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THE QUESTION OF PAYMENTS BY NONPROFIT  
TAX-EXEMPT INSTITUTIONS FOR  
MUNICIPAL SERVICES IN PHILADELPHIA

Prepared for Office of Director of Finance  
City of Philadelphia

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## PREFACE

This is the final report on a study undertaken by the Pennsylvania Economy League (Eastern Division) at the request of the Director of Finance of the City of Philadelphia. The Director of Finance asked the Economy League to study "the alternatives for levying a municipal service charge for requesting a payment in lieu of taxes from institutions whose property is currently tax exempt."

The Economy League agreed to undertake a study which would be strictly analytical and factual, and would contain no recommendations.

The report includes the following sections:

1. Review of legal base for tax exemption, including any legislation on the topic introduced in the state legislature.
2. Statistics on taxable and tax exempt valuations.
3. Survey of practices in other municipalities as to payments by tax exempt institutions for municipal services.
4. Review of state programs for payments in lieu of taxes, to determine if they provide any guidelines for local programs.
5. Review of federal programs for payments to local government, as possible source of guidelines for local programs.
6. Analysis of major municipal functions to determine which ones provide direct services to institutions and what bases are available for allocating costs or benefits among users.
7. Testing financial implications of various alternatives for Philadelphia.
8. Summary presentation of arguments for and against payments by tax exempt institutions for municipal services.

The staff principal for this study was Senior Research Associate Edgar Rosenthal. Valuable assistance was provided by Beth Morss, a student intern, and Research Associate Marjorie L. Jacob.

Edwin Rothman  
Director

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## 1. LEGAL BASE FOR TAX EXEMPTION

The purpose of this section is to give a brief overview of the legal base for tax exemptions in Philadelphia. A detailed examination of the legal base is beyond the scope of this study.

This section turns first to the Pennsylvania constitution, and then to the statutes implementing the constitutional provisions regarding exemptions of real estate from taxation. It then reviews bills currently before the Pennsylvania General Assembly on this subject and also reviews the question of whether tax-exempt institutions are liable for paying local taxes other than real estate.

### Constitutional Provision

Tax exemption in Philadelphia, as in the remainder of Pennsylvania, is controlled by the state constitution and laws. The state constitution itself exempts only one category of property--the residences of certain needy, disabled veterans\*--and empowers the General Assembly to exempt certain classes of property by general law (Pennsylvania Constitution, Article VIII, Section 2). According to the constitution (Article VIII, Section 5), any law purporting to exempt any property other than the enumerated classes is void.

The reason for this constitutional restriction on the power to grant tax exemptions was that exemptions had run rampant under prior Pennsylvania constitutions which did not include any restrictions on exemptions. Many acts dealing with specific nonprofit corporations included sections

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\* Honorably discharged veterans who served in any war or armed conflict, if, as the result of military service, they are blind, paraplegic, double or quadruple amputees or 100% disabled, and if the State Veterans' Commission determines that they are in need of the tax exemption.

exempting the corporation's property from taxation.\*

In Article VIII, Section 2, the Pennsylvania Constitution provides that the "General Assembly may by law exempt from taxation" five classes of property:

- (i) Actual places of regularly stated religious worship;
- (ii) Actual places of burial, when used or held by a person or organization deriving no private or corporate profit therefrom and no substantial part of whose activity consists of selling personal property in connection therewith;
- (iii) That portion of public property which is actually and regularly used for public purposes;
- (iv) That portion of the property owned and occupied by any branch, post or camp of honorably discharged servicemen or servicewomen which is actually and regularly used for benevolent, charitable or patriotic purposes; and
- (v) Institutions of purely public charity, but in the case of any real property tax exemption only that portion of real property of such institution which is actually and regularly used for the purposes of the institution.

Moreover, the General Assembly may, by general law:

1. Set up standards for private forest reserves and agricultural land and make special provisions for their taxation.
2. Establish as a class or classes of subjects of taxation the property or privileges of persons who, because of age, disability, infirmity, or poverty are deemed in need of tax exemption.
3. Establish standards by which local taxing authorities may make uniform tax provisions for a limited time to encourage improvement of deteriorating property areas.
4. Make special tax provisions, not to exceed two years, on any increase in value of real estate resulting from residential construction.

In Article VIII, Section 4, the constitution makes real property of public utilities taxable. However, the article also provides that the

\* See Northampton County v. Lehigh Coal and Navigation Company, 75 Pa. 461, 1874, at 463. The court states in Donohugh's Appeal (86 Pa. 306, 1878) that the primary purpose of the constitution was to restrict exemptions by special acts; the secondary purpose was to limit the type of exemptions. The court noted that between 1850 and 1873, 130 special acts had been passed providing for tax exemption for specific institutions.

Commonwealth will distribute in lieu payments to local governments for public utility realty taxes, based on payments to the Commonwealth of gross receipts taxes or other special taxes by the utilities.

#### Statutory Provisions

The statutes exempting properties from taxation, pursuant to the Pennsylvania Constitution, were consolidated in the general assessment law.\* This law, as amended, established 12 classes of exempt property, expanding upon the framework of the five classes listed in the constitution.

#### Listing of Exempt Property

The following is a listing of the 12 classes of property exempted "from all county, city, borough, town, township, road, poor and school tax." These are listed here in abbreviated form; the full legal definition in the statute is more elaborate and often circumscribes the conditions of exemption in some detail.

1. Churches.
2. Nonprofit cemeteries.
3. Hospitals, universities, colleges, seminaries, and institutions of learning, benevolence or charity, founded, endowed and maintained by public or private charity.
4. Public schools.
5. Courthouses, jails or poor houses.
6. Public parks.
7. All other public property used for public purposes.
8. Veterans' posts.
9. Institutions of purely public charity.
10. Playgrounds founded, endowed or maintained by public or private charity.
11. Public libraries.
12. Nonprofit public libraries, museums, art galleries, or concert music halls.

\* Act of May 22, 1933, P.L. 853, Section 204, as amended, 72 P.S. sec. 5020-204.

### Restrictions on Revenue-Producing Property

Under certain conditions, a property may lose its exemption if the property is revenue producing. The relevant clause of the assessment

law reads:

"Except as otherwise provided in clause (11) (pertaining to public libraries), all property real or personal, other than that which is actually and regularly used and occupied for the purposes specified in this section, and all such property from which any income or revenue is derived, other than from recipients of the bounty of the institution or charity, shall be subject to taxation except where otherwise exempted by law for State purposes, and nothing herein contained shall exempt same therefrom."

This is a sweeping statement which would make taxable any property from which any income is derived (except in the case of a charity, income from recipients of the bounty of the charity), regardless of the amount. However, the courts have construed the clause to mean generally that the exemption is not lost if some revenue is obtained when using property directly for the purposes of the institution.

### Bills Before the Pennsylvania General Assembly

Senate Bill No. 315, Session of 1981, was introduced into the Pennsylvania Senate on February 10, 1981. If enacted into law, the bill would provide for a municipal service charge on nongovernmental tax-exempt property, (Nongovernmental tax-exempt property consists largely of schools, hospitals, and churches.)

According to the bill:

The "municipal service charge" is the charge authorized by this act to be imposed by municipalities on otherwise tax-exempt property within their jurisdiction.

". . . . A municipal service charge . . . is hereby levied on the assessed value of all tax-exempt property in the Commonwealth. . . . The municipal service charge shall be payable to the municipality in which the real property is located and shall be credited to the municipality's general fund. Revenues from the municipal service charge shall be used by the municipality to offset its expenses in providing municipal services.

"The municipal service charge . . . shall be levied annually at a rate to be determined by the governing body of the municipality; however, such rate shall not exceed 25% of the tax liability of the assessed property if it were taxable.

". . . All tax-exempt property shall be annually assessed in the same manner as is taxable property in the various counties of the Commonwealth.

"No property shall be exempt from the municipal service charge unless a tax-exempt certificate has been issued (annually) for such property."

According to the sponsor of Senate Bill 315 (Sen. Frank O'Connell), "everything would be included except buildings actually used as churches and primary and secondary schools. The concept is that they would pay a service charge in lieu of taxes."\*

As of the end of January 1982, no action on this bill was scheduled by the General Assembly. A similar bill was also introduced in the Pennsylvania House of Representatives in 1981.

### Must Tax-Exempt Institutions Pay Local Taxes Other Than Real Estate?

The question arose in a Pittsburgh case whether the institutions which are exempt from real estate taxes are also exempt from other local taxes.

