flat fee because the administrative costs of making individualized determinations were prohibitive.²⁴⁵ However, any property owner could install its own alternate rainwater collection system and seek an exemption from the fee.²⁴⁶

Michigan requires local governments to subject taxes to a "vote of the people," though local governments can impose user fees and regulatory fees through normal ordinance procedures.²⁴⁷ The Michigan Supreme Court held that the stormwater remediation fee was a "tax" under Michigan law, and therefore invalid because the city had not held a vote.²⁴⁸

242. Flooding & Pollution, Nat'l Oceanic & Atmospheric Admin., <http://www.noaa.gov/resource-collections/watersheds-flooding-pollution> [<https://perma.unl.edu/UMJ3-NSW6>] ("The blotches of leaked motor oil on parking lots, plastic grocery bags, pesticides, fertilizers, detergents, and sediments are known as non-point source pollutants. If untreated, these pollutants wash directly into waterways carried by runoff from rain and snow melt. These contaminants can infiltrate groundwater and concentrate in streams and rivers and can be carried down the watershed and into the ocean.")

243. *Bolt*, 587 N.W.2d at 267.

244. *Id.*

245. *Id.*

246. *Id.* at 278 (Boyle, J., dissenting).

247. *Id.* at 266.

248. *Id.*

The Michigan court considered whether the levy (1) “serve[d] a regulatory purpose rather than a revenue-raising purpose,” (2) was “proportionate” to the benefit conferred, and (3) was in some sense voluntary.²⁴⁹ The court found that the fee served a revenue raising purpose because it was designed to recover the cost of capital expenditures involved in installing the stormwater treatment equipment over a time period shorter than the useful life of the investment.²⁵⁰ The court found this feature meant “the ‘fee’ [was] not structured to simply defray the costs of a ‘regulatory’ activity, but rather to fund a public improvement designed to provide a long-term benefit to the city and all its citizens.”²⁵¹ Moreover, as the court noted, Lansing only needed new infrastructure for one quarter of city parcels, but the fee was levied against all property owners. The court held that because the fee was not targeted exclusively at those who benefited, it was neither proportional nor imposed for a regulatory purpose.²⁵² Further, the court found the fee “lack[ed] . . . a significant element of regulation” because the fee calculation did not look at individual property factors (like pollutants present on the property).²⁵³ Finally, the court found the fee compulsory because property owners had no choice about whether to use the service.²⁵⁴

Three justices dissented. Rather than focusing narrowly on whether the fee allowed the city to recoup its capital expenditures too quickly, the dissent would have determined whether it had a “revenue-raising purpose” by looking to whether Lansing officials earmarked the money for the service charged.²⁵⁵

Further, as the dissent noted, Lansing officials designed the fee to be proportional to the harm imposed by landowners. On larger parcels, the fee varied based on the ratio of impermeable to pervious land acreage to permeable acreage, recognizing that pervious surfaces did not contribute to the runoff problem. Administrative costs limited such tailoring for smaller, residential parcels, but as the dissent argued “[c]onsidering the fee method as a whole, the city used a logical system to compute the proportionate amount of runoff that each parcel contributes to the overall system.”²⁵⁶ This was especially true because landowners could petition (and had successfully petitioned) for credits against the fee based on their ability to independently collect stormwater.²⁵⁷ The dissent suggested this was evidence that the fee

249. *Id.* at 269.

250. *Id.* at 270–71.

251. *Id.* at 270.

252. *Id.* at 271.

253. *Id.* at 272.

254. *Id.*

255. *Id.* at 276 (Boyle, J., dissenting).

256. *Id.* at 277.

257. *Id.* at 278.

was both proportionate and voluntary, especially under Michigan's expansive understanding of voluntariness.²⁵⁸

As Darien Shanske has observed, rather than see the parallels between Lansing's stormwater remediation fee program and traditional user fees, the *Bolt* majority struggled unnecessarily with the idea that Lansing's stormwater fee rates required all landowners to share the capital costs of the system, even when that capital improvement did not directly benefit their property.²⁵⁹ Of course, failing to make those capital improvements would have increased the costs of running the system for everyone, as all local taxpayers would be responsible for the legal fees associated with a municipal violation of the Clean Water Act.

The majority struggled to fit stormwater remediation into the definition of user fees in part because user fee doctrine does not readily lend itself to pricing externalities. And in some rough sense, that is what stormwater remediation attempts to do. The externality is the stormwater runoff—the result of property development. Further, the majority failed to appreciate the significance of the exemption for property owners who install their own drainage systems. While the majority correctly noted that the benefits of storm drainage are diffuse, it failed to appreciate that the harms caused by stormwater runoff are traceable to specific property owners and that Lansing's pricing system attempts to trace these costs in an administratively efficient manner.

IV. A NEW WAY FORWARD

As I suggested in Part III, Pigovian taxation and other regulatory levies do not fit neatly into either the tax or user fee categories as defined under existing doctrine. In this Part, I suggest a new approach to defining these categories. This new approach would clarify existing doctrinal confusion and provide more predictability to policymakers and litigators.

