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## User Fee Design by Canadian Municipalities: Considerations Arising from the Case Law

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### PRÉCIS

Les gouvernements municipaux au Canada en sont venus à compter de plus en plus sur les frais d'utilisation pour financer les services locaux, alors qu'ils tentent de résister à la pression du transfert des responsabilités fédérales et provinciales pour de tels services et à la tentation de hausser les impôts fonciers pour laquelle il y a un prix politique à payer. Bien qu'il y ait une documentation abondante sur le bien-fondé des frais d'utilisation, peu d'information existe sur la façon de concevoir et de mettre en œuvre des frais d'utilisation conformes aux exigences légales relatives à l'imposition de ce type de taxe. Les auteurs font un examen détaillé de la jurisprudence canadienne existante pour mettre en évidence les principales questions juridiques, techniques et administratives auxquelles font face les municipalités lors de la conception et de la mise en œuvre de frais d'utilisation. L'analyse porte principalement sur les principaux critères juridiques pour les frais d'utilisation et l'application de ces critères dans des cas spécifiques. Tout au long de leur analyse, les auteurs attirent l'attention sur plusieurs questions et disparités non résolues dans l'application et l'interprétation des critères, qui doivent être parcourus et abordés par les tribunaux.

### ABSTRACT

Municipal governments in Canada have come to rely increasingly on user fees to fund local services, as they struggle to deal with the combined pressures of federal and provincial devolution of responsibility for such services and the political costs of raising property taxes. While there is a substantial body of literature regarding the rationale for user fees, little information exists about how to design and implement a user fee so as to ensure that it satisfies the legal requirements for imposing this type of levy. The authors provide a detailed review of the existing Canadian case law to highlight key legal, technical, and administrative issues facing municipalities in designing and implementing user fees. The discussion focuses in particular on the principal legal tests for user fees and the application of those tests in specific cases. Through their analysis, the authors

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draw attention to several unresolved issues and inconsistencies in the application and interpretation of the tests, which need to be navigated and addressed by the courts.

**KEYWORDS:** FEES ■ USER CHARGES ■ MUNICIPAL FINANCE ■ TAX LAW

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## INTRODUCTION

A growing concern for Canadian municipalities is their ability to generate sufficient revenue to fund activities, using the most appropriate policy instrument, while balancing complex policy challenges. As “creatures of the provinces,” Canadian municipalities may raise revenue only through means authorized by the provinces.<sup>1</sup> As a result, fewer revenue-generating instruments are available to municipalities as compared with those available to the provincial and federal governments. These concerns have led Canadian municipalities to turn increasingly to user fees as an alternative to property taxes.<sup>2</sup>

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- 1 The expression “creatures of the provinces” is often used in reference to, and is derived from, the constitutional status of municipal governments in Canada, discussed in the next section of the article. Throughout the article, the term “provinces” is used in a broad or general sense and may include one or more of Canada’s three territories.
  - 2 On average, revenues from municipal user fees have grown at an annual rate of 2 percent since 1988, surpassing the growth rate in property taxes: Federation of Canadian Municipalities, *The State of Canada’s Cities and Communities 2012* (Ottawa: Federation of Canadian Municipalities, 2012), at 4. ([www.fcm.ca/Documents/reports/The\\_State\\_of\\_Canadas\\_Cities\\_and\\_Communities\\_2012\\_EN.pdf](http://www.fcm.ca/Documents/reports/The_State_of_Canadas_Cities_and_Communities_2012_EN.pdf)).

While the rationale for user fees is well established in the literature,<sup>3</sup> little information exists on how to satisfy the Canadian legal requirements for the imposition of user fees, despite the presence of significant relevant case law.<sup>4</sup> In fact, the legal requirements for user fees do not appear to be well understood, if they are even considered, in the existing literature. There is evidence suggesting that municipalities have experienced legal difficulties in implementing user fees. Not only have municipal user fees in a number of forms faced legal challenges across Canada (examples include campground fees,<sup>5</sup> volumetric gravel removal fees,<sup>6</sup> and waste disposal fees<sup>7</sup>), but they have also been the subject of negative internal audit reviews.<sup>8</sup>

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- 3 See, for example, Richard M. Bird, *Charging for Public Services: A New Look at an Old Idea*, Canadian Tax Paper no. 59 (Toronto: Canadian Tax Foundation, 1976); Harry M. Kitchen, *Local Government Finance in Canada* (Toronto: Canadian Tax Foundation, 1984); Harry M. Kitchen, *Municipal Revenue and Expenditure Issues in Canada*, Canadian Tax Paper no. 107 (Toronto: Canadian Tax Foundation, 2002); Harry Kitchen, "Pricing of Local Government Services," in Paul A.R. Hobson and France St-Hilaire, eds., *Urban Governance and Finance: A Question of Who Does What* (Montreal: Institute for Research on Public Policy, 1997); Richard M. Bird and Thomas Tsiopoulos, "User Charges for Public Services: Potentials and Problems" (1997) 45:1 *Canadian Tax Journal* 25-86; Donald N. Dewees, "Pricing Municipal Services: The Economics of User Fees" (2002) 50:2 *Canadian Tax Journal* 586-605; and David G. Duff, "Benefit Taxes and User Fees in Theory and Practice" (2004) 54:4 *University of Toronto Law Journal* 391-447.
- 4 We note, in particular, one Canadian study and three US studies on the legal criteria applicable to user fees: Catherine Althaus, Lindsay M. Tedds, and Allen McAvoy, "The Feasibility of Implementing a Congestion Charge on the Halifax Peninsula: Filling the 'Missing Link' of Implementation" (2011) 37:4 *Canadian Public Policy* 541-61, briefly summarize the key Canadian case law on the legal criteria for a user fee in Canada, to evaluate whether a congestion charge could be designed to satisfy the legal requirements for a user fee; Wisconsin, Legislative Audit Bureau, Joint Legislative Audit Committee, *Best Practices Report: Local Government User Fees* (Madison, WI: Legislative Audit Bureau, April 2004) (<http://legis.wisconsin.gov/lab/reports/04-0UserFeesFull.pdf>), provides a brief overview of the statutory and case law that governs the distinction between a tax and a user fee in Wisconsin; Leslie A. Powell, "User Fee or Tax: Does Diplomatic Immunity from Taxation Extend to New York City's Proposed Congestion Charge?" (2009) 23:1 *Emory International Law Review* 231-71, uses statutes and case law to determine whether the city of New York's proposed congestion charge meets the legal criteria to be considered a user fee and therefore not subject to the Vienna Convention on Diplomatic Relations; and Hugh D. Spitzer, "Taxes vs Fees: A Curious Confusion" (2003) 38:2 *Gonzaga Law Review* 335-65, considers the case law for distinguishing a tax and a user fee in the state of Washington.
- 5 *Carson's Camp Ltd. v. Amabel*, 1998 CanLII 14917 (ONSC).
- 6 *Allard Contractors Ltd. v. Coquitlam (District)*, [1993] 4 SCR 371.
- 7 *Antigonish (Town) Waste Disposal Charges Bylaw, Re* (1999), 7 MPLR (3d) 165 (NSSC).
- 8 For example, City of Ottawa, Office of the Auditor General, *2010 Audit Report* (Ottawa: Office of the Auditor General, 2011) ([www.ottawa.ca/city\\_hall/mayor\\_council/auditor\\_general/audit\\_reports/2011/annual\\_report\\_2010\\_en.pdf](http://www.ottawa.ca/city_hall/mayor_council/auditor_general/audit_reports/2011/annual_report_2010_en.pdf)), where the auditor general wrote, first, that there was no comparison of planned amounts and actual costs and volumes to validate the user fees charged by the city of Ottawa; second, that city council was not provided with the details of the costing used to justify the user fees; and finally, that some user fee calculations included costs that were in no way attributable to the service being provided.

The primary purpose of this article is to assess the current state of the law on user fees in Canada and to highlight key issues that present challenges to Canadian municipalities in ensuring that user fees are legally permissible and appropriate.<sup>9</sup> By carrying out a detailed review and critique of the existing case law, we aim to provide clarity with respect to the principles developed in the jurisprudence on the topic of user fees, particularly from a municipal implementation perspective. Our main focus is on the legal tests and criteria that are relevant for municipal public administrators. While these tests may address some questions regarding the legitimacy of user fees, the law in this area is complex and not definitive. As a result, many legal questions remain unresolved, creating uncertainty with respect to the specific requirements that must be met in designing municipal user fees. Our intention in highlighting these grey areas of the law is to illuminate the inconsistencies between the existing legal tests, not only to ensure that municipalities are aware of potential vulnerabilities but also to guide courts toward resolving these inconsistencies. An important caveat of our work is that, because municipalities derive their authority to charge user fees from their enabling legislation, the analysis presented here cannot and should not supplant careful review of such legislation by any municipality contemplating the introduction of user fees.

The discussion that follows is divided into six sections. In section one, we outline the constitutional authority for municipalities to charge user fees. Then, in section two, we explain the legal tests for user fees and review the leading cases establishing these tests and their respective criteria. Our discussion focuses on those cases in which the legal criteria have been elaborated or clarified; by no means do we attempt to cover all municipal user fee cases. However, we do include user fee cases outside municipal law where the judgment would apply in the municipal context. Drawing on this case-law review, in section three we identify and explain a number of unresolved issues related to the existing legal tests, and make recommendations for clarification of the test. Then, in section four, we address an important complication that arises in the jurisprudence—the difference between a user fee and a regulatory charge. Again, our review of the case law highlights several unresolved questions related to the distinction between a user fee and a regulatory charge, and these are discussed in section five. Section six presents a few brief concluding comments.

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9 While our work focuses on issues related to municipal user fee design, many of the lessons that we expound can also be applied to user fees designed by other levels of government. Municipalities, however, operate within a constrained fiscal environment that serves as a backdrop for the application of these legal principles. Other levels of government are not so constrained, and some of the considerations that we outline would not apply beyond municipal governments. This is not to suggest that there are no restrictions on the fiscal powers accorded to the federal and provincial governments. Governments at both levels are constrained not only constitutionally but also procedurally. In particular, the Constitution Act, 1867 stipulates that before a tax can be enacted, it must be approved by Parliament or a provincial legislature, as the case may be. See sections 91 and 92 of the Constitution Act, 1867 (UK), 30 & 31 Vict., c. 3. Failure to meet this procedural requirement would result in “taxation without representation.”

## CONSTITUTIONAL AUTHORITY FOR MUNICIPALITIES TO CHARGE USER FEES

As noted in the introduction, municipalities have only limited revenue-raising powers. These powers are derived from the allocation of jurisdiction among the three levels of government—federal, provincial, and municipal—under Canada’s constitution. The Constitution Act, 1867<sup>10</sup> sets out, in sections 91 and 92, the division of powers between the federal and provincial governments, respectively. The federal and provincial governments are able to pass laws only on the matters for which they are given specific authority. Thus, if a law is outside the jurisdiction of a government—that is, the government is not authorized, by the constitution, to govern in that area—the law is said to be “ultra vires” (beyond the powers or legal authority); conversely, if a law is within the jurisdiction of a government, it is said to be “intra vires.”