In 1968, the City of Pittsburgh enacted an "Institution and Service Privilege Tax Ordinance" (under Act 511, the "tax anything" law). The ordinance, which levied a tax at the rate of 6 mills on each dollar of gross income, applied to hospitals, nursing homes, colleges, universities, schools other than elementary or secondary schools, and other nongovernmental institutions which provide services to the public. The ordinance carried this definition:

"Service: Carrying on or exercising within the City of Pittsburgh medical, educational, social, recreational, vocational, or any other type of service for which a charge is collected. Service shall not include those services which are given free and without fee to the general public or part thereof."

\*The Times Leader, Wilkes-Barre, December 1, 1981.

The ordinance became known as the "sick tax" and was promptly challenged in the courts.

In a case involving hospitals, a lower court said that the tax could not be applied against institutions of "purely public charity."

"While permitting the imposition by certain municipalities of a privilege tax upon non-profit institutions does not specifically exempt from the tax public charities, it must be so interpreted, and the ordinance of the city of Pittsburgh imposing the institution and service privilege tax adopted pursuant to the act is invalid and unenforceable against all institutions of purely public charity in areas incidental to their charitable purposes." (emphasis supplied) (Appeal of Hospital Council of Western Pennsylvania, 118 P.L.J. (5, 1969.)

The lower court opinion was sustained by the Pennsylvania Supreme Court (439 Pa. 295, 1970).

Thus, without specific statutory authority, Pennsylvania municipalities cannot apply non-real estate taxes to institutions whose property is tax exempt.\*

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\*An excellent study of the problem of tax exemption (The Free List, by Alfred Balk, The Russell Sage Foundation, 1971) mentions Pittsburgh's imposition of the "sick tax." Many subsequent studies of tax exemption refer to the Pittsburgh tax, citing Balk. Unfortunately, the Balk study went to press before the Pennsylvania courts overturned the application of the tax to tax-exempt charities.

## 2. VALUATION OF EXEMPT REALTY IN PHILADELPHIA

For 1982, exempt realty in Philadelphia was valued at \$2.75 billion by the Board of Revision of Taxes, or 31.9% of all valuations.

### Major Categories of Exempt Realty

Table 1 shows the valuation of exempt realty in Philadelphia in 1982, based upon the classification of the Board of Revision of Taxes. (The board codes 26 classes of property separately; we have reduced these to 21 classes, by combining various railroads, transit, and public utility properties under the one class "public utility.")

About 60% of exempt property in Philadelphia is government owned. The largest holder is the city itself with approximately \$654 million or 24% of all tax-exempt property. The school district and federal government own \$308 million and \$296 million of exempt properties, occupying second and third positions respectively. They are followed in turn by the state, the Housing Authority, the Redevelopment Authority, miscellaneous authorities, and the Housing Development Corporation.

Three categories account for most non-governmental exempt property: institutions of learning (\$269 million, or 10% of all tax-exempt property); hospitals (\$243 million); and churches (\$229 million). (The church category includes many parochial schools.) These are followed by "miscellaneous exempt properties," public utilities, cemeteries, museums and libraries, veteran's posts and disabled veteran's residences.

The types of properties included in each of these categories are generally evident from the designations. The "miscellaneous exempt properties" category includes YMCA's, settlement houses, homes for the aged, recreation centers

Table 1. Tax-exempt realty in Philadelphia, by category: January 25, 1982

<u>Governmental</u>	<u>Valuation (millions)</u>	<u>Percentage of total</u>
1. Federal	\$295.5	10.7%
2. State	216.9	7.9
3. City	653.5	23.7
4. School district	307.6	11.2
5. Housing authority	113.5	4.1
6. Redevelopment authority	37.5	1.4
7. Housing development corporation	3.8	.1
8. Philadelphia authority for indus. develop.	9.0	.3
9. Miscellaneous authorities	19.9	.7
Subtotal	1,657.2	60.2
<u>Nongovernmental</u>		
10. Churches	229.0	8.3
11. Cemeteries	9.0	.3
12. Museums, libraries, art galleries	7.2	.3
13. Institutions of learning	268.7	9.8
14. Hospitals	243.3	8.8
15. Disabled veterans' spec.	.6	-
16. Veterans' posts	2.2	.1
17. Public utilities (a)	75.2	2.7
18. Miscellaneous exempt property	90.4	3.3
19. Others	.2	-
Subtotal	925.8	33.6
<u>Temporary exemptions (b)</u>		
20. Industrial, commercial improvements	169.5	6.2
21. Residential improvements	.1	-
Subtotal	169.6	6.2
Grand Total	\$2,752.6	100.0%

(a) Railroad corporations (Penn Central, R.R. not Penn Central, SEPTA), public utilities, Bell Telephone, and Philadelphia Electric are included under the heading "public utilities."

(b) Temporary exemptions include: (1) industrial and commercial improvements exempted under a 1978 ordinance (Bill No. 1130) providing relief from real estate taxes on improvements to industrial, commercial or other business properties for a period of five years and (2) residential exemptions, under a 1974 ordinance, providing relief for limited improvements for five years on a reducing sliding scale.

(other than governmental), and all other exempt non-governmental properties which do not fall in any of the other categories. The "hospitals" category includes diagnostic and treatment centers in addition to hospitals. Some institutions which do not have any students (e.g., the College of Physicians) are included in the "institutions of learning" category.

Finally, there are the temporary exemptions of private property. Under a 1978 ordinance, industrial and commercial improvements are exempt from real estate taxes for five years. In 1982, nearly \$170 million of real estate was exempted by this provision. Under another ordinance, certain residential improvements are exempted for five years on a sliding scale (100% exempt the first year, 80% the second, etc). Exemptions under this provision totalled less than \$100,000 in 1982.\*

#### A Comparison For 11 Years

Between 1971 and 1982, the valuation of tax-exempt realty increased from \$1,794.3 million to \$2,752.6 million, an increase of \$958 million or 53%. Table 2 compares 1971 and 1982 valuations of tax-exempt realty by major category.

Valuations of government property increased \$450.7 million or 37%. The largest percentage increase--96%--was recorded for property of the Commonwealth of Pennsylvania, which increased in valuation by \$106.2 million. (The large increase in state government tax-exempt property was not confined to the years 1971 to 1982, however. During the previous decade (1960-1971) a percentage increase of 224% in valuation of state government property was recorded.) The Redevelopment Authority and Housing Development Corporation experienced a decrease in total tax-exempt valuation of 35% and 3% respectively.

\*The temporary exemption ordinances are found in Sections 19-1303(2) and 19-1303(3) of the Philadelphia Code.



Table 2. A comparison of tax-exempt realty in Philadelphia, by category:  
1971 and 1982

	Valuations		Increase	
	1971	1982	1982 over 1971	
	\$Millions	\$Millions	\$Millions	Percent
<u>Government</u>				
Federal	228.4	295.5	67.1	29.4
State	110.7	216.9	106.2	95.9
City	449.1	653.5	204.4	45.5
School district	228.4	307.6	79.2	34.7
Housing authority	106.3	113.5	7.2	6.8
Redevelop. authority	57.9	37.5	-20.4	-35.2
Housing develop. corp.	3.9	3.8	-.1	-2.6
Phila. authority for indus. devel.	-	9.0	9.0	NA
Miscel. authorities	21.8	19.9	-1.9	8.7
Subtotal	1,206.5	1,657.2	450.7	37.4
<u>Nongovernmental</u>				
Churches	161.0	229.0	68.0	42.2
Cemeteries	7.5	9.0	1.5	20.0
Museums, libraries, etc.	32.8	7.2	-25.6	-78.1
Inst. of learning	156.2	268.7	112.5	72.0
Hospitals	129.7	243.3	113.6	87.6
Disabled veter.	.2	.6	.4	200.0
Veterans posts	1.7	2.2	.5	29.4
Public utilities	54.6	75.2	20.6	37.7
Misc. exempt property	44.1	90.6	46.5	105.4
Subtotal	587.8	925.8	338.0	57.5
<u>Temporary exemptions</u>				
Industrial, commercial, residential improvements	-	169.6	169.6	NA
Total	1,794.3	2,752.6	958.3	53.4

Valuations of nongovernmental exempt property increased by \$338 million or 58% during the 11-year period. Major increases were recorded for hospitals (\$113.6 million), institutions of learning (\$112.5 million) and churches (\$68.0 million). The assessed valuation of tax-exempt property owned by museums and libraries, meanwhile, decreased from \$32.8 million in 1971 to \$7.2 million in 1982.