In the first section of Part IV, I summarize the problems with existing user fee doctrine. In the second, I describe my proposal in detail. In the third, I address some criticisms of my proposal.

A. The Need for Reform

Existing user fee doctrine is messy. In close cases, decisions are unpredictable. This ambiguity causes two problems. First, it creates legal uncertainty surrounding important sources of revenue and the programs they fund. For example, Arizona funded its Medicaid expan-

²⁵⁸. *Id.*

²⁵⁹. Darien Shanske, *Interpreting State Fiscal Constitutions: A Modest Proposal*, RUTGERS L. REV. (forthcoming).

sion with revenue from a user fee assessed against large hospitals by the state's health department. Lawmakers opposed to Medicaid expansion challenged this hospital assessment as a disguised tax enacted without the supermajority approval required by Arizona law.²⁶⁰ While the Arizona Supreme Court ultimately upheld the hospital assessment as a valid tax, the case demonstrates how the fate of an important state policy might turn on whether its state courts determine that an assessment is a tax.²⁶¹ As the defendant told the Arizona Supreme Court during oral argument, its decision about the constitutionality of the assessment could potentially cause several hundred thousand Arizona residents to lose health insurance.²⁶² And it seems impossible to believe that the policy stakes of their decision did not impact the court's ultimate legal conclusion.

Second, this uncertainty may discourage policy innovation even where a state or local government has the authority to act. Policymakers and legislators may simply think the likelihood of litigation is too great to be worth the candle of legislation and implementation.

Given these problems, one might be tempted to simply end the tax or user fee distinction, at least in certain contexts. I have argued elsewhere in favor of granting municipalities greater taxing authority,²⁶³ and there is a voluminous literature criticizing the consequences of laws that make it harder to pass tax increases.²⁶⁴ If user fees were subject to the same legal and procedural requirements as taxes, clearly delineating the line between the two would be an interesting, but ultimately unimportant, exercise.

260. Ken Alltucker, *Court Rejects Arizona GOP Lawmakers' Medicaid Challenge*, AZCENTRAL (Mar. 16, 2017), <http://www.azcentral.com/story/news/politics/arizona/2017/03/16/arizona-appeals-court-rejects-gop-lawmakers-medicaid-challenge/99258714/> [<https://perma.unl.edu/N2XC-U39J>].

261. *Biggs v. Betlach*, 404 P.3d 1243 (Ariz. 2017) (upholding the constitutionality of the assessment under a three-factor test derived from the *San Juan Cellular* factors).

262. Alexandra Olgin, *AZ Supreme Court Hears Arguments About Whether to Drop Medicaid Expansion Lawsuit*, KJZZ (Nov. 6, 2014), <http://theshow.kjzz.org/node/64408> [<https://perma.unl.edu/W9U3-3K3M>].

263. *Cf.* Scharff, *supra* note 12.

264. *See* THERESE J. MCGUIRE & KIM S. RUEBEN, *THE COLORADO REVENUE LIMIT: THE ECONOMIC EFFECTS OF TABOR*, (2006), <http://www.urban.org/sites/default/files/publication/50226/1000940-The-Colorado-Revenue-Limit.PDF> [<https://perma.unl.edu/7XJD-BZZC>]; ARTHUR O'SULLIVAN, TERRI A. SEXTON, & STEVEN M. SHEFFRIN, *PROPERTY TAXES AND TAX REVOLTS: THE LEGACY OF PROPOSITION 13* (1995); Terri A. Sexton, Steven M. Sheffrin, & Arthur O'Sullivan, *Proposition 13: Unintended Effects and Feasible Reforms*, 52 NAT'L TAX J. 99 (1999). *But see* Therese J. McGuire, *Proposition 13 and Its Offspring: For Good or for Evil?*, 52 NAT'L TAX J. 129 (1999); Iris J. Lav & Erica Williams, *A Formula for Decline: Lessons from Colorado for States Considering TABOR*, CTR. ON BUDGET AND POL'Y PRIORITIES (Mar. 15, 2010), <http://www.cbpp.org/research/a-formula-for-decline-lessons-from-colorado-for-states-considering-tabor> [<https://perma.unl.edu/697S-PXGR>].

Nevertheless, the current political landscape makes such reforms unlikely. Efforts to roll back laws limiting tax authority have not had much success.²⁶⁵ And in the meantime, judges must still confront cases raising these distinctions.

Even if state law were to eliminate the distinction between taxes and user fees for the purposes of municipal authority and supermajority requirements, courts would still need to categorize levies. State courts would still need to know whether a particular levy was a fee, which could be assessed against a tax-exempt entity, or a tax, which could not be so assessed.

