DECISION

THE COMPTROLLER GENERAL
OF THE UNITED STATES
WASHINGTON, D.C. 20548

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FILE: B-166506 DATE: JUL 2 1974

MATTER OF: Use of ad valorem tax to satisfy statutory requirement for a user charge system for water treatment works.

DIGEST: Statutory requirement that grantees under Public Law 92-500 will adopt system of charges assuring that each recipient of waste treatment services shall pay its proportionate share of treatment works' operation and maintenance costs is not met by use of ad valorem tax since potentially large number of users--i.e., tax exempt properties--will not pay for any services; ad valorem tax does not achieve sufficient degree of proportionality according to use and hence does not reward conservation of water; and Congress intended adoption of user charge and not tax to raise needed revenues.

We have been requested to render a decision as to the propriety of the Environmental Protection Agency's (EPA) authorizing grant recipients to meet the user charge requirements of section 204(b)(1) of the Federal Water Pollution Control Act (FWPCA) as amended by Public Law 92-500, 33 U.S.C. (Supp. II) 1284(b)(1), through the use of an ad valorem tax system. In connection with the matter, we have considered the views of EPA and other concerned parties.

Subsection 204(b)(1) of the FWPCA provides that EPA's Administrator should not approve any grant for any treatment work after March 1, 1973, "unless he shall first have determined that the applicant (A) has adopted or will adopt a system of charges to assure that each recipient of waste treatment services within the applicant's jurisdiction, as determined by the Administrator, will pay its proportionate share of the costs of operation and maintenance (including replacement) of any waste treatment services provided by the applicant; * * *." Subsection (2) provides that the Administrator shall issue guidelines applicable to payment of waste treatment costs by industrial and nonindustrial recipients of waste treatment services which --

> "shall establish (A) classes of users of such services, including categories of industrial users; (B) criteria against which to determine the adequacy of charges imposed

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on classes and categories of the users reflecting all factors that influence the cost of waste treatment, including strength, volume, and delivery flow rate characteristics of waste; and (C) model systems and rates of user charges typical of various treatment works serving municipal-industrial communities."

One of the major purposes of the aforequoted provisions of section 204 was to assure self-sufficiency on the part of the treatment works. Within that framework S. Rept. 92-414, dated October 28, 1971, accompanying S. 2770 states in pertinent part:

"Although the committee is aware of the many different legal and financial circumstances that characterize state and local governments and agencies throughout the country, the bill directs the Administrator to promulgate guidelines for the establishment and imposition of user charge systems as a guide to grant applicants for waste treatment works grants. These guidelines should take into account the diversity of legal and financial factors that exist from jurisdiction to jurisdiction, and each applicant should be permitted reasonable flexibility in the design of a system of user charges that meets the unique requirements of his own jurisdiction. As a general rule, the volume and character of each discharge into a publicly owned system should form the basis of determining the rate at which each user should be required to pay.

"The committee devoted a great deal of attention to the difficult issue posed by the discharge of industrial pollutants into publicly owned treatment systems. There is much to be said for encouraging industrial use of public facilities. Each industrial discharge into a public system is one less outfall that must be monitored, and in many cases the economies of scale that characterize public treatment works would permit a net capital saving to the economy as a whole, assuming that the alternative to industrial use of public facilities is the on-site treatment by industry of its own wastes.

"The bill would deal with industrial pollutants in this way: each industrial user of a public system would pay a charge that would include not only that share of operating and maintenance costs allocable to such user but which would also be sufficient to recover that portion of the Federal share of the capital cost of the facility allocable to such user. That portion of the Federal share of the capital cost allocable to each industrial user would be returned to the federal treasury.

"The committee believes that this approach to the issue of industrial use of public facilities appeared to the committee to be the most reasonable and equitable one that can be devised. Any scheme that did not provide for full recovery of the Federal share of capital costs allocable to industrial users would clearly constitute a Federal subsidy of private industry and, more particularly, of those industries that were so situated as to make use of public facilities and industries producing wastes that are compatible with public treatment systems. Any other approach would discriminate unfairly against those industries which, for whatever reason, were unable to utilize public systems.

"It may be that the Congress will, at some future time, determine that some form of Federal financial assistance to industry in meeting pollution control costs--whether through tax relief, loans, or grants--is appropriate. The committee does not prejudge the propriety or need for such assistance. But the committee does conclude that subsidy of private industry through the waste treatment works grant program would be haphazard and inappropriate.

"Discretion is left to the Administrator and to state and local authorities as to the structure of each individual system of user charges. A difficult problem associated with industrial discharges is the calculation of the rate of assessing such charges. Industrial wastes vary considerably in their volume and character. The bill authorizes the Administrator to establish guidelines in the development of industrial user charge rates, which will at the minimum, consider factors such as strength, volume, and delivery flow characteristics of such waste.