The temporary exemption program did not exist in 1971.

The growth of the tax-exempt and taxable valuation between 1971 and 1982 is summarized below.

	Assessed value		
	1971	1982	Percent increase
Taxable	\$4,787	\$5,868	22.6%
Tax exempt	1,794	2,753*	53.4%
Total	\$6,581	\$8,621	31.0%
Tax exempt as % of total	27.3	31.9	

#### Impact of Tax-exempt Nongovernmental Property

The fact that certain nongovernmental property is tax exempt increases the tax burden on the taxable sector. In Fiscal 1982, for example, the city's real estate tax rate was 3.475% of assessed value. If the \$926 million of nongovernment assessed valuation were taxable, the tax rate could have been reduced by about 14%--or to a rate of 3.0%, to raise the same real estate revenues.

\*Part of the increase in tax exemption reflects the impact of the ordinance providing for 5-year exemptions for improvements to certain properties. If these are excluded, 1982 exemptions amount to \$2,583 million, or a 44% increase over 1971.

3. PRACTICES OF LARGE CITIES AS TO  
PAYMENTS BY NONPROFIT CHARITABLE  
INSTITUTIONS FOR MUNICIPAL SERVICES

The Pennsylvania Economy League made a brief survey of other large cities as to payments by nonprofit tax-exempt institutions for municipal services. Included were questions regarding rates for utility services; the use of service charges for other municipal services (e.g., police, fire, street); and any programs for payments in lieu of taxes.

Municipal Utility Service Charges

The most common type of municipal service charges are for utility-type services such as water and sewer services. Philadelphia gives reduced water and sewer rates to institutions--a 25% reduction is given to universities, colleges and hospitals; and a 50% reduction for water and a 20% reduction for sewer charges is given to public and private schools, churches, and charities.\*

The Philadelphia practice of reductions is in the minority among the large cities surveyed, as shown in Table 3. Chicago exempts institutions which are tax exempt, from water and sewer charges. The New York City response indicated that some tax-exempt institutions pay the full amount and some do not. In the remaining cities, tax exempt institutions paid the going rate.

Other Payments by Tax-Exempt Institutions for Municipal Service

The Economy League survey sought information from large cities on any other payments by tax-exempt institutions for municipal services. Such payments were reported in Boston and Detroit based on newly started programs.

\*Philadelphia Water Regulation No. 62 (effective July 1, 1981), except that the 50% reduction in water rates for public and private schools, churches, etc. will become effective July 1, 1982.

Sewer rates vary in relation to meter size. The amount indicated above is based on the smallest size meter.

Table 3. Practices as to payments by tax exempt institutions for water and sewer services in large cities: January 1982

City	Payment practice applying to tax-exempt institution
Baltimore	Full rate
Boston	Full rate
Chicago	Exempt
Cleveland	Full rate
Houston	Full rate
Indianapolis	Full rate
Los Angeles	Full rate
New York	Some pay full rate, some don't
Philadelphia	Reduced rate
St. Louis	* Full rate

\* Sewer services in St. Louis are the responsibility of the Metropolitan St. Louis Sewer District. Tax-exempt institutions are required to pay its sewer service fees and benefit assessment but not its small property tax.

Source: Responses by citizen-sponsored organizations in the respective cities to questionnaire of Pennsylvania Economy League.

## Boston

In early 1982, Boston imposed an "Augmented Fire Service Availability Charge" applicable to both taxable and exempt property. The charge was a fee for the stand-by capacity to suppress fires in buildings beyond a defined basic and normal level of service. The estimated yield was \$15.7 million per year, with tax-exempt institutions paying 36% of the total. However, the charge was struck down by the courts as a tax which Boston did not have the power to impose without legislative authorization.

## Detroit

In 1980, Detroit imposed special charges for defined police and fire services for certain cultural institutions. The city police department established a "cultural center detail" of 18 police officers (presumably, an additional detail) to serve the Historical Museum, Detroit Art Institute, and the main branch of the Detroit Public Library. The costs are allocated among the institutions based on 1979 attendance levels. In addition, Detroit charges the Art Institute for fire protection based on the value of the structure and contents.

### Benefit Assessments for Municipal Operating Costs

A way for a municipality to have tax-exempt institutions pay a share of municipal services costs is to impose benefit assessments for operating costs. In Pennsylvania, benefit assessments are used only for capital improvements--such as curbs, street paving--which are charged to all property owners including tax-exempt ones. However, California and Ohio permit the use of benefit assessments for operating costs.

### California Special Benefit Assessments

The passage of Proposition 13 by the California voters in 1978 has spurred the search by local governments for alternative sources of revenue not based

on the property tax. One approach has been the use of benefit assessments to finance services and maintenance of facilities. This contrasts with the traditional use of benefit assessments for capital improvements benefiting property.\*

Legislation passed in 1979-80 permits the use of benefit assessments to finance police and fire protection, street lighting, and flood control facilities. Under the 1979-80 legislation, the use of benefit assessments for police or fire services required two-thirds voter approval; flood control and street lighting required majority approval. Later legislation regarding special assessments for fire services permits the local legislative body to levy the assessments without a referendum; however, if 5% of the voters petition, the special assessment must be approved by majority vote in a referendum.

The legislation does not spell out the basis for the special assessment, but the basis may not be the assessed value of property. The assessments must be related in amount to the service's benefit to each parcel of property.

Benefit assessments were also authorized by the County Service Areas Law enacted in the early 1950's, in order to extend governmental services to unincorporated areas. Services which may be financed by benefit assessments include water, sewer, pest and rodent control, street and highway sweeping and lighting, refuse collection, and transportation. In 1981, there were 742 county service areas statewide. San Diego County uses these extensively, and the special districts administering the function quantify the benefit to properties from each service, in order to establish equitable assessments.

Under the California law, special assessments are payable by all property

\*"Benefit Assessments: A Born Again Revenue Raiser," Cal-Tax Research Bulletin, June 1981. Telephone interview, 2/16/82, with California County Supervisors Association.

owners, including owners of property exempt from real estate taxation (with exception of the Federal government).

#### Ohio Benefits Assessments

In Ohio, state law permits the use of special operating assessments for street lighting, tree care, snow removal, street cleaning and general street maintenance. The cost of the service is computed, and all properties, tax-exempt and nontax-exempt alike, are charged on a front footage basis. Though many cities in Ohio have reportedly dropped special assessments due to administrative costs, at least two--Toledo and Cuyahoga Falls--use them as a source of operating revenue.\*

Toledo uses benefit assessments, allocated on the basis of street frontage, for street cleaning, snow removal, street lighting, and tree care.\*\* The amount of charge is shown in the tax bill for taxable property, and in a special bill for tax-exempt property, two years after the services were performed. For example, charges for 1980 benefits would be shown in the 1982 tax bill. To provide operating cash in the meantime, Toledo issues two-year revenue anticipation notes.

#### Voluntary Payments By Colleges and Universities

Many colleges and universities voluntarily make in-lieu of tax payments to universities for services provided. However, the Economy League survey (cited earlier) of larger municipalities, reported in-lieu payments by colleges and universities in only one city.# A survey conducted during the late 1960's indicated that Seattle is the only large city which receives in-lieu

\*Questionnaire completed by Cleveland Governmental Research Institute.

\*\*Telephone interview with Frank Britt, Toledo Area Governmental Research Association, February, 1982.

#In Boston, two educational institutions, N.E. School of Law (\$13,125) and Suffolk University (\$454,395) made in-lieu payments in 1981, according to the questionnaire completed by the Boston Research Bureau. Also payments may be made in the form of services, such as free tuition for a number of Boston public school graduates.

payments from a university, in this case, the University of Washington.\*

For those municipalities which do receive money from either a college or university, the method of payment varies considerably. Occasionally, lump sum payments are made to the city's general fund; more often, however, the university makes payments to the city for a special service such as police and fire protection or sanitation.

In 1928, Harvard University and Massachusetts Institute of Technology signed an agreement with the City of Cambridge. Under that agreement, the university consented to pay the city at the current rate of taxation applied to the assessed value of all newly acquired land. (Buildings were not included in the agreement.) The agreement was renewed in 1949 for another 20 years, but starting in 1968, agreements have been made annually. In 1971, payments under the agreement were about \$333,000. A new formula was used in 1972, which brought payments to about \$600,000; a revised formula for 1973--based on a payment per square foot of land--was anticipated to yield \$1,000,000.\*\*

Similarly, Princeton University donates a flat sum to the town of Princeton on an annual basis. The university, in addition, pays full taxes on faculty housing, the university stadium and theater and 5000 off-street parking spaces.\*\*\* Other colleges and universities have similar types of arrangements with the municipalities in which they are located. The amounts involved range from several thousand to well over one million dollars.