Noting the confusion surrounding user fees under state law, Darien Shankse has also suggested some reforms of the doctrine.²⁶⁶ Shankse notes that courts attempting to distinguish user fees from taxes often get distracted by the relationship between the government's charge and the benefit conferred on the user. As Shanske observes, however, there are many administrative reasons (and basic economic explanations) for why precision is difficult, if not impossible. He therefore proposes that courts engage in a procedural review, looking less at the substance of the ratemaking process and more at the processes the government used in setting rates. I am sympathetic to his proposal, as it would clearly improve current doctrine. His proposal, however, does not clarify what kinds of costs the government should be allowed to consider.

As I argue more fully below, courts should explicitly recognize differences between different kinds of user fees. Recognizing the variety of user fees governments charge would bring needed clarity to state court efforts to distinguish taxes and user fees and would allow courts to take a more sensible approach to charges based on Pigovian principles.²⁶⁷ Absent the recognition of the disparate types of user fees, courts will continue to struggle with distinguishing taxes and user fees.

B. The Proposal

I propose a new framework for courts to use as they attempt to distinguish taxes from user fees. While this proposal builds upon existing state law, I argue that courts should adopt a new framework that explicitly recognizes the variety of user fees charged and develop

265. *C.f.* Williamson, *supra* note 31 (discussing the frequency with which voters actually improve rate increases at the local level to pay for local infrastructure improvements).

266. Shanske, *supra* note 26, at 1345–49.

267. Hugh Spitzer has made similar suggestions for reform of Washington State's user fee law, but my proposal focuses explicitly on the problems of Pigovian taxation. *See* Spitzer, *supra* note 35, at 336.

tests that reflect these differences.²⁶⁸ Courts should recognize that benefit charges are only one kind of user fee and in analyzing other kinds of user fees, the benefit conferred to the payor may be less obvious. The law works reasonably well for classic user fees, but it works far less well when governments move beyond these types of fees.

Single-factor approaches are often too narrowly focused. For example, consider how one should analyze state fuel taxes under a general-revenue test. Almost all states earmark fuel tax receipts for highway repairs—repairs that benefit the motorists paying the fuel tax. Under the general revenue approach, fuel taxes are really fees, especially in states that place the fuel tax receipts in a segregated State Highway Fund.²⁶⁹

More broadly, the problem with the general revenue approach is that government revenues are fungible and all fees are levied, at least in part, to provide revenue. It is hardly satisfying for a court to conclude that some government charge is a fee because the money doesn't go to that government's general revenue when collecting this fee allows the government to collect less general revenue.

Similar opacity infects the multi-factor tests. This opacity exists because state laws designed to distinguish between user fees and taxes have never caught up with the multiplicity of charges now collected and levied by governments. In an era of simpler government budgets and more limited government activity, the general revenue approach may have adequately policed the line between taxes and user fees.

Consider a court analyzing a local law imposing a charge on the sale of alcohol. A court might reasonably conclude that if the collected charge goes into an account dedicated to enforcing regulations on the sale of alcohol, it is a regulatory fee designed to force consumers to pay for the cost of policing alcohol consumption. However, if that same charge went into the city's general revenue fund, and thus provided financial support to a broad array of government services, the charge begins to look more like an excise tax. This assumption would be stronger if prior to the imposition of the fee, the government did little to regulate the sale of alcohol. As governments have become more so-

268. *See id.* at 353–54.

269. JAIME RALL, ET AL., TRANSPORTATION GOVERNANCE AND FINANCE xiii (2011) <http://www.ncsl.org/documents/transportation/FULL-REPORT.pdf> [<https://perma.unl.edu/N5EG-Z6A4>] (“For example, 23 states have constitutional provisions—and three have statutory provisions—that restrict use of state fuel tax revenues exclusively to highway and road purposes. Most other states dedicate these and other transportation-related revenues to general or multimodal transportation purposes, with a few limited exceptions. In addition, 35 states reported they have provisions that direct use of the funds or accounts to which transportation revenues are deposited. At least six states also explicitly prohibit diversion or transfer of transportation revenues to other purposes.”).

phisticated and face pressure to shift funding of existing services and programs to user fees, the importance of segregated accounts seems less clear.

As I've suggested in Part III, these doctrinal problems are compounded by the increasing variety of user fees that local governments charge and the ways governments determine the amount charged. As technology allows governments to calibrate the costs of providing particular services more precisely, courts have struggled with how fine-grained such calibrations should be. For example, Darien Shanske argues that the *Bolt* court struggled to understand Lansing's stormwater charges as user fees because the capital infrastructure costs of the system swamped the marginal costs of providing stormwater remediation for individual properties.²⁷⁰ Of course, private market prices are also not based purely on marginal costs of production.

User fee doctrine should explicitly recognize the variety of charges imposed under the rubric of user fees and the complexity of these fees. In particular, courts should define user fees to include three types of charges. The first category would encompass classic user fees, i.e. payments for government provided products or services. Following Hugh Spitzer's suggestions for Washington State, the second category would be traditional regulatory fees. The final category would cover what I term price-based regulatory tools.