"The recovery of the Federal share of capital costs allocable to industry will presumably occur over a rather protracted period of time. Factors that might be taken into account in determining the rate of 'pay-back' by industrial users should include the term during which any debt incurred for the non-Federal share of the capital cost will be retired and the term during which each industrial user is expected to make use of the facility. Also, a particular industry should repay that portion of the Federal grant that reflects its percentage use of the plant's total capacity, which should include any firm commitment of increased use of the facility by that industry. The committee does not believe it would be wise to require that existing industry's capital share be computed on that industry's share of the wastes actually treated when the facility initiates operation. The committee affirmatively concluded that capital

costs recovered from industry should not include an interest component.

"It may prove to be the case in certain instances that individual industrial operations will conclude that it will be more economical to treat their own wastes than to discharge into a public system. If and where such instances arise, it is assumed to indicate that a net saving to the taxpayer and to the environment will result. It is certainly not the intent of the committee to discourage industrial use of public systems. It is the judgment of the committee that the industrial 'pay-back' requirement will not discourage such use in most cases. It is clear that the environmental costs should be borne by those who place demands on the environment. User charges carry out this principle." (Emphasis added.)

H. Rept. 92-911, dated March 11, 1972, accompanying H.R. 11896 states at pages 90-92, in pertinent part:

"A major new condition for receiving a grant relates to the establishment of user charges. This section specifically provides that the Administrator shall not approve any grant for publicly owned treatment works, after June 30, 1973 unless the applicant has accepted or will adopt a system of user charges to assure that each recipient of waste treatment services within his jurisdiction, as determined by Administrator, will pay its proportionate share of operation, maintenance (including replacement) and expansion costs. The applicant's jurisdiction means his entire service area.

"The Committee believes it is essential to the successful operation by public agencies that a system of fair and equitable user charges be established. The Committee recognizes that differing circumstances and conditions in local areas may call for especially designed systems and has therefore proposed that the Administrator promulgate general criteria and that such general criteria allow for variations to meet local conditions. This section contains standards the Committee believes should be taken into account by the Administrator; foremost among these is the underlying objective of achieving a local system that is self-sufficient.

"In connection with industrial users of publicly owned systems, the Committee desired to establish within the user

charge system an arrangement whereby industrial users would pay charges sufficient to bear their fair portion of all costs including the share of Federal contributions for capital construction attributable to that part of the cost of constructed facilities attributable to use by industrial sources. It is the Committee's view that it is inappropriate in a large Federal grant program providing a high percentage of construction funds to subsidize industrial users from funds provided by the taxpayers at large. Accordingly, the bill imposes an obligation on the part of publicly owned systems to incorporate into their user charge schedule a component to recover, without interest, that proportion of the total Federal grant to the community for construction purposes attributable to industrial users. The committee recognizes that there will be some administrative difficulties involved in establishing classes of industrial users and has left to the local system the obligation to set up an effective and equitable system, subject to the approval of the Administrator, inasmuch as the establishment of such a system is a precondition to Federal grants.

"Since one of the objectives of the legislation is the development of self-sufficiency among local systems, the Committee has recommended that the revenues obtained by user charges covering the Federal contribution attributable to the use of the local system by industrial users remain with the local system. The Committee believes, however, that these funds should be used by the local system only for those purposes related directly or indirectly, to the maintenance, operation and development of the system. The Committee strongly opposes rebates to industrial users or any other form of a special treatment which would thwart the objective of the Committee stated above to prohibit Federal subsidies to industrial users.

"Among the purposes for which the Committee believes the revenues so received might be used are the following: (1) construction, operation, maintenance, repair and replacement of sewage systems and for the repayment of principal and interest for indebtedness incurred therefore; (2) support for monitoring the quantity and quality of effluents to the agency's system for industrial, commercial, and residential sources; (3) monitoring of receiving water to ensure maintenance of adopted water quality standards; (4) water pollution control and abatement planning, particularly with respect to developing the interrelationships between such planning and water resources management, air resources management, solid waste

management, and land use planning; (5) establish, operate, and maintain, where feasible, central facilities for the storage and analysis of systemwide operating data to promote the most efficient use and operation of the agency's interceptors, regulating stations, pump stations, and treatment facilities; (6) enhancement of agency-owned property to provide community multi-use facilities over and above the basic function of controlling and abating water pollution; and (7) agency personnel training programs.

"The following are examples of items which the Committee believes should not be financed by such revenues: (1) facilities for the pretreatment and monitoring of industrial waste in order to meet the agency's reserve system requirements; (2) reductions in user charges for specific categories of users, especially industrial users; and (3) payments of agency bonds or other long-term indebtedness outstanding for construction financed under the law as it heretofore has existed.