\*Alfred Balk, The Free List: Property Without Taxes (The Russell Sage Foundation, 1971) p. 171.

\*\*Charles R. Lavery, Jr., and Rudolph R. Russo, "Developing a Progressive In-Lieu Payments Program for Exempt Property in Cambridge," The International Assessor, February 1975, p. 22.

\*\*\*Balk, p. 120.

Though payment is ordinarily in the form of a negotiated cash sum, occasionally a university will contribute to the municipality through partial funding of a specific project, if that project is seen to be of particular benefit to the university. The University of Toledo, for example, paid over 30% of the costs of street improvements in the university area. The total amount of those improvements was well over \$2,200,000, the university's share, \$697,000.\* Chapel Hill, North Carolina is a particularly interesting example of a university contribution toward municipal services. The University of North Carolina owns and operates Chapel Hill's water, power, light and telephone systems. The university contributes 55% toward operating costs, the town, 45%. Police and fire costs are similarly distributed between the university and town. These figures correspond roughly to the relative populations of the two.\*\*

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\*Ibid; p. 171.

\*\*Roy H. Owsley and Pauline Maris Mayo, College and University Tax and "In Lieu" Payments to Municipalities (Chicago: American Municipal Association, 1948), p. 4.

#### 4. STATE PROGRAMS FOR PAYMENTS IN LIEU OF TAXES

At least four states have programs for payments in lieu of property taxes on state-owned property. The states are Connecticut, Michigan, New Jersey, and Wisconsin. All base their payment formulas on the assessed value of state-owned property, but they differ on how this is applied to calculate each municipality's share.

Connecticut also makes in-lieu payments to municipalities on account of tax-exempt property of colleges and hospitals.

New York and Virginia gave municipalities the option of imposing special service charges, measured by the value of property valuation, upon tax-exempt properties. However, New York repealed its plan before it was implemented.

The purpose of this section is to present information on these programs and particularly to review the standards or bases for such in-lieu payments, in the hope that they can provide useful guidelines for local programs.

##### New Jersey In-Lieu Payments

New Jersey's program for state in-lieu payments to municipalities on account of state property was enacted in 1977.

The payments are based on the assessed value of the state property, as determined by the local assessor. Excluded is state-owned property used, or held for future use, for highway, bridge, or tunnel purposes. The amount paid to each municipality is 25% of the "local purpose" tax rate, that is, the municipal tax rate excluding county and school taxes. According to the director of the Division of Taxation, "valuation of state-owned property according to the same standard applicable to taxable

property has proved to be a realistic basis for determining state aid payments."\*

Information is not indicated in the literature on the program as to why the 25% figure (25% of local tax rate) was chosen.

#### Wisconsin In-Lieu Payments

The state of Wisconsin has, since 1973, made in lieu of tax payments to local governments which have state owned property within their boundaries. Payments are restricted to payments for police and fire protection and solid waste disposal. The Payments for Municipal Service (PMS) program "recognizes that property taxes in some communities are inflated because essential services have to be provided to tax-exempt state property."\*\* In 1974, the PMS program made over \$3.7 million of payments to communities in an attempt to lessen the fiscal burden of state properties.

The program contains three basic elements: "(1) the actual net cost of a local service must be determined; (2) the portion of the cost paid out of net property taxes must be determined; (3) the State pays its proportionate share of service function cost attributable to the net local property tax as defined." The precise amount is calculated as follows:

1. The total amount of direct federal and state aid, local charges, and subsidies directly related to the municipal function (e.g., police operations) is subtracted from the gross operating cost of the function to determine the net operating cost.
2. The net operating cost is further reduced by the percentage attributable to state and federal revenue sharing. This determines the adjusted net cost theoretically attributable to the local property tax.
3. The adjusted net cost is then multiplied by the ratio of the estimated full value of state buildings and improvements to the total full value of all improved property in the municipality.\*\*\*

\* Sidney Glaser, "In Lieu Payments--New Jersey's Program," New Jersey Municipalities, January 1981, p. 39.

\*\* Patrick J. Lucey, "State Payments for Municipal Services," State Government (Autumn, 1975), p. 220.

\*\*\* Ibid, p. 223.

In summary, the Wisconsin in-lieu payments use real property valuations multiplied by the local real property tax rate for the three covered functions--police, fire, and solid waste disposal.

#### Connecticut In-Lieu Payments

A similar program compensating local governments for state-owned property has existed in Connecticut for many years. Every jurisdiction containing state property receives a minimum payment of \$2,000. The amount then increases with the size of state holdings. No payment may exceed \$600,000. The size of the state's contribution, however, is based on the following formula.

The ratio of a community's property taxes collected to the total amount of property taxes collected state-wide is determined. Once determined, this fraction is multiplied by the value of the state-owned property located in the community. The resultant dollar figure is then multiplied by ten times the local mill rate.\*

In 1978, the payment program was extended to include private colleges and general hospitals. Under the terms of the new arrangement, the state pays municipalities "twenty-five percent of the property taxes which . . . would have been paid with respect to such exempt property on the assessment list . . . ."\*\* During the first year of the program the state appropriated \$10 million to fund reimbursements.

#### Michigan In-Lieu Payments

Michigan makes a payment to municipalities on account of fire protection for state-owned properties. The program became effective in 1978.

\* Michael A. Segan, Tax Exempt Real Property in Pennsylvania (Harrisburg, PA: Local Government Commission, 1979), p. 48.

\*\* Substitute Bill 5997, LCO No. 3176, General Assembly, February 1978. In Greater Hartford Chamber of Commerce, Property Tax Exemptions for Non-Profit Institutions (Hartford: 1978) p. 29.

The amount of payment is based, in effect, by determining the millage rate for fire protection and applying that rate to the valuation of state properties. Payments are not made to municipalities if the amount of payment is less than \$500, or if state property equals less than 1% of property value in the municipality, or if the state facility provides its own fire protection.\*

#### Virginia Local Enabling Act

In 1971, the Virginia General Assembly passed legislation which allows municipalities to impose service charges for police and fire protection and sanitation on both public and private tax-exempt properties.\*\* (Religious property is excluded.) The law includes a provision giving localities the right to exempt properties from the service charge "at their discretion." Local governments have taken full advantage of this option. "Private exempt properties have generally been able to convince the municipalities to release them from the requirements of paying the service charge."# As a result, the state has been, for the most part, the only owner of tax-exempt property forced to pay the service charge.

The service charge is determined by dividing the amount of expenditures for police and fire protection and for collection and disposal of refuse by the assessed value of all real estate in the community, including nontaxable property. The mill rate thus determined is levied against the value of those exempt properties on which the local government wishes to levy the charge. However, the charge may not exceed 20% of the local real-estate-tax rate.

\*Michigan Statutes Annotated, Cumulative Supplement, Section 4.208(1) ff.

\*\*Kenneth T. Palmer and Roger W. Shin, "Compensatory Payment Plans in the State" State Government (Autumn 1975), p. 216.

#Segan, p. 49.

#### New York Local Enabling Act

In 1971, the New York state legislature enacted a law whereby municipalities would be permitted to charge certain types of tax-exempt properties for municipal services such as police and fire protection, street maintenance and sanitation. Properties affected totalled only 21.5% of all exempt property, with state-owned properties comprising the largest share. Specifically exempt from the law were all institutions established for religious, educational or charitable purposes.

The service charge was to be based "upon the ratio of net costs of chargeable services . . . to the net cost of all municipal services, excluding those for which a special ad valorem levy or special assessment is imposed."\* That percentage would be then multiplied by the municipal tax rate to give the service charge rate, which would then be applied to the assessed valuation of real property subject to service charges.

The law was never implemented; every year the legislature postponed its effective date due to unresolved conceptual and practical problems. In particular, many believed that "the service charge mechanism . . . is a tax and has no relationship to services actually rendered to exempt property."\*\* Certain tax-exempt properties might therefore bear a greater percentage of the burden than is justified. In addition, though a majority of towns in New York state would have been affected by the law, most would not have benefitted appreciably from its implementation. These and other problems led the state legislature eventually to repeal the law.