1. *Classic User Fees*

Classic user fees involve prices charged when a government is acting in a proprietary capacity similar to a private company. Often, the government lacks a monopoly or is providing a nonessential good. Green Bay residents are not required by law (though some may feel compelled by loyalty) to purchase Packers tickets. Similarly, users of municipal swimming pools are not required to be there nor are visitors to a county-run zoo.

Some levies, however, involve charges for services that the government provides by monopoly (or close to it). These are charges for things like municipally provided water, sewer connections, and trash services.²⁷¹

270. See Shanske, *supra* note 26, at 1350–51.

271. By including sewer connections as classic user fees, I am suggesting a broader definition of the term than Hugh Spitzer, who would consider such charges burden-offset charges. However, sewer fees provide a direct benefit to property owners. Most city residents want a functioning sewage connection in their home. Our sewer connection fees are payments for the service of having our waste treated at a distance from our place of residence or work. These are not charges compensating for harms our actions impose on others.

Under my proposed framework, charges paid in exchange for a government-provided service would be a user fee so long as the charge approximately equals the government's cost of providing that service. For this purpose, a government's cost of providing a service should include both marginal costs and also a reasonable share of infrastructure costs.

Of course, there will remain some questions about how precise a fit "approximately equally government costs" requires, but courts could continue relying on existing doctrine to test this point. Alternatively, courts could consider Darien Shanske's proposal to test fitness by looking at the methodology a government used in setting its fee rather than evaluating the substance of the fee itself.²⁷²

In some sense, this category is meant to encompass the types of charges that courts think of as model user fees (like municipal garbage disposal charges and tolls) that are uncontroversially classified as user fees. While theoretically such fees may be difficult to clearly distinguish from taxes, courts usually have little trouble thinking of such charges as conferring a benefit on the payor proportional to the cost.

2. *Traditional Regulatory Fees*

Courts also allow governments to charge user fees to cover the costs they incur in regulating a specific business activity or person. Thus, licensing fees and inspection fees are valid user fees, what Spitzer refers to as "true regulatory fees."²⁷³ Such fees, however, fit imperfectly with a benefits theory of user fees. While regulations often do provide some benefits to regulated parties, many regulations are designed to benefit not just the regulated entity and its customers but also the broader public. For example, when we require residential homes to be built to code, we are not just protecting homeowners but also their neighbors from the dangers of shoddy construction work.

My proposal would not change the categorization of regulatory fees under most state law. However, courts should more clearly articulate this as a fee category, so as to clarify the role of "benefit" in the current doctrine.

3. *Price-Based Regulatory Tools*

The most dramatic change in my proposal would be for courts to recognize a new category of price-based regulatory tools that could qualify as fees. In creating this new category, I am explicitly expanding the concept of government-provided benefit to include the government granting a license to create a social cost. As I argue below,

272. See Shanske *supra* note 26, at 1350.

273. Spitzer, *supra* note 35, at 349–50.

there are a number of reasons why such a charge comes closer to a user fee than a tax. Nevertheless, not all price-based regulations should qualify as user fees. Rather, courts should consider placing charges in this category under two circumstances.

First, policies can qualify as user fees if the government sets the price so that it roughly approximates the externality cost. Second, policies can qualify as user fees if the government restricts the use of proceeds from the fee to projects focused on abating the externality.

A disjunctive test is necessary because it provides local governments the opportunity to assess a user fee in situations where precisely measuring the externality cost would be cost-prohibitive, but where the revenue raised from the fee is clearly allocated to remediating problems caused by the externality. At the same time, it offers governments attempting to precisely calculate externality costs the option of obtaining a double dividend by repurposing the revenue raised from the user fee.²⁷⁴ Further, allowing governments to repurpose revenue may give policymakers more flexibility in dealing with the distributional concerns raised by Pigovian levies. For example, to the extent that carbon pricing may be regressive because low-income households spend a greater portion of their income on utilities, governments could create rebates and other programs to curb the impact of carbon pricing on these households.²⁷⁵

Courts should treat priced-based regulatory tools as user fees for three reasons. First, economically, they are more similar to user fees than they are to taxes. Classical economic theory suggests self-interested buyers and self-interested sellers will collectively determine a market clearing price, i.e. a price at which all goods produced by the market will find willing buyers. This market clearing price is the “efficient” price for the good because at that price both producers and consumers benefit from the market transaction—no beneficial transactions are left on the table.

When a government introduces a tax on a good or service, that tax raises the price of the good. This drives a wedge between the price consumers must pay for the good and the amount of revenue producers obtain from making and selling it. A portion of this wedge is revenue for the government, but a portion of the wedge, known as deadweight loss, consists of transactions that would have happened

274. *See supra* notes 169, 170, and accompanying text.