The broadest revenue-raising powers are accorded to the federal government. Section 91 of the Constitution Act provides, in part,

91. . . . [I]t is hereby declared that (notwithstanding anything in this Act) the exclusive Legislative Authority of the Parliament of Canada extends to all Matters coming within the Classes of Subjects next hereinafter enumerated; that is to say, . . .

3. The raising of Money by any Mode or System of Taxation.

The more limited revenue-raising powers of the provinces are set out in sections 92(2) and (9), as follows:

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

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

. . .

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

Section 92(2) grants the provinces the authority to impose direct taxation, to raise revenue for provincial purposes. This authority has been interpreted to include the legislative power to impose user fees.<sup>11</sup> Section 92(9) authorizes the provinces to

10 Supra note 9. Unless otherwise stated, references herein to “the Constitution Act” are to the Constitution Act, 1867.

11 See *City of Ottawa v. City of Ottawa Electric Railway Co.* (1929), 64 OLR 537, at 543 (CA), where the court stated: “That the fee or charge imposed by the by-law is a tax is, I think, quite clear. It is fixed at ‘one-tenth of a cent per scheduled passenger mile of travel or along all streets traversed by such service within and under the jurisdiction for the City of Ottawa.’ It is not a licence-fee, and the legislative power to impose the ‘fee or charge’ must rest upon the power to make laws in relation to ‘direct taxation within the Province’ given by para. 2 of sec. 92 of the British North America Act [emphasis added].”

raise revenues for provincial, local, or municipal purposes through the issuance of licences. As discussed in a later section of this article, the interpretation of this provision also has been broadened to include regulatory charges.

Municipal governments are not recognized in the Constitution Act as having separate jurisdiction or authority over any areas or matters. Instead, section 92(8) of that act grants provincial governments jurisdiction over municipalities. (This is why we refer to municipalities as “creatures of the provinces.”) Consequently, any revenue-raising powers that municipalities possess are limited to those that are delegated to them by the particular province within whose jurisdiction they lie.<sup>12</sup> In general, user fees and property taxes (under section 92(2)) and licence fees or regulatory charges (under section 92(9)) are the main forms of revenue-raising powers that are devolved to municipalities.

It is important to understand that provinces exercise the delegation of powers to municipalities in different ways, with the result that municipalities across Canada will not all have the same powers. In relation to user fees, this means that a municipality in one province may be able to adopt a user fee for a particular public good or service, and may choose the particular characteristics of that fee, while a municipality in another province may not be permitted to enact a similar fee, or to choose the same characteristics. As a result, careful examination of the legislation governing municipalities in a particular province is required to establish the authority to charge user fees and to determine whether there are any legal limitations on such authority, either in that legislation or in other provincial or federal statutes applicable to user fees.<sup>13</sup> Where the governing statute for a municipality or other legislation has not codified a user fee test, the test to determine whether a particular levy constitutes a user fee will follow legal precedent. These legal principles have been established in the case law, as discussed below, and inform the interpretation of the municipal legislation.

## THE USER FEE TEST

One of the main legal challenges to municipal user fees is the argument that a municipality has acted outside the provincially delegated authority. Typically, this means that the challenging party argues that the user fee is a tax, and the taxing power either has not been devolved to the municipality (as a form of direct tax) or cannot be so devolved because it is ultra vires the province (as a form of indirect tax). As a result, the case law has developed around ensuring that a levy is, in fact, a user fee.

Currently, the courts apply a two-part test to make this determination. First, the levy is evaluated against four criteria established in *Lawson v. Interior Tree Fruit and Vegetables Committee of Direction*,<sup>14</sup> to determine whether the levy is a tax. Under the

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

13 An example of such legislation is the federal User Fees Act, SC 2004, c. 6.

14 [1931] SCR 357.

*Lawson* test, a levy may be found to be a tax if it is (1) enforceable by law; (2) imposed under the authority of the legislature; (3) imposed by a public body; and (4) generated for a public purpose. Then two additional criteria are applied, as set out in *Eurig Estate (Re)*,<sup>15</sup> to determine whether the levy is a user fee. The first requirement under *Eurig* is that there is a nexus between the cost of the service and the fee. The second requirement is that there is a reasonable connection between the cost of the service and the amount charged.<sup>16</sup> With respect to the second requirement, the cost of the service and the amount of the fee do not have to exactly correspond. The respective criteria of the *Lawson* and *Eurig* tests and the generally accepted sequence of their application are summarized in figure 1.

In this section, we describe the context for the development of the *Lawson* and *Eurig* tests, and discuss how these tests have been applied in the case law.

### Is a Levy a Tax?

The *Lawson* test was established by the Supreme Court of Canada in 1931, and it remained the principal test until the *Eurig* decision in 1998. As described above, under *Lawson*, in order to be found to be a user fee, a levy must be found not to be a tax. One of the questions before the court in *Lawson* was whether the levy fell under provincial jurisdiction, pursuant to section 92(2) or (9) of the Constitution Act. The court applied four criteria in determining that the levy in question was a tax; namely, the levy was “(1) enforceable by law; (2) imposed under the authority of the legislature; (3) levied by a public body; and (4) intended for a public purpose.”<sup>17</sup> This is the test that continues to be applied to determine whether a levy is a tax.

In *Lawson*, the court found that the levy met all the elements of a tax. The levy was enforceable because it could be sued for, a certificate demonstrated the amount

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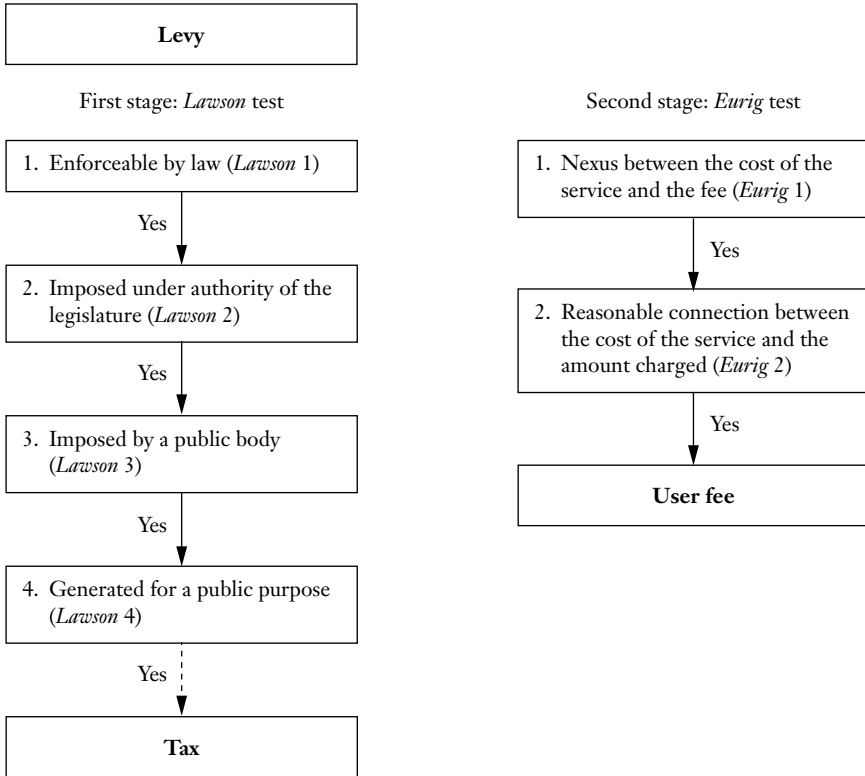
15 [1998] 2 SCR 565.

16 One could argue that these two elements in *Eurig* are one requirement for a reasonable cost nexus; however, we have chosen to keep the two elements separated since this is how they are commonly described and applied.

Most recently, the *Lawson* and *Eurig* criteria were restated in the 2008 Supreme Court of Canada decision in *620 Connaught Ltd. v. Canada (Attorney General)*, 2008 SCC 7. The question addressed in *620 Connaught* was whether a levy on liquor licences for businesses operating in Jasper National Park was a regulatory charge or a tax. It was not argued that the levy constituted a user fee. In its decision, the court provided guidance with respect to the assessment process applied in the determination of fees, using the *Eurig* criteria. The court stated, at paragraph 19, “A user fee, by definition, is a fee charged by the government for the use of government services or facilities. In the case of user fees, as stated by this Court in *Eurig*, there must be a clear nexus between the quantum charged and the cost to the government of providing such services or facilities. The fees charged cannot exceed the cost to the government of providing the services or facilities. However, ‘courts will not insist that fees correspond precisely to the cost of the relevant service. As long as a reasonable connection is shown between the cost of the service provided and the amount charged, that will suffice’ (see *Eurig*, at para. 22).” *620 Connaught* demonstrates that the *Lawson* and *Eurig* criteria remain valid.

17 The four criteria as summarized by Major J in *Eurig*, supra note 15, at paragraph 15, paraphrasing the findings of the majority in *Lawson*, supra note 14, at 363 (per Duff J).

**FIGURE 1 Summary of the Current User Fee Test**



owed, and failure to pay was an offence. The levy was imposed by the authority of the legislature through a public body; it was demonstrated that the committee of direction was a public body because the committee chair was appointed by the lieutenant governor in council, had wide powers of regulation over an extensive territory, and was constituted by and acted according to statute. The court also found that the levy was made for a public purpose, citing, as support for this conclusion, the fact that the committee that imposed the levy was a public body, as well as the extent of the territory and the number of people affected by the levy.<sup>18</sup>

**Is a Levy a User Fee?**

In 1998, the Supreme Court of Canada’s decision in *Eurig* added a second test to distinguish a tax from a user fee. In *Eurig*, the appellant was the executrix of an estate who objected to paying approximately \$5,700 in probate fees imposed by the province of Ontario. She argued that the fees were a tax, the authority for which

18 *Lawson*, supra note 14, at 363.



was not procedurally granted by the provincial legislature, and therefore they were ultra vires.<sup>19</sup> The Constitution Act provides that before a tax can be enacted, it must be approved by Parliament or a provincial legislature.<sup>20</sup> In the case of Ontario's probate fees, however, the authority to impose such fees had been delegated by regulation and did not go through the legislature. In determining whether the levy was a tax, the first step for the court was to apply the test set out in *Lawson*. The court evaluated the probate fee against the four criteria in *Lawson* and found that the levy appeared to satisfy all of them.

