



ADVANCING LIBERTY
WITH RESPONSIBILITY
BY PROMOTING
MARKET SOLUTIONS
FOR MISSOURI
PUBLIC POLICY

ESSAY

MARCH 31, 2011

PAYMENTS IN LIEU OF TAXES AS A SUPPLEMENTAL REVENUE SOURCE AFTER THE EARNINGS TAX ELIMINATION

By David Stokes

Missouri Revised Statutes 137.100(5):

“All property, real and personal, actually and regularly used exclusively for religious worship, for schools and colleges, or for purposes purely charitable and not held for private or corporate profit, except that the exemption herein granted does not include real property not actually used or occupied for the purpose of the organization but held or used as investment even though the income or rentals received therefrom is used wholly for religious, educational or charitable purposes;”

INTRODUCTION

Proposition A, passed by Missouri voters last November, requires that Kansas City and Saint Louis allow citizens the opportunity to vote on the continuation of their local earnings taxes within six months of the measure’s passage. Those local votes are scheduled to occur on April 5. Voters may decide to maintain their earnings taxes at that time, or they may choose to sunset it over the coming 10 years. As they weigh their decision, it is important for officials to begin considering alternative methods by which their cities can raise revenues that will fund necessary services.

Not all forms of taxation have equal effects. The efficiency of a tax

system depends on a variety of factors, including the economic distortions that a particular type of tax may cause, whether a tax is flat, progressive, or regressive, the ease of collection, the difficulty of enforcement, and more. If Saint Louis and Kansas City voters choose to vote out the earnings tax, they need to consider which combination of offsetting tax increases, tax base expansions, and budget cuts will best serve the people and businesses of their communities. A number of changes would likely be required to replace earnings tax revenues. One possible replacement for a portion of this revenue is payments in lieu of taxes (PILOTs) from nonprofit agencies that do not currently pay property taxes.

David Stokes is a policy analyst at the Show-Me Institute, an independent think tank promoting free-market solutions for Missouri public policy.

If either city were to eliminate its earnings tax, is it reasonable to expect some other level of financial contribution to the government for municipal services?

WHO PAYS PILOTS?

PILOTS are common within some communities, although their use varies among cities that have them. Cities with a significant level of nonprofit activity are, understandably, more likely to enact or request them. Out of the total assessed value of property in Saint Louis, 22 percent is tax-exempt because it is owned by nonprofit organizations. According to a report by PFM Consulting, that percentage is above average for comparable cities.¹ It does not include land or property owned by various governments, nor property values temporarily removed from the tax base because of economic incentives such as tax increment financing (TIF).² It strictly comprises the land and property owned by nonprofits.

The situation is different in Kansas City. Inside the portion of Kansas City within Jackson County, less than 2 percent of total property parcels are owned by nonprofit entities. The available data regarding nonprofits in Kansas City is not comprehensive, but it is clear that a far smaller percentage of the total assessed value in the city is tax exempt because of nonprofit ownership.³

The largest of the nonprofits in both cities are widely known. They include private colleges like Washington, Rockhurst, and Saint Louis Universities. Each city has several private nonprofit hospitals, including the enormous Barnes-Jewish complex in Saint Louis. Churches, charities, and private schools are all off of the tax rolls. Cemeteries, in particular, can take up a significant amount of land.

The benefits these institutions bring to Missouri's two major cities are numerous, and many of those benefits can be hard to measure quantitatively. They bring

good jobs to our communities, provide wonderful services to residents, and contribute to our economic vibrancy. From a revenue perspective, their numerous employees contribute to the tax base via the earnings tax.⁴

USE OF PILOTS IN THE UNITED STATES

If either city were to eliminate its earnings tax, is it reasonable to expect some other level of financial contribution to the government for municipal services? A word like "contribution" may appear strange when talking about taxes, which are a black-and-white field in which one owes a certain amount of money to the government, under threat of penalty if unpaid. However, many examples of PILOTS across the country are completely voluntary. In Massachusetts, Boston and Cambridge — home to some of the nation's most famous universities and hospitals — have long had a voluntary PILOT program. In 2004, more than 43 nonprofit entities together paid Boston more than \$12 million in voluntary payments for public services.⁵

There is no official database of PILOT programs in America. Cities with PILOT-related programs include: Boston and Cambridge, Mass.; Baltimore, Md.; Detroit, Mich.; Indianapolis, Ind.; Minneapolis, Minn.; New Haven, Conn.; Philadelphia and Pittsburgh, Pa.; Palo Alto, Calif.; Providence, R.I.; Madison, Wis.; Norfolk, Va.; Omaha, Neb.; Knoxville, Tenn.; and Wilmington, Del. Two things stand out about this substantial yet incomplete list. First, many of these cities are strong university towns. Obviously, cities with more tax-exempt property will give more

