

April 1935

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Recommended Citation

Robert L. Merricks, *The Problem of Financing Municipal Capital Outlays in West Virginia*, 41 W. Va. L. Rev. (1935).

Available at: <https://researchrepository.wvu.edu/wvlr/vol41/iss3/9>

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THE PROBLEM OF FINANCING MUNICIPAL CAPITAL OUTLAYS IN WEST VIRGINIA

The city of Grafton, by statute,¹ proposed to borrow money from a federal agency to construct a city hospital on a self-liquidating basis. A subsequent statute² authorized the city to pay \$5,000 a year on the hospital, to be set aside from revenues "other than taxes levied directly on real estate and personal property." *Held*, the project "is manifestly not self-liquidating" and fails to make provision for levy of a direct tax to meet the debt requirements, as provided by the Constitution.³ *Warden v. City of Grafton*.⁴

The United States Supreme Court, in the *Pollock* case⁵ and subsequent decisions,⁶ has defined a direct tax for purposes of the Federal Constitution as "a tax on property, either personal or real, because of its ownership."⁷ Economically, direct taxes include "those assessed on the property, persons, business, income, (and the like) of those who are to pay them, while indirect taxes are levied upon commodities before they reach the consumer, and are paid by those upon whom they ultimately fall, not as taxes, but as part of the market price of the commodity."⁸ The court in the principal case did not define "direct tax" but it is not unlikely that its meaning would be limited to property taxes.⁹ It seems that a capitation tax is equally direct. Historically and practically, however, the type of tax associated with municipal debt services has been the property tax.

The "tax limitation amendment"¹⁰ has left the cities of

¹ W. Va. Acts, 1st. Ex. Sess. 1933, c. 68.

² W. Va. Acts, 2nd. Ex. Sess. 1933, c. 160.

³ W. VA. CONST. Art. 10, § 8. "No . . . municipal corporation . . . shall hereafter be allowed to become indebted . . . without . . . providing for the collection of a direct annual tax sufficient to pay annually the interest on such debt and the principal thereof within and not exceeding thirty-four years."

⁴ 176 S. E. 706 (W. Va. 1934).

⁵ *Pollock v. Farmers' Loan and Trust Co.*, 157 U. S. 429, 15 S. Ct. 673 (1895). Affirmed on rehearing, 158 U. S. 601, 15 S. Ct. 912 (1895).

⁶ *Knowlton v. Moore*, 178 U. S. 41, 20 S. Ct. 747 (1900); *Brushabor v. Union Pacific R. Co.*, 240 U. S. 1, 36 S. Ct. 236 (1916).

⁷ *Riddle, The Supreme Court's Theory of a Direct Tax* (1917) 15 MICH. L. REV. 566, 577.

⁸ COOLEY, *THE LAW OF TAXATION* (4th. ed. 1924) § 50.

⁹ THE JOURNAL OF THE CONSTITUTIONAL CONVENTION OF 1872 (Charleston, 1872) does not show the intent of the draftsmen of the section in inserting the provision for a "direct annual tax." It was not in the West Virginia Constitution of 1863.

¹⁰ W. Va. Acts, Ex. Sess. 1932, c. 9.

West Virginia without adequate current revenues and without any visible source of funds for the purpose of future debt outlays.¹¹ The enabling act¹² has provided for a 70-30 division of possible levies under the amendment; 70 per cent. for current expenses and 30 per cent. for debt services. Twenty per cent. of the current expense levy has been allotted to municipalities. It has proven quite inadequate. The 30 per cent. for debt services has had to be constantly exceeded to meet the necessary demands.¹³ The cities are confronted primarily with a serious problem in raising funds for current operation, and the Legislature has left the problem unsolved. As for future capital outlays, the prospect is equally cloudy but resources are not entirely wanting. The need for new equipment and structures, the cost of which exceeds any possible purchase from the limited amounts for current expenses, is constantly increasing. Under present legislation, there are several possible sources of funds.

The *Warden* case has removed one practical possibility, — the use of indirect revenues, but by reversing the scheme used there the object may be attained. It is possible for cities to collect enough funds by indirect taxation (which does not include fees for special services) to pay part of their current expenses. Many special charter cities have scant legislative authority to impose such taxes and, of course, the grant of the power in the future should be carefully limited and adjusted to the state system of indirect taxation for obvious reasons. By exploiting indirect taxes and the power to impose fees for special services to meet current operating charges, some levying power might be left free to provide for necessary borrowing. Under the police power, the Legislature has authorized the charging of fees for special services including police and fire protection, sewerage, garbage collection and disposal, and street lighting and cleaning.¹⁴

Another scheme very popular at the moment is to borrow funds to construct or improve self-liquidating projects like waterworks, other utilities, and toll bridges with the provision that the loan be paid solely out of income. Strictly, revenue bonds do not constitute a debt in the constitutional sense, even under the "broad

¹¹ Sly and Shipman, *West Virginia S. O. S.* (1933) 22 NAT. MUN. REV. 584.

¹² W. Va. Acts, 2d. Ex. Sess. 1933, c. 67, § 2.

¹³ The Legislature provided for levies in excess of the limitation. *Ibid.* c. 67, § 23, as amended by c. 68.