The court, however, decided that this was not sufficient to determine that the levy was indeed a tax. The seminal point in *Eurig* is a new element that the court introduced in conducting the user fee analysis. The court wrote:

Another factor that generally distinguishes a fee from a tax is that a nexus must exist between the quantum charged and the cost of the service provided in order for a levy to be considered constitutionally valid.<sup>21</sup>

This led the court to add a second element to its test. In relation to setting the price of user fees, the court stated:

In determining whether that nexus exists, courts will not insist that fees correspond precisely to the cost of the relevant service. As long as a reasonable connection is shown between the cost of the service provided and the amount charged, that will suffice.<sup>22</sup>

The court relied on the evidence provided to determine that there was no correlation between the cost of the service provided (the service being the issuing of letters probate) and the amount charged by the province. The court found that the levy was tied to the value of the estate, but the cost for issuing letters probate did not increase or decrease depending on an estate's value. As a result, the court found that there was no nexus between the cost of the service and the levy charged. The court held that the levy was a tax, not a user fee, and was ultra vires the province, since the province had imposed the tax without the properly delegated authority.<sup>23</sup>

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19 For a detailed description of the case, see Paul LeBreux, "Eurig Estate: Another Day, Another Tax" (1999) 47:5 *Canadian Tax Journal* 1126-63.

20 Constitution Act, supra note 9, sections 91 and 92.

21 *Eurig*, supra note 15, at paragraph 21.

22 *Ibid.*, at paragraph 22.

23 *Ibid.*, at paragraphs 22-23. If a user fee is found to be invalid, the court must then decide the appropriate remedy. This issue was taken up in *Kingstreet Investments Ltd. v. New Brunswick (Department of Finance)*, 2007 SCC 1. In *Kingstreet*, the Supreme Court addressed the question whether restitution is available for the recovery of monies collected under legislation that is later declared to be ultra vires. The court determined that restitution is generally available and that there is no general immunity affecting recovery of an invalid tax. In particular, the court decided that the government that had enacted the ultra vires legislation could amend the legislation to make it valid, and to ensure that it was valid retroactively, so that the government would not have to pay restitution. See also *Barbour v. University of British Columbia*, 2009 BCSC 425.

### Application of the Lawson and Eurig Tests

While the *Lawson* and *Eurig* tests may appear straightforward, uncertainties may arise in applying their respective criteria. Examples drawn from the municipal-law jurisprudence provide additional clarification on each of the four *Lawson* criteria, and these will be discussed here.

In *Grande Prairie (City) Re*,<sup>24</sup> a decision of the Alberta Electric Utility Board, the first *Lawson* criterion was considered, which requires a levy to be enforceable by law in order to be a tax. In this case, the city of Grande Prairie and its natural gas provider, ATCO Gas (“ATCO”), reached an agreement that increased a contractual fee that ATCO was required to pay for the provision of natural gas to the city. The board concluded that the fee was not a tax because it was imposed through an agreement and was not required by law. More specifically, the board was persuaded that the arrangement did not meet the first element of *Lawson* since the manner of payment was negotiated between the parties to the agreement and was thus not enforceable by law. The board further held that the fee was not compulsory or enforceable by law in the sense that it was charged pursuant to a freely negotiated agreement between the city and ATCO.<sup>25</sup> The board was also persuaded by a provision in the contract that the fees were paid in lieu of a tax, reasoning that a fee cannot be a tax if it is paid instead of a tax.<sup>26</sup> *Grande Prairie* is useful as an example of a levy that fails on the first *Lawson* criterion: that is, where a levy is not compulsory but rather arranged by negotiation, it will be found not to be a tax.

The first element of *Lawson* was also discussed by the Supreme Court of British Columbia in *Cariboo College v. Kamloops (City)*.<sup>27</sup> At issue in this case were development cost charges imposed by the municipality for the purpose of funding certain expenditures on infrastructure (relating to the construction of sewers, water, drainage, highways, and public open space).<sup>28</sup> The court concluded that the development cost charge was not a tax<sup>29</sup> because Cariboo College was not obliged to obtain a building permit from the city unless it chose to construct a new building, and if it chose to do so, it must pay the development cost charges to defray the city’s capital cost of providing the services.<sup>30</sup>

In 2012, the BC Supreme Court offered further insight into the interpretation of the first element of *Lawson* in its judgment in *Canadian Wireless Telecommunications Association v. Nanaimo (City)*.<sup>31</sup> At issue in this case was a per-call fee option that wireless service providers (WSPs) could elect to charge in lieu of charging consumers

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24 2003 CarswellAlta 2132 (Electric Utility Board).

25 *Ibid.*, at paragraph 24.

26 *Ibid.*, at paragraphs 29-30.

27 (1982), 133 DLR (3d) 241 (BCSC).

28 *Ibid.*, at paragraph 13.

29 *Ibid.*, at paragraph 30.

30 *Ibid.*, at paragraph 27.

31 2012 BCSC 1017.

a flat monthly rate imposed by the city of Nanaimo to support the 911 emergency call system. For the first *Lawson* criterion, the court examined whether the single-call fee was compulsory and enforceable by law. On the basis that the WSP must pay the single-call levy if it did not agree to the flat-rate monthly charge, the court found that there was a “practical compulsion” to pay the single-charge levy and found the levy to be a tax.<sup>32</sup>

Three of the *Lawson* criteria were considered in *Antigonish (Town) Waste Disposal Charges Bylaw, Re*,<sup>33</sup> a decision of the Nova Scotia Supreme Court. In this case, a university challenged a municipal bylaw that imposed a waste disposal charge on landowners but provided an exemption for residents who were paying the waste disposal charge in their property tax. The result was that the charge applied only to entities that were exempt from paying property tax, such as the university. The court undertook a detailed analysis of the *Lawson* criteria. As to the first criterion, that the levy must be enforceable by law to be a tax, the court found that (1) the charges would bear interest if they were outstanding, (2) they could be registered as a lien, and (3) the town of Antigonish could sue for an collect payment of the charges.<sup>34</sup> The court concluded that these characteristics were sufficient to meet the first *Lawson* criterion.<sup>35</sup>

The decision in *Antigonish* also contributes to further understanding of the third and fourth criteria of the *Lawson* test. The third criterion, requiring that the levy be imposed by a public body, is rarely considered in any depth, since it is generally obvious that the imposing body is a public body; yet it was considered by the court in this case. In concluding that the municipality was a public body, the court stated, “A municipal corporation is the body politic and corporate constituted by the incorporation of the inhabitants of a city or town for the purpose of local government.”<sup>36</sup> The court then referred to two sources supporting this view. First, it cited Rogers, *The Law of Canadian Municipal Corporations*, which states, “[A] municipality can also be described as a public corporation created by the government for political purposes and having subordinate or local powers of legislation.”<sup>37</sup> Second, the court cited a 1911 decision, *Dugas v. Macfarlane*, that described municipal corporations as “miniature parliaments, institutions by which the people’s will is expressed through elected representatives.”<sup>38</sup> The court held that the third *Lawson* criterion, that the levy must be imposed by a public body, was met on the basis of these authorities.

32 Ibid., at paragraph 62. This conclusion is particularly interesting given that there were two options for the wireless service provider to select from in terms of payment, and the court examined this point carefully in reaching its final determination.

33 *Antigonish Waste Disposal*, supra note 7.

34 Ibid., at paragraph 18.

35 Ibid., at paragraph 19.

36 Ibid., at paragraph 21.

37 Ibid., citing Ian MacFee Rogers, *The Law of Canadian Municipal Corporations*, 2d ed. (Toronto: Carswell, 1971).

38 (1911), 18 WLR 701, at paragraph 24 (YT Terr. Ct.), cited in *Antigonish Waste Disposal*, supra note 7, at paragraph 22.

The fourth *Lawson* criterion requires a court to establish that the levy is intended for a public purpose. Unfortunately, the interpretation of this criterion has been inconsistent as between two meanings—either that the revenue generated is intended to be used for public benefit, or that the revenue generated is to be put into a general account (rather than designated to fund a particular good or service). The first interpretation is found in *Antigonish*. The municipal bylaw in that case included a purpose statement, which was referred to by the court. The court wrote, “It is obvious that the By-law was enacted as a means of helping to defray the costs associated with the use of waste processing facilities.”<sup>39</sup> The conclusion that the court reached was that there was a twofold public purpose: (1) to reduce the tax burden on municipal taxpayers, and (2) to increase the municipality’s revenue.<sup>40</sup> The court found that the bylaw was a tax and not a user fee, and was inconsistent with the legislative scheme that created tax-exempt institutions. In other words, the town of Antigonish was attempting to tax the tax-exempt university.

As seen in *Lawson* and *Antigonish* regarding the interpretation of the fourth element, the court did not consider the accounting treatment of the revenue from a user fee; rather, the court was concerned with whether the revenue was fulfilling a “public purpose.” However, by the time of the *Eurig* decision, the notion of public purpose had shifted. In *Eurig*, the Supreme Court instead considered the account in which the revenue generated by the levy would be held, in order to evaluate public purpose. The court wrote:

[P]robate fees do not “incidentally” provide a surplus for general revenue, but rather are intended for that very purpose. The revenue obtained from probate fees is used for the public purpose of defraying the costs of court administration in general, and not simply to offset the costs of granting probate.<sup>41</sup>

The public purpose factor can be influential in the analysis, likely because some of the other elements in the *Lawson* test are fairly easily established; for example, most levies of concern will be imposed by a government body. The interpretation of the public purpose factor as providing a public benefit is also often easily established, since most government levies could be found to have some sort of purpose that serves the public. The shift in *Eurig* toward more of a bright-line test, focused on how the revenue is accounted for, is helpful though not consistently reflected in subsequent case law.

An example of the revenue-focused interpretation of the public purpose element is found in *Greater Toronto Apartment Association v. Toronto* (herein cited as “*GTAA*”).<sup>42</sup> This case dealt with a user fee scheme, the intended purpose of which was to divert

39 *Antigonish Waste Disposal*, supra note 7, at paragraph 25.

40 *Ibid.*, at paragraph 30.

41 *Eurig*, supra note 15, at paragraph 20.

42 2012 ONSC 4448.

70 percent of the municipality's residential garbage away from landfill.<sup>43</sup> The Ontario Superior Court examined the levy against the four *Lawson* criteria and found that it met all of them. The court took specific note of the difficulty with this test, namely, that a user fee may also meet all the criteria for a tax,<sup>44</sup> a point that we will return to in the next section of this article. The court then went on to consider whether the levy at issue was in fact a user fee and undertook significant analysis to determine the nexus between the levy and the service provided. The court cited *Eurig* and held that the user fees in *GTAA* were different from the probate fees in *Eurig*, which were found not to meet the nexus element. The court used evidence provided by the city of Toronto regarding the cost of the service to support this analysis. The total cost of the program was \$237.5 million, with the base amount of the program being established from the previous year. In this respect, the court stated that the fee charged "cannot be said to be arbitrary or unrelated to the cost of the service for which the fee is being collected."<sup>45</sup> Ultimately, the city intended to recover only 83 percent of the actual cost of the service from residential user fees. The city did not achieve the level of waste diversion it anticipated and therefore collected more revenue from multi-residence buildings than had been expected. The *GTAA* argued that this failure converted the fee to a tax because it eliminated the nexus between the amount of the fee and the cost of the service. The court found that there was in fact a nexus, stating:

The fact that some of the City's assumptions were wrong is hardly surprising. I would venture to say this is almost inevitably the case when one is attempting to predict the future in respect of a question that inherently contains a number of variable values. In any event, in determining whether a nexus exists, it is not for the court to look behind the methodology used and question the assumptions made in respect of individual values adopted.<sup>46</sup>

The point made clear in this case is that while a user fee is meant solely to recover costs, that purpose does not preclude the accrual of surpluses in any given year, provided that those surpluses were not an intentional design element.

