

PROPOSED STUDY PLAN FOR AN INTERIM STUDY OF THE EXEMPTION OF NONPROFIT ORGANIZATIONS FROM PROPERTY TAXES

Prepared for the Revenue and Transportation Interim Committee

by

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Introduction and Background

Senate Joint Resolution No. 23 requires a study of the Montana income and property tax exemptions received by nonprofit corporations and organizations and whether these exemptions are justified. SJR 23 was ranked highly in the poll of legislators: 5th of 16 interim studies.

State law allows property and income tax exemptions for a variety of nonprofit organizations including health care facilities, churches, educational institutions, and other organizations registered as nonprofits. An entity that imposes property taxes is allowed to maintain the level of taxes levied in the prior year (and add half of the average rate of inflation for the previous three years). When property is acquired by a nonprofit organization and qualifies as tax-exempt, the taxing entity can shift the taxes that were previously collected on that property to other taxpayers, thereby increasing their property taxes. Income tax rates are set in statute, so there is no automatic reallocation when income collected by nonprofits is exempt. However, if the Legislature chose to increase tax rates due to dwindling collections, exemptions -- including nonprofit income tax exemptions -- might be considered at least a partial cause.

As stated by the sponsor during the SJR 23 hearing, the purpose of SJR 23 is to explore this tax shifting in light of an increase in the number and variety of nonprofit corporations and organizations and to consider whether the current tax structure, developed when nonprofits were less prevalent, is appropriate.¹

A bill introduced in the 2011 legislative session would have removed property tax exemptions for hospitals. House Bill No. 305 introduced by Rep. Keith Regier was tabled in the House Taxation Committee. The tax treatment of hospitals may play a significant role in the study because hospitals receive property tax exemptions, may purchase property for investment, and are specifically mentioned in SJR 23 as an industry in which for-profits and nonprofits compete.

¹ See Minutes of the Senate Taxation Committee on April 6, 2011.

Study Issues

The reasons for SJR 23 as contained in the "whereas" clauses include:

- a continuing increase in the number of nonprofit corporations and organizations in Montana;
- the variety of functions of nonprofit corporations and organizations, from the purely charitable that operate solely through the receipt of donations to those that function based on receipt of fees for services or government appropriations and contracts;
- nonprofit corporations' and organizations' exemptions from payment of income and property taxes that are paid by for-profit organizations that may provide the same or similar services; and
- the increasing purchase and removal from the property tax rolls of office buildings and other real estate investments by nonprofit corporations or organizations and the shifting of the property tax burden to small businesses and homeowners who remain on the tax rolls under the operation of section 15-10-420, MCA.

Direction from the Legislature

General directions for conducting the study are contained in the "resolved" clauses and direct the Committee to study:

- the valuation of property in each of Montana's seven most populous counties that does not appear on the tax rolls because of the nonprofit exemption from property taxes in those counties and in each city in those counties;
- the amount of business equipment in each of Montana's counties that has been removed from the tax rolls because of the nonprofit exemption from property tax;
- the amount of tax shifting that has occurred because nonprofit corporations or organizations have acquired property that has been removed from the tax rolls;
- the appropriateness of allowing nonprofit corporations or organizations to acquire investment property not related to their charitable goals and to pay taxes at a reduced rate compared to for-profit investors;
- the effects of allowing private parks that were created to comply with subdivision standards and that are not open to the public to be removed from the tax rolls;
- the impact of competition by nonprofit corporations or organizations offering essentially the same services as for-profit entities and the competitive advantage that lack of income tax and property tax provides; for example, nonprofit medical clinics owned by nonprofit hospitals compared to medical clinics owned by physicians and health clubs owned by colleges or hospitals compared to investor-owned health clubs;
- the impact of limiting income tax exemptions and property tax exemptions to reflect the percentage of gross receipts of the nonprofit corporation or organization that represent charitable donations compared to the percentage of fee-for-service or government appropriations or contracts;
- how the other 49 states treat nonprofit corporations or organizations for income tax and property tax purposes and how nonprofits differentiate from for-profit and purely charitable organizations;
- the nonprofit corporations or organizations that own farmland or ranchland for purposes of preserving unique historical, archaeological, or environmental resources;

- the effects that nonprofit land ownership has had on the local tax base and whether taxes are paid on that land and how that compares to similar land classifications in the area;
- legal restrictions or limitations on nonprofit land ownership in other states; and
- whether services provided by nonprofit corporations or organizations justify the property tax exemptions and state income tax exemptions or reduced tax rates that they receive.