275. I’m once again indebted to Katie Pratt for reminding me that the double dividend might be an efficiency payout, but it can also be used to improve equity. Of course, the distributional effects of a carbon tax are quite complicated. The impact on household energy costs is surely regressive, but the impacts on the transportation sector are likely more heterogeneous. Upper-income drivers are more likely to have newer, more fuel-efficient cars, but also to purchase bigger cars than lower income drivers, and upper-income commuters are more likely to drive than to use public transportation.

but for the tax. For this reason, classical economics suggests taxes reduce market efficiency. Because of the tax, transactions that would otherwise have benefitted both producers and consumers fail to take place.²⁷⁶

Traditional user fees, in contrast, should produce no equivalent inefficiencies. The government is merely providing a service that a willing buyer can pay for. The price the government charges, at least theoretically, should accord with the market price of the good.

In this way, Pigovian policies begin to look more like user fees. Pigovian policies seek to eradicate inefficiencies in the market. These policies try to ensure that producers and consumers take into account not only their costs but also the costs imposed on others. Pigovian theory taxes these transactions because taking into account these social costs, there are *too many* transactions happening, and the efficient market would have fewer transactions. As a result, Pigovian taxation, in theory, produces no deadweight loss—just like a classic user fee.

Second, like traditional user fees, Pigovian policies provide information about the private value of the activity producing the negative externality.²⁷⁷ For those payors willing to pay the Pigovian charge, the private benefit outweighs the social cost. Under traditional user fee doctrine, courts might evaluate this parallel under tests that consider “voluntariness.” But as discussed above, evaluating voluntariness directly leads to contorted analysis from state courts. Identifying a category of “market-based” regulations allows courts to avoid such contortions.

Third, and finally, these market-based regulatory fees are conceptually more similar to fees than taxes. Tax limitations treat a government’s exercise of its taxing authority to raise revenue differently than its policy power to regulate behavior. Price-based regulatory policies are designed to regulate behavior. Treating command-and-control regulatory tools more favorably will distort state and local regulatory choices. Governments may choose not to regulate or regulate using more expensive command-and-control options because they lack the authority to implement market-based regulatory tools.

Asking courts to distinguish between revenue and regulatory purposes of a statute can be difficult if the charge is imposed for multiple reasons. And governments are always thinking about revenue when they impose user fees because money is fungible. Rather than ask the revenue versus regulatory purpose question directly, as current law

276. Of course, the elimination of deadweight loss in these transactions depends on certain assumptions about how the new tax interacts with other existing economic distortions. Removing a single distortion may not always improve efficacy. See R.G. Lipsey & Kelvin Lancaster, *The General Theory of Second Best*, 24 *REV. ECON. STUD.* 11 (1956).

277. See Gillette & Hopkins, *supra* note 28, at 803–04.

requires courts to do, my proposed definition asks courts to evaluate the fit between the fee charged and how it was calculated.

Under my proposed definition of price-based regulatory tools, carbon-pricing programs could receive user fee treatment, so long as the size of the fee is reasonably proportional to the costs imposed by the payor's emissions. Such carbon-pricing schemes could still qualify as user fees even if the revenue earned from carbon pricing exceeds the cost of administering the carbon-pricing program and is used for other purposes, including reduction of other tax burdens.

To the extent all revenue is fungible, tying abatement costs to the amount of the charge does not prove that the imposition of the charge has no revenue purpose. Rather, in classifying such charges as user fees, my goal is to provide an alternate way for localities to measure the externality cost. Of course, it may be easier for governments to limit the revenue collected from such fees to abatement costs and thereby avoid litigation challenging its externality cost estimates. As I discuss in subsection IV.C.3, determining "externality" costs is not a straightforward proposition.

Not all environmental taxes would qualify for user fee treatment, however. Boulder's carbon tax would likely not qualify under either prong. First, because the city charges the tax at a higher rate for residential than commercial users, it is hard to see how the city designed the tax to match the cost of the externality. On a per-unit basis, carbon emitted by residential users contributes to climate change in the exact same way as carbon emitted by residential users.²⁷⁸ And while Boulder has invested the money raised through its carbon tax in its climate action plan, this plan does not exclusively fund the direct costs Boulder incurs in abating climate change. Rather, it funds a variety of environmental programs that are only loosely tied to the abatement of costs Boulder bears from climate change.

Similarly, few sin taxes would qualify as fees under this proposal. Some have justified cigarette and alcohol taxes on Pigovian grounds, and these taxes receive support in part because they may limit consumption. However, such taxes have long played an important revenue role, and these taxes are rarely used to fund targeted public health investments, in part because the revenue raised by these taxes may dwarf the public spending needs in these categories. In fact, states have frequently raided Tobacco Settlement funds that were set aside for such public health purposes to supplement general revenue

278. Some types of user fees do contain cross-subsidizations that charge different rates for different types of users. Municipal electrical bills, for example, may charge different rates to residential and commercial consumers. I think a stricter standard needs to apply, however, to price-based regulatory tools because the benefit conferred to the payor is more attenuated.

shortfalls,²⁷⁹ and studies consistently show that governments are most likely to raise taxes on cigarettes and alcohol during recessions to offset lower revenues raised through other means.²⁸⁰ Further, studies suggest the external costs of tobacco consumption imposed on the state and federal government is smaller than the tobacco taxes themselves.²⁸¹

