



IN PARTNERSHIP WITH



THE USE AND ABUSE OF USER FEES AND CHARGES

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EXECUTIVE SUMMARY

Fees and charges constitute a significant revenue source for cities and towns (in some cases as much as one-fifth of total revenues). This report discusses the different kinds of fees, their proper use, and the methods for calculating them. Cities and towns impose two distinct kinds of fees:

- User fees are charged for a particular benefit an individual receives such as water. The purpose of this kind of fee is to recover all or part of the cost of providing the service.
- Regulatory fees are charged to regulate activities for public health, safety, or other protective purposes. Restaurant inspections fall under this category.

For the sake of administrative efficiency and equity, the Research Bureau suggests that communities follow the GFOA (Government Finance Officers Association) recommended guidelines discussed in the report (p. 5). Of the fourteen towns that responded to the Research Bureau's survey, it appears that only Worcester adheres to most of the GFOA guidelines.

I. INTRODUCTION

The current fiscal crisis in Massachusetts, resulting in cuts in local aid (\$17.5 million in Worcester alone), has left many cities and towns looking for new revenue streams to close their budget gaps. Since the passage of Proposition 2½ in 1980, which limited the rate of property tax increases, municipalities have increasingly turned to non-property taxes for extra revenue. One of the most popular non-property revenue sources is user fees and charges. In FY03, these revenue sources accounted for about \$78 million, or 17.5% of Worcester's total revenues, \$9.5 million or 14% of Shrewsbury's, and \$3 million, or 22% of Spencer's total revenues.¹

User fees and charges, however, are not immune to criticism or citizen complaints. The State Senate's budget for the Commonwealth proposed raising \$500 million from existing fees and the imposition of new fees.² The final version of the budget may raise fees by as much as \$625 million. Many watchdog groups argue that the new fees are actually taxes, and are threatening legal challenges. Locally, the town of Spencer is facing a legal challenge to its transfer station sticker fee and garbage bag fee, even though the new fees seem to comply with all the requirements of the Commonwealth's Department of Revenue (DOR) and the standards recommended by the GFOA.³

After defining user fees, this report will discuss the benefits and limitations of using them to boost municipal revenues. It will also outline the DOR's recommended guidelines for establishing and increasing user fees and charges. By following the recommended guidelines, cities and towns can ensure that they are complying with regulations and administering these fees in an efficient and effective manner. The report will also discuss the results of the Municipalities Organized for Regional Effectiveness

¹ See "Municipal Budget Revenues" (res.03.xls) at Department of Revenue Website <http://www.dls.state.ma.us/allfiles.htm>

² http://www.boston.com/dailyglobe2/142/metro/State_Senate_eyes_new_feest.shtml

³ "Hearing on Fees Tomorrow," *Telegram & Gazette* May 18, 2003, <http://www.telegram.com>.

(MORE) user fee survey based on data provided by fourteen participating communities.⁴ All survey data are available at www.wrrb.org/more. Finally, the Appendices contain state statutes regulating the use of fees, brief summaries of court cases challenging the imposition of fees, and a comparative analysis of home building permit costs in fourteen towns in the region.

II. WHAT ARE FEES AND CHARGES?

Local governmental agencies can raise revenues from their own resources or from intergovernmental agencies.⁵ Intergovernmental revenues are grants or payments from the Federal or state governments. Revenues from a town's own resources include taxes and user fees and charges.⁶ Taxes support general government functions such as public schools and public safety for which individual beneficiaries cannot be identified. Rather these services benefit the community as a whole.

DOR distinguishes fees from charges although many people use the terms interchangeably. In this report, we will distinguish between user fees or charges and regulatory fees. Under DOR guidelines, user fees and charges are defined as voluntary payments ("voluntary" in the sense that they are paid only to the extent the individual chooses to use the service) that are used to finance traditional governmental services such as water, sewerage, and mass transit; recreational activities such as golf and swimming; and miscellaneous programs such as animal shelters, continuing education programs, and dangerous tree removal.⁷ These charges are for a particular benefit that an individual receives. The purpose of the fee is to recover all or part of the cost of providing the service. To the extent that the government charges the full cost of the service, it is trying to imitate the private market.

Another way to define user fees is that they must exhibit the following three characteristics: separability, voluntarism, and chargeability.⁸ A fee to use the town pool fulfills these three criteria. The use of the town pool can be separated out from other town services. It is easy to identify users of the pool – anyone who shows up to swim! The activity of swimming is completely voluntary. It is very easy to collect the fee at the entrance to the pool. The costs of running a pool can be clearly calculated; therefore it is not difficult to determine the fee that needs to be charged to cover the cost of maintaining and operating the pool.