Study Design

The SJR 23 study can be approached in four phases that follow the resolution outline:

- Phase I Build a foundation of facts and evidence regarding income and property tax exemptions for nonprofit corporations and organizations, including quantifying the amount of property that is exempt from taxation and the tax shifting that results from these property tax exemptions.
- Phase II Examine the competitiveness of for-profit corporations as compared with nonprofit corporations and organizations that receive tax exemptions and whether the services provided by nonprofit corporations justify the tax exemptions.
- Phase III Develop, through Committee discussion and action, findings and conclusions about the tax treatment of nonprofit corporations and organizations.
- Phase IV Identify, through Committee discussion and action, legislative options for addressing any recommended changes to the tax treatment of nonprofit corporations.

Phase I: Building a Foundation

Compiling facts and evidence about income and property tax exemptions for nonprofit corporations and organizations includes the following elements:

- An overview and legislative history of state laws related to income and property tax exemptions for nonprofit corporations or organizations.
- A summary of other states' tax treatment of nonprofits for income and property tax purposes, how nonprofits are different from for-profits and purely charitable organizations, and whether there are legal restrictions or limitations on nonprofit land ownership.
- A quantitative analysis of the value of property in each of the seven most populous counties and the cities in each of those counties that is exempt from property taxes because of the nonprofit exemption; the value of business equipment that is exempt from the property tax in each county; and the tax shifting that results from each.
- Identification of the nonprofit corporations or organizations that own farmland or rangeland for purposes of preserving historical, archaeological, or environmental resources.
- Evaluation of the effects of removing from the tax rolls private parks created to comply with subdivision standards.

As originally drafted, SJR 23 included detailed language of how to study the ownership of nonprofit corporations or organizations that own farmland or ranchland. The Senate Taxation Committee reoutlined some of this language to apply to the entire resolution (subsection (10) of the resolution) and struck the remainder of the language to give the Committee discretion over how to conduct this portion of the study. The Committee should consider how much information is desired about the ownership of farmland and ranchland by nonprofit corporations and organizations.

Phase II: Further Examining the Tax Exemptions

Having received data on the value of the income and property tax exemptions for nonprofit corporations and organizations and how other states treat such entities for tax purposes, the Committee will shift focus to evaluate the tax benefit received by nonprofits and the services they provide. This phase of the study will include:

- Examination of the competitiveness of nonprofit corporations or organizations that receive income or property tax breaks as compared with for-profit entities that offer the same services.
- Evaluation of whether the services provided by nonprofit corporations or organizations justify the income and property tax exemptions or reduced tax rates.
- Examination of the effects of nonprofit ownership on the local tax base, including whether taxes are paid and comparison with similar land classifications in the area.
- Consideration of the appropriateness of allowing nonprofit corporations and organizations to pay reduced property taxes on investment property not related to the organizations' charitable goals.

The Committee will also have the opportunity to refine, clarify, or reestablish priorities within the guidelines of SJR 23. This may include:

- an issues and options decision tool, prepared by staff, that the Committee can use to clarify priorities and focus the study. The objective is to establish clear categories of questions and overall goals and objectives regarding the desired outcome and outputs of the study.
- compiling or analyzing additional information, including information identified as necessary or useful to the Committee's future discussions or goals. The information may be provided by stakeholders or the Committee's staff or may involve a panel of experts.

Phase III: Considering Alternatives

With the knowledge gained from the first two phases of the study, the Committee can begin to draw conclusions about the tax treatment of nonprofit corporations and organizations. This phase of the study will include consideration of alternatives to the current system. The resolution specifically requests consideration of the impact of limiting income and property tax exemptions for nonprofit corporations to reflect the percentage of gross receipts of charitable donations compared to the percentage of fee-for-service or government appropriations or contracts.

This phase will also include:

- compiling, analyzing, and reporting information directly related to the policy options identified by the Committee. This information may be available from current resources or may have to be developed by staff, stakeholders, Committee members, or others.
- establishing formal findings by examining and discussing the information. (Staff can develop decision tools to assist in this exercise.)
- drawing conclusions from previously adopted findings to help form the basis of recommendations, including proposed legislation, that may be developed in Phase IV.