\* New York Legislative Commission on Expenditure Review, The Optional Service Charges Law, 1977, p. 15.

\*\*Ibid., p. 23.

5. FEDERAL PAYMENTS TO LOCAL GOVERNMENT  
ON ACCOUNT OF FEDERALLY OWNED PROPERTY

Federal government property is "immune" from taxation by state or local governments, unless the federal government gives its consent to taxation. Several programs for federal payments in lieu of taxes have been enacted over the years, and others have been discussed. The purpose of this section is to review the existing and recommended programs, as possible source of guidelines which might be relevant to the topic of payments by nongovernmental tax-exempt institutions for local government services. This section relies heavily on a recent report of the Advisory Commission on Intergovernmental Relations entitled Payments in Lieu of Taxes on Federal Real Property.\*

The federal government is the single largest owner of real property in the United States. Current estimates suggest that 775.3 million acres of real property (or more than one third of the nation's entire land area) are federally owned. In addition, the federal government owns billions of dollars worth of buildings and facilities. In 1978, U.S. real property was valued at \$279 billion, 23% in land, 53% in buildings, and 24% in structures and facilities.

Obviously, the presence of federal property reduces the amount of taxable property within a state. At the same time, state and local governments will ordinarily be providing services such as police and fire protection and road maintenance to federally owned properties.

\* The Commission, Washington, D.C., September 1981, Report No. A-90.

Types of Federal Programs

Three major categories of federal payments to local governments can currently be identified: revenue or receipt-sharing payment programs; payment in lieu of taxes programs (PILOT); and formula-based programs.

Revenue or Receipt Sharing

Revenue or receipt sharing programs are the oldest form of federal compensation in the United States. A certain percentage of a land fund or a resource fund is allocated to the jurisdictions where the lands are located, were recovered or were used. The percentages range from 10% to 90% of gross program receipts.

Payment in Lieu of Tax (PILOT) Programs

The federal government's payment in lieu of taxes program consists of 18 separate programs. Of the programs, 11 distribute funds on a fixed-sum basis; three provide for full tax equivalency; and four provide for partial tax-equivalent payments related to the value of the tax-exempt property. Full or partial payments are based on the amount of taxes which normally would be collected were the property fully taxable in private ownership.

The federal Department of Housing and Urban Development, for example, pays local governments based on the normal valuation of properties acquired by the department due to foreclosures. The Department of Agriculture pays 75% of the appraised value of certain forest lands. In most cases, this type of partial payment to a jurisdiction is based either on the ratio of federal to total real property value or on the percentage of federal to total land.

Under fixed sum and partial tax equivalency programs, the amount of payment is, in general, arbitrarily determined "with no firm conceptual basis." Possible guidelines are therefore few. In addition, some federal payment in lieu of taxes



programs apply to expanses of unimproved land or major federal projects such as dams and river basin projects.

#### Formula-Based Programs

The federal government's formula-based programs represent a third form of compensatory payment. Within this broad category several types of payment can be identified: fixed fee per acre of government-owned land; fixed fee per federal employee; cost-of-service computations; and various grants for community assistance for certain local governments that are burdened with large amounts of capital expenditures due to rapidly expanding activities and service requirements on tax-exempt government lands.

The most comprehensive of these programs compensate localities based on the amount of federal land within their jurisdiction.

The federal Education Impact Aid program, the nation's largest compensatory payment program, is unique in that it provides payment on a per-employee basis. The federal government compensates school districts for the number of school children living on a federal installation whose parents are employed there.

A number of federal programs compensate jurisdictions on a cost-of-service basis, reimbursing them for the additional operating costs brought about by the presence of federal properties. Such payments may be made either in the form of general contributions to revenue "for extra services rendered," as is the case with the Tennessee Valley Authority, or they may be specific contributions. (The Bureau of Land Management makes payments to several jurisdictions for law enforcement services.)

A common and distinctive feature of formula programs is their negotiated payment character: they typically do not reflect a sophisticated cost analysis nor do they purport to fully reimburse localities for community services. Instead, they represent a series of payments to help defray local government costs. More important, perhaps, is the abandonment of the property-related basis

for payment. As a result, a property-based compensatory payment becomes a form of intergovernmental transfer or grant, unrelated to its legislative intent as an in lieu payment.\*

#### ACIR-Recommended Program

Authorization for either full real property taxation of the federal government or a full tax equivalency system of payments in lieu of real property taxes is an appropriate policy response to the status quo, the Advisory Commission on Intergovernmental Relations (ACIR) decided.\*\*

According to the ACIR, this federal payment, whether it is a grant or a tax payment, can be absorbed into local revenue structures as easily as are present property tax revenues. The enactment of a comprehensive uniform PILOT should replace several of the existing ad hoc federal payment programs. the ACIR said.

\*Ibid, p. 14.

\*\* Ibid, p. 16.

6. PAYMENTS FOR MUNICIPAL SERVICES  
PROVIDED TO TAX-EXEMPT INSTITUTIONS

As pointed out in the introduction, the purpose of this report is to be analytical and factual; the report deals only with the pros and cons of alternative financing methods and the report makes no recommendation.

The purpose of this section is to examine Philadelphia's municipal services financed from the General Fund to determine (a) which ones are of direct service to tax-exempt institutions, and (b) what bases are available for allocating the costs among various users. The listing of these bases in the discussion does not mean that the Pennsylvania Economy League recommends any of these. (The final section of this report--Section 8--summarizes arguments for and against any type of payment for municipal services by tax-exempt institutions.)

Which Services Are of Direct Benefit

From the broadest perspective, it may be argued that all local government services are of benefit to nonprofit institutions, because all the local government services play a part in producing an environment in which the nonprofit institutions can operate successfully. Thus, from this broad perspective, it would not be logical to try to determine whether one or another service is of greater benefit to such institutions.

From another, perhaps narrower, perspective, there may be some municipal services which are of direct benefit to the institutions, while others are of no direct benefit.

The classification of functions in the city's budget presentation may provide an initial basis for identifying the services of direct benefit to institutions.

The Philadelphia budget document includes a classification into nine "programs." Eight of these are direct services; the ninth is general management and support, which includes activities required for the maintenance of city government as well as pension, employee welfare, and debt service costs of all programs.

One of the programs is designated service to property, and would therefore appear to be of direct benefit to institutions in their capacity as property owners. Included in the program are activities of the fire protection, water, and streets sanitation function (which includes refuse collection, refuse disposal, and street cleaning). However, large institutions (and large commercial, industrial, and apartment properties) do not receive refuse collection services. Therefore, it is necessary to go beyond the several program structures to identify the items of direct benefit to institutions.

Table 4 is a PEL classification of city functions, within the program structure, identifying those which are, and are not, of direct benefit to institutions as property owners, employers, or enterprises. The classification is based on judgment; one conceptual guideline was: would there be incremental costs for the particular service if a large tract, located outside city boundaries and utilized only by tax-exempt institutions, were annexed to the city?

Table 4 deals only with services financed by the city's general fund, the only fund in the city's budget structure financed from local tax revenues. However, the general fund is also financed from local nontax revenues such as existing fees and charges, as well as intergovernmental revenues. Table 4 identifies separately functions of direct benefit to institutions, if the function is now financed from fees or charges. Obviously, if a function is currently

Table 4. Division of principal Philadelphia general fund functions between those of direct benefit and those not of direct benefit to institutions

Program and function	Direct benefit to institutions		
	Tax supported function	Now financed from fees or charges	Not of direct benefit to institutions
	(1)	(2)	(3)
<u>Services to property program</u>			
Collection and disposal of refuse			x (a)
Street cleaning	x		
Snow removal	x		
Fire department	x		
<u>Transportation program</u>			
Police traffic safety	x		
Street design, construction, maintenance	x		
Street lighting	x		
Street traffic engineering	x		
Transit subsidy and planning	x		
<u>Judiciary and law enforcement program</u>			
Police department	x		
Welfare department--care of delinquent children and criminally insane	x		
Philadelphia prisons	x		
Director of finance, defender and court fees	x		
Youth study center	x		
Clerk of quarter sessions	x		
Register of wills		x	
District attorney	x		
Sheriff	x		
Municipal court	x	x(b)	x
Common pleas court	x	x(b)	
<u>Economic development program</u>			
Department of commerce			x
Philadelphia civic center			x
<u>Conservation of health program</u>			
Management of air resources		x(c)	
Control of environmental hazards		x(c)	
Other department of health functions			x
<u>Housing and neighborhood development program</u>			
Welfare--relocation of families			x
Dept of L & I--general support		x(c)	
City planning			x

(a) City does not collect refuse from large institutions.

