

You Can Fight City Hall and Win – A Small Taxpayer Victory in Texas

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Taxpayers seem to be barraged by either new or increased taxes as governmental entities seek ways to increase revenue. To avoid the dissent of more taxes, some cities institute new fees instead. However, a recent decision by the Supreme Court of Texas limits the ability of local governments to assess such fees. The decision was based on a case where commercial property holders were required to register and pay a fire safety fee. Those paying the fee considered it to be an occupancy tax and not a legitimate fee. Because of opposition, the city first reduced the fee and then later repealed it. One of the taxpayers brought a class action suit against the city of Dallas to receive reimbursement of the fee. He originally resisted the fee and did not pay until “threatened” with violation of a criminal offense and a penalty. After the fee was abolished, he requested a refund; however, the city did not have a refund procedure in place for protested fee payments. The taxpayer pursued the matter and the court determined that since he only paid the fee after being made aware of the possible criminal offense violation, he was entitled to a refund because the threat of a criminal offense for not paying a fee can act as duress in compelling individuals to pay such a fee. This case represents a small victory for taxpayers in Texas.

INTRODUCTION

In the current economic environment, all levels of government are facing severe funding difficulties. Large shortfalls in revenue are common and there is much discussion regarding how best to solve this problem. One of the ways most often suggested is to increase revenue by way of new taxes or increased tax rates. In many cases, governments are seeking to avoid criticism for raising taxes by instead instituting new fees. Such fees are appealing when the governmental entity can claim that the fee is fair because it is simply charging the taxpayer for benefits received or services provided.

A recent decision by the Supreme Court of Texas limits the ability of local governments to assess such fees. In the case of *Jim Lowenberg, on Behalf of Himself and all Others Similarly Situated, Petitioner, v. City of Dallas, Respondent (Lowenberg), (2008)*, the Court handed commercial building owners a small tax victory.

The City of Dallas had passed Ordinance 22206 which became effective on January 1, 1995. The Ordinance was to provide funds for fire protection for commercial buildings. Compliance with the Ordinance required a certificate of registration “to own, operate or control a commercial building within the city” (Lowenberg, 2008). Certificates were valid for one year. To obtain the certificate required the submission of an application disclosing some basic fire safety information relating to the property such as

the type of business, unique aspects of the building, fire safety protection features and any hazardous operations. Payment of a “fire registration fee” was required with submission of the application. This fee ranged from \$70 up to \$2,150 depending upon the square footage of the building. Under the ordinance, anyone not having the required certificate committed a criminal offense punishable by a fine of up to \$2,000 (Lowenberg).

The City’s purpose for the ordinance was to establish “a fire safety registration program ... to improve fire prevention and suppression services and thus to reduce loss of life and property to fire” (Lowenberg, 2008). The purpose of the fee was “to recover ... the costs of fire prevention services to commercial properties that had previously been funded by general revenue [and] the additional commercial-property-related costs of obtaining and administering fire registration information.” Though called a fire registration fee, the fee was seen by many as an occupancy tax.

The fee was very unpopular with those affected. Following its announcement, there was so much opposition that the City of Dallas actually reduced the fee by 50% even before it went into effect. It was totally abolished after only nine months. However, the City did not refund any fees that had already been collected or stop collecting fees which were due from when the Ordinance had been in effect.

Lowenberg (2008) applied to have his commercial building registered under the Ordinance but did not pay the \$80 fee. Almost eight months after the fee was abolished, the City requested payment from him, warning that “[v]iolators will be issued citations...and, upon conviction, will be subject to fines up to \$2,000” (Lowenberg). Lowenberg continued his refusal to pay. In February 1997, more than 16 months after the fee had been abolished, he was cited to appear in municipal court. He then paid the fee and the charge was dismissed. He had paid under protest but the city had no protest procedures. Consequently, in July 1997 he began legal action to recover his payment. It took more than 11 years before the issue was finally resolved.

After an initial defeat, he filed a class action lawsuit. He alleged the registration fee was an unconstitutional taking in violation of his state and federal constitutional rights, and was an occupation tax in violation of Article VIII, Section 1 (f) of the Texas Constitution (Lowenberg, 2008). The trial court agreed with him, declaring that the fee was an illegal occupation tax, that persons who paid the fee on or after July 28, 1995 (approximately 19,000) were entitled to a refund, that claims for payments made before that date were barred by limitations, and that the refund totaled \$1,009,751.25 (Lowenberg). Final judgment for the plaintiffs for refunds, prejudgment interest, and attorney fees was rendered in January 2003 for \$1,847,454.36.

On appeal the decision was reversed by the court of appeals. The court concluded unanimously, as a matter of law, that the registration fee was an unlawful tax. However, with one dissenting vote, it also held that the fees were not paid under duress and therefore recovery was barred by the voluntary payment rule.

Upon review, the Supreme Court of Texas agreed with the court of appeals that the registration fee was an unlawful tax. The relevant part of the Texas Constitution, Article VIII, Section 1 (f) states that an “occupation tax levied by any county, city or town for any year on persons or corporations pursuing any profession or business, shall not exceed one half of the tax levied by the State for the same period on such profession or business” (Lowenberg, 2008). It was Lowenberg’s contention that the registration fee was really a tax on the business of owning, operating, or controlling a commercial building, and since the state levies no such tax, the fee was constitutionally prohibited.

In making its decision the Court quoted its prior decision in *Hurt v. Cooper*, where they stated,

It is sometimes difficult to determine whether a given statute should be classed as a regulatory measure or as a tax measure. The principle of distinction generally recognized is that when, from a consideration of the statute as a whole, the primary purpose of the fees provided therein is the raising of revenue, then such fees are in fact occupation taxes, and this regardless of the name by which they are designated. On the other hand, if its primary purpose appears to be that of regulation, then the fees levied are license fees and not taxes.