A regulatory fee, on the other hand, is imposed as a result of a need to regulate activities for the public good, typically for public health, safety, or other protective purposes. Fees purchase a privilege or authorization that applies only to those individuals who want to engage in an activity deemed to have a significant impact on the health and well-being of the community as a whole. Regulatory fees are applied

⁴ Towns that participated: Auburn, Charlton, Douglas, Grafton, Hubbardston, North Brookfield, Northborough, Oxford, Princeton, Shrewsbury, West Brookfield, Westborough, Winchendon, Worcester.

⁵ "Introduction," John E. Petersen and Dennis R. Strachota, in Local Government and Finance: Practices, edited by John E. Petersen and Dennis R. Strachota, GFOA (Chicago, 1991), p.2.

⁶ Ibid.

⁷ "Municipal Fees and Charges: Legal and Cost Analysis," prepared for the Worcester Regional Research Bureau by the Division of Local Services, Massachusetts Department of Revenue, February 7, 2003, p.13.

⁸ "User Charges & Fees," C. Kurt Zorn, edited by John E. Petersen and Dennis R. Strachota p. 143.

to such activities as restaurant inspections, landfill use, building permits, dog licenses, and marriage licenses.⁹ While the individual who pays the fee does not necessarily benefit personally from the service provided, the public does benefit. Furthermore, since a regulatory fee is not necessarily related to the cost of providing the service, this kind of fee does not try to approximate the private market.

The authority to impose fees and licenses in Massachusetts comes from general or special laws and home rule powers. The power to set the amount of a fee is controlled by state and local statutes. (See Appendix A for M.G.L. Ch. 40, SS21E, SS22F.)

III. USER FEES AS A TOOL OF PUBLIC POLICY

User fees are a proper tool of public policy in connection with the provision of certain kinds of goods and services, for the following reasons:

- **Rationing to conserve resources:** For example, in the case of public water supplies, metering use and billing of individual users in proportion to their use is essential to promote water conservation, as well as to avoid compelling thrifty users to subsidize extravagant ones. So long as charges are based on the actual cost of providing a service, they also “signal” users of services on the cost-efficiency of investing in devices to reduce unnecessary use, or waste. Another example of how user fees can promote conservation is Worcester’s trash bag fees, which encourage residents to recycle paper, plastic and glass (for free) rather than putting recyclables in trash bags, which heightens dumping fees the City must pay.
- **Avoiding public subsidies for nonessential services consumed by limited segments of the population:** With respect to (for instance) the lighting of public tennis courts, only a rather small minority of the population is likely to consume the service, and no one would deem it essential to the public health and well-being. Thus it is reasonable, where the cost of collecting fees is sufficiently low, for the local government to impose a fee on the users that will cover part or all of the cost of providing the service (e.g., by coin-operated boxes for controlling the lights).
- **Covering regulatory costs resulting from the activities of discrete groups of the population:** It is customary to charge a nominal dog-license fee to assist owners in the recovery of lost dogs and to reduce problems arising from stray dogs, especially since dog ownership is a non-essential activity in which only a limited part of the population participates.
- **Assessing the real need or demand for a nonessential service not widely enjoyed:** Sometimes (owing to political pressures from relatively small groups of the population) city budgets may be inflated by the provision of optional services for which there is little real demand. Adding a nominal fee can help to determine the real demand for a service: if people aren’t willing to pay a nominal fee for a service, it may be that there’s no real need for the City to provide it, and it might better be left to private (profit-making or nonprofit) providers. For

⁹ “Municipal Fees and Charges: Legal and Cost Analysis,” p. 13.

example, the City of Worcester used to provide genealogical research to citizens free of charge, a service which was labor-intensive and for which there was little demand. Rather than imposing a fee, the City Clerk's Office now refers individuals to privately maintained websites to conduct their own searches. Similarly, the City used to sell hunting and fishing licenses required by the state to engage in those activities. The revenue received by the City was inconsequential, and the cost of maintaining the service was greater than the demand. These licenses are now sold through sporting goods stores.

The same reasons that make user fees appropriate in certain circumstances also dictate, however, restrictions on their proper use and extent:

- User fees should **not** ordinarily be used as merely a revenue-enhancement device, since they conceal the real total cost of government from taxpayers (and serve to evade limitations on the level of taxation that were voted by taxpayers, e.g. in Proposition 2½). Thus they interfere with the practice of self-government.
- The administration of a user fee system can cost a disproportionate amount relative to its revenue yield.
- Excessive fees (e.g., building permits) may limit the amount of useful goods that are supplied by the private sector (e.g., construction or renovation of residential and commercial properties).
- Excessive fees can also reduce the attractiveness of a city to new businesses (and even to potential residents, if they are high enough).
- Additionally, it should be borne in mind that since user fees are not deductible on individual Federal tax returns as taxes are, their net cost to taxpayers who itemize their Federal tax returns is significantly higher.
- User fees cannot be charged if the good or service they finance cannot be limited to those who benefit. The Massachusetts Appeals Court struck down a sewer connection fee in 1993 because the fee was going to be used to upgrade the town's sewer system and would therefore benefit all users. In 2000, the Massachusetts Appeals Court also struck down a school impact fee charged by the town of Franklin on property owners seeking occupancy permits, because the fee was going to benefit people other than the fee payers. The Court also declared that funding schools was a general government cost, and should be financed by all taxpayers. (See Appendix B.)