(b) Civil courts, which may be of direct benefit to the institutions, are financed at least in part from fees.

(c) Aspects of these functions of benefit to institutions are financed from fees; other aspects are tax supported.

Table 4. Division of general fund functions--continued

Program and function	Direct benefit to institutions		Not of direct benefit to institutions
	Tax supported function	Now financed from fees or charges	
	(1)	(2)	
<u>Cultural and recreational program</u>			
Department of recreation			x
Fairmount park commission			x
Free library of Philadelphia			x
<u>Improvement of general welfare program</u>			
Department of public welfare			x
Department of L & I, licensing		x	
Department of L & I code enforcement		x	
Community college grant			x
<u>General management and support program</u>			

(Generally, functions and costs should be allocated to the above programs)

financed from user charges (payable by both tax-exempt and taxable property owners), there is no point to discussing alternative ways of allocating the costs among beneficiaries.

#### Allocation Bases

Tax-financed services which appear to be of direct benefit to institutions in their roles as property owners, employers, or enterprises are, of course, also of benefit to other property owners, employers, or enterprises, and also to individuals. Therefore, it is necessary to find bases for allocating the costs among the various beneficiaries.

The following reviews the basis which might be used for allocating the costs of each of the services of direct benefit to institutions.

#### Street Cleaning

An appropriate unit for allocating street cleaning costs would be front footage of property. This would have to be weighted by a factor to account for frequency of cleaning on that particular street--such as daily, twice weekly, weekly, or less frequent interval.

The practice of Toledo, Ohio cited earlier of assessing property for the cost of street cleaning is an application of this approach to financing street cleaning costs. All property owners, including tax-exempt institutions, are assessed for the cost of street cleaning.

#### Snow Removal

Some of the costs of snow plowing and removal could also be charged to the abutting property owner on a front footage basis. Toledo provides an example of the use of benefit assessments for charging snow plowing to abutting property on the basis of front footage.

The appropriateness of charging snow plowing and removal costs to the abutting owner would depend on the type of street. In many cases, snow plowing is concentrated on the main arteries. In that case, there are two beneficiaries--the abutting owners and the through traffic, and the costs should be allocated between the two. In case of local streets, the full cost could be allocated to the abutting owner.

#### Street Lighting

Street lighting may be considered of primary benefit to the abutting property owner, although there may be arguments that the lighting also benefits the travellers through the area, both pedestrian and motorist.

In any event, California and Ohio permit assessment of operating costs of streetlighting to owners of the abutting property. Toledo, Ohio and Riverside, California are examples of municipalities charging abutting owners on a front footage basis.

If street lights are uniformly placed, a uniform front footage figure would be appropriate. Otherwise, to be equitable the front footage charge should vary by street, depending on the spacing and types of lights and their operating costs.

#### Street Maintenance

State gasoline tax funds returned to municipalities pay for a portion of the cost of street construction and maintenance in Pennsylvania. However, in

Philadelphia's case such funds do not pay the full costs, and some local tax funds are required to supplement the gasoline tax funds.

It could be argued that it would be appropriate to allocate the local tax fund cost to the direct beneficiaries. In the case of a local service street, this would be the abutting property owner, and the benefit could be measured by front footage. In the case of feeder roads and major arteries, the benefits are shared between the abutting property owner and the general transportation network. The possibility of allocating general transportation costs among various users is discussed below.

#### Street Trees

Street trees are of particular benefit to the abutting owner. Often, original planting is paid by the abutting owner; street tree maintenance by the municipality.

In the Toledo, Ohio example, municipal costs for street trees are charged on a front footage basis to the abutting owners.

#### Other Transportation Functions

Other transportation functions financed from local tax revenues are traffic engineering, police traffic control, and transit service and subsidy.\*

On the one hand, it may be argued that these transportation functions benefit the public at large, and that they should continue to be financed from general tax revenues. On the other hand, it could be argued that various users benefit in different amounts, and that it would be equitable to allocate the costs among users in relation to benefits.

Undoubtedly, it would require development of data for the purpose of allocating benefits. One possible source would be surveys on the number of trips generated by various land uses, and whether the trips were by automobile, surface

\*Hanover Park, Illinois imposes a fee upon commercial business to pay part of the operating costs of traffic signals which are of benefit to the businesses. Municipal Finance Officers Association, Newsletter, February 16, 1982, p. 16.

transit, rail transit, etc. A cruder allocation would first allocate transportation costs between work, school, and other purpose trips and then allocate the portion attributable to work trips in accordance with number of workers at various locations.

No examples of comprehensive transportation charges were found in the review of the literature. San Francisco had instituted a charge based on square footage of downtown office space for payment of transit costs.#

#### Fire Protection

Fire protection is a function primarily of benefit to property, although lives often are at stake. There are different ways of allocating the fire protection costs among the beneficiaries.

If the allocation is based upon benefits, the value of the improvements would be a measure, although the value of the contents might not be directly in proportion to the value of the improvements.

If the allocation is based on costs, several measures have been suggested. One is front footage or square footage, a measure of the distance factor which is used to determine the distribution of fire stations to meet minimum response time standards. William Vickrey has suggested front footage as the best measure for allocating fire protection costs.\*

Another possible allocation would be derived from the incidence of fires in relation to different types of structures and the existence of prevention measures (e.g., sprinklers). An example of such a system is that employed by the City of Inglewood, California, where the charge system for the fire depart-

#Cal Tax, p. 5.

\*William Vickrey, "General and Specific Financing of Urban Services," in Public Expenditure Decisions in the Urban Community, Howard G. Schaller, ed., (Resources for the Future, 1963), p. 64.

ment is based on the relative fire risk of each structure and the water, personnel, and equipment that would be required to extinguish a major fire.\*

A third possible allocator of costs would take the height as well as the value (or square footage) of the property into account. An increase of height above a standard level imposes marginal costs upon the fire department both for equipment and additional water pressure requirements. Boston is an example where the marginal costs, beyond a standard height, were to be charged to the beneficiaries (including tax-exempt institutions).

#### Law Enforcement, Including Judiciary

The most costly service of benefit to institutions is law enforcement, which includes, in this analysis, not only police service but also prosecution, detention, court, and related services.

A review of the available literature did not indicate any examples of attempts to allocate the total cost of law enforcement among the beneficiaries. Theoretically, such an allocation might be based on studies of the incidence of reported crime for various types of property use (e.g., residential, commercial, industrial, institutional) as related to the square footage of the property.

A less ambitious allocation would focus on police patrol costs only. For these, front footage might be an appropriate allocator, modified, as necessary, if different patrol frequencies apply to different property types. In California, operating benefit assessments may be used for police costs, with the costs allocated on measures other than assessed value of real estate.

Also, it might be possible to identify and charge for incremental costs of police service to particular institutions. The Detroit charges for the cultural center police patrol are an example.

\* Illinois Department of Commerce and Community Affairs, User Charges--An Overlooked Revenue Source (Springfield: The Department, October 1991).

#### Functions Now Financed By Fees and Charges

Excluded from the discussion have been a number of functions of Philadelphia's general fund which are of direct benefit to institutions, but which are now financed from fees and charges. Examples are the building inspection functions of the Department of Licenses and Inspections and environmental health inspections of the Health Department. The City of Philadelphia establishes fees for these functions to equal the costs. In some cases, apparently there is a waiver of fees for certain nonprofit institutional users.

## 7. FINANCIAL IMPLICATION OF ALTERNATIVES FOR PHILADELPHIA

The review of practices elsewhere indicates that there are two main approaches to having tax-exempt institutions pay for municipal services: (a) the use of service charges, benefit assessments, or the like, applicable to all property owners (whether or not tax-exempt) and (b) the use of an in-lieu tax payment, applicable only to tax-exempt property. The previous section (Section 6) reviewed some of the factors that might be used for allocating services among various users. This section tests some of the alternative practices to determine if data are available to apply to the Philadelphia situation, and where data are available, make some "order of magnitude" estimates of their financial impact.

The arguments for and against payments by institutions for municipal services are in the final section (Section 8) of this report.

### If Service or Benefit Charges Were Made for Specific Services

As discussed in Section 6, benefit or service charges could be developed for a number of tax-supported services of direct benefit to tax-exempt institutions. Presumably, the city would institute a charge applicable to all property owners, whether taxable or exempt. (Further research would have to be done to determine whether such a charge would apply to federal government properties.)