Table 1 — Examples of PILOT Programs for Nonprofits in the United States

City	PILOT Program or Payer	\$ Raised, or PILOT Rate
Baltimore, Md.	Johns Hopkins Hospital	\$2.1 million in FY 2005
Boston, Mass.	Numerous hospitals and universities	\$12 million annual total; program ongoing
Cambridge, Mass.	Harvard University	PILOT payments since the 1920s; \$1.77 million in 2004
Detroit, Mich.	General program of nonprofit payments	Program existed since 1966
New Haven, Conn.	Yale University	\$2 million per year for fire services
Philadelphia, Pa.	General program of nonprofit payments	Nonprofits had paid 1/3 of taxes otherwise due; program currently much smaller
Pittsburgh, Pa.	General program of nonprofit payments	\$4.3 million in 2008
Palo Alto, Calif.	Stanford University	\$6 million in 2001–2 for fire and police services
Durham, N.C.	Duke University	\$300,000 per year for fire services
Providence, R.I.	General program of university PILOT payments	\$50 million over 20 years, beginning in 2003
Lebanon, N.H.	Dartmouth Medical Center	\$1 million per year for 20 years, beginning in 2001
Knoxville, Tenn.	Payments from nonprofits and public utilities	\$12 million in 2008, primarily from public utilities
Omaha, Neb.	General program of nonprofit payments	\$6 million in 2008
Minneapolis, Minn.	General program of nonprofit payments	\$427,229 in 2008
Norfolk, Va.	General program of nonprofit payments	\$3.5 million in 2008

Sources:

- Schiller, Zach, “Memorandum RE: PILOTs,” Policy Matters Ohio, Dec. 17, 2004. Online here: tinyurl.com/4ze64rj
- Leland, Pamela, “PILOTs: A Comparative Analysis,” *Government Finance Review*, July 1999.
- Murphy, Mark, “PILOTs Give Local Government Revenues A Lift,” American Federation of State, County, and Municipal Employees, 2002. Online here: tinyurl.com/4spa7b7
- “St. Louis, Missouri Comprehensive Revenue Study,” The PFM Group, July 2009, p. 124.

consideration to implementing PILOTs. Second, the list includes cities both with and without earnings taxes.

Utah followed a different pattern than Boston by carefully examining the tax status of nonprofit entities in the state, to be certain they actually qualified for property tax exemptions.⁶ Local governments in Missouri can do the same. The Missouri state statute quoted at the beginning of this essay is far less clear than it may seem. Although for-profit businesses are taxable and nonprofit charities are not, what about a retirement

home for seniors that reserves 5 percent of its rooms for charity cases? Should that be tax-exempt? How about day care centers that claim to operate as nonprofits and reserve a few spaces for families that can’t afford the regular rates? Should they be tax-exempt? Should spiritual groups that do not formally worship a deity qualify for religious tax exemption? Missouri state law provides less guidance on some of these questions than one might think. Many of these decisions are left up to local county boards of equalization. Saint Louis and Kansas City can choose to carefully

Missouri state law provides less guidance on some of these questions than one might think.

PILOTs have been enacted in some areas within Missouri. As mentioned previously, Saint Louis County makes use of them, generally as part of negotiations with organizations seeking tax exemption.

review the status of the tax-exempt entities operating within city limits. At a minimum, this could serve to ensure that any properties that had been granted tax exemption in the past are still being used for their original tax-exempt purposes.

Local governments in Pennsylvania used a harder-edged approach. There, in the 1980s and '90s, a number of local governments directly challenged the tax-exempt status of nonprofits in their communities after the state's Supreme Court tightened the requirements for nonprofit status. Often, these tactics were designed to convince nonprofits to make PILOTs as part of a settlement that would allow them to keep nonprofit status. Philadelphia established a program during this period that called for larger nonprofit organizations to pay a third of the property taxes that would have been due for taxpaying organizations of similar size, and specified that a third of that payment could be provided in services rather than money. Philadelphia collected \$8.8 million in 1996 from this program. That Philadelphia program is no longer in effect, but if Saint Louis were to use it as a guideline, the city could collect \$6.2 million⁷ dollars each year from nonprofits — \$4.1 million of it in cash.⁸

The American Federation of State, County, and Municipal Employees (AFSCME) has encouraged even tougher tactics. In an article about PILOTs published for its membership, AFSCME cited city tactics such as stalling or withholding zoning changes and code approvals for nonprofits as part of a strategy to force them to agree to PILOTs.⁹ Here in Missouri, Saint Louis County has negotiated PILOTs with entities that were seeking tax exemption, although it has

never come close to these repugnant tactics of bureaucratic stonewalling.