## UNRESOLVED ISSUES FROM LAWSON AND EURIG

While the criteria established by *Lawson* and *Eurig* are easily identified, their interpretation and application is more complicated. In particular, despite the acceptance of these tests, the legal distinction between a fee and a tax often depends largely on

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43 Ibid., at paragraph 1.

44 Ibid., at paragraph 24: "The problem is self-evident. Based on these criteria, virtually any money collected by the City would be identified as a tax." See *infra* note 48 and the accompanying text, where we reproduce the broader context for the court's comments on this issue.

45 Ibid., at paragraph 30.

46 Ibid., at paragraph 41.

the particular levy being considered. If a levy is challenged, courts will look beyond mere nomenclature to determine whether the levy has the elements of a user fee or a tax; specifically, they will examine the structure and context of the levy under dispute. In addition, the evolution of the two tests has resulted in inconsistencies between them. The result is significant uncertainty, with many questions remaining unresolved.

In this section, we ponder some of these unresolved questions. The first is, how exactly should the tests be applied? Do all elements of the tests, particularly those in *Lawson*, need to be examined? Is it possible for a levy to meet all of the *Lawson* criteria (and thus be found to be a tax) and still meet the *Eurig* criteria (and thus be found to be a user fee)? What exactly is a “public purpose”? To what activities can user fee revenues be directed? And, depending on the answers to the foregoing questions, would it be more appropriate to apply the test criteria in a different order than that set out in the *Lawson* and *Eurig* decisions?

We find that the jurisprudence does provide some clarification with respect to the uncertainties we raise. First, *Eurig* appears to suggest that it should not be possible for a levy to meet all of the *Lawson* criteria and still be found to be a user fee, if the public purpose element is interpreted to mean that the revenues generated are put into a general account. Second, as a result, it appears that there is a more logical way of reordering the *Lawson* and *Eurig* tests. While the jurisprudence has not taken this step, we suggest that rearranging the *Lawson* and *Eurig* criteria to allow for a clearer application of the user fee test may be appropriate. The first factor to consider should be how the revenues are designated; if the revenues go into a general revenue account, the remaining *Lawson* criteria should be applied to determine whether the levy is a tax. If the revenues go into a specific revenue account that is designated for the cost of the service, the *Eurig* test to find a nexus should be applied. The user fee analysis in the existing case law, while clearly articulated in terms of the elements required, leaves gaps with respect to the order of application of the test criteria, and whether certain criteria must be met before others are considered. The establishment of a clear procedure would assist the parties to a dispute in presenting their arguments in court, and would be helpful to the courts in ensuring that they are considering all factors appropriately. Such a reordering would provide support for the notion that not all elements of the *Lawson* test need to be examined in every case.

### How Do the Tests Work Together in Application?

An initial difficulty in reading and attempting to reconcile the jurisprudence regarding user fees is that the courts seldom examine fully all the elements of the tests. Instead, it is more common for one element to be the deciding factor while the others are left unexamined.<sup>47</sup> As discussed above, the question arises as to whether

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<sup>47</sup> More recently, however, exceptions may be found; for example, in *Canadian Wireless Telecommunications*, supra note 31, the BC Supreme Court examined all of the requirements for a tax, found that the charge at issue was a tax, and then further ruled out the possibility that the charge could be a user fee.

it is possible for a levy to meet all of the *Lawson* criteria, implying that the levy would be a tax, and still meet the *Eurig* criteria, and then be found to be a user fee. This question was specifically asked, but not answered, by the court in *GTAA*. There does not appear to be a case in which a court states whether or not the entire *Lawson* test must be applied before the *Eurig* criteria can be considered. In fact, as noted earlier, the court in *GTAA* made specific mention of the difficulty of applying the full test. It is worthwhile to quote extensively from the decision with respect to the court's concern on this point:

Counsel for 373041 Ontario Limited submitted that each of these four characteristics [the *Lawson* criteria] attached to the “fee” set out in By-law 506-2008. They suggested that it was enforceable because the City could sue for any unpaid fees. More importantly, the fee is collected as part of the Utility Bill sent to an owner. It is an offence to fail to pay the account. The fee is imposed pursuant to a provincial statute, the *City of Toronto Act, 2006*, and was levied by a public body. Finally, the proceeds are intended for a public purpose, waste diversion. All four criteria are fulfilled and, on this basis, it was asserted that the payment is a tax and not a fee.

The problem is self-evident. Based on these criteria, virtually any money collected by the City would be identified as a tax. This idea was enunciated in *620 Connaught Ltd. v. Canada (Attorney General)* [2008 SCC 7, at paragraph 49, as cited in note 16 of the decision]:

. . . these [characteristics] will likely apply to most government levies.

The true impact of the application of the criteria was explained in *MacMillan Bloedel Ltd. v. British Columbia* [1985 CanLII 313 (BCSC), at paragraph 7, as cited in note 17 of the decision]:

It was enforceable by law, it was imposed under the authority of the legislature, it was imposed by a public body, and it was made for a public purpose. With great respect, although that case [*Lawson*] is authority for the proposition that an impost cannot be a tax unless it meets those criteria, I do not think the converse necessarily follows, that anything meeting those four criteria must be a tax. I do not, of course, dispute the ruling in that case that the royalty surcharge was a tax, but those four tests would apply to a ferry fare in British Columbia, although in my opinion that fare is not a tax but a fee for service imposed under statutory authority.<sup>48</sup>

As the foregoing comments from *GTAA* suggest, considerable uncertainty surrounds the application of the *Lawson* and *Eurig* tests; in particular, it is not clear if all of the elements of *Lawson* have to be met before *Eurig* can be applied. Further, as we explain below, there is some confusion in the analysis of the elements of the tests.

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48 *GTAA*, supra note 42, at paragraphs 23-25.

### What Is a “Public Purpose”?

The fourth criterion in the *Lawson* test requires the court to establish whether the user fee in question is meant for a public purpose. As discussed below, the interpretation of this element varies as between two possibilities: (1) that the revenues generated are put toward the funding of a specific publicly provided good or service; or (2) that the revenues generated go to a general account. The following example illustrates this divergence. Where a levy is imposed on garbage bags for municipal garbage removal, the revenue generated from that levy could be interpreted as funding a publicly provided good (the removal of garbage), in which case the use of the funds would be an element weighing in favour of a tax. However, if a court chooses the second interpretation—that the garbage bag levies are allocated to a general account—then the determination of whether the levy is a tax or a user fee lies in the balance (assuming that the other three *Lawson* criteria are met). Most revenues collected by government are likely to be found to be supporting the provision of a good or service, while user fee revenue must have a nexus to the good or service, indicating that it belongs to a specific account. Given the inconsistency in the application of this criterion, it is our position that, first, the public purpose element should be clarified, to establish that it is determined on the basis of how the revenue generated is to be allocated; and second, the user fee test should be modified to consider this criterion first. Below, we examine some municipal user fee cases that demonstrate the differences in the interpretation of this aspect of the *Lawson* test.

In *Urban Outdoor Trans Ad v. Scarborough (City)*,<sup>49</sup> the Scarborough city council passed a bylaw to limit the number of outdoor signs being erected. Under the bylaw, an annual fee was imposed for each third-party billboard sign, charged at \$100 per face for ground-mounted signs and \$200 per face for roof-mounted signs. The Ontario Court of Appeal concluded that the funds were not intended for a public purpose, on the basis that the funds generated by the fee were not being deposited into a general revenue account. The decision in this case is therefore an example of the shift in interpretation of this element of *Lawson*, which appears to examine only the accounting treatment of the revenue when evaluating whether the fee is levied for a public purpose. Recall that we discussed this shift earlier, in considering the application of this element in *Eurig* and *GTAA*.

It appears, from *Eurig*, *GTAA*, and *Urban Outdoor Trans Ad*, that the public purpose element in *Lawson* is determined by establishing whether the revenue generated goes to a general revenue account or to a specific account that funds the service. The Supreme Court in *Eurig* was persuaded that the levy was for a public purpose because the monies levied from the fee were allocated as surplus in general revenue accounts rather than used to directly offset the costs of probate.<sup>50</sup> If the levy is intended for a public purpose, as in *Eurig*, the revenues from the levy are designated

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49 2001 CanLII 24140, at paragraph 1 (ONCA).

50 *Eurig*, supra note 15, at paragraph 20.



for inclusion in general revenues. In contrast, the allocation of the levy to the specific account that funds the service is an indicator that the revenues are not intended for a public purpose, as in *GTAA* and *Urban Outdoor Trans Ad*.

It is clear that this point has not yet been clarified sufficiently in the case law when one considers the analysis in *Canadian Wireless Telecommunications*. In that case, the BC Supreme Court considered arguments that the levy was “provided for the benefit of all residents of the City, and therefore, the fee is intended for a public purpose,”<sup>51</sup> and, conversely, that “there is a commercial marketing advantage for a telecommunications operator to be able to offer 911 service to its customers.”<sup>52</sup> The court found that because the Canadian Radio-television and Telecommunications Commission mandated the provision of 911 services by the WSPs (wireless service providers), the WSPs could not decline to offer the service and thus the fee was intended to fund a public service.<sup>53</sup> Nowhere in its analysis did the court consider the allocation of the revenues.

It is our position that it would be more sensible for the public purpose criterion to be based on the designation of account, rather than on whether the good or service provides a public benefit. Simply put, an argument that a good or service provides a public benefit is easily crafted, since there are no parameters around the element and there is no case law to suggest that a government-funded good or service does not provide any benefit to the public. A clarification that the public purpose criterion requires a court to consider where the revenues are deposited and the service that they fund would provide a stronger point to which courts may turn to strengthen their analysis and to make a reliable and consistent determination. Relating back to broader economic principles in the user fee analysis, this suggestion also supports the principle that users should pay for goods or services that they consume.

### **What Programs and Services Can Be Funded from the Specific Account?**

A related question arises with respect to the issue of specific accounts and general accounts.<sup>54</sup> If user fee revenues are directed to a specific account, what programs and services can be funded from that account? It does not appear that this issue has been addressed in the case law to this point—an omission that, given the confusion

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51 *Canadian Wireless Telecommunications*, supra note 31, at paragraph 76.