IV. GFOA AND DOR RECOMMENDATIONS:¹⁰

In order to insure the effective and efficient setting and administration of fees and to decrease the likelihood of legal challenges, the Research Bureau suggests that communities adopt the following DOR- and GFOA-recommended practices for setting and administering fees:

- Identify the manner in which fees and charges are currently set and the extent to which they cover the cost of the service provided. A policy should identify what factors shall be taken into account when pricing goods and services. It should also state whether the jurisdiction intends to recover the full cost of providing goods and services. The policy should further explain under what circumstances the jurisdiction might set a charge or fee at less than full cost (e.g., subsidies for the elderly or low income population).
- Evaluate the effects of potential changes on revenue sources in order to understand the impact on future revenue collections.
- Prepare and maintain a revenue manual that documents revenue sources and factors relevant to present and projected levels of those revenues.
- Conduct a cost study for each of the services for which a fee is charged. DOR provides a costing workbook that details the costing process.¹¹ A costing study will allow a municipality to analyze the efficiency of those services, make budgetary decisions, set appropriate fees and charges, and consider alternative methods of providing services.
- Review and update charges and fees periodically in order to keep pace with the costs of providing the service as well as inflation.
- Communicate with the public. A city or town should clearly explain to its residents why it is charging user fees and the advantages of this type of revenue collection.

V. RESEARCH BUREAU SURVEY OF USER FEES AND CHARGES: OBSERVATIONS AND RECOMMENDATIONS

As noted earlier in this report, the Research Bureau asked MORE members to participate in a survey of user fees and charges. The purpose of this survey was two-fold: to provide participating towns with the opportunity to review their fees and the processes used for implementing and collecting them; and to provide a database that allows towns to compare their fee structures with those of other towns in the region as background in reviewing and updating their own fee schedules. In addition, the file can be

¹⁰ “Municipal Fees and Charges: Legal and Cost Analysis,” p.13.

¹¹ “Costing Municipal Services: Workbook and Case Study,” Massachusetts Department of Revenue, Division of Local Services, January 2003, <http://www.dls.state.ma.us/PUBL/MISC/costing.pdf>

used by the towns to maintain and update their own data. It can then be accessed by all town administrators and shared with town residents.

The following limitations emerged in the survey findings:

- Of the fourteen towns that participated in the survey, only Worcester had a single document with all user fees, charges, and licenses listed.
- Many of the schedules were incomplete and did not include fees for such basic services as dog licenses. The incomplete files were more than likely a function of not having all the fees listed in one easily accessible form. GFOA recommends that towns have one file or manual with a complete listing of all user fees, charges and licenses for the sake of greater government accountability and transparency. Such a file will allow citizens to get information on all fees they may need for a project at one time, such as building a house. It also makes it easier for a town to track and review the revenues it receives from user fees, charges, and licenses.
- Some of the schedules provided by the towns were difficult to understand. The duration of a permit or license, or what the fee covered, was not always clear. For example, it was hard to determine whether a building permit also included fees for inspection. On some schedules, fees for fire alarm installation and inspection were listed under both the fire department and the building inspection department.
- Only one town of those surveyed responded that it conducts a comprehensive annual review of its fee schedule.
- Only two towns reported that some departments conduct an annual review of the fees and licenses they charged, but this was not town-wide policy. One of the fee schedules was dated 1989.
- None of the towns reported initiating a comprehensive costing review of their fees and charges. Most town governments believe, however, that the fees charged cover the costs of services provided. For reasons of fairness and equity, a town should charge the full cost of the service unless there is a clearly stated policy to the contrary.

APPENDIX A¹²

Commonwealth of Massachusetts Statutes Concerning Fees Set by Municipalities

M.G.L. Ch. 40 SS 21E – Cities and towns may by by-law or ordinance establish due dates for payment of municipal charges and bills and fix an interest rate for delinquent bills. Maximum interest rate is that for outstanding property taxes under G.L. Ch. 59 SS57 (currently 14%).