¹⁴ Fee ordinances are authorized by W. Va. Acts, 1st. Ex. Sess. 1933, c. 27, repealing W. VA. REV. CODE (1931) c. 8, art. 4, § 20. Since the ordinance has to be ratified by a majority of the voters the power is likely to be ultimately denied the city council. This is a serious defect in the act.

special fund" theory recently adopted by the Legislature.¹⁵ After they are completely paid for, they may show a profit which can be used by the municipality for any purpose. Thus is created the anomaly of so-called "tax-free" cities,¹⁶ which are supported by utility profits. Such measures should be taken advisedly because it is apparent that the expense of government is not decreased, although distribution of the burden may be different.

A fourth possibility is the use of surplus levies under the levy limitation enabling act. The act provides that where a taxing district does not use all of the proportionate part of the whole levying power allotted to it for current expenses, and it is not required in that district for indebtedness, the excess can be passed down to the next smaller district within it for debt purposes only.¹⁷ The Supreme Court of Appeals in *City of Charleston v. Fox*,¹⁸ has passed upon the section and ruled that the "debt" referred to can be one created after the passage of the levy limitation amendment. In that case, it was used to meet a casual deficit. As a source of funds for a capital outlay, it would be useless. Debt requirements call for annual payments, provision for which must be made on a reliable basis. A more reliable source of funds which might release some taxing power for debt services is a municipal capitation tax, which may be authorized by the Legislature.¹⁹

Another means of financing improvements, the levy of special assessments, has not been extended by statute. Provision is made by general law for special assessments only for paving streets, alleys and sidewalks and the construction of sewers.²⁰

A more effective property assessment would result in increased revenues from direct taxes. A scientific reassessment is

¹⁵ See (1934) 41 W. VA. L. Q. 78. The comment there related to the "restricted special fund" theory, under W. Va. Acts, 1st. Ex. Sess. 1933, c. 26, § 6. Section 6 was amended and the "broad special fund" theory adopted by W. Va. Acts, 2d. Ex. Sess. 1933, c. 49. For an extensive collection of statutes and cases see Foley, *Some Recent Developments in the Law Relating to Municipal Financing of Public Works* (1935) 4 *FORD. L. REV.* 13, 26, *et seq.*, esp. nn. 68 and 73-82.

¹⁶ See *City of Logansport v. Public Service Commission*, 202 *IND.* 523, 177 *N. E.* 249 (1931); Bartell, *Tax-Free Cities* (1934) 23 *NAT. MUN. REV.* 613; W. S. Smith, *Municipally-Owned Utilities — Profit or Service?* (1934) 23 *NAT. MUN. REV.* 616.

¹⁷ W. Va. Acts, 2d. Ex. Sess. 1933, c. 67, § 20.

¹⁸ 175 *S. E.* 859 (W. Va. 1934).

¹⁹ *E. g.*, see city of Huntington's charter, W. Va. Acts, 2d. Ex. Sess. 1933, c. 161, § 41. The only limitation on capitation taxes is that a state tax of one dollar must be levied. After that the Legislature can go ahead under its plenary power to authorize municipalities to impose capitation taxes.

²⁰ W. VA. REV. CODE (1931) c. 8. arts. 8 and 9.

needed, which would bring under-assessed properties up to their proper level and erase existing inequalities. Much West Virginia land, especially mineral property, is badly assessed.²¹ A general increase in the assessment level would provoke a great outcry, whether fully justified or not.²² Doubtless a centralized state system of assessment in which was employed a staff of trained assessors would be more effective and would serve the interests of equality and economy. Study should be accorded the difficult problem of bringing taxable intangibles to light.

Under the levy limitation amendment, cities can increase their levies as much as fifty per cent. of the authorized rates. This increase must be approved by sixty per cent. of the voters,²³ and can continue only three years without resubmission.²⁴ In this way, short term financing may be effected. However the practical utility of the device is seriously limited by the requirement of a referendum. The Supreme Court of Appeals has already evinced a disposition to construe the amendment strictly in this respect.²⁵

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²¹ BLAKEY, REPORT ON TAXATION IN WEST VIRGINIA (1930) 58 *et seq.* He gives the average assessment for real estate as 65.22 per cent. of sale prices. See pp. 11 and 107 *et seq.*

²² Elwell, *Municipal Finance and Taxes* (1933) 11 TAX MAG. 37.

²³ Does that mean sixty percent. of all the voters? In the recent Charleston vote, sixty percent. of those voting was deemed enough.

²⁴ See n. 10, *supra*, and W. Va. Acts, 2d. Ex. Sess. 1933, c. 67, § 16.

²⁵ *McMillan Motors v. Walker*, 178 S. E. 278 (W. Va. 1935). Plaintiff sued to enforce a contract for the purchase of a truck by the city of Charleston, to be paid for over a three year period. Relief was denied because the resolution submitting the additional levy to the people contained "no clause which purports in any way to provide for the payment of interest," or other reference to "debt" to indicate that an indebtedness was to be created. There is merit in the reasoning of Maxwell, J., dissenting, that the voters authorized the expenditure of a total sum, and the municipal authorities should be permitted to expend it as they deem best.