October 30, 2013 Meeting of the Nonprofit Tax Review Task Force
Summary
(Prepared by the Maine Municipal Association)

Members present:

Sawin Millett, Chair, Commissioner of the Department of Administrative and Financial Services
Rep. Gary Knight (Livermore Falls)
Sen. Patrick Flood (Kennebec Cty.)
Rep. Mike Carey (Lewiston)
Brenda Peluso (Director of Policy, Maine Association of Nonprofits)
Joe Grube (Assessor, City of Lewiston)
Jim Libby (Academic Dean, Thomas College)

Members absent:

Arthur Blank (CEO, Mt. Desert Island Hospital)
Sen. Rebecca Millett (Cumberland Cty.)

Introductions and overview. Commissioner Millett opened the meeting by asking for introductions around the horseshoe. In general, members spoke of the challenge and complexities of the charge given to the Task Force which requires balancing the broad tax exemptions that are provided to certain nonprofit organizations against the pressure on local governments to provide services to all constituencies with limited tax resources.

The Commissioner then provided a review of Part AA of the state budget that created the Task Force, including:

- A requirement that the Task Force conduct its first meeting no later than September 1, (noting the significant delay in getting started);
- The principle charge, which is to "*evaluate the feasibility and desirability of identifying parameters and a process for imposing a temporary assessment on certain nonprofit organizations that will generate approximately $100,000,000 in revenue annually*", (noting the inherent flexibilities strung throughout the sentence in such words as "feasibility", "desirability", "parameters", "temporary", "certain", and "approximately");
- The direction to examine the practices used in other state and municipal tax jurisdictions to elicit contributions from tax exempt institutions; and

- The so-called "1-5" list under the principle charge, directing the Task Force to identify:
  - The nonprofit institutions that should be made subject to a tax;
  - The method of determining the value of those institutions for taxation purposes;
  - The appropriate tax levy;
  - The method of crediting against the tax levy any contributions voluntarily made by the tax exempt institutions; and
  - How to transfer the state-collected revenue to the municipalities.

The Task Force recommendations are to be reported to both the Taxation Committee and the Appropriations Committee by December 1, 2013, and the Appropriations Committee is authorized to implement the recommendations through legislation.

Presentation by Nonprofits. Task Force member Brenda Peluso provided a 40-minute overview of nonprofit organizations in Maine, including the demographics of nonprofits, the history and rationale for their tax exempt status, the economic impact of nonprofits on the state's economy, the nonprofits' sources of revenue, and the current state or financial status of nonprofit organizations. Much of the material used in the presentation is contained in a January 2013 publication entitled The Maine Nonprofit Sector Impact (link provided below) published by the Maine Association of Nonprofits, the Maine Community Foundation and the Unity Foundation. (http://www.nonprofitmaine.org/wp-content/uploads/2013/01/P-in-P-Full-color.pdf)

In summary, Ms. Peluso's presentation included the following:

- Nonprofits perform functions that governments don't or won't perform. Nonprofits are community-based vehicles for civic engagement, and generally smaller and therefore more flexible than governments.
- There are "public benefit" nonprofits (hospitals, educational institutions, animal shelters, etc.) and "mutual benefit" nonprofits (e.g., homeowners' associations), with the obvious focus of this Task Force on the public benefit nonprofits.
- For IRS purposes, the public benefit nonprofits fall into the "public charities" category (actual service providers) or "private foundation" category (philanthropic).
- There are approximately 6,000 public charity nonprofits in Maine. Approximately 2,600 of that total receive income over the respective $5,000 and $50,000 levels

to be required to file a “990” form with the IRS. Filers of the 990 form with income greater than $50,000 have to provide detailed financial data to the IRS.

