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

Woods Bowman, Ph.D.

DePaul University

November 30, 2012

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

- Brody (2007) "The States' Growing Use of a Quid Pro Quo Rationale for the Charity Property Tax Exemption," *Exempt Organization Tax Review* 56(3): 269-288.

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
- Probably unconstitutional (*Camps Newfound-Owatonna* v. *Town of Harrison*, No. 94-1988)

⇒ 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**
  - Bowman, 2001. "The Property Tax Exemption as an Exit Tax on Capital," *Proceedings of the 93rd Annual Conference on Taxation*, National Tax Association, pp. 180-184.
- **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.

- See: Bowman (2002) "Impact Fees, an Alternative to PILOTs," pp. 301-319 in Evelyn Brody (ed.), *The Property Tax Exemption: Mapping the Battlefield*. Washington DC: Urban Institute Press.

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.

The End

wbowman@depaul.edu