PAYMENTS IN LIEU OF TAXES

A Position Paper

Prepared by the
NSFRE Government Relations Committee
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SUMMARY

The National Society of Fund Raising Executives (NSFRE) is opposed to proposals by state and local governments to require payments in lieu of taxes (often referred to as P.I.L.O.T.) by tax-exempt charitable organizations described in section 501(c)(3) of the federal Internal Revenue Code.

Taxation redirects private funds to public purposes. Contrary to popular belief, tax-exempt organizations do pay taxes as employers, such as Social Security and Medicare taxes. Employee salaries are subject to income and Social Security taxes. Additionally, employees pay sales tax on their purchases and, in some states, not-for-profit organizations pay sales tax on purchases. In reality, exemption essentially provides relief from taxes on property and investment income from portfolio assets owned by not-for-profit organizations.

The purpose of taxation is to redirect a portion of private (personal and private enterprise) earnings to public service: the collected monies are used to pay for services needed by the community as a whole. The theory behind income tax exemption for section 501(c)(3) organizations is that they are providing needed community services (“public good”), and to extract payments for taxes from these organizations would decrease the amount of service or “public good” these organizations could provide. In addition, tax-exempt organizations are required by law to direct the surplus of any money collected but not used in operating expenses back into the community in the form of services or grants. In contrast, individuals and for-profit enterprises are allowed to keep this surplus (profit) to use in whatever way they choose.

The move to impose payments in lieu of taxes threatens the very basis of the tax-exempt status provided to the thousands of not-for-profit organizations that contribute to the well-being of hundreds of citizens in every community.
PRODUCTION

In recent years, many municipalities have had to deal with the problem of rising costs while revenues remain flat or are decreasing. Some governments have attempted to extract from section 501(c)(3) organizations payments that are designed to replace tax revenue foregone because of the exempt status of the organization, or payments in lieu of taxes.

In fact, requiring payments from not-for-profit organizations in lieu of taxes would require these organizations to increase fees for services provided, eliminate programs, and force them to raise additional philanthropic funds from the community to cover the payments. NSFRE’s concern is that donors contribute to support programs and services, not to make payments in lieu of taxes. To be sure, it is not appropriate to claim exemption for property owned by not-for-profit groups, but used for purposes outside the charitable mission of the organization. However, property held for charitable use as defined in the Internal Revenue Code should be tax-exempt.

BACKGROUND ON TAX-EXEMPTION

Charitable institutions have been exempt from property taxation as a legal and moral tradition since pre-Revolutionary America. These institutions perform functions that, in their absence, government would have to perform. Therefore, government has been willing to forego the revenues in return for the public services.

The U.S. Supreme Court noted that “the exemption is made in recognition of the benefit which the public derives from corporate activities of the class named . . . (Trinidad v. Sagrada Orden de Predicadores, 263 U.S. 578, 581 [1924]).” Congress expressly reconfirmed this view in providing the income tax deduction for charitable contributions.

“The exemption from taxation of money and property devoted to charitable and other purposes is based on the theory that the government is compensated for the loss of revenue by its relief from financial burdens which would otherwise have to be met by appropriations from other public funds, and by the benefits resulting from the promotion of the general welfare.” (H.R. Rep. No. 1860, 75th Cong., 3d Sess. 19 [938]).

The tradition of citizens combating problems and reaching solutions independent of government is at the core of the very nature of American society. Philanthropy – voluntary action for the public good – has been responsible for creating and maintaining libraries, hospitals, schools, churches, health care initiatives, animal welfare, civic concerns, social services, museums, etc., which are an integral part of society. Not-for-profit organizations supported by private philanthropy are a vital part of our daily lives and culture.
If the purpose of taxation is to capture private dollars to be used for the common good, then there is no need to tax section 501(c)(3) organizations because their resources are already going directly into the community as services. In fact, taxes or payments in lieu of taxes would decrease the amount of services provided by not-for-profits, thereby placing a burden on government, forcing it to raise taxes further to provide those same services or reduce the service level. To tax these entities would both place a burden on government that would far outweigh any revenue gained from payments in lieu of taxes and strike at the heart of society.

CURRENT SITUATION

All across the country, local governments are beginning to look at section 501(c)(3) organizations as sources of revenue to help support government budgets. Colleges, hospitals and social service organizations have been faced with bills, in some cases totaling millions of dollars, for payments that governments claim are owed to them in return for services provided to the organizations, such as sewer, water, fire and police protection.