Closely related to PILOTs are reimbursement programs from other levels of government. Two states, Connecticut and Rhode Island, reimburse local governments for a portion of lost revenues from the land and property owned by nonprofits. Missouri, like most states, has no such program. The federal government also makes payments for federal property that is off of the tax rolls, albeit to a very small extent.¹⁰ For an unknown reason, the city of Saint Louis does not receive any money from the federal government through this particular program, even though some very valuable riverfront property is owned by the National Parks Service. The amount of money involved is likely extremely small, but Saint Louis should investigate why it is not included in the payments generated by this program.

USE OF PILOTs IN MISSOURI

PILOTs have been enacted in some areas within Missouri. As mentioned previously, Saint Louis County makes use of them, generally as part of negotiations with organizations seeking tax exemption. Lutheran Senior Services is one organization in Saint Louis County that makes yearly PILOTs to several government entities as part of its tax exemption agreement with the county.¹¹ Washington University has an arrangement with the city of Clayton to provide fire protection services on its campus, but that would be more properly viewed as a contractual payment for chosen services than as a PILOT.¹²

The city of Saint Louis does use

PILOTs in other capacities. As part of the negotiating process to receive public support for a new Cardinals stadium, the team agreed to make PILOTs to Saint Louis Public Schools and a few other government entities. This is a clear example of an organization agreeing to make such payments because it wishes to maintain a good public image. The PILOT agreement helped avoid potential headlines reading, “Rich ballplayers take tax money from schoolchildren.”

It is not realistic to attempt to estimate how much money is available to Saint Louis or Kansas City via PILOTs. We do not know what percentage of the land and property within Kansas City is held by nonprofits.¹³ Any PILOT program would, in the end, be a voluntary contribution that nonprofits would be free to refuse — but other cities, such as Boston, have engaged in successful negotiations for PILOT payments. Many nonprofit operators in other cities have recognized that the municipal services they receive are not free, and are willing to make contributions. Most importantly, that model of negotiating PILOTs with nonprofits has also been used closer to home, in Saint Louis County. However, the presence of earnings taxes in Saint Louis and Kansas City has made the issue of PILOTs generally moot until now.

Saint Louis and Kansas City each have a number of nonprofit organizations, both large and small, operating within their borders. In the event that either city’s earnings tax is repealed, it would be reasonable to request some contribution for city services that those organizations receive. Saint Louis, especially, has an opportunity to make the argument to a number of its nonprofit organizations

that some level of property-based contribution to city funds is appropriate. The discussion should not be focused only on larger nonprofits. Many larger nonprofits fund their own services, which might be supplemented by the city but do not depend primarily on the city. One such example is the security forces employed by hospitals and universities. Smaller nonprofits, however, likely use city services to the same extent as most comparable residents and businesses.

CONCLUSION

If the earnings tax were eliminated, PILOTs could be a source of new revenue for Saint Louis and Kansas City governments. Several cities that are comparable to Saint Louis and Kansas City in size generate approximately \$5 million per year in voluntary PILOT payments. In 2008, Omaha generated almost \$6 million from these programs. Pittsburgh received \$4.3 million, while Baltimore took in \$5.6 million, and Norfolk raised \$3.5 million.¹⁴

PILOTs could play a small — but fair and valuable — role in a revision of city tax and spending policies. It is only one measure among many, which should also include budget cuts, alternative tax increases, user fee expansions, privatization, and consolidation efforts. A high-end estimate, using Philadelphia’s program as a model, is that Saint Louis could expect at most approximately \$6 million from a major PILOT program. A more reasonable estimate for Saint Louis, using the comparable cities listed above, would be in the range of \$4 to \$5 million.¹⁵

The estimating difficulties are even greater in Kansas City. Less than 2 percent of the city’s total parcels are tax-

If the earnings tax were eliminated, PILOTs could be a source of new revenue for Saint Louis and Kansas City governments. Several cities that are comparable to Saint Louis and Kansas City in size generate approximately \$5 million per year in voluntary PILOT payments.

exempt, so I am hesitant to estimate a potential PILOT total of more than \$1 to \$2 million. Such payments could potentially generate a few million dollars per year for each city's funds, but a formal estimate is prohibitively difficult.

