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Tax Status of Municipally Owned Transit System

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Tax Status of Municipally Owned Transit System

RECENT EFFORTS of state and county officials to tax municipal property which has heretofore been tax exempt[1] have brought into sharp focus the decision in *Zangerle v. Cleveland.*[2] This case has furnished authority for the gradual removal of exemptions formerly granted. In attempting to predict the effect of this case on municipal property which is now tax immune, a reexamination of the decision is helpful.

The Cleveland Transit System is a municipally owned public utility furnishing Greater Cleveland with its primary means of public transportation. It was acquired by the City of Cleveland in 1942 when the assets of the privately owned Cleveland Railway Company were purchased pursuant to Article 18, Section 4 of the Ohio Constitution.[3] The necessary funds were derived from the sale of mortgage revenue bonds. When the City became owner it applied to the State Board of Tax Appeals to have the Transit System property declared exempt from taxation on the ground that it was "public property used for a public purpose" within the purview of Ohio General Code Section 5351.[4] The Board granted this request, but on appeal the decision was reversed by the Ohio Supreme Court in the case of *Zangerle v. Cleveland.* It was there held that the Cleveland Transit System was engaged in a "private competitive business for profit" and thereby forfeited its immunity from taxation under the "public purpose" clause of Section 5351.

In concluding that the Transit System was organized for profit the court emphasized that in its first three years of operation the System had taken in sufficient revenue to pay off almost half the purchase price. This seems the equivalent of saying that a public

[1]Shaker Heights v. Zangerle, 148 Ohio St. 361, 74 N.E. 2d 318 (1947) (Municipally-operated rapid transit system held taxable); Case No. 15436, State Board of Tax Appeals (April 4, 1949) (Cleveland Municipal Stadium held taxable on the grounds that it is not used exclusively for a public purpose).

[2]145 Ohio St. 347, 61 N.E. 2d 720 (1945).

[3]"Any municipality may acquire, construct, own, lease and operate within or without its corporate limits, any public utility the products or service of which is or is to be supplied to the municipality or its inhabitants. . . ."

[4]"Real or personal property belonging exclusively to the State or United States, and public property used for a public purpose, shall be exempt from taxation." This statute was passed pursuant to Article 12, Section 2, of the Ohio Constitution which authorized the General Assembly to pass laws exempting from taxation such real property as was public property used "exclusively for any public purpose."

utility which is efficiently operated and self-sustaining loses its tax immunity, while one which operates "in the red" is granted a premium of tax exemption. The reasonableness of such an approach might well be questioned. One wonders whether the decision would have been different if the suit had been brought two years later when the System was operating at a loss. Furthermore, the court's position on the profit question is in conflict with earlier Ohio decisions[5] and the Cleveland City Charter.[6]

In *Toledo v. Jenkins*,[7] the authority upon which the Board of Tax Appeals based its decision, the question presented was the tax status of the Toledo Municipal Airport. This airport was purchased by the City of Toledo from a private corporation. Some of the hangars and other facilities were rented to private airlines. Upon application for exemption of this property from taxation the Supreme Court of Ohio held that a municipally owned and operated airport constituted a public utility and would be considered public property within the meaning of Article 12, Section 2, of the Ohio Constitution and, therefore, within the scope of Ohio General Code Section 5351. The court further stated that all the real estate necessary and incidental to the operation of such an airport and used therein is devoted to a public use, and the fact that revenue is incidentally derived from public property does not in and of itself alter the public character of its use. This view is in accord with the general rule.[8] This decision was rendered notwithstanding the fact that the facilities of the airport were used to purchase tickets for transportation on privately owned airlines, and that hangars were rented to the airlines for storage purposes. Using the court's criterion of private competitive business, it appears that there would have been greater justification for taxing the Toledo Municipal Airport than the Cleveland Transit System.

It is interesting to note that the Airport and the Transit System decisions were made by the same court.[9] *Zangerle v. Cleveland*

[5]Toledo v. Jenkins, 143 Ohio St. 141, 54 N.E. 2d 656 (1944); Cleveland v. Ruple, 130 Ohio St. 465, 200 N.E. 507 (1936).

