What Should Be the Tax Treatment for Property Held by Nonprofits?

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Agenda

• Observations on property tax exemption

• Where to go from here?
  i. Eliminate NP status?
  ii. Eliminate exemption?
  iii. Donation credits?
  iv. PILOTS?
  v. Quid pro quo (SILOTs)?
  vi. Status quo?
  vii. Impact Fees?
Observations on property tax exemption
The property tax

Different from all other taxes.

- It is a “zero-sum” tax

A new rate is calculated every year to collect whatever is needed.

- Rate is budget-driven instead of the other way around, as is the case with all other taxes
Impact of exemption

Exemption shifts tax burden
- Elimination could raise same revenue at lower rate
- *Why I call it a zero-sum tax*

If *eliminated*, local governments *could*:
- *Increase* their budgets, but only by increasing their property tax *levy* (increased revenue is not automatic)
- But with a larger base, the *rate* could stay constant
Conversely

When property is removed from the tax rolls, local governments might:

- Reduce their budgets, in order to
- Hold the property tax levy constant.

But they also could:

- Increase the property tax levy, in order to
- Hold their budget constant

Which is better? It’s political.
Econ 101: Principles of taxation

Benefit principle

• Big institutions (e.g., hospitals and universities) use municipal services but do not pay for them
  • Basis for PILOTs & *Quid pro quo* policies

Ability-to-pay principle

• Hospitals, universities, cultural institutions are seen as wealthy and can easily afford to pay
  • *Not* a basis for PILOTS (if it were, school districts would share)

Which is more urgent? A political question.
Two theoretical approaches

- **Partial Equilibrium**

- **General equilibrium**
  - A tax on property is capitalized
  - Hence, exemptions create no long-term burden on taxpayers
    - They pay higher rates but they bought their property for less
    - Taxpayers experience an impact (capital loss) when property is removed from tax rolls
    - Exemptions create an “exit tax”
  - Exemption is a political question
2. Where do we go from here?

(using nonprofit hospitals to illustrate)

i. Eliminate NP status

ii. Eliminate exemption

iii. Donation credits

iv. PILOTs

v. Quid pro quo (SILOTs)

vi. Status quo

vii. Impact fees
i. Eliminate NP status?

- Blue Cross/Blue Shield precedent (1986)
- Forced conversion might change the practice of medicine
  - In 114 comparative hospital studies, NPs performed better in terms of quality of care (14 studies), and accessibility for unprofitable patients (28 studies) (Schlesinger and Gray 2006, Table 16.1).
  - 11 studies found that for-profits performed better on both criteria.
- Consequences are hard to predict
ii. Eliminate exemption?

Theoretically, a tax on hospitals would have a low “deadweight loss”
- Demand for their services is highly inelastic.
- A tax would be a small proportion of total cost

But, elimination would raise cost & escalating health cost is already a problem

What about teaching/research hospitals?
iii. Donation credits?

Reduce property tax bill by the amount of voluntary monetary contributions
• Since charitable contributions are deductible, their fruits should not be taxed either

1 in 5 general hospitals would have no property tax liability (my rough estimate from NCCS data)
• 1 in 5 would pay something
• 3 in 5 would pay “full freight”
iv. PILOTs?

- PILOTs are the worst possible response
  - They do not apply to all exempts
  - Payments uniform
  - PILOTs lack transparency
  - *Note*: they don’t raise much money (they are a political solution to a political problem)
v. *Quid pro quo* (SILOTs)?

This option is gaining traction


*Quid pro quo* requires services of equal value & those benefiting & paying must be same group

- Logical conclusion: only service to local residents would justify exemption
something to think about

- *Quid pro quo* commercializes “charity”
- In many states, cultural institutions are also exempt as “institutions of public charity”
  - They serve no more impecunious people; probably fewer.
- By the logic of *SILOTs*, shouldn’t they have to “work off” their exemptions too?
- But how? *SILOTs* open a can of worms
vi. Status quo?

• Exemption matters less than people think
  • Taxes are capitalized into land values
• Taxpayers residing in a community when property is removed from tax rolls lose
• Future property taxpayers are substantially unaffected
  • Many studies show capitalization to be 50% to 90%
vii. Impact Fees?

One-time fee when property is removed from the tax rolls or when major improvement occurs.


Compensates taxpayers who feel impact prior to capitalization
as an alternative to PILOTs

- It is transparent, simple to administer, and (I think) legal
  - It is one-time, like a special assessment, which is legal
- But it derives from the ability to pay principle of taxation
  - PILOTs derive from the benefit principle of taxation
  - So, people may not accept impact fees
Conclusion (pick one)

From most liberal to least liberal –

1. Broaden concept of charity.

2. Leave well enough alone. (Public finance dictum: “the best exemption is an old one.”)

3. If we must change, use impact fees.