Similarly, most soda taxes would be taxes rather than fees under this proposal. Though advocates of soda taxes laud them as regulatory tools, there is little evidence that any soda tax has been designed to approximate the externality costs imposed by consuming soda.²⁸² In part, such soda taxes are difficult to implement because measuring the externality cost is difficult and would likely vary by consumer.²⁸³

Further, some soda taxes are passed with specific revenue goals in mind that are unrelated to the costs imposed by soda. Philadelphia's soda tax revenues are funding an expansion of the city's preschool program and other public works projects.²⁸⁴ Philadelphia's mayor suggested that his soda tax proposal "could raise more than \$400 million over five years, enough to fund not just universal preschool, but also renovations to local libraries, parks and recreation centers; 'community schools' that wrap social services with education; and cash for the

279. GOVERNMENT ACCOUNTABILITY OFFICE, TOBACCO SETTLEMENT: STATES' USE OF MASTER SETTLEMENT AGREEMENT PAYMENTS 26–28 (2001).

280. Richard H. Matoon & Sarah Wetmore, *Sin Taxes: The Sobering Fiscal Reality*, 339 FED. RES. BANK CHI. (2015), <https://www.chicagofed.org/~media/publications/chicago-fed-letter/2015/cfl339-pdf.pdf> [<https://perma.unl.edu/KM8W-C57G>]; NICHOLAS JOHNSON, ET AL., CTR. ON BUDGET & POL'Y PRIORITIES, STATE TAX CHANGES IN RESPONSE TO THE RECESSION 2 (2010) <https://www.cbpp.org/sites/default/files/atoms/files/3-8-10sfp.pdf> [<https://perma.unl.edu/S92A-B2MJ>] (noting that 22 states increased excise taxes on tobacco, alcohol, or motor fuels in response to the Great Recession); see also John L. Mikesell, *The Cyclical Sensitivity of State and Local Taxes*, 4 PUB. BUDGETING & FIN. 32, 37 (1984) (noting that inclusion of excise taxes, including sin taxes on alcoholic beverages and tobacco, makes sales tax revenue seem more stable and that "[t]he lower sensitivity of sales tax revenue results from statutory rate increases enacted to maintain revenue growth during recession, not from base stability").

281. Pratt, *supra* note 169, at 79; W. Kip Viscusi, *Cigarette Taxation and the Social Consequences of Smoking*, 9 TAX POL. & ECON. 51, 72–92 (1995).

282. This is not to say such taxes are necessarily ineffective. See Luz Maria Sánchez-Romero, et al. (2016) *Projected Impact of Mexico's Sugar-Sweetened Beverage Tax Policy on Diabetes and Cardiovascular Disease: A Modeling Study*, PLOS MED. (Nov. 1, 2016), <http://journals.plos.org/plosmedicine/article/file?id=10.1371/journal.pmed.1002158&type=PRintable> [<https://perma.unl.edu/NF8S-9Y63>].

283. N. Gregory Mankiw, *Can a Soda Tax Save Us from Ourselves?*, N.Y. TIMES (June 5, 2010), <http://www.nytimes.com/2010/06/06/business/06view.html>.

284. Reed DesRosiers, *Philadelphia's Mayor Took on Big Soda to Fund Pre-K, but Will It Pay Off?*, NEW AMERICA (July 12, 2016), <https://www.newamerica.org/education-policy/edcentral/philadelphias-mayor-took-big-soda-fund-pre-k-did-it-pay/> [<https://perma.unl.edu/C3BN-VRVQ>].

troubled municipal pension program.”²⁸⁵ In other words, the funds received are not being used to combat the public health costs of increased sugar consumption, and so under the proposal Philadelphia has implemented a soda tax and not a fee.

Berkeley’s soda tax would likely fail the user fee test, too. The revenue from the Sugar-Sweetened Beverage Product Tax goes to the city’s general revenue account.²⁸⁶ Though the tax also required the city to appoint a group of experts in nutrition and public health to provide an annual recommendation on how to use these revenues to improve the health of Berkeley’s children, the city council has full discretion about whether to adopt these recommendations. As a result, the funds are not reserved for abatement costs. Further, although healthcare is more closely related to soda-consumption externalities than preschool education, not all of the health problems facing Berkeley children are obesity-related, let alone related to increased sugar consumption. Thus, the soda tax revenue is not exclusively targeted at abating the problems caused by excess soda consumption.

By creating an explicit category of price-based regulatory fees, my proposal offers greater predictability in user fee doctrine. Such predictability will create a legal environment that should encourage more state and local governments to experiment with price-based regulatory fees. It will also better reflect the division between taxation and other types of government charges because it will treat regulatory activity different than government efforts to raise revenue.

C. Problems with the Proposal

1. Greater Revenue Authority Is Undesirable

To the extent the proposal broadens the definition of user fees, it provides states and local governments greater revenue authority than currently exists. As a result, one criticism of the proposal is that it unnecessarily increases this revenue authority.