"Finally, this section provides that approval of a grant to an interstate compact agency would satisfy any other requirement for congressional authorization."

The Conference Committee Report basically states that its substitute is the same as the Senate bill as revised by the House amendment. (Senate Rept. 92-1236, September 28, 1972, pp. 111-112.)

EPA cites the relevant committee reports as well as statements by Congressmen Grover and Mizell in support of their view that the Administrator is to promulgate general criteria, taking into account local conditions which may justify variations of approach and charge. EPA states that the Administrator is required to take into account the historical, legal, and financial background of the community.

To achieve proportionality between classes a surcharge will, under EPA's proposal, be levied upon a class from which tax revenue is insufficient to pay that class's proportionate share of operation and maintenance costs attributable to it. EPA feels that the statute does not address the issue of proportionality within classes and with the exception of cases of gross disproportionality, it is not necessary to show that each user within a class is paying the same rate as all other users within its class.

On the other hand, it appears that much testimony was received at congressional hearings in 1970 indicating that user charges

could provide the economic incentive to improve efficiency and reduce the volume of waste produced. However, no action was taken on water pollution legislation in 1970. Congressional committees received similar testimony in 1971 in their consideration of the bill which was subsequently enacted into law. At that time, EPA's then Administrator indicated that the Administration believed that all communities should operate waste treatment systems on a "utility" basis with each user paying a fair share of the cost. We might also point out that in the Senate debate over the Conference Report on FWPCA, Senator Boggs, a conferee, inserted a statement into the Congressional Record which reads, in pertinent part, as follows:

> "The bill requires that a grant recipient establish an equitable user charge system that covers the operating, maintenance, and replacement costs of the project. User charges are designed to assure that the burden of any system's costs will be spread among all users of the system, in relation to the volume of waste discharge, not financed out of local taxes." Cong. Rec., October 4, 1972, p. S16891.

Finally, we note that the bill as passed by the Senate had provided that the Administrator shall determine that there has been adopted "a system of charges to assure that by each category of users of waste treatment services, as determined by the Administrator, will pay its appropriate share of the costs of operation and maintenance." However, the finally enacted provision provides that the Administrator shall not approve any grant until he has determined that the applicant has adopted a system of charges to assure "that each recipient of waste treatment services within the applicant's jurisdiction, as determined by the Administrator, will pay his proportionate share of the costs." In other words, instead of charges by each category of users, Congress apparently decided to require each recipient of services to pay his proportionate share.

We agree that the issue is clearly a difficult one to resolve. Part of the problem is that in the absence of meters--which no one contends are required--it is difficult, if not impossible, to obtain true proportionality within and among the classes of users. The basic difficulty with EPA's position is that the ad valorem system is clearly a tax based on the value of the property and, conceptually at least, the Congress did not intend that a tax be used to obtain the user charges. In addition, the ad valorem system will not reach tax-exempt property and the users of waste treatment services could constitute a relatively significant segment of the users of sewage systems. This omission is, in our view, one of the major failings of an ad valorem system. Moreover, ad valorem taxes will reach

industrial operations and others that do not discharge into a public sewage system. Of major importance also is the fact that the ad valorem tax does not in any way reward conservation of water and this was clearly an important factor in the congressional adoption of the user charge. In addition, as a practical matter, it is difficult to see how EPA could establish guidelines imposing varying surcharges in order to achieve any real degree of proportionality.

We recognize that alternatives to use of the ad valorem method may fall short of achieving absolute proportionality. Nonetheless, such other methods would appear to provide a degree of proportionality with respect to each recipient of sewer services which seemingly cannot be reached by ad valorem taxes. As imprecise a measure as such alternatives might be, they would be more consonant with the intent of Congress that every user should pay its fair share of operation and maintenance costs according to its use of the sewage treatment works and the underlying congressional feeling that the operation and maintenance of these works should be financed on a user, and not a tax, basis. Moreover, the alternative would not penalize those who do not use the sewage system.

Accordingly, while the matter is quite complex and not entirely free from doubt, it is our view that the section 204(b)(1) requirement that each recipient of sewer services will pay its proportionate share of the treatment works' operation and maintenance expenses may not be met through the implementation of an ad valorem tax system. We understand from an article in the Environmental Reporter that EPA's Deputy Administrator has advised several Members of Congress that if this Office were to question the use of an ad valorem user charge system, EPA would seek legislative authority therefor. We agree that if EPA believes that an ad valorem system would be appropriate in certain circumstances, it should seek to obtain statutory authority therefor.

SIGNED ELMER B. STAATS

Comptroller General
of the United States