In *Lowenberg* (2008), the registration fee was intended to offset the administrative costs of collecting fire safety information on commercial buildings and incorporating it in a database used in fire prevention efforts. These, the court held, were clearly regulatory efforts. However, the city had acknowledged that the fee was also intended to raise enough revenue to cover all costs of fire prevention in commercial buildings, which would shift that burden off taxpayers. The city also conceded that the fee was to benefit the general public by improving fire protection for everyone. The court had “little trouble concluding that the fee was a tax” (Lowenberg, 2008), noting that even if the fee was intended to be used only for fire protection of commercial buildings, the revenue it generated greatly exceeded any regulatory costs. Despite the fact that the City is a home-rule municipal corporation with broad powers of self-government, the Court held that “it cannot impose regulatory fees that are really taxes prohibited by the Constitution.”

The second issue for the Court to address was the voluntary payment rule. It had stated in *Dallas County Cmty. Coll. Dist. v. Bolton* “a person who pays a tax voluntarily and without duress does not have a valid claim for its repayment even if the tax is later held to be unlawful” (Lowenberg, 2008). The court of appeals in *Lowenberg* held that, as a matter of law, class members’ payment of the registration fee was not under duress because “The ordinance in this case did not otherwise impact business operations, the right to do business, the building premises, or the title to the real property.” In light of the public policy consideration, the terms of the ordinance, and the options available to challenge the fee, we cannot hold that the possibility of being fined up to \$2,000 constitutes the type of duress that would “interfere with another person’s exercise of free will and judgment” (Lowenberg).

In so ruling, the court cited Bolton’s observation that “a common element of duress in all its forms... is improper or unlawful conduct or threat of improper or unlawful conduct that is intended to and does interfere with another person’s exercise of free will and judgment” (Lowenberg, 2008). However, the Supreme Court stated that *Bolton* only dealt with economic duress. They felt the court of appeals has focused too narrowly on whether the threat of a \$2,000 fine posed a financial hardship and failed to consider that nonpayment of the registration fee was a criminal offense – a Class C misdemeanor. The Supreme Court had not considered duress from criminal penalties in *Bolton*. However, it had made this consideration in *Hoefling v. City of San Antonio* where a butchery paid an unlawful occupation tax under protest only after the city began criminal proceedings. Holding that the business could recover the tax, the court stated, “If appellants had voluntarily paid the sum claimed as a tax, then they would not be entitled to recover it; but they paid it upon coercion, after the institution of criminal proceedings against them, and under the agreement of the parties are entitled to recover the sum so paid, together with costs incurred in all the courts” (Lowenberg).

The rule in *Hoefling* applied to the current case, they held. Both the butchery in *Hoefling* and *Lowenberg* were cited with a criminal charge. However, in a more extensive defense of the taxpayer, the Supreme Court held that it was not the citation which coerced payment, but the actual Ordinance itself, which had made nonpayment of the fee criminal. In so deciding, they noted the wording of the Ordinance: “A person *commits an offense* if he owns, operates, or controls a commercial building in the city without a valid certificate of registration issued under this article” (Lowenberg, 2008).

The original trial court had awarded attorney fees against the City under the Declaratory Judgment Act (Lowenberg, 2008). In one of its arguments contending that this was an error, the City argued that the declaratory judgment claim was mooted by the class members’ voluntary payments followed by the repeal of the registration fee. In its strong support for the taxpayer in this case, the Supreme Court was very emphatic in ruling against the City’s argument. They held “But the City cannot extract millions in unlawful fees and fines, decide the whole thing was a mistake, keep the money, and insist the whole matter is moot. For those who paid, the controversy remains real” (Lowenberg). In so deciding, the court reversed the judgment of the court of appeals and rendered judgment in accordance with the judgment of the trial court, in favor of Lowenberg.

CONCLUSION

While this case related to the City of Dallas, the decision is applicable to any county, city or town in the entire state of Texas. It clearly reinforces prior case law which held that it does not matter what any such body calls an occupation tax, if it raises more revenue than is required to fulfill a regulatory function, the assessment is a tax. If it is a tax, its size is limited by the Texas State Constitution to one half of the tax levied by the State on the same businesses. If no such state tax exists, then a local tax cannot either. The Court clearly stated that if the levy was to be recognized as a fee, it could only be set at a level high enough to pay for the performance of the function for which the fee was instituted.

The Court strengthened the position of the taxpayer in this case by expanding the definition of duress. While referring to its past rulings on economic duress, the Court held that the actual wording of an ordinance could in and of itself be held to be duress when nonpayment of the fee was defined to be a criminal offense. Normal law abiding citizens, including those in business, have no desire to commit criminal offenses, and so the definition of not paying a registration fee as a criminal offense can act as duress in compelling them to pay such a fee.

REFERENCES

Jim Lowenberg, on Behalf of Himself and all Others Similarly Situated, Petitioner, v. City of Dallas, Respondent, 261 S.W. 3d 54 (2008, March 28). Retrieved February 10, 2010, from <http://www.supreme.courts.state.tx.us/opinions/HTMLOpinionInfo.asp?OpinionID=2001136>

Hurt v. Cooper, 110 S.W. 2d 896.

Dallas County Cmty. Coll. Dist. v. Bolton, 185 S.W. 3d 868.

Hoefling v. City of San Antonio, 20 S.W. 85 (Tex. 1892).