[6]See note 10 *infra*.

[7]143 Ohio St. 141, 54 N.E. 2d 656 (1944).

[8]". . . where the primary and principal use to which the property is put is public, the mere fact that an income is incidentally derived from it does not affect its character as property devoted to a public use." 3 A.L.R. 1439, 1445 (1919).

[9]The same members comprised the court in both cases; however, Judges Zimmerman and Williams were the only two who felt that the *Toledo Airport* case should be controlling in the decision in the principal case, and dissented on that basis.

was distinguished on the ground that "the primary and principal object of the enterprise is profit," whereas the revenue in the case of the Toledo Airport was termed "incidental".

It is difficult to see how the Transit System could be termed an organization for profit when there are no stockholders to whom any profit could be distributed, nor any provision in the Cleveland City Charter for the transfer of an operating surplus from the treasury of the Transit System to the general fund of the city. One would naturally suppose that any operating surplus would be reflected in improved service or lower fares, or be held to cover future deficits. Furthermore, the Charter inferentially provides for operation at cost.[10]

In stating that the Transit System was engaged in a "private competitive business", the court apparently disregarded the case of *Cleveland v. Ruple*.[11] There the question presented was whether a municipal underground hall constructed for holding public exhibitions and for other public purposes could be operated as a private garage. The court held that it could not, saying: ". . . neither the Constitution nor the statutes contain language which can be construed as an attempt to confer upon a municipality the privilege of engaging in a purely private competitive business." And further: "No attempt . . . has been made to confer power upon public corporations in this state to enter into private competitive business."[12] A close observance of the above would necessitate a finding that if the Transit System is engaged in a private competitive business it is thereby carrying on an unauthorized function. There has been no such finding. Casting further doubt upon the accuracy of the description of the Transit System as a "private competitive business" is the fact that it operates as a virtual monopoly in the public transportation field within the city.

Another factor upon which the court relied in reaching its decision in the principal case was that the operation of the Cleveland Transit System was a "proprietary" as distinguished from a "governmental" function, and as such would not come within the "public purpose" provision of Section 5351. A proprietary function is one which relates to the development of a municipality and is primarily for the comfort and convenience of its citizens,[13]

[10]"The rates of fare shall be such as will wholly reimburse the Board for the costs of operation. . . ." § 113-5.

[11]130 Ohio St. 465, 200 N.E. 507 (1936).

[12]*Id.* at 470, 200 N.E. at 510 (1936).

[13]Akron v. Butler, 108 Ohio St. 122, 140 N.E. 324 (1923); 28 OHIO JUR., Municipal Corporations §63.

in contrast to a governmental functon which is designed to protect health and safety. A municipally owned property which has been held to be for a proprietary purpose includes the operation and maintenance of a municipal light plant,[14] a railroad,[15] a bus line,[16] a waterworks supplying water to its inhabitants,[17] and the operation and maintenance of an airport.[18] The court's conclusion that the Cleveland Transit System is engaged in a proprietary function is, therefore, sound.[19] The fallacy in the court's position lies in its basic assumption that the employment of public property in a proprietary function precludes its use for a "public purpose" and, therefore, its exemption from taxation. A reference to prior decisions would have disclosed the unsoundness of this conclusion as the Ohio Supreme Court has held exempt from taxation by virtue of their use exclusively for a public purpose, municipally owned and operated airports,[20] and equipment and fixtures of a plant used to supply natural gas to its citizens.[21] No distinction is apparent between the Transit System and the aforementioned tax-exempt public utilities. To exempt it would be in accord with the majority rule,[22] which holds that where a statute exempts from taxation municipal property used for public purposes, municipally owned power and light plants,[23] waterworks,[24] gasworks,[25] and transit systems[26] are included within the meaning of the statute.

[14]Travelers Ins. Co. v. Village of Wadsworth, 109 Ohio St. 440, 142 N.E. 900 (1924); Butler v. Karb, 96 Ohio St. 472, 117 N.E. 953 (1917).

[15]State *ex rel.* Forchheimer v. Le Blond, 108 Ohio St. 41, 140 N.E. 491 (1923).