52 *Ibid.*, at paragraph 77.

53 *Ibid.*, at paragraph 79.

54 While there is no explicit requirement in the case law that user fee revenues must be put into a specific account, it is not clear how one would satisfy the *Eurig* requirements of a nexus between the cost of the service and the levy, and a reasonable connection between those respective amounts, if the revenues were placed in a general account. The issue is twofold. First, for practical purposes, if funds are allocated to general revenues, it may be more difficult for the municipality to track the source of funds, the amount collected, and the use of the funds. Second, from the court’s perspective, some judges will prefer a literal reading of the law, so if the test refers to a “specific account,” those judges will interpret it to mean exactly that.

on this point, is understandable. However, in a practical sense, municipalities must concern themselves with the breadth of revenue collection and spending from specific versus general revenue accounts.

One hint as to the acceptable breadth of spending that appears in the case law may be found in *Urban Outdoor Trans Ad*, where the court listed the use of funds by the administrative body that collected and used the specific fund (the “Sign Section”). The court found that the specific fund covered the operation of the Sign Section.<sup>55</sup> However, it provided no additional commentary on this point.

A current example from the community of Saanich, British Columbia, illustrates the difficulty of determining whether a levy constitutes a user fee where the revenues collected are allocated to a specific account but used for multiple purposes. In this case, revenues raised from residential garbage collection fees are also used to offset the costs of other municipal environmental programs, including leaf collection, composting, and bus shelter litter pickup.<sup>56</sup> In this instance, while the programs are arguably related, it is not clear from the existing case law whether a court would consider such broad spending to be permissible for a levy that purports to be a user fee.

A relevant consideration in this context is the deference of the courts to the discretion of municipalities to frame and implement bylaws that they deem appropriate for their communities. In this respect, it is presumed that the municipality has significant expertise in exercising its decision-making authority, and that a court will take that expertise into account and not lightly interfere with municipal decisions. The Supreme Court of Canada recently affirmed this position in *Catalyst Paper Corp. v. North Cowichan (District)*, where it stated, “The case law suggests that review of municipal bylaws must reflect the broad discretion provincial legislators have traditionally accorded to municipalities engaged in delegated legislation.”<sup>57</sup> This means that a court must meet a high threshold in finding that a municipality’s policy or decision verges on improper law. The Supreme Court also commented on this point in the same case, stating, “[T]he power of the courts to set aside municipal bylaws is a narrow one.”<sup>58</sup>

### Reordering the Test Criteria

A broader question emerges upon examination of the *Lawson* and *Eurig* tests as to whether rearranging the order in which the criteria are applied might provide a clearer and more consistent method for determining the nature of a levy. Though the dates of the cases seem to establish the order in which the tests are to be applied,

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55 *Urban Outdoor Trans Ad*, supra note 49, at paragraph 10.

56 Kyle Slavin, “Saanich Waives Garbage Fee for Home That Recycles All Its Waste,” *BC Local News*, April 25, 2012 ([www.bclocalnews.com/news/148914485.html](http://www.bclocalnews.com/news/148914485.html)).

57 2012 SCC 2, at paragraph 19. At issue in this case was the ability of the courts to overturn municipal taxation bylaws.

58 *Ibid.*, at paragraph 9.

with *Lawson* predating *Eurig* by more than six decades, it appears that it would be both helpful and appropriate to apply the criteria in a different order. We suggest that the public policy element—the fourth criterion in the *Lawson* test—which states that a levy will be found to be a tax if it is levied for a public purpose, should be the starting point for the user fee analysis, assuming that, as discussed above, this element is interpreted to mean that the revenues are allocated to either a general account (in the case of a tax) or a specific account (in the case of a user fee). We argue that this proposed rearrangement would provide clarity with respect to the state of the law on user fees.

Our examination of the user fee test and its application by the courts also indicates that it should not be possible to meet all of the *Lawson* criteria and the *Eurig* criteria. The nexus and reasonable connection requirements under the *Eurig* test imply that a fee can be charged for a service only if there is a specific revenue fund for that service. In contrast, where a levy satisfies the first three *Lawson* criteria and also is found to have been imposed for a public purpose, it will be characterized as a tax, with all of the revenues therefrom being paid into a general revenue account. Clearly, a levy cannot be imposed for a public purpose, with the funds going into general revenues, and be treated as a user fee, with the funds going into a specific revenue account.

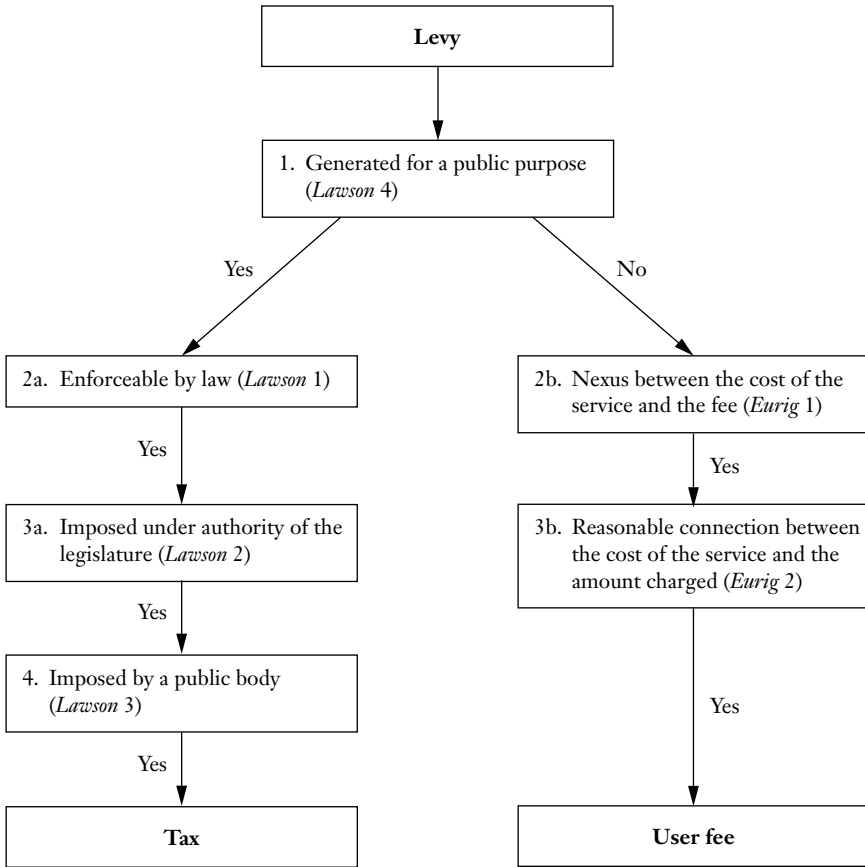
Under the rearrangement of the criteria proposed here, the first step of the test would be to determine whether the revenue collected from the levy goes to a general revenue account—that is, it is collected for a public purpose according to *Lawson*—or whether it goes to a specific revenue account, which indicates a nexus according to *Eurig*. If the revenue from the levy goes to a general revenue account, the other three *Lawson* criteria would be applied to determine whether the levy is a tax. Conversely, if the revenue goes to a specific revenue account, and the requisite nexus is established, the second criterion of *Eurig* would be applied to determine whether the amount charged is “reasonable” relative to the cost of the service. Figure 2 illustrates this proposed modification of the user fee test.

## USER FEES AND REGULATORY CHARGES

Having outlined the legal criteria that distinguish a user fee from a tax, we now need to expand the analysis and consider the difference between a user fee and a regulatory charge. As discussed earlier, the provinces—and, if properly authorized, municipalities—have the authority to charge direct taxes (pursuant to section 92(2) of Constitution Act). In addition, the provinces—and, if properly authorized, municipalities—have the authority to charge licence fees (pursuant to section 92(9) of the Constitution Act).

As we will show, the term “licence fee” becomes synonymous with “regulatory charge” over the course of the jurisprudence. Regulatory charges are an alternative to user fees as a means of raising revenue; however, these two types of levy share some similar features. Accordingly, the issue that arises is how a regulatory charge can be distinguished from a user fee. This is important because, depending on the authorizing legislation, a regulatory scheme can bear a strong resemblance to a user fee.

**FIGURE 2 Proposed User Fee Test**



What exactly are licence fees? In addition to providing the four criteria used to establish that a levy is a tax, the court in *Lawson* held that the jurisdiction of the provincial government to impose direct taxes under section 92(2) of the Constitution Act does not carry over to section 92(9) with respect to licence fees. Although section 91(3) of the Constitution Act seemingly reserves to the federal government the exclusive jurisdiction to impose taxes other than the direct taxes described in section 92(2), the court’s comments in *Lawson* imply that provincial or municipal licence fees may be charged as “indirect taxes”:<sup>59</sup>

59 A direct tax cannot be shifted from the person intended to pay the levy, while an indirect tax can. Alarie and Bird have noted that the “distinction between what constitutes a direct tax and what constitutes an indirect tax has been a frequently contested one that has given rise to sporadic and inconsistent treatment by the courts”: Benjamin Alarie and Richard M. Bird, *Tax*

The question has never yet been decided whether or not the revenue contemplated by this head [section 92(9)] can in any circumstances be raised by a fee which operates in such a manner as to take it out of the scope of “direct taxation.” *Prima facie*, it would appear, from inspection of the language of the two several heads, that the taxes contemplated by [section 92(9)] are not confined to taxes of the same character as those authorized by [section 92(2)], and that accordingly imposts which would properly be classed under the general description “indirect taxation” are not for that reason alone excluded from those which may be exacted under [section 92(9)]. On the other hand, the last mentioned head authorizes licences for the purpose of raising a revenue, and does not, I think, contemplate licences which, in their primary function, are instrumentalities for the control of trade—even local or provincial trade. Here, such is the primary purpose of the legislation. The imposition of these levies is merely ancillary, having for its object the creation of a fund to defray the expenses of working the machinery of the substantive scheme for the regulation of trade.<sup>60</sup>

In other words, if the levy is found to have an indirect incidence, it will be found to be ultra vires the province or municipality, and therefore invalid, because the imposition of such a levy is not permitted under section 92(9) of the Constitution Act. However, if the levy is found to be “ancillary or adherent to a regulatory scheme,”<sup>61</sup> meaning that the imposition of the levy is not the dominant purpose but rather an effect of the dominant purpose, then it will be held to be valid, according to the Supreme Court’s interpretation of section 92(9) in *Lawson*. A levy so characterized may be called a regulatory charge.

The question of the validity of a regulatory charge has reached the Supreme Court of Canada on a number of occasions, each time resulting in additional clarity. A review of the decisions reveals modest changes in the test and the tone of the courts.

