

NOW

BGR's Spotlight on Local Government Issues

It's Time for Common Sense on Nonprofit Exemptions

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With the Louisiana Legislature facing an extraordinary fiscal crisis, an important dialogue has opened regarding state revenue sources, tax dedications and priorities. But some measures proposed to close the state's fiscal gap could have a negative impact on local government revenues. The Legislature will therefore need to consider ways to offset the fiscal impacts on local governments, which face their own budgetary challenges.

In November 2015, BGR issued **a report** exploring the array of tax dedications in New Orleans, with revenues totaling more than \$1 billion for various local purposes. The report found that only one-fourth of local tax revenue is available for broad municipal purposes. The other three-fourths is dedicated to specific municipal purposes or to other entities. These sizeable dedications limit the City's ability to meet basic responsibilities and pressing needs. The report concluded that it is time to identify taxes that are ripe for redeployment to meet basic needs.

BGR's report told an important part of the story on the city's finances. But it did not explore the hundreds of millions of dollars in tax revenues that are never collected – dollars that for one reason or another have been exempt from taxation. Chief among these exemptions are those granted to nonprofit organizations under the Louisiana Constitution.¹

In 1996 and 2011, BGR published reports exploring the cost of these exemptions. In the 1996 report, BGR found that a staggering two-thirds of New Orleans' real property value was off the tax roll. This is due primarily to government and nonprofit ad valorem property tax exemptions, with the homestead exemption accounting for a significant portion as well. In 2011, BGR estimated that 60% of property value was off the tax roll, and local taxing bodies had to forego more than \$125 million in revenue due to nonprofit exemptions alone. BGR also found that the

number of parcels owned by nonprofits had grown rapidly, increasing by 60% between 1996 and 2011.²

New Orleans is a center for nonprofit activity – and it pays a price for that distinction. In particular, non-exempt property owners pick up the tab for services provided to the expanding base of nonprofit entities. Nonprofits benefit from taxpayer-funded services and infrastructure, such as local flood protection, streets and police and fire protection.

Every major U.S. city must contend with the impact of nonprofit property tax exemptions to some degree. Churches, cemeteries, and educational and charitable institutions are exempt from property taxes across the country. But the problem of excessive nonprofit exemptions is particularly acute in New Orleans for several reasons.

The exemption provisions in the constitution are too broad. The Louisiana Constitution takes a kitchen-sink approach to exemptions. Like other state constitutions, it offers exemptions for cemeteries, religious institutions, schools and charities. But some of the exemptions granted in Louisiana are highly unusual, including exemptions for property owned by: labor organizations; organizations devoted to promoting trade, travel and commerce; and trade, business, industry and professional societies.³ There are also specially crafted exemptions that target housing nonprofits, Mardi Gras activities and Tulane University.⁴

The exemption provisions are not tied to specific public benefits. The most basic threshold standard for granting an exemption should be to identify public services or amenities provided by nonprofits that are important to quality of life and deserving of an indirect government subsidy. But Louisiana's constitution grants tax breaks to virtually any nonprofit.

There is no use requirement. The Louisiana Constitution does not require that property owned by a nonprofit actually be used for the purpose on which its exemption is based. Rather, it states only that the property cannot be used for an unrelated commercial purpose. As a result, property that is sitting idle, held for future investment or even used for a related commercial purpose is exempt from taxation.⁵ Like other states, Louisiana used to require that the property actually be used for an exempt purpose, and it specifically prohibited exemptions for property leased for profit or income. Unfortunately, the 1974 constitution eliminated these requirements.⁶

Local governments bear the brunt of these poorly-crafted and idiosyncratic nonprofit exemption provisions. BGR's **2011 report** offers numerous recommendations to improve administration of the exemption and revise the constitution, including giving local governments the power to opt out of certain exemptions. But, at a minimum, the Legislature should approve and submit to voters a constitutional amendment that tightens the eligibility requirements for the exemption. The constitutional amendment should:

- Limit exemptions to property of nonprofits formed exclusively for religious, educational, charitable, cultural⁷ or burial purposes, and engaged solely in those activities.⁸
- 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.
- Prohibits 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.

We note that local assessors can act independently and immediately to improve administration of the exemption. For instance, BGR has recommended that assessors place the burden of demonstrating eligibility on nonprofit property owners and require owners to reapply for their exemption on a regular basis, as set forth under state law.⁹ BGR recommended that assessors regularly inspect exempt properties to ensure eligibility and terminate the exemption for property owners who cannot prove eligibility.

The state fiscal crisis demands a look at the bigger picture. It gives the Legislature an opportunity to look afresh at the constraints state law places

on local revenues. Among the items ripe for the Legislature's consideration are nonprofit tax exemptions, which affect the income of local governments statewide. Fixing the constitutional provisions governing these exemptions is long overdue.

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ENDNOTES

1 La. Const. Art. VII, Sec. 21(B)(1)(a)(i) states, "Property owned by a nonprofit corporation or association organized and operated exclusively for religious, dedicated places of burial, charitable, health, welfare, fraternal, or educational purposes, no part of the net earnings of which inure to the benefit of any private shareholder or member thereof and which is declared to be exempt from federal or state income tax."

2 Bureau of Governmental Research, *The Nonprofit Margin: Addressing the Costs of the Nonprofit Exemption in New Orleans*, March 2011, pp. 2-3. See also, BGR, *Property Taxes in New Orleans: Who Pays? Who Doesn't? And Why?*, October 1996.

3 When BGR last conducted a 50-state survey in 1999, it was unable to find any exemptions in other states for labor organizations or entities promoting trade. It found only one state that exempted special interest groups, such as professional associations. See BGR, *Property Tax Exemption and Assessment Administration in New Orleans*, December 1999.

4 La. Const., Art. VII, Sec. 21(B) (1-3) and (C)(12), and Sec. 14. See also La. Legislature, Acts 1884, No. 43, Sec. 5.

5 See *Hotel Dieu v. Williams*, 410 So. 2d 1111 (La. 1982); *Willis Knighton Medical Center v. Edmiston*, 979 So. 2d 656 (La. App. 2 Cir. 2008); *Board of Administrators of the Tulane Education Fund v. Louisiana Tax Commission*, 701 So. 2d 702 (La. App. 4th Cir. 1997), writ denied, 709 So. 2d 705 (La. 1998); and *Hotel Dieu v. Williams*, 403 So.2d 1255 (La. App. 4th Cir. 1981).

6 BGR reviewed the transcripts of the 1974 constitutional convention and found no evidence that the elimination of the use requirement was intentional.

7 BGR cautions that these categories are vague and potentially subject to manipulation absent legislation clarifying and limiting the scope of appropriate uses. In particular, it is BGR's position that the "cultural" category should be narrowly construed. For instance, while the North Carolina constitution allows the state assembly to grant property tax exemptions to property held for "cultural" purposes (N.C. Const. Art. IV, Sec. 2 (3)), state law explains that a cultural purpose "is one that is conducive to the enlightenment and refinement of taste acquired through intellectual and aesthetic training, education, and discipline" (N.C. Gen. Stat. Sec. 105-278.7(f)(5)). Texas allows its legislature to grant exemptions "for the preservation of cultural, historical, or natural history resources" (Texas Const. Art. VIII, Sec. 1(f)); the tax code then specifies the uses: historic landmarks, museums, zoos, libraries, theaters and performance halls (Texas Tax Code, Sec. 11.18 (d)(4-5)).

8 See BGR, *The Nonprofit Margin*, pp. 18-20, for approaches used in other states.

9 La. R.S. 33:2828.