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BGR MEDIA RELEASE

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Report on nonprofit exemption: Service fees, constitutional changes would build fairness

The Bureau of Governmental Research today releases *The Nonprofit Margin: Addressing the Costs of the Nonprofit Exemption in New Orleans*.

The report examines the impact of the nonprofit exemption on government finances and tax rates and various approaches for mitigating that impact. It is the fifth installment in a series of BGR reports focusing on the city's financial situation. It is available on BGR's website, www.bgr.org.

When BGR last examined the cost of exemptions in 1996, it found that a staggering two-thirds of New Orleans' real property value was off the tax roll due to various exemptions. Although the tax rolls show a significant drop in the percentage since then, there is little reason to think that the decline is real. Rather, the change appears to be attributable in large part to the fact that the assessors regularly reassess taxable property, but not exempt property.

Exemptions deprive local government of revenue and drive up the taxes on non-exempt residences and businesses. Extrapolating from the information available, BGR prepared illustrative scenarios of those impacts. One scenario indicated that, if nonprofit property were not exempt, revenues for tax-recipient bodies in Orleans Parish could increase an additional \$125 million at the current tax rate. In a revenue-neutral scenario, the millage rate could be cut by 44 mills, or nearly one-third.

To mitigate the impact of the exemption on government revenue and taxpayers, *The Nonprofit Margin* explores a full array of options, including elimination of the exemption. Ultimately, it recommends establishing a more restrictive framework for exemptions; improving administration; taxing nonprofits at a reduced level; and imposing service charges.

Establishing a New Framework for Exemptions

Louisiana's constitution exempts a wide range of nonprofit-owned properties, on very lax terms. The exemptions are not clearly defined in either the constitution or state law. The constitution does not even require that exempt property actually be used for the exempt purpose; it merely excludes unrelated commercial property from the exemption. This approach has serious financial consequences for local governments.

In order for the nonprofit exemption to serve strategic ends, BGR is recommending a more restrictive approach that targets exemptions to activities that the government considers deserving of an indirect subsidy. As a threshold matter, each activity should either relieve the government of a burden or provide the public with services and amenities that are important to quality of life. These activities should be carefully defined and limited to ensure that they serve the desired purpose. There should be a compelling, and clearly articulated, reason for each exemption.

The exemption should be limited to property that is owned by a nonprofit organization, and (subject to an exception for minimal non-exempt uses) the property should be used directly and exclusively for an exempt purpose. Partial exemption should be allowed in limited circumstances.

While the constitution can and should provide broad guidance, the details of the nonprofit exemption should be spelled out through legislation. Local governments, which bear the brunt of property tax exemptions, should have the power to decide which exemptions to allow within their jurisdictions.

BGR recommends revising the legal framework for granting exemptions, so that the constitution spells out the broad parameters for exemptions and the State Legislature specifically defines them. The constitution should:

- Require a clear and identifiable quid pro quo for exemptions. Nonprofits benefiting from exemptions should relieve the government of a burden or provide important public benefits.
- Limit the realm of possible exemptions to property of nonprofits formed exclusively for religious, educational, charitable, cultural or burial purposes, and engaged solely in those activities.
- Require the Legislature to establish the parameters of exemptions in a targeted manner that further defines, but in no case expands, the universe of possible exemptions set forth in the constitution.
- Prohibit the Legislature from defining exemptions that have the effect of exempting specific entities, rather than groups of entities.
- Eliminate exemptions for organizations devoted primarily to the interests of a private membership.
- Impose a strict use requirement limiting the exemption to property owned by an eligible nonprofit that is directly and, subject to the exception in the next sentence, exclusively used for an exempt purpose. When a small portion of a property otherwise dedicated to an exempt purpose is used for a related and supporting non-exempt purpose, the exemption should be pro-rated.

- Allow the governing authority of the local government to opt out of some or all exemptions.

Improving Administration of Exemptions

Redefining the nonprofit exemption should be accompanied by changes in the administration of exemptions, to ensure that the exemption benefits the intended properties. BGR recommends that the Orleans Parish assessor:

- Place the burden of demonstrating eligibility on the applicant.
- Require nonprofit property owners to reapply for their exemption on a regular basis and terminate the exemption for those who do not comply with this requirement.
- Conduct regular inspections of exempt property to confirm compliance with applicable eligibility criteria.
- Re-assess exempt property as frequently as non-exempt property to allow analysis of the cost of exemptions.
- Internally classify nonprofit exemptions in a manner that corresponds to all eligible purposes set forth in the constitution and state statutes.

Revenue-Raising Options

Tightening the eligibility requirements and improving administration are critical, regardless of what other steps government officials and the voters take. However, these actions alone are insufficient to address the fiscal problems facing local government and unfair burdens on taxpayers. Addressing local government's fiscal woes will ultimately require a significant contribution from properties that are off the tax roll.

The Nonprofit Margin explores four options: voluntary payments of lieu of taxes, or PILOTs, from nonprofit institutions; a state program to reimburse local governments for revenue lost due to nonprofit exemptions; taxing nonprofit-owned property at a reduced level; and service fees.

The report discards two of these options. It finds that PILOTs are unlikely to yield fair or significant results. And while a state reimbursement program may make sense from a policy perspective, it would require a significant financial commitment from the state in a time of budget deficits and face other hurdles.

Another option, taxing nonprofit-owned property where practical at a reduced level, would result in nonprofits paying something toward the city services from which they benefit, while providing them with a discount in exchange for the services they provide. Coupled with sound reassessments of nonprofit-owned properties, this approach would significantly expand the tax base and improve fairness. Of course, even a discounted rate might not be appropriate for all types of nonprofit properties.

The final approach that the report examines – service fees – offers the most practical approach to solving the revenue and fairness problems. If properly crafted, it could raise significant revenue to meet local needs. By requiring all property owners to contribute, a well-crafted service charge would distribute costs more fairly and help to keep millage rates down.

In New Orleans, streets and drainage are both prime targets for special fees. A drainage fee or street maintenance charge, applied according to a rational formula, would require action only at the local level.

BGR recommends two revenue-raising measures:

- Where appropriate and fair, local government entities should impose carefully crafted service charges or fees to fund services, such as drainage and street maintenance. Those

charges should apply to all property owners in the city, including nonprofit property and government property, with exemptions only for property owned by the entity imposing the charge. In devising charges, the government entity should attempt to distribute them on a fair basis, taking into account factors such as size and use.

- The Legislature and voters should amend the constitution to impose a reduced tax on nonprofit property, to the extent feasible. This can be done by assessing the property at a lower percentage than that for land or residential property.

BGR Chairman Sterling Scott Willis said he hopes the report will aid the recently-established New Orleans Tax Fairness Commission in its work.

“The current city administration has made a priority of tax fairness, and mitigating the effects of the nonprofit exemption is an important step in that direction,” Mr. Willis said.

BGR is a private, nonprofit, independent research organization. Since its founding in 1932, it has been dedicated to informed public policy-making and the effective use of public resources in the Greater New Orleans area. For more information call 525-4152 or visit BGR’s website, www.bgr.org.