M.G.L. Ch. 40 SS22F – Local acceptance statute that allows boards and officers to set reasonable fees and charges for permits, licenses or certificates issued or services delivered by their departments and to increase certain fees and charges set by state law beyond those amounts if local costs are higher. (www.state.ma.us/legis/legis.htm)

APPENDIX B¹³

Massachusetts Court Cases Concerning the Imposition of Fees on Government Services

Emerson V. Boston, 391 Mass. 415 (1984) – Boston’s augmentation of the fire services fee for tall buildings was declared invalid as an illegal tax based on the application of three criteria the Supreme Judicial Court established for determining whether a monetary exaction is a fee or tax. The three criteria are: (1) the charge must be for a particular benefit or service; (2) it must be paid by choice; and (3) it must be collected to defray expenses.

Southview Co-operative Housing Corporation v. Rent Control Board of Cambridge, 396 Mass. 395 (1985) – Charges assessed against landlords by city’s Rent Control Board in connection with their petitions for rent adjustments were judged to constitute valid fees that the board had authority to impose as incident to regulation.

Commonwealth v. Caldwell, 25 Mass. App. Ct. 91 (1987) – Beverly mooring and slip fee imposed by city ordinance to defray expenses of city Harbormaster was upheld as valid fee using *Emerson College* criteria.

Bertone v. Department of Public Utilities, 411 Mass. 536 (1992) – Hook-up or connection fee charged to customers seeking new or expanded electrical service from Hull municipal light plant was upheld as valid fee where designed to finance plant upgrades needed to accommodate the new demand for service.

Berry v. Danvers, 34 Mass. App. Ct. 507 (1993) – Hook-up or connection fee charged to new customers seeking to connect to Danvers sewer system was declared invalid tax where intended to finance system upgrades and repairs of benefit to all users.

Nuclear Metals, Inc. v. Low-Level Radioactive Waste Management Board, 421 Mass. 196 (1995) – Assessments imposed on manufacturers licensed by United States Nuclear Regulatory Commission to receive, possess and transport radioactive materials were upheld as valid regulatory fees.

Baker v. Department of Environmental Protection, 39 Mass. App. Ct. 444 (1995) – Fees paid to DEP and local conservation commissions by property owners filing notice of intention to alter protected wetlands were upheld as valid regulatory fees.

Morton v. Hanover, 43 Mass. App. Ct. 197 (1997) - A surcharge on the user charges assessed to water customers in the Hanover Mall commercial area were held to be valid where intended to recover cost of upgraded water mains needed to ensure adequate water pressure and flow to that area for fire protection and water supply purposes during periods of peak usage.

Greater Franklin Developers Association, Inc. v. Town of Franklin, 49 Mass. App. Ct. 500 (2000) – School impact fee imposed by by-law on property owners seeking certificates of occupancy for new or expanded residential buildings for the purpose of raising funds to build or improve public schools to accommodate increased demand attributable to new development was declared invalid because the benefit of schools is not limited to fee payers and providing schools is therefore a general government cost.

¹² *Ibid.*, p. 1.

¹³ *Ibid.*, pp. 1-2.

Appendix C

Comparative Analysis of Building Permit Costs in Fourteen Towns Participating in Research Bureau Survey

Comparison done for a 2,000-square-foot single-family home with construction costs of \$45 per square foot unless indicated otherwise. The table shows a considerable variation in the fees charged by each town.

City	Building Permits	Cost
Auburn	\$6 per \$1,000 of valuation	\$540
Charlton	\$5 per \$1,000 of valuation	\$450
Douglas	\$250 plus \$0.06 per sq. ft. of living space	\$370
Grafton	\$35 minimum or \$0.12 per sq. ft.	\$240
Hubbardston	\$8 per \$1,000 with set construction costs of \$50 per sq. ft. (first floor) and \$40 per sq. ft. (second floor)	For a house with 1,000 sq. ft. on first floor and 1,000 sq. ft. on second floor= \$720
Northboro	\$6 per \$1,000 of valuation	\$540
Oxford	\$0.05 per sq. ft.	\$100
Princeton	\$25 plus construction value x \$0.003	\$295
Shrewsbury	\$5 per \$1,000 of construction cost	\$450
Sturbridge	\$5 per \$1,000 of construction cost	\$450
West Brookfield	\$275 plus \$0.10 per sq. ft.	\$475
Westborough	\$5 per 1,000 valuation	\$450
Winchendon	Up to 1,500 sq. ft. \$375-575 Up to 2,500 sq. ft. \$650-950 Up to 3,000 sq. ft. \$1,050-1,125	\$650 - 950
Worcester	Up to 1,500 sq. ft. \$150 Up to 2,500 sq. ft. \$200 Up to 2,500 sq. ft. \$250	\$200

Prepared by: Worcester Regional Research Bureau