These actions are motivated by a thirst for property tax revenues with no regard to the fact that, for over 400 years, western societies have exempted not-for-profit organizations from taxation because of “community benefit.” Not only do those living in the communities served by not-for-profit organizations benefit from their presence, the not-for-profits work to preserve America’s voluntary philanthropic tradition. Studies continually reaffirm the finding that not-for-profit organizations deliver programs more cost-effectively and with better quality than government efforts.

In 1994, 10 million people were employed in the not-for-profit sector with an annual payroll of $144 billion. This is 10.6 percent of the total workforce. In addition, volunteers provided the full-time employee equivalent of 5.46 million people. If the services provided by these volunteers alone were not available, the government would have to pay over $49 billion to provide the same level of service.

Imagine a town without the public education offerings by the local hospital: prenatal classes, cancer support groups, nutrition awareness classes, first aid courses, etc. How much business would local merchants, restaurateurs and motels lose without the presence of students at local colleges and universities? Cleaning services, plumbers, carpenters, grocery stores and office supply firms all would have less business if not-for-profits had less money for program services because of tax payments. What would happen to government budgets without the sales tax revenues generated from purchases made by students, their families and patrons of university sports, academic and cultural programs? How far would the people currently employed by not-for-profit organizations have to travel to find other jobs if the not-for-profits were not there, or were forced to reduce their workforces because they had to make payments in lieu of taxes?
In many areas, property and facilities owned by not-for-profit organizations are near those owned by government agencies. For example, 60 percent of the exempt property in the city of Baltimore, Maryland, is owned by the local, state or federal government. Why should property owned by charitable organizations, which are providing direct benefits to the community and saving the government the expense of providing those services, be taxed and those facilities owned by government be tax-exempt?

In addition, many local communities and states are waiving property and other taxes on for-profit entities to attract them into the community to create jobs. The presence of those corporations and their workforces creates a greater demand for the services from not-for-profits. Why should the creators of the demand be granted special exemptions from property taxes, but traditionally exempt service providers be required to begin payments?

The problems faced by the local, state and federal governments are the result of the converging structural economic and demographic forces. Section 501(c)(3) organizations have, in fact, tended to be the bulwarks of areas with economic problems. Unlike for-profit entities, not-for-profit organizations rarely uproot and move from the communities they serve, no matter how poor the conditions. Not-for-profits embody and sustain the fundamental social, cultural and spiritual values of trust, compassion, justice and moral behavior that bind us together. Our founding fathers recognized the unique role played by charitable organizations and provided tax-exemption to allow more of the resources donated by the community to be returned to the entire community in the form of services and programs that benefit everyone.

The exemption from taxation for property used to help fulfill the charitable mission of section 501(c)(3) organizations must be preserved. The strength of the threads that hold society together depends on it.
WHAT YOU CAN DO

- Offer to work with state and local government agencies to educate the public about services provided by not-for-profit organizations in the community.
- Assist not-for-profit organizations in carefully documenting all services provided to the surrounding community and assign dollar amounts to them. These should include both direct services, such as free use of campus libraries, easy access to medical services, etc., and indirect services, such as increased revenues to local business from clients of the not-for-profit organization through restaurants, motels, shops, etc., and services that the not-for-profit pays for but extends to the local community, such as campus police that patrol perimeter areas, etc.
- Work with local communities to determine ways to off-set the problem of eroding tax bases, particularly as it affects local schools.¹

CONCLUSION

Section 501(c)(3) organizations are considered to be “institutions of charity.” “Charitable purposes,” by tradition, include the relief of poverty, the advancement of education, the advancement of religion, the promotion of health, government or other municipal purposes, and other functions that are considered to be for the good of the community. The National Society of Fund Raising Executives and its members, who are employed by and volunteer for not-for-profit organizations all across the country, support the position that property used by section 501(c)(3) organizations to fulfill their charitable missions should remain exempt from taxation.

The National Society of Fund Raising Executives is opposed to the imposition of payments in lieu of taxes.

Approved by the NSFRE Board of Directors July 13, 1996.

¹ While opposed to payments in lieu of taxes for the reasons stated herein, NSFRE acknowledges that there may be a limited role for certain voluntary user fee payments in certain exceptional circumstances. In those exceptional circumstances, such payments could be justified only if they are voluntary, principled, and consistent among all recipients of the services. In addition, they must also be commensurate with the benefit received by the organization, not detract from the organization’s ability to carry out its charitable mission, and be made in recognition of the fact that the local government might not otherwise be able to provide such essential protection and utility services.