The first notable case concerning regulatory charges and schemes is the decision of the BC Supreme Court in *Re: LaFarge Concrete Ltd. and Coquitlam*.<sup>62</sup> The district of Coquitlam amended a bylaw to change the design of a soil removal licence fee from a flat rate of \$50 per year to a volumetric rate of 15 cents per cubic yard of soil removed. LaFarge Concrete Ltd. argued that under the new scheme, the incidence of the charge would be passed on to customers. Consequently, the fee was alleged to be a form of an indirect tax, and therefore outside the municipality’s jurisdiction to impose.

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*Aspects of Canadian Fiscal Federalism* (September 30, 2010) (Social Science Research Network) ([http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1689311](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1689311)). See also *Hudson’s Bay Co. v. Ontario (Attorney General)*, 2000 CanLII 22392 (ONSC), which provides significant detail on the background of direct and indirect taxation in the context of the Constitution Act.

60 *Lawson*, supra note 14, at 363-64.

61 *Westbank First Nation v. British Columbia Hydro and Power Authority*, [1999] 3 SCR 134, at paragraph 30.

62 (1972), 32 DLR (3d) 459 (BCCA).

The court found that the levy was an indirect tax yet still *intra vires* the municipality, and laid the foundation for the test for a regulatory scheme. The court stated, in part:

It appears to me that the principle that emerges from the authorities is that taxation which can be characterized as other than direct, and hence not falling within the ambit of provincial legislation by s. 92(2) of the B.N.A. Act [the Constitution Act, 1867], may still be within the scope of provincial competency if contemplated by, and fairly authorized under, another head such as here—s. 92(9). In my view, the key lies in the question as to what is the primary and real purpose, or pith and substance, of the legislation—is the levy or tax (whether direct or indirect by nature) merely ancillary, or adhesive, to the licensing scheme of regulating or prohibiting trade, or is it essentially a fiscal imposition, or taxation, under a form of disguise or colourable concept?<sup>63</sup>

The court undertook a pith and substance analysis to determine whether the bylaw was a form of indirect taxation that had been disguised, and was therefore invalid, or instead was ancillary to a regulatory scheme, and therefore valid. In reaching its decision, the court relied upon the following facts: (1) the citizens of Coquitlam had raised concerns about the removal of the gravel; (2) taxpayers were likely to bear the cost of road provision and regulatory expenses; and (3) the 15 cent fee imposed a heavy burden on permit holders and greatly increased their costs of doing business.<sup>64</sup> The court concluded:

The bylaw being amended constitutes a complete and detailed code for the regulation of the gravel and soil extraction and removal trade, including the provision of the performance bonds and operation plans and surveys, obviously directed to safety and environmental control.<sup>65</sup>

This was sufficient to render the levy ancillary or incidental to the regulatory licensing of a trade or business.<sup>66</sup>

In 1993, a constitutional challenge reached the Supreme Court of Canada in *Allard Contractors*.<sup>67</sup> In this case, the Supreme Court was asked to rule on the validity of a gravel removal fee.<sup>68</sup> The appellants argued that there was nothing in the

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63 *LaFarge Concrete*, supra note 62, at paragraph 14, quoted in part in *Allard Contractors*, supra note 6, at paragraph 65. The term “colourability” or “colourable concept” is used to describe circumstances where a policy or legislative scheme aims to achieve an outcome that it would not otherwise be entitled to achieve.

64 *LaFarge Concrete*, supra note 62, at paragraph 17.

65 *Ibid.*, cited with approval in *Ontario Home Builders' Association v. York Region Board of Education*, [1996] 2 SCR 929, at paragraph 120.

66 *Supra* note 62, at paragraph 18.

67 *Allard Contractors*, supra note 6.

68 The facts in *Allard Contractors* are similar to those described above in the *LaFarge Concrete* case, in the text following note 62.

applicable statute or bylaws that limited the amount of revenue from licensing to the actual costs of the regulatory scheme. The appellants' objective in making this argument was to demonstrate that there was potential for surplus to be generated that went beyond the cost of the regulatory scheme, invalidating the regulatory charge.<sup>69</sup> The court took note of the standard developed by the line of cases on indirect taxes, that the power of indirect taxation through a regulatory scheme can be used only to defray the costs of regulation. The court observed that

[w]hile *Larson* . . . gave a reading to s. 92(9) which opened up the possibility for indirect taxation within that section, it did so in the context of language suggesting that the possibility would be limited to the recoupment of regulatory expenses.<sup>70</sup>

The court then responded specifically to the appellants' argument, stating:

[I]t is not for this Court to undertake a rigorous analysis of a municipality's accounts. A surplus itself is not a problem so long as the municipalities made reasonable attempts to match the fee revenues with the administrative costs of the regulatory scheme, which is what occurred in this case. It is easy to imagine reasons for the existence of a so-called "surplus" at any given time. For example, changes in forecasted prices might lead to road repair being over-budgeted, or a municipality might choose not to repair a certain road in order to undertake more extensive repairs or reconstruct at a later date.<sup>71</sup>

Recall that the *Eurig* test for user fees requires the existence of a nexus between the cost of the service and the fee, and a reasonable connection between the cost and the fee; in other words, the revenues generated by the fee should not exceed the costs of the service. To this point in our review of the case law on regulatory schemes, the term "nexus" has not been used; however, the same principle is emerging with respect to regulatory charges, in that they must be reasonably connected to the cost of the service. Thus, we see a blurring of the line between user fees and regulatory charges.

*Westbank First Nation v. British Columbia Hydro and Power Authority*<sup>72</sup> is another case that came before the Supreme Court of Canada, involving the validity of a regulatory charge. In its decision, the court summarized the features of regulatory schemes and reformulated the previously identified characteristics into a test to identify a regulatory scheme. In this case, Westbank First Nation was attempting to assess and impose a levy on BC Hydro, an agent of the provincial Crown; however, section 125 of the Constitution Act essentially prohibits one level of government from taxing another level of government. If the levy were found to be a tax, it would

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69 *Allard Contractors*, supra note 6, at paragraph 70.

70 *Ibid.*, at paragraph 58.

71 *Ibid.*

72 *Westbank*, supra note 61.

be invalid because of the prohibition in section 125. However, if the levy were found not to be a tax, but rather some type of regulatory charge, then section 125 would be inapplicable, and Westbank First Nation could continue to impose the levy on BC Hydro.<sup>73</sup>

In its decision, the court summarized “[c]ertain indicia” that

have been present when this Court has found a “regulatory scheme.” The factors to consider when identifying a regulatory scheme include the presence of: (1) a complete and detailed code of regulation; (2) a specific regulatory purpose which seeks to affect the behaviour of individuals; (3) actual or properly estimated costs of the regulation; and (4) a relationship between the regulation and the person being regulated, where the person being regulated either causes the need for regulation or benefits from it. This is only a list of factors to consider; not all of these factors must be present to find a regulatory scheme. Nor is this list of factors exhaustive.<sup>74</sup>

The most recent Supreme Court of Canada decision considering the issue of regulatory charges is *620 Connaught Ltd. v. Canada (Attorney General)*.<sup>75</sup> The issue in this case was the validity of licence fees imposed under the authority of the minister of Canadian heritage on businesses wishing to sell liquor in Jasper National Park. The minister of Canadian heritage was permitted to charge only such fees as were provided for in the governing legislation (the Parks Canada Agency Act). If the licence fee were found to be a tax, it would be held to be ultra vires. The court concluded that the fee was in fact a regulatory charge and was validly imposed.<sup>76</sup>

There was no suggestion that the levy in this case was a user fee for the provision of government services or facilities. Rather, the question was whether in pith and substance the levy was a tax or a regulatory charge.<sup>77</sup> Nevertheless, the court took the opportunity to discuss the distinction between a user fee and a regulatory charge. It affirmed that these forms of levies are still considered to be different, even though they may rely on similar elements. The court’s comments on this point are set out below:

It will be useful to first differentiate a regulatory charge from a user fee. A user fee, by definition, is a fee charged by the government for the use of government services or

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73 The court makes an interesting comment, *ibid.*, at paragraph 22, concerning the establishment of the nexus requirement in *Eurig*: “This was a useful development, as it helps to distinguish between taxes and user fees, a subset of ‘regulatory charges’ [emphasis added].” The court cites no authority for describing a user fee as a subset of a regulatory charge. Notably, this characterization did not reappear in the court’s subsequent decision in *620 Connaught*, *supra* note 16 (discussed below), where it would have been appropriate, so it is possible that the court has backed away from the concept that user fees are a subset of regulatory charges.

74 *Westbank*, *supra* note 61, at paragraph 24.

75 *620 Connaught*, *supra* note 16.

76 *Ibid.*, at paragraph 3.

77 *Ibid.*, at paragraph 17.



facilities. In the case of user fees, as stated by this Court in *Eurig*, there must be a clear nexus between the quantum charged and the cost to the government of providing such services or facilities. The fees charged cannot exceed the cost to the government of providing the services or facilities. However, “courts will not insist that fees correspond precisely to the cost of the relevant service. As long as a reasonable connection is shown between the cost of the service provided and the amount charged, that will suffice” (see *Eurig*, at para. 22).

By contrast, regulatory charges are not imposed for the provision of specific services or facilities. They are normally imposed in relation to rights or privileges awarded or granted by the government. The funds collected under the regulatory scheme are used to finance the scheme or to alter individual behaviour. The fee may be set simply to defray the costs of the regulatory scheme. Or the fee may be set at a level designed to proscribe, prohibit or lend preference to a behaviour, e.g. “[a] per-tonne charge on landfill waste may be levied to discourage recycling the production of waste [or a] deposit-refund charge on bottles may encourage recycling of glass or plastic bottles” (see *Westbank*, at para. 29).<sup>78</sup>

After the court set aside the user fee concerns, it proceeded with the regulatory scheme analysis. First, it helpfully restated another consideration that was put forth in *Westbank*, that the government levy would be in pith and substance a tax if it was unconnected to any form of regulatory scheme. The court commented that “[t]his . . . consideration provides that even if the levy has all the other indicia of a tax, it will be a regulatory charge if it is connected to a regulatory scheme.”<sup>79</sup>

This holding makes good sense since it removes the consideration of direct or indirect incidence of a tax from the initial stage of the analysis. The benefit of this approach is clear, given the murky test that must be applied to differentiate direct taxes from indirect taxes.<sup>80</sup> The parameters of a regulatory scheme are, for the most part, clearer than the legal incidence test and less controversial than those attempting to define direct and indirect taxes. The overall order of the regulatory scheme test is therefore reversed: the four *Lawson* elements are still applied to determine whether a levy is a tax, and a fifth element is added, to determine whether there is an ancillary regulatory scheme. If there is no regulatory scheme and the levy is found to be a tax, then a direct and indirect incidence analysis will likely follow.