NOTES

- 1 "St. Louis, Missouri Comprehensive Revenue Study," The PFM Group, July 2009, p. 119.
- 2 Payments made in conjunction with TIF projects are also commonly referred to as PILOTs. However, these payments are part of the legally required TIF process, and do not refer to the voluntary payments made by nonprofit organizations under discussion in the present essay.
- 3 The primary reason for this problem is that Kansas City is located within four different counties, which do not use the same systems for calculating or counting tax-exempt status. For example, Platte County can document how many tax exempt parcels lie within the county, but not how many of those are within Kansas City.
- 4 Nonprofits are exempt from taxes other than property taxes. Nonprofits in Saint Louis do not pay the half-percent payroll tax that other companies pay on earnings. Nonprofits are exempt from paying sales taxes on work-related purchases, although individual employees or customers (i.e., patients or students) certainly pay sales taxes when making personal purchases. Nonprofits are often exempt from business licensing requirements.
- 5 Schiller, Zach, "Memorandum RE: PILOTs," Policy Matters Ohio, Dec. 17, 2004. Online here: tinyurl.com/4ze64rj
- 6 Leland, Pamela, "PILOTs: A Comparative Analysis," *Government Finance Review*, July 1999.
- 7 The assessed valuation of land, improvements, and personal property owed by nonprofit, tax-exempt organizations in Saint Louis amounts to \$1,283,851,000. That value, multiplied by the city's commercial rate of \$1.4518 per \$100 of assessed value, leads to a total tax payment of \$18,638.95. One-third of that is approximately \$6.2 million.
- 8 In Philadelphia at the time of the program — the 1990s — many smaller nonprofits were exempted.
- 9 Murphy, Mark, "PILOTs Give Local Government Revenues A Lift," American Federation of State, County, and Municipal Employees. Online here: tinyurl.com/4spa7b7
- 10 In 2010, the federal government paid Saint Louis County \$218 for 91 acres of federal property. Jackson County, which includes much of Kansas City, received somewhat more: \$21,620 for 7,528 acres of federal property.
- 11 Those governmental units include the city of Webster Groves, the Webster Groves school district, the Webster Groves library district, and Saint Louis County.
- 12 Stanford University in California has a similar arrangement with Palo Alto.
- 13 As discussed in note 2, it is likely that this total in Kansas City is much lower than the 22 percent in Saint Louis. Kansas City has a much larger total area than Saint Louis, and it has fewer major private hospitals and universities within city limits.
- 14 "St. Louis, Missouri Comprehensive Revenue Study," The PFM Group, July 2009, p. 124.
- 15 Again, because we don't know the percentage of nonprofit owned property in Kansas City, I cannot compute any estimate using the Philadelphia program as a model.

OTHER PUBLICATIONS IN OUR ESSAY SERIES

New Evidence of the Effects of City Earnings Taxes on Growth, by
Howard J. Wall (March 25, 2011)

Income Taxes vs. Sales Taxes: A Welfare Comparison, by Grant
Casteel and Joseph Haslag (December 15, 2010)

The Missouri Compromise, by Arthur Laffer (November 23, 2010)

The Negative Effects of Targeted Development Tax Credits in Missouri,
by Christine Harbin (October 11, 2010)

Why a Sales Tax Is Better for Missouri Than an Income Tax, by Rex
Sinquefield and Jack Naudi (December 18, 2009)

SHOW-ME INSTITUTE POLICY AREAS

TAXES

Our economy works better when the tax system is simple, fair, and lets workers keep more of the money they earn. Show-Me Institute scholars study the impact of tax and spending policies, and develop reforms that will give us more for our tax dollars and spur faster economic growth.

EDUCATION

The latest education research confirms what common sense has always told us: Kids learn better when their parents have more choices. The Show-Me Institute studies how to empower parents by expanding educational options and providing them with better information, so that every child can attend a school that best meets his or her unique needs.

CORPORATE WELFARE

From eminent domain abuse to subsidies and tax breaks for the powerful and well-connected, government officials often try to pick winners and losers in the market. The Show-Me Institute develops policy recommendations to protect property rights and promote economic growth without caving in to demands for corporate welfare. Secure property rights encourage investment and entrepreneurship. Trying to create economic success through government intervention is a formula for failure.

HEALTH CARE

The standard employer-based model for health insurance leaves a remarkable number of people out. The Show-Me Institute highlights the ways that a consumer-driven, market-based model for coverage can help more people get the care they need while taking ownership for their own health and lifestyle decisions.

PRIVATIZATION

Many government services can be provided more effectively, and at a lower cost, by the private sector. When public services are provided by private industry, economic incentives and accountability provide a critical feedback loop that is largely absent in government bureaucracy. Show-Me Institute scholars analyze public programs to determine how taxpayers can benefit from market-based alternatives.

RED TAPE

One thing that government officials do well is establish barriers to market innovation and erect hurdles for entrepreneurs to clear. The Show-Me Institute is committed to showing how burdensome regulations stand in the way of economic growth and individual prosperity. Market solutions lose their strength when bound by red tape.



**ADVANCING LIBERTY WITH RESPONSIBILITY
BY PROMOTING MARKET SOLUTIONS
FOR MISSOURI PUBLIC POLICY**