In this manner, the tax-exempt institution would pay its share of the cost of the municipal service. What would be the impact of such a charge on taxable property owners? There are several possibilities. One is that the property owners would also directly pay the charge for the service. In order that their payments to municipal government would not increase, the city would have to reduce the tax rate. For example, the city would reduce its tax levy by the amount paid in new service charges

by the taxable property owners, and reduce the tax millage rate accordingly. For example, if presently taxable property owners paid \$20 million annually for a service, tax millage could be reduced by approximately 4 mills.

Another possibility is that the property owner could use the service charge as a credit against his tax liability or, conversely, use the real estate tax as a credit against his service charge liability. If the latter, then the service charge would have to be paid as such only if the service charge exceeded the tax liability. Under either of the crediting methods, the service charge and real estate tax would be shown together on the tax bill, with the property owner liable only for the net amount after the credit. The PEL has not explored the legal questions regarding the crediting approach. No precedent for the crediting approach was found in the literature on service charges.

### Availability of Data Necessary for Estimate

As a basis for allocating costs or benefits, Section 6 discussed front footage, traffic counts, and various other direct measures relating to the use, supply, or benefit of a service. However, none of these measures is readily available for the purpose of developing firm fiscal estimates.

Front footage figures are undoubtedly included among the data developed to prepare real estate assessments; however, they are not available in summary form. Perhaps such data are available in the records of the Streets Department; this would require further review.

The only readily available figures for tax-exempt property are the assessed valuations, divided between land and improvements (e.g., buildings).

Allocation of fire benefits by building valuations. One measure suggested in Section 6 for allocating the benefits of fire protection was the

valuation of the improvements. The discussion below illustrates how such a base can be used to estimate the order of magnitude of a benefit or service charge.

First, it is necessary to determine the total cost of fire protection. For fiscal 1981, total obligations of the Fire Department in the general fund were \$59.8 million. However, this is not the total cost of fire protection since it does not include employee benefits, facility or equipment costs budgeted to other departments, nor allocation of general management and support or debt service.

Based on the relationship of employee benefits to personal services in the general fund, a crude measure of employee benefit costs is 31% of personal services. When this is added, Fire Department costs including employee benefits become \$77.8 million.

To arrive at the net tax-supported cost of fire protection, it would be necessary to add costs for facilities, equipment, general management and support and to subtract the Fire Department's share of general revenue sharing and other nontax revenues, such as the utility tax refund, liquor licenses, and interest earnings. The result would be the net tax-supported cost. Such computations are outside the scope of this report, which is intended only to illustrate the approach which might be applicable.

Let us assume for illustration that the net tax-supported cost of fire protection is \$78 million, and that it is desired to compute a fire benefit charge, with the measure of the benefit being assessments of improvements. For 1982, Philadelphia's total assessment of improvements--both taxable and exempt--was \$6,519 million. Dividing the assessment into the assumed

cost of \$78 million, one obtains a service charge of 12 mills on the assessed value of improvements. If this approach were used, how much would tax-exempt institutions pay? Based on their assessments of improvements, the figure would be about \$8.4 million. This is only a preliminary "order of magnitude" figure, for illustrative purposes.

The above calculations assume that the total tax-supported cost is allocated. An alternative would be to allocate only the portion of the cost which is supported from the property tax.\* In Philadelphia in fiscal 1981, the real-property tax accounted for 23% of tax revenue. Thus, of the above-assumed \$78 million expenditure for fire protection, only \$18 million (23%) is the property-tax-supported cost. When this is allocated to beneficiaries in accordance with assessments of improvements (\$6,519 million), the service charge would be 2.8 mills on each property's improvement valuation.

In summary, the only measure readily available for allocating costs among users is the assessed value of improvements, which some suggest as appropriate for allocating fire protection costs. Illustrations were developed indicating the magnitude of a fire protection charge, allocating either total tax-supported costs or only property-tax-supported costs, on the basis of valuation of improvements. However, as noted in Section 6, some believe that other bases, such as square footage or front footage, would be better allocation measures. Unfortunately, these measures were not available to prepare an illustration.

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\* This technique is suggested in James E. Kaldy, "A Service Charge Model for Tax Exempt Property," The International Assessor, January 1975, p. 2.



If There Were An In-Lieu-of-Tax Charge  
For Services of Benefit to Institutions

The alternative to service charges for individual functions benefiting institutions is a single in-lieu-of-tax charge for all of the functions benefiting the institutions. Philadelphia would need enabling legislation to implement such a charge.

Presumably, the in-lieu payments should be equal to the product of the institution's assessed value multiplied by a percentage of the regular municipal tax rate. The question is: How can an equitable percentage be determined?

There are several possible approaches. Method A would be based on the percentage relationship of the net cost of services of direct benefit to institutions to the net cost of all tax-supported municipal services.

Method B would take the results of Method A as a starting point, and then attempt to ascertain the proportion of each service which should be allocated to tax-exempt institutions.

Method A--Net Tax Cost of Direct Benefit Functions

After the services of direct benefit to institutions are identified (e.g., see Table 4), several steps would be required to calculate the net tax-supported costs of such service as a percentage of net tax-supported costs for all city functions. These steps are:

1. Tabulate departmental and functional expenditures, divided between those functions of direct benefit to institutions and other functions.
2. Add to the above costs an appropriate allocation for the cost of general management and support functions, employee benefits, and debt service, to determine gross costs of all services.
3. Subtract from the above costs the categorical grants and local nontax revenues applicable to each function, to determine net tax costs of all services.
4. Calculate net costs of functions of direct benefit to institutions as a percentage of total net tax costs.

Table 5 is a pro forma illustration of the results of the methodology, applied on a preliminary basis to figures for fiscal 1981 shown in available published documents.

As indicated in the table, functions of direct benefit to institutions account for 75% of the net tax-supported cost of all city service functions (excluding management and support functions). If only the departmental costs were used in the calculations without the other adjustments, the percentage would be 63%. (See lines 1a and 10.)

These are rough figures, presented for illustrative purposes. But they do indicate that the tax-supported costs of services of direct benefit to institutions greatly exceed the 20% to 25% limit placed on in-lieu payments in the few states that have such payments (as discussed earlier).

There are several possible reasons for the difference. One reason is that the PEL tabulation (Table 4) identified more than the police, fire, and sanitation services cited several times in the other state programs as the items of direct benefit to the tax-exempt property in question (state property generally). The additional items are a matter of judgment, and the listing could be modified. Perhaps the most borderline item is judiciary, prosecution and detention, all part of law enforcement. If police services are provided to institutions, the cited services would come into the picture once an arrest was made. But some might consider these as "general public good services" which should not be allocated back to the police activity which generates them.

The transit subsidy is included by the PEL as of direct benefit to the employees and users of the institutional services; again some might want to assign the service to "the general public good."

Table 5. Pro forma illustration of proportion of tax-supported budget devoted to functions of benefit to institutions: based on estimated figures for fiscal 1981

(dollar amounts in millions)

	Functions of direct benefit	Other functions <sup>b.</sup>	Total
1. Total departmental costs	\$438	\$262	\$700
1a. Percentage distributions	63%	37%	100%
2. <u>Plus</u> estimated fringe benefit costs	<u>\$104</u>	<u>\$ 35</u>	<u>\$139</u>
3. Subtotal	<u>\$542</u>	<u>\$297</u>	<u>\$839</u>
3a. Percentage distribution of subtotal	65%	35%	100%
4. Allocation of general management and support	a	a	a
5. Allocation of debt service	a	a	a
6. Total costs	\$542	\$297	\$839
<u>less revenues applying to the functions</u>			
7. Categorical grants applying to the functions	\$ 15	\$102	\$117
8. Local nontax revenues applying to functions	<u>5</u>	<u>22</u>	<u>27</u>
9. Net cost	\$522	\$173	\$695
10. Percentage distribution of net costs	75%	25%	100%

a. Data were not available to make this allocation. In effect, by omitting the figures, it is assumed that the items on lines 4 and 5 were distributed in the same proportion as figures on line 3.

b. Excluding general management and support functions.

Source: Computed from financial reports and budgets for fiscal 1981.

Method B--Allocation of Net Tax Cost

The 75% figure calculated under Method A assumes that the assessed value of property is the proper allocator of the benefit of the services among the various users. However, as shown in Section 6, assessed value of property is not a good measure of benefit (or cost) of services, except perhaps for fire protection.