In *620 Connaught*, the court restated the regulatory scheme analysis set out in *Westbank*. First, the court must consider whether the levy has the attributes of a tax (pursuant to the four *Lawson* criteria). Second, the court must consider whether the levy is connected to a regulatory scheme—an analysis that requires an initial evaluation of the relevant regulatory scheme to determine whether it is sufficient, followed by an examination of the relationship between the levy and the regulatory scheme.<sup>81</sup>

78 *Ibid.*, at paragraphs 19-20.

79 *Ibid.*, at paragraph 24.

80 Alarie and Bird, *supra* note 59, at 12.

81 *620 Connaught*, *supra* note 16, at paragraph 28.

In application, the court found that the fees for business licences required by the minister of Canadian heritage for the sale of liquor in Jasper National Park met all the attributes of a tax. The court also found that the four criteria for a regulatory scheme, according to *Westbank*, were met.<sup>82</sup>

Another distinction, which was not carefully drawn out by the court but which becomes apparent when comparing user fees and regulatory charges, is the court's treatment of the fourth element of the *Lawson* test, that to be a tax, the levy must be intended for a public purpose. In the user fee context, we have suggested that this is a significant element in distinguishing user fees from taxes; and accordingly, we have proposed a reordering of the *Lawson* and *Eurig* tests to first consider whether the revenues generated from a particular user fee are accounted for in general revenues or in a specific revenue fund. In *620 Connaught*, the court did not consider the *Lawson* elements individually but rather stated, "[t]hese characteristics [referring to the *Lawson* elements] will likely apply to most government levies."<sup>83</sup> It is unclear what effect this could have on the public purpose element of *Lawson*, but a prudent argument would be to consider both the general public purpose and the revenue accounting when examining this element.

Returning to the regulatory scheme analysis, the second step as described in *620 Connaught* was to discern the relationship between the business licence fees and the regulation of Jasper National Park. The court stated:

In order for a regulatory charge intended to defray the costs of a regulatory scheme to be "connected," the fee revenue must be tied to the costs of the regulatory scheme.<sup>84</sup>

The regulatory charge may reflect two separate intentions, as the court initially described when distinguishing a regulatory charge from a user fee:

The fee may be set simply to defray the costs of the regulatory scheme. *Or* the fee may be set at a level designed to proscribe, prohibit or lend preference to a behaviour.<sup>85</sup>

The first intention, to match the costs of regulation, seems analogous to there being a nexus between the fee and the cost of the service. The second intention, whether expressed separately or in tandem with the first, opens the door to increased revenue beyond the cost of the service if it is meant to alter behaviour. This is a significant shift in the jurisprudence, further differentiating regulatory charges from user fees, and is discussed in the next section.

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82 Ibid., at paragraph 37.

83 Ibid., at paragraph 23.

84 Ibid., at paragraph 38.

85 Ibid., at paragraph 20 (emphasis added).

## UNRESOLVED ISSUES CONCERNING USER FEES AND REGULATORY CHARGES

Two main concerns arise from the case law on regulatory charges. First, a theme that emerges in the discussion above is that there are shared features between user fees and regulatory charges, and it can be hard to distinguish definitively between these two types of levies. For example, a levy imposed on landfill waste may be analogized to a levy imposed on the use of a recreation facility and appear to be a user fee; alternatively, as a “charge . . . levied to discourage the production of waste,” such a levy may be viewed as a regulatory charge.<sup>86</sup> Unfortunately, the Supreme Court of Canada has not provided clarity on this issue. There are, however, two ways to resolve this quandary. The first is to look to the municipality’s authorizing legislation to determine whether it specifies that a particular levy is a user fee or a regulatory charge. The danger in choosing this approach is that it relies entirely on the literal wording of the law, rather than the underlying purpose of the levy. The second approach is to apply a pith and substance analysis, the intent of which is to assess the purpose of the levy, beyond the wording of the statute or bylaw. Given that the latter approach was the one adopted by the Supreme Court in *620 Connaught*, this appears to be the preferred method of analysis.

The second concern that arises is the introduction of a behavioural modification objective underlying regulatory charges. It is suggested that where a regulatory charge has such an objective, the charge is not necessarily tied to the cost of the good or service being provided, a criterion established by *Westbank*. However, this objective seems to imply that such a regulatory charge would be found to be an indirect tax, making it ultra vires provinces, and by extension, municipalities. We elaborate on these concerns in the discussion that follows.

### What Is the Distinction Between a User Fee and a Regulatory Charge?

To date, no case has been brought before a court in which the court has been asked to decide whether a particular levy is a user fee or a regulatory charge—although in *Canadian Wireless Telecommunications* it was argued that were the court to find that the levy was not a user fee, in the alternative, the levy was a regulatory charge. Such a challenge may be raised, for example, if the municipality has authority to impose user fees but not regulatory charges, and an individual or business that is unhappy paying the levy seeks to argue that the user fee is a regulatory charge and therefore ultra vires. As discussed above, there are two approaches that a court may use in attempting to distinguish a user fee from a regulatory charge: (1) to examine the authorizing legislation; or (2) to conduct a pith and substance analysis. Each of these approaches is described in more detail below.

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86 See supra note 78 and the accompanying text.

### *Authorizing Legislation*

“Authorizing legislation” in this context refers to both provincial legislation (likely found in statutes with titles such as the Community Charter or the Municipal Act) and municipal bylaws. The provincial legislation delegates specific powers to municipalities and “authorizes” their exercises of those powers. A municipality may implement only such bylaws as are based on the authorities provided. The bylaws, in turn, authorize policy decisions made by municipal council. Both levels of law will be relevant to any discussion on authorizing legislation. In addition, from the municipal perspective, both levels of law certainly require scrutiny at the beginning of the policy design stage, to ensure that the municipal council is permitted to pursue the proposed course of action.

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

In *620 Connaught*, the relevant legislation provided that the minister of Canadian heritage was authorized to “fix the fees or the manner of calculating fees in respect of products, *rights or privileges* provided by the [Parks Canada] Agency.”<sup>87</sup> The Supreme Court specified in its definition that “regulatory charges are not imposed for the provision of specific services or facilities. They are normally imposed in relation to *rights or privileges* awarded or granted by the government.”<sup>88</sup> A liquor licence was perceived to be a right or privilege, rather than a service provided by government. Neither party in this case made an argument that the “fee” that was authorized was in fact a user fee.<sup>89</sup> Notably, the wording in the legislation is reflected in the definition of the regulatory charge. Additionally, it should be noted that the critical point may not be simply whether “fee” or “charge” is the term found in the authorizing legislation, but that further scrutiny of the law is required to determine the appropriate test.

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87 Ibid., at paragraph 1 (emphasis added), quoting from the Parks Canada Agency Act, SC 1998, c. 31, section 24.

88 Ibid., at paragraph 20 (emphasis added).

89 Ibid., at paragraph 17.

Additional support for this hypothesis is found in the decision rendered in *Kirkpatrick v. Maple Ridge*.<sup>90</sup> In this case, the Supreme Court of Canada considered the constitutionality of a volumetric fee on the removal of sand and gravel. The enabling bylaw granted the power to “fix a fee for the permit,” and because the fee was volumetric and therefore varied with the amount of soil removed, the Supreme Court disallowed the bylaw.<sup>91</sup> The fixed fee requirement could only be applicable to a flat fee; a variable fee was not permitted. Consequently, the bylaw was struck down.

After the decision in *Maple Ridge*, attempts were made to reconfigure the municipal bylaw to allow for volumetric fees, and the bylaw at issue was amended. The amended bylaw was ultimately found to grant the appropriate variable-rate volumetric permit fee, which was then considered by the Supreme Court in *Allard Contractors*.<sup>92</sup> This fee was considered to be a permit fee, analogous to a licence fee under section 92(9) of the Constitution Act. This series of amendments demonstrates the necessity of careful examination of governing legislation.

A more recent example is the 2008 BC Court of Appeal decision in *Greater Vancouver Sewerage and Drainage District v. Ecowaste Industries Ltd.*<sup>93</sup> The court in this case considered the validity of a waste disposal scheme and whether a disposal fee was a regulatory charge or an unconstitutional tax. The authorizing legislation provided:

Whereas . . .

C. Greater Vancouver Sewerage and Drainage District is operating under a Solid Waste Management Plan which defines a *regulatory system* for the management of all privately operated municipal solid waste and Recyclable Material operations. The goal of *the regulatory scheme* is to ensure proper management of privately operated facilities by specifying operating requirements so as to protect the environment and public health, to protect the region’s land base in accordance with the host municipality’s zoning and land use policies, to ensure that regional and municipal facilities and private facilities operate to equivalent standards and to achieve the objectives of the Solid Waste Management Plan.<sup>94</sup>

Given this context, the court delved into the regulatory scheme analysis from *Westbank* and *620 Connaught* and did not consider the disposal fee (despite its name) under the user fee analysis, but rather considered it as a regulatory charge.

The 2001 Ontario Court of Appeal decision in *Urban Outdoor Trans Ad* demonstrates how a court may choose to deal with the interpretation of authorizing legislation. In this case, the court found that the Municipal Act authorized the annual fee in place, levied against sign companies for each third-party billboard sign,

90 [1986] 2 SCR 124.

91 *Ibid.*, at paragraph 10.

92 *Allard Contractors*, supra note 6, at paragraph 12.

93 2008 BCCA 126.

94 *Ibid.*, at paragraph 31 (italics added; underline in original).

at a cost of \$100 per face for ground-mounted signs and \$200 per face for roof-mounted signs.<sup>95</sup> The Municipal Act authorized both fees and charges. Urban Outdoor Trans Ad (the plaintiff) argued that the levy was an indirect tax and therefore the municipality was unauthorized to levy the tax. The city argued that the levy was a fee and was therefore within the authority of the municipality, pursuant to the governing legislation. While the term “user fee” was not explicitly used, the court considered the *Eurig* analysis and held that the levy was indeed a fee. *Urban Outdoor Trans Ad* demonstrates a possible approach that a court could take to determine whether a particular levy is a user fee or a regulatory charge, by only applying the test that is suggested by the parties—in this case, the *Lawson-Eurig* test for a user fee—though arguably, given the governing legislation, the regulatory charge test also could have been applied.

With respect to an existing levy, or where a levy is being proposed but it is unclear as to whether it is a user fee or a regulatory charge, courts will have to decide which test to apply to determine the validity of the levy. Since, as noted above, there is no jurisprudence on the characterization of a particular levy as either a user fee or a regulatory charge, opinions must be discerned from the existing case law as to how a court may proceed with this analysis. As discussed above, in several cases, the wording in the authorizing legislation has guided the court as to the test that should apply:

- In *620 Connaught*, the court used identical wording from the legislation imposing the regulatory charge to inform the definition of a regulatory charge.
- In *Maple Ridge*, the gravel removal bylaw was held to be invalid because it was based on a volumetric amount rather than a flat fee.
- Lastly, in *Urban Outdoor Trans Ad*, where both a fee and a charge were authorized by the provincial legislation, the court applied the user fee test.