[16]Cleveland Ry. Co. v. Village of North Olmstead, 130 Ohio St. 144, 198 N.E. 41 (1935).

[17]Winona v. Botzet, 169 Fed. 321 (C.C.A. 8th 1909); Lynch v. Springfield, 174 Mass. 430, 54 N.E. 871 (1899); Wiltse v. City of Red Wing, 99 Minn. 255, 109 N.W. 114 (1906); City of Barberton v. Miksch, 128 Ohio St. 169, 190 N.E. 387 (1934); Stiles v. Village of Newport, 76 Vt. 154, 56 Atl. 662 (1904).

[18]Toledo v. Jenkins, 143 Ohio St. 141, 54 N.E. 2d 656 (1944).

[19]28 OHIO JUR., Municipal Corporations § 63.

[20]See note 18 *supra.*

[21]Toledo v. Hosler, 54 Ohio St. 418, 43 N.E. 583 (1896); Toledo v. Yeager, 8 Ohio Cir. Ct. 318 (1894).

[22]51 AM. JUR., Taxation § 563.

[23]Logansport v. Public Serv. Comm., 202 Ind. 523, 177 N.E. 249 (1931).

[24]*Ibid;* Johnson City v. Weeks, 133 Tenn. 277, 180 S.W. 327 (1915).

[25]Commonwealth v. Richmond, 116 Va. 69, 81 S.E. 69 (1914).

[26]Collector of Taxes v. Boston, 278 Mass. 274, 180 N.E. 116 (1932); Sun Printing v. Mayor, 152 N.Y. 257, 46 N.E. 499 (1897). Note, 9 U. Detroit L.J. 46 (1945).

As a further basis for its decision in the principal case the court adopts the view that municipal ownership and operation of the Cleveland Transit System was not within the contemplation of the framers of the Constitution of Ohio in 1851. Therefore, reasons the court, as it has not since been specifically included, it should be considered excluded, as a constitution should be interpreted in the light of conditions which obtained at the time of its adoption. This is a very narrow view. The writer feels that the generally prevailing and more liberal manner of constitutional construction should be adopted, namely that a constitution is intended to meet and be applied to newly arising conditions and circumstances which come fairly within the purview of the language used.[27]

In characterizing the Transit System as a private competitive business for profit the court seems to have assumed the point in issue without a clear analysis of the problem. It either disregarded or ineffectively distinguished earlier Supreme Court decisions exempting municipally operated public utilities from taxation.[28] In so doing it destroyed the landmarks of the past without furnishing new guides in their place. City officials are now understandably uncertain as to the tax status of much municipal property used for proprietary purposes. Recent decisions following *Zangerle v. Cleveland* have measurably increased their concern in this matter.[29]

It is believed that the Court was motivated primarily by concern over the growing encroachment by municipalities upon fields of traditional private endeavor and anxiety over loss of needed tax revenue resulting from a removal from the tax duplicate of substantial property once listed. Fundamental changes based on such considerations are more properly the concern of the legislature than the judiciary. To restore certainty to this field it is now necessary for the legislature to redefine the nature of the exemption accorded to municipal corporations engaged in public functions.

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[27]Euclid v. Amber Realty Co., 272 U. S. 365, 47 Sup. Ct. 114 (1926); Gaiser v. Buck, 203 Ind. 9, 179 N.E. 1 (1931; Carter v. Craig, 27 N.H. 200, 90 Atl. 598 (1914); State *ex rel.* Columbus v. Ketterer, 127 Ohio St. 483, 189 N.E. 252 (1934); Payne v. Racine, 217 Wis. 550, 259 N.W. 437 (1935); 8 OHIO JUR., Constitutional Law § 26; 11 AM. JUR., Constitutional Law § 51.

[28]Toledo v. Jenkins, 143 Ohio St. 141, 54 N.E. 2d 656 (1944); Toledo v. Hosler, 54 Ohio St. 418, 43 N.E. 583 (1896); Toledo v. Yeager, 8 Ohio Cir. Ct. 318 (1894).

[29]Cases cited note 1 *supra*.