Phase IV: Legislative Options and Committee Recommendations

The findings and conclusions developed in Phase III may lead the Committee to develop options for legislative consideration, including draft legislation.

If the Committee determines that no action should be taken at this time, it should consider making a clear statement to that effect and supporting the statement with findings and conclusions developed as a result of the study.

Proposed Committee Meeting Schedule and Work Plan

SJR 23 requires the study to be completed by September 15, 2012. The proposed Committee schedule includes eight meetings. With the first meeting composed largely of organizational matters and the final meeting in November 2012 devoted to the revenue estimating resolution, the Committee will have six meetings to complete the SJR 23 study. All meetings except the final meeting are scheduled as two-day meetings, and the Committee should anticipate spending about one-half of one day during each two-day meeting on the SJR 23 study.

The following is a proposed schedule for conducting the study:

September 15-16, 2011

- ▶ Staff briefing on state laws related to income and property tax exemptions for nonprofit corporations and organizations.
- ▶ Staff review of the legislative history of laws related to income and property tax exemptions for nonprofit corporations and organizations.
- ▶ Staff summary of other states' tax treatment of nonprofits for income and property tax purposes, how nonprofits are different from for-profits and purely charitable organizations, and whether there are legal restrictions or limitations on nonprofit land ownership.
- ▶ Committee work session to identify core areas of interest and focus study, if necessary.
- ▶ Committee requests for additional research and analysis.

December 1-2, 2011

- ▶ Responses to Committee requests from previous meetings.
- ▶ Briefing on the value of the nonprofit property tax exemption in each of the seven most

populous counties and the cities in each of those counties, the amount of business equipment owned by nonprofits that is exempt from the property tax in each county, and the tax shifting that results from each.

- ▶ Briefing on the nonprofit corporations or organizations that own farmland or ranchland for purposes of preserving historical, archaeological, or environmental resources and the effects of nonprofit ownership on the local tax base. The briefing will include whether taxes are paid on the property and how that compares with similar land classifications in the area.
- ▶ Briefing on the effects of removing from the tax rolls private parks created to comply with subdivision standards.
- ▶ Committee discussion to focus future work on the study and direct research and analysis.
- ▶ Discussion of panelists for next meeting.

February 16-17, 2012

- ▶ Responses to Committee requests from previous meetings.
- ▶ Panel discussion on the competitiveness of nonprofit corporations or organizations that receive income or property tax breaks as compared with for-profit entities that offer the same services. Panelists might include representatives from nonprofit and for-profit businesses that compete (specific entities mentioned in SJR 13 are hospitals/clinics and health clubs); representatives from business, nonprofit, and taxpayer trade associations; an economist or other academic; and a representative of the Department of Revenue.
- ▶ Evaluation of whether the services provided by nonprofit corporations or organizations justify the income and property tax exemptions or reduced tax rates.
- ▶ Examination of the appropriateness of allowing nonprofit corporations and organizations to pay reduced property taxes on investment property not related to the organizations' charitable goals.
- ▶ Develop preliminary findings and conclusions.

April 26-27, 2012

- ▶ Responses to Committee requests from previous meetings.
- ▶ Briefing on the impact of limiting income and property tax exemptions for nonprofit corporations to reflect the percentage of gross receipts or charitable donations compared with the percentage of fee-for-service or government appropriations or contracts.
- ▶ Discuss alternatives to the current system, specifically considering limiting income and property tax exemptions for nonprofit corporations to reflect receipts of charitable donations.
- ▶ Refine findings and conclusions previously developed.
- ▶ Develop, refine, or adopt new or additional findings and conclusions.
- ▶ Direct additional research and analysis or draft legislation.

July 19-20, 2012

- ▶ Responses to Committee requests from previous meetings.
- ▶ Establish, revise, and adopt final findings and conclusions.
- ▶ Discuss options previously identified; propose and discuss additional options.

- ▶ Recommend options, including draft legislation, for legislative consideration.
- ▶ Review, revise, and adopt outline of Committee report to the Legislature.

September 13-14, 2012

- ▶ Final responses to Committee requests from previous meetings.
- ▶ Adopt final findings and conclusions.
- ▶ Adopt final recommendations, including draft legislation or recommendation to continue status quo.
- ▶ Review draft final report.

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