I have argued elsewhere that municipalities should have more expansive revenue authority, but there may be reasons to think otherwise. Especially at the local level, increased authority may “contribute to the pervasive privatism that is the hallmark of contemporary

285. Margot Sanger-Katz, *Making a Soda Tax More Politically Palatable*, N.Y. TIMES (Apr. 3, 2016), <https://www.nytimes.com/2016/04/04/upshot/making-a-soda-tax-more-politically-palatable.html?action=click&contentCollection=the%20Upshot&module=relatedCoverage®ion=marginalia&pgtype=article>; see also Vauhini Vara, *There’s Now a Soda Tax in Philadelphia, but Not Because Sugar Is Bad for You*, NEW YORKER (June 16, 2016), <http://www.newyorker.com/business/currency/theres-now-a-soda-tax-in-philadelphia-but-not-because-sugar-is-bad-for-you> [<https://perma.unl.edu/K8Q5-AQHJ>] (describing political battles over soda taxes).

286. Berkeley, Cal., Code tit. 7, ch. 7.72 (2018), <http://www.codepublishing.com/CA/Berkeley/> [<https://perma.unl.edu/X3NA-D8YY>].

American politics.”²⁸⁷ As Laurie Reynolds has forcefully argued, relying on user fees rather than general taxation for government revenue reduces the progressivity of public spending because an increasing percentage of government services are provided only to those residents who can afford them.²⁸⁸

But classifying price-based regulatory tools as user fees does not privatize government services. Rather, these price-based regulatory tools do the opposite. They prevent the public from paying to mitigate the public harms imposed by private actors.

Other critics may focus less on the privatization of government services and more on contracting such services. In particular, small government advocates may view this proposal as a “stealth argument” for giving governments more money. This proposal, however, creates few “stealth” opportunities for governments.

In suggesting that courts delineate between three categories of user fees, I am first trying to offer an intervention in the doctrine that will reduce uncertainty among governments and payors. Litigation is costly and unpredictable legal tests aid neither government nor taxpayers.

Second, to the extent that the category of “price-based regulatory tools” does expand the category of user fees, there is no reason to believe such fees could be imposed without significant public attention. Of course, to the extent governments have more legal authority to enforce user fees than taxes, my proposal will result in fewer legal obstacles to enacting such policies. But legal obstacles are not the only relevant constraint. Regulatory activity to control externality costs, either by banning certain behavior or limiting it, would certainly be subject to significant scrutiny. I see little reason to believe that policies seeking to price externalities would somehow evade the attention of small government anti-regulatory activists. I am comfortable with the political process working as a check on such undesirable expansion.

One advantage of current law is that it offers state courts the opportunity to use a single, consistent definition of user fee. There is some complexity required by adding multiple types of tests, and under this proposal there will surely be appeals based on whether courts applied the correct test for a particular type of fee.

Courts currently struggle to fit Pigovian levies within the doctrine, creating exceptions or loosening definitions beyond recognizable meanings.²⁸⁹ Making the rule clearer can sometimes mean adding complexity, but that does not necessarily make the rule more difficult

287. Richard Briffault, *Our Localism: Part I—The Structure of Local Government Law*, 90 COLUM. L. REV. 1, 1–2 (1990).

288. Reynolds, *supra* note 42.

289. See, e.g., *supra* notes 117–20 and accompanying text (discussing how Michigan courts have interpreted a “voluntariness” standard).

to apply. Trying to make a variety of charges match a one-size-fits-all rule leads to instability in the doctrine.

2. *Voter Preferences / Constitutional Interpretation*

Another objection to the proposal is that it pushes back on the express wishes of voters, especially when it comes to political process limitations enacted through popular referenda. Voters, at least in California, have repeatedly objected to the California courts' narrow application of tax limits.

As a substantive matter, it is not clear whether voters' support for broad definitions of taxes should extend to price-based regulatory fees. Of course, it is possible that such support represents general anti-government zeal, but data suggest that most taxpayers are not zealots, though all else equal, everyone prefers to pay less in taxes.²⁹⁰ Rather, what voters may have objected to was what appeared to be government subterfuge—the idea that these taxes were hidden and designed to escape existing limitations.

While the same voters who want to make it harder for state and local governments to raise taxes may also want to make it harder for state and local governments to regulate behavior, the arguments for restricting state and local authority in these two cases are different. In the first case, voters may object to the quality of the services they are getting in relation to the tax dollars they are paying. In the second, they may object to the state's obstruction into private activity. It is possible, however, that the “double dividend” of Pigovian charges would allow governments to lower other taxes and fees, as the stormwater remediation fee did in Ithaca.²⁹¹

Further, to the extent voters do not like these changes to common law definitions of user fees, they can seek recourse in other popular referenda or legislative champions at the state level in response to state court changes to the doctrine. Until then, the courts must attempt to define these terms for themselves.