### ***Pith and Substance Analysis***

It has been established that user fees and regulatory charges are indeed different forms of levies, and that while they have been described in case law, the courts have not yet dealt with a case where it was necessary to establish a means of distinguishing the one form from the other. As discussed above, one strategy to determine which test should be applied is to carefully review the authorizing legislation. However, the authorizing legislation may not be clear as to the nature of the levy, as in *620 Connaught*, or it may authorize both fees and charges, as in *Urban Outdoor Trans Ad*.

As suggested above, in a situation where a court is faced with deciding which test to apply, an alternative method that the court may use is a pith and substance analysis. In the discussion that follows, we will attempt to forecast the types of challenges that may be anticipated by municipalities and then proceed to describe the pith and substance analysis process. We will conclude by discussing the application

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95 *Urban Outdoor Trans Ad*, supra note 49, at paragraph 12.

of pith and substance analysis in the case law previously reviewed and discerning the features that the courts may rely on for a user fee and regulatory charge pith and substance analysis.

It is possible to forecast circumstances that may arise in which a user fee and a regulatory charge must be distinguished by a court. In addition to the type of attack that has been seen in the jurisprudence to this point—that is, that the levy is ultra vires—future challenges may come in the form of insufficient authorizing legislation, not meeting the requirements of the test, or not meeting an aspect of either test. Both user fees and regulatory charges are vulnerable to attacks on costing, since this is a key feature of the tests although (as will be discussed below) the threshold to be met is not significant. It is also possible that a challenge may involve arguing that a user fee is a regulatory charge, but does not have the authorizing legislation to permit that possibility. Given the decision in *620 Connaught*, which arguably authorizes two forms of regulatory charges, for either revenue-raising or behaviour modification purposes, a court will not likely be satisfied with simply reading the authorizing legislation and may also consider, in addition to a careful reading of that legislation, a pith and substance analysis.

A pith and substance analysis is a legal interpretation technique, often used in constitutional analysis. The technique was described as follows in the dissenting reasons in *Ontario Home Builders' Association v. York Region Board of Education*:

The identification of the pith and substance of a law involves an analytical process conducted according to the approach carefully described by Sopinka J. in *R. v. Morgentaler*, [1993] 3 S.C.R. 463, at pp. 481-88. As he explained, at p. 482, the analysis “necessarily starts with looking at the legislation itself, in order to determine its legal effect,” but courts also “‘will look beyond the direct legal effects to inquire into the social or economic purposes which the statute was enacted to achieve,’ its background and the circumstances surrounding its enactment . . . and, in appropriate cases, will consider evidence of the second form of ‘effect,’ the actual or predicted practical effect of the legislation” (p. 483).<sup>96</sup>

This passage points to a close reading of the legislation to determine the legal effect of a law, but also describes a second level of analysis. This second level refers to the incidence of the legislation and the purposes it was intended to achieve. It is likely that a court would undertake both a careful reading of the legislative authority and a pith and substance analysis, if such analysis is a method that the court determines to be appropriate.

While not previously used in the context of distinguishing between user fees and regulatory charges, the pith and substance analysis has been applied in the broader context of the user fee case law. For example, as discussed above, this approach was used by the BC Court of Appeal in *LaFarge Concrete*, where the court considered

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96 *Ontario Home Builders' Association*, supra note 65, at paragraph 117.

whether a volumetric fee on gravel was ancillary to a regulatory scheme or a form of taxation disguised as a regulatory scheme. The court stated:

[T]he key lies in the question as to what is the primary and real purpose, or pith and substance, of the legislation—is the levy or tax (whether direct or indirect by nature) merely ancillary, or adhesive, to the licensing scheme of regulating or prohibiting a trade, or is it essentially a fiscal imposition, or taxation, under a form of disguise or a colourable concept?<sup>97</sup>

In order to reach a decision in *LaFarge Concrete*, the court examined the rationale for the imposition of the fee. One of the main reasons for the fee increase was that a new road was required for the trucks hauling gravel to be diverted around the neighbourhood.<sup>98</sup> The court also considered the nature of the legislation, in that a detailed regulatory scheme had been enacted, which involved safety and environmental controls.<sup>99</sup> As a result of these features, the court determined that the levy was ancillary to the regulatory scheme.<sup>100</sup>

The Supreme Court of Canada strongly indicated in *620 Connaught* that the pith and substance analysis may be employed to distinguish between user fees and regulatory charges, as demonstrated by the court's use of this method to distinguish between a tax and a regulatory charge. The court stated:

In summary, if there is a regulatory scheme and it is found to be relevant to the person being regulated under step one, and there is a relationship between the levy and the scheme itself under step two, *the pith and substance of the levy will be a regulatory charge and not a tax*. In other words, the dominant features of the levy will be its regulatory characteristics.<sup>101</sup>

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

### **What Is the Difference Between a Regulatory Scheme and a Behaviour Modification Objective?**

The decision in *620 Connaught* raises the question as to whether and in what circumstances a levy may be exempt from the reasonable connection or nexus requirement, found as a testable element for both user fees and regulatory charges. Pursuant to

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97 *LaFarge Concrete*, supra note 62, at paragraph 14.

98 *Ibid.*, at paragraph 17.

99 *Ibid.*, at paragraph 18.

100 *Ibid.*

101 *620 Connaught*, supra note 16, at paragraph 28.



the decision in *620 Connaught*, the limitation on revenue to the cost of the service appears to be lifted when a regulatory charge is implemented to alter behaviour. However, our view is that this exemption is likely available only in respect of a federal regulatory scheme. This is a recent development in the case law, arising from *620 Connaught* (though alluded to in *Westbank*), and it has yet to be challenged or interpreted. Here we will examine more closely the court's reasons for the exemption, as set out in *620 Connaught*, and then consider the rationale behind limiting the exemption to levies imposed under the authority of the federal government.

As discussed above, the issue before the Supreme Court in *620 Connaught* was whether liquor licence fees charged to businesses operating in Jasper National Park were part of a regulatory scheme or instead a tax. If the levy was found to be a regulatory charge, it would be within the jurisdiction of the minister of Canadian heritage. The court's comments extend beyond the constitutional distribution of regulatory fees and taxes, and include a section distinguishing between the application of regulatory charges and user fees. With respect to regulatory charges, Rothstein J, writing for the court, stated:

[R]egulatory charges are not imposed for the provision of specific services or facilities. They are normally imposed in relation to rights or privileges awarded or granted by the government. The funds collected under the regulatory scheme are used to finance the scheme or to alter individual behaviour. The fee may be set simply to defray the costs of the regulatory scheme. *Or the fee may be set at a level designed to proscribe, prohibit or lend preference to a behaviour.*<sup>102</sup>

This is a significant clarification of the case law. The Supreme Court not only suggested, but nearly advocated, the possibility that a regulatory charge may be set at a level to influence behaviour, rather than measured by the standard that is the test for a user fee and for a different type of regulatory charge, which is intended to defray the costs of the regulatory scheme. The court's phrasing clearly suggests that there are two types of regulatory schemes, one in which costs are defrayed for the administration of a service ("revenue raising") and a second type that attempts to influence behaviour through financial incentives ("behaviour modifying").

Two other paragraphs in *620 Connaught* further this proposition. First, the court reinforced its position when Rothstein J stated:

Whether the costs of the regulatory scheme are a limit on the fee revenue generated, where the purpose of the regulatory charge is to proscribe, prohibit or lend preference to certain conduct, is not an issue before the Court in this case, and it is not necessary to answer that question here.<sup>103</sup>

102 Ibid., at paragraph 20 (emphasis added).

103 Ibid., at paragraph 48.

Second, the court cited *Westbank* directly when describing the test for regulatory fees:

This is only a list of factors to consider; not all of these factors must be present to find a regulatory scheme. Nor is this list of factors exhaustive.<sup>104</sup>

*620 Connaught* demonstrates that the court is opening a door for regulatory schemes to have a charging component that is not tied to the cost of the service, though the contours of such a scheme are yet to be decided. It would be wise to consider that the second step in the regulatory charge test is titled “the relationship between the licence fees and the regulation.” The title suggests that while the costs do not have to be related to the charges, a “reasonable relationship” is still required in which the regulator would likely have to demonstrate how the behaviour-modifying regulatory charges are intended to modify behaviour.

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

This constitutional quandary was contemplated by La Forest in the following passage from *The Allocation of Taxing Power Under the Canadian Constitution*, which was cited with approval by Iacobucci J writing for the majority in *Ontario Home Builders' Association*:

If section 92(9) is limited to direct taxation, it adds nothing to section 92(2), for there is no doubt that direct taxation may be raised under section 92(2) even though it is framed in the form of a licence. On the other hand if section 92(9) permits a province to levy indirect taxation by means of a licence, there would seem to be no limit on

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104 Ibid., at paragraph 26, citing *Westbank*, supra note 61, at paragraph 24.

provincial taxing power (there being no restriction on the types of licences falling within the section) so long as a tax is framed in the form of licensing provisions. Yet the British North America Act [the Constitution Act, 1867] appears to contemplate that indirect taxation should be within the sole competence of the federal Parliament.<sup>105</sup>

It therefore appears that to avoid the unwarranted extension to the construction that is created by the behaviour-modifying regulatory scheme, the jurisdiction of provinces and the authorities delegated to municipalities should be limited to cost-recovery regulatory schemes. A potential counterargument to this point is that the behaviour modification regulatory scheme still requires a relationship to be established between the charge and the regulatory scheme. So while a behaviour modification regulatory scheme is likely not limited to cost recovery, there are limitations in place in terms of justifying the relationship. It is likely to be difficult to distinguish this costing mechanism from indirect taxation, which may have an alternative purpose or effect that is invalid, though on the face it appears to be valid (the type of measure referred to as a “colourable scheme”).

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

## CONCLUSION

Municipalities are increasingly turning to user fees as an alternative revenue source. The economic literature advocates a “whenever possible, charge” approach, endorsing user fees for many municipal goods and services. The benefits of user fees, from the economic perspective, are that constituents know the value of the good or service they are consuming and those who most value the goods and services will pay to use them. In this article, we have sought to add to the general understanding of user fees, well established in the economic literature, by providing an outline of the legal tests for taxes, user fees, and regulatory charges, so as to distinguish between these three revenue-generating instruments. This information can be used to inform the

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105 G.V. La Forest, *The Allocation of Taxing Power Under the Canadian Constitution*, 2d ed., Canadian Tax Paper no. 65 (Toronto: Canadian Tax Foundation, 1981), at 155-56, quoted in *Ontario Home Builders' Association*, supra note 65, at paragraph 52.

design of user fees so as to survey or avoid a legal challenge. As we have traced through some examples of applying these tests, we have set out some concerns regarding their application, and provided our views on how these concerns could be reconciled. In practical terms, however, municipalities are likely to continue to struggle with uncertainty in their user fee policy until the law is clarified.