Method B would use the net tax cost as established in Method A and then, for each function, allocate the proportion that is of benefit to institutions. However, as noted previously in this section, the kind of measures needed for such an allocation--front footage of various types of property, traffic generated from various types of property, incidence of crime by various types of property--are not available. Thus, at this stage, it is not possible to estimate the tax equivalent rate which would be applicable as the basis for an in-lieu-of-tax payment under Method B.\*

\* A 1967 Pennsylvania Economy League report on this topic made some rough arbitrary allocations for illustrative purposes. The result of this rough methodology was that cost of services of benefit to property equalled 30% of the net cost of all tax-supported services. The Problem of Tax-Exempt Property in Philadelphia: Report No. 2, Revenue Producing Property of Educational Institutions and Other Charitable Institutions (Report No. 344, 1967), p. 37.

8. ARGUMENTS FOR AND AGAINST PAYMENTS BY TAX-EXEMPT INSTITUTIONS FOR MUNICIPAL SERVICES

All of the states have property tax exemptions for nonprofit religious, charitable and educational institutions of various kinds. The reasoning for the exemptions is twofold: First, is the view that some of these institutions are assuming a burden that government would otherwise have to undertake, such as health care. Second, is the view that the exempt institution is performing humanitarian, cultural and socially desirable activities that government should encourage, even if the government would not or could not be forced to assume the burden of carrying out the activity.

From the institution's point of view, whether a payment to the municipality is called a tax or a service charge, it reduces the resources available for the institution's service, and may force cutbacks in such services or increases in fees. The latter course may mean that some clientele can no longer afford the service or the institution may go bankrupt, if fees cannot be raised.

From the municipality's point of view, it is argued that municipalities can no longer afford to bear the cost of providing services to such institutions. Also, a service charge paid by the institution for municipal services is a cost which the institution should pay in the same manner that it pays for other costs--such as materials and supplies which the institution purchases. Private suppliers of goods and services do not provide their items free to charitable institutions, neither should or can local government.

Appropriateness of Charges

There are arguments whether service charges for any type of property owner (taxable and nontaxable) are appropriate for municipal services other than those which have measurable products, such as water supply.

The California Commission on Governmental Reform in a 1979 report stated that local governments should consider "adoption of user fees and service charges where a group of beneficiaries from a specific service can be identified, the costs of service can be determined, and the service is not found to be of general community-wide benefit."\* (Emphasis supplied.)

On the above criteria, service charges for police, fire, or transportation services would not be appropriate, because these are of general community benefit; any allocation to individual properties would be artificial and arbitrary.\*\*

Moreover, user charges are said to be efficient resources allocators if the beneficiary of the service can make a choice as to the quantity of the service to use, and can therefore reduce costs if necessary by reducing the quantity utilized.

On the other hand, the advocates of service charge for such items as police and fire protection would argue that these charges are desirable as a way to make tax-exempt institutions pay their share of the costs. Moreover, some of the charges could induce efforts to encourage reduced demand for the municipal services. For example, charges for fire service could provide a reduction for fireproof construction, sprinklers, or other fire prevention measures, and surcharges for higher risks. Police service charges could be reduced if the institution provides its own police patrol, or undertakes various measures to reduce the incidence of burglary and larceny.

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\*Illinois Department of Commerce and Community Affairs, User Charges--an Overlooked Revenue Source (Springfield: the Department, October 1981), p. 1.

\*\*The appropriateness of user charges based on public/private service continuum is discussed in Patrick C. Glisson and Stephen H. Holley, "Developing Local Government User Charges: Technical and Policy Considerations," Governmental Finance, March 1982, p. 3.

### Federal Income Tax Deduction

Property taxes are deductible on the federal income-tax return. Thus, for property taxpayers who itemize, the gross municipal tax is reduced by a cut in the federal income-tax liability.

User charges are not deductible on the federal income-tax return. Thus, if the city shifted from a tax to a user charge basis for a service, a reduction in the tax rate made possible if revenues are received from tax-exempt institutions may be offset for some homeowners by additional federal income-tax liability.

However, if the service charges are viewed as "benefit assessment," they may be considered taxes, and thus may be deductible in computing the federal tax liability.\*

### Summary of Specific Arguments

The following summarizes the more specific arguments which may be raised for and against service charges or other payments by tax-exempt institutions for municipal services.\*\*

#### Cost v. Benefits

Pro exemption. Benefits provided by the tax-exempt institutions exceed the additional (or incremental) costs of providing municipal services to the institutions. Not only do institutions relieve government of the burden for providing services themselves but also the institutions bring economic benefits to the community. The competition among local governments for tax-exempt federal facilities is another indication that tax-exempt institutions are a net gain for the locality.

\*"Benefit Assessments: A Born Again Revenue Raiser," Cal-Tax Research Bulletin, June 1981, p. 5.

\*\*The appendix contains a brief listing of selected references on arguments for and against tax exemption of institutional property and the merits of service charges.

In the case of Philadelphia, which relies heavily on the wage tax, the wage-tax receipts from the institution's employees may very well exceed the incremental costs of municipal service.

Con exemption. The costs of municipal service to the institution are paid by the other taxpayers in the municipality; the benefits accrue to a much wider area. Even if the benefits throughout the wider area exceed the costs, this is not true in the municipality where the tax-exempt property is located. For example, a hospital or a university may provide health, educational, and economic benefits to a wide area; however, the costs of providing municipal services are limited to the municipality.

Further, even if, in the Philadelphia example, wage-tax receipts from employees exceed incremental costs of service, this is not a proper comparison. Costs of service should be allocated on an average cost, not an incremental cost basis.

#### Payments by Similar Institutions

Pro exemption. In the case of private taxable entities, the valuation of real property is a measure (albeit imperfect) of ability to pay. For a charitable tax-exempt institution, valuation of property does not measure ability to pay. Any payment to the municipality will reduce the services that the institution is able to offer.

Con exemption. Similar institutions which are privately owned, and therefore taxable, generate real-property-tax revenue in addition to wage-tax revenue.

### Invisible Subsidy

Pro exemption. If it is admitted that the real estate tax exemption is a governmental subsidy, this subsidy has the advantage of low visibility. It is a certain subsidy, which does not require any lobbying effort on the part of the institution, since the subsidy never appears in a state or local budget. This type of subsidy permits the institution to operate without political interference or political considerations in its actions. Elimination of tax exemption, or the imposition of service charges, would force the institutions into the political arena at budget time.

Con exemption. There is ordinarily no reasoned relationship between the size of the subsidy occasioned by tax exemption and the value of the benefits generated by the institution. If government wishes to support a function or service, it should make annual direct budgetary appropriations, based on a defensible rationale. The certainty which is cited by the proponents of exemption is a defect; it means that the purpose served is not reviewed periodically, nor the costs of the exemption weighed against alternative uses of the public funds.

### Valuation of Exempt Property

Pro exemption. Much of the property used by tax-exempt institutions is useful only for the purposes of the tax-exempt institutions; therefore it is not possible to place a market value on the property which is comparable to the market value used as the basis for setting the assessments of taxable property.

Con exemption. Although the properties of institutions may differ in some respects from other properties, there are techniques available for assessing such properties on a comparable basis with other nonresidential properties.

### Appendix

#### SELECTED REFERENCES ON ARGUMENTS FOR AND AGAINST TAX EXEMPTION OF INSTITUTIONAL PROPERTY

- Advisory Commission on Intergovernmental Relations, Local Revenue Diversification: Income, Sales Taxes and User Charges (Washington, D.C.: The Commission, October 1974), pp. 63-77.
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- Gabler, Richard L. and John Shannon, The Exemption of Religious, Educational and Charitable Institutions from Property Taxation (Washington, D.C.: Advisory Commission on Intergovernmental Relations, 1975), pp. 13-22.
- Hummer, Charles D., Payments in Lieu of Taxes: An Intergovernmental Issue (Harrisburg: Pennsylvania Intergovernmental Council, October 1981), pp. 2-8.
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- Quigley, John M. and Roger W. Schmenner, "Property Tax Exemption and Public Policy," Public Policy, Summer 1975, pp. 272-278.
- Segan, Michael A., Tax-Exempt Real Property in Pennsylvania (Harrisburg: Local Government Commission, February 1979), pp. 7-13.
- Note: A comprehensive bibliography on this subject is Stuart W. Miller, compiler, Property Tax Exemptions and In Lieu Payments (Chicago: International Association of Assessing Officers, August 1980), 30 pp.