Finally, I put forward this proposal mindful that there are fifty different state approaches to this issue. While my proposal may work in some states, given the legislative and constitutional history of the state and the political meaning of these distinctions, it may be more difficult (or impossible) for judges in other states to adopt it, at least in its entirety. Explicitly recognizing that governments impose user fees for a wide variety of purposes should be a possibility in almost all states and that step in and of itself would offer some clarity to the doctrine.

290. *See generally* WILLIAMSON, *supra* note 31.

291. *See supra* note 71 and accompanying text.

3. *Measuring Externality Costs*

A final and significant difficulty with this proposal is that it requires courts to assess the government's measurement of externality costs. To the extent a government seeks to capture the double dividend of Pigovian taxation while exercising that user fee authority, the definition I propose requires that government's pricing regulation to reflect a true externality cost and that cost be the externality borne by the specific geographic unit imposing the cost. Measuring such costs is not a trivial matter.

Under the existing doctrinal framework, state courts currently struggle—and sometimes stumble—in their efforts to assess the relationship between the economic benefit conferred on the payor and the costs to the government providing that benefit. But at least such measurements ostensibly relate to actual expenditures that the government will make and that should be reflected in its capital expenditure budget. Externality costs, in contrast, are necessarily speculative. As Victor Fleischer suggests, such costs are often heterogeneous, that is, there may be significant variation in the externality cost imposed by two people engaging in the same behavior.²⁹²

As Darrien Shanske's work has suggested, state courts might do better to evaluate such questions procedurally rather than substantively.²⁹³ Courts that are not adept at answering whether the price is actually set correctly might still be able to identify flaws in a government's methodological approach. Did they consult the right experts? Did they commission the right studies?

And, of course, all is not lost should courts decide that the government's methodology is not sufficient to support a conclusion that the price matches the externality cost. Governments could then either impose the price under their taxing authority or change their methodology. Shanske persuasively argues that such a procedural review would also provide more certain guidance to policymakers as they design policies to be implemented under their user fee authority.

Under my proposed two-pronged definition of price-based regulatory tools, a government can forgo measuring the externality and opt instead to qualify a charge under the user fee doctrine by restricting revenue to abatement costs. Courts, however, must then evaluate the fit between the "abatement costs" identified by the government and externality costs imposed by payor behavior. Such an inquiry may be straightforward. In the case of stormwater remediation fees, fees are dedicated to stormwater infrastructure, and so there is a clear link between the user fee and the cost to the local government of abating the water pollution. In the case of other charges, the government's

292. See Fleischer, *supra* note 1.

293. See generally Shanske, *supra* note 26.

abatement costs may be less clear. If the government uses revenue from a carbon tax for infrastructure improvements necessitated by rising sea levels or to develop drought resistant water supplies, those costs would strike most environmentalists as costs imposed by climate change.²⁹⁴ But what if a government uses its carbon pricing revenue to further reduce emissions, for example, by investing in less energy-intensive infrastructure? Are those costs related to abating the externality? Or are those additional abatement opportunities?

And given the vogue of calling all social bads externalities,²⁹⁵ courts may also feel pressure to police the definition of externalities. Public health officials often lament the externalities imposed by sugar, for example, while many economists question the extent of the social costs (as opposed to individual costs) imposed by the obesity epidemic.²⁹⁶ Such debates could open the door to more complexity in the doctrine, as courts struggle to limit the definition of externality. Though such an outcome is clearly possible, courts are up to this task, and further, policing the limits of the definition of “externality” may be significantly easier than policing the definition of user fee under existing doctrine. After all, the definition of user fee is a pure legal construct, and drawing a clearly defensible line between user fees and taxes is all but impossible as a theoretical matter. The term externality, on the other hand, is not a legal concept, but an economic one. While measuring externality costs with precision may be difficult, rough measurements should suffice in determining whether the externality is real or not.

As the discussion of various objections to my proposal reveals, creating clear lines between user fees and taxes is not easy. This proposal does not completely eliminate the problems of current approaches, but it does offer a way forward that should both simplify some definitional questions and, at the very least, help courts clarify and grapple directly with why the line is difficult to draw.

V. CONCLUSION

State and local governments are increasingly interested in regulating through pricing and other market-based mechanisms. Such regulatory efforts will get caught in the thicket of judicial attempts to

294. I do not deal directly with the concerns of climate change skeptics. Rather, I assume that a government willing to impose carbon pricing has an electorate willing to believe that climate change is real.

295. *See generally* N. Gregory Mankiw, *Can a Soda Tax Save Us from Ourselves?*, N.Y. TIMES (June 5, 2010), <https://www.nytimes.com/2010/06/06/business/06view.html>; Pratt, *supra* note 169 (arguing that public health advocates focusing on the cost of soda consumption are looking at both social costs (true externalities) and internalities (individual costs that are borne at a future date)).

296. *Id.*

distinguish taxes from user fees. Courts should reform the law in this area by adopting definitions that more closely match the reasons state law distinguishes between taxes and user fees. The proposal discussed in this Article is one attempt to clarify this doctrine.