- According to a survey conducted by the Maine Association of Nonprofits, with 109 respondents, “many” nonprofits provide Payments in Lieu of Taxes (PILOTs) or Services in Lieu of Taxes (SILOTs) to their host communities.
- Nonprofits earn their tax exemption by foregoing profits, political influence, private benefits, and privacy with respect to the management of their income. They are duty-bound to promote the public good and their contributions reduce the cost of government.
- The nonprofits maintain that case law has established that the concept of nonprofits reducing the cost of government does not necessarily mean the cost of the local government where the nonprofit may be located, but “government” in a larger sense. They also maintain that case law provides that the service a nonprofit may be providing does not have to be a service the government would actually provide in the nonprofit’s absence.
- On a nationwide basis, the number of nonprofit organizations in Maine is above average, but similar to other geographically large, rural states.
- Nonprofit organizations employ approximately 86,000 employees, or 15% of the state’s workforce. The largest category of nonprofit employer, with 37% of all nonprofit employees, are hospitals.
- There is no general rule regarding sources of revenue for nonprofits. Religious nonprofits tend to obtain funding from individual and foundation sources. Human service nonprofits get a much larger share from government sources. Higher education nonprofits receive a large share of funding from private fees and tuitions.
- Typically, the larger the nonprofit organizations, the larger share of government subsidy. [*MANP NOTE: We would not categorize government funds as subsidy – these are payments for services rendered.*]
- Foundation giving in Maine is relatively low compared to other states. Individual contributions to nonprofits is low in terms of dollars but middle of the pack in terms of percent of income. [*MANP NOTE: Middle of the New England pack – very low relative to the entire country.]*
- Surveys of nonprofits show that most are experiencing an increase in demand for services with roughly half of those respondents unable to meet the increased demand. About 30% of survey respondents just broke even in recent years, and another 30% are experiencing revenue-to-expenditure deficits.

Questions from Task Force members after the presentation focused on what information sources were available that could identify the value of the nonprofits’ assets and whether there was any hard data on the PILOTs that are actually provided by the nonprofits in Maine.

Maine Revenue Services presentations. Three Maine Revenue Services employees provided the Task Force with information about the taxation of nonprofit organizations under Maine's current tax code.

Income taxation. Two handouts were provided during the income tax presentation: a listing published by IRS of the various tax exempt categories, and the IRS 990 form, which calls for detailed income information and must be submitted to the IRS for any filing over certain income thresholds. The thrust of the presentation was that, in general, Maine's treatment of nonprofit organizations builds off the federal income tax code. There is no separate Maine version of the 990 form. Tax exempt nonprofits that earn or receive taxable "unrelated business income" and file accordingly with the IRS must also file for tax treatment at the state level with respect to that non-exempt income.

Questions from the Task Force after the presentation focused on what elements of the information provided on the 990 form could help identify a nonprofit's capacity to make a contribution to the provision of governmental services. For example, could the 990 data be searched or stratified to profile nonprofits individually or in categories to determine (1) their asset value, (2) the margin of their income-to-expenditure information, and/or (3) staff compensation profiles that might reasonably identify a capacity to pay?

Property taxation. Three handouts were provided for the property taxation presentation, including the statutes governing the tax exemption for non-governmental institutions (36 MRSA, section 652) and the "service charge" authority (36 MRSA, section 508), a 2008 working group report (attached to this email) on the development of a more comprehensive "service charge" approach, and the 2012 Municipal Valuation Return Statistical Summary, which tabulates the value of exempt property, by category and by municipality, as those values are determined on the local level.

Each category of exempt property ("benevolent and charitable", "literary and scientific", fraternal, etc.) was briefly reviewed, with references made to the statewide value of the exempt category (e.g., $2.5 billion of charitable property, $1.86 billion of "literary and scientific" property, etc.).

The presentation included a discussion of the expansion to the veterans' organization exemption enacted several years ago that allows areas of the veterans' halls to be exempt even though not exclusively related to meetings, ceremonials and instructions, provided those additional areas of the facilities are used to further the charitable activities of the organization (e.g., generate income used for the veterans' organization's purpose).

Questions were also asked about how municipal assessors determine if the compensation received by the directors and other staff of a non-profit organization fall within the "reasonable" category. Are seven-figure salaries "reasonable"?

The "service charge' statute (section 508) was also reviewed, and the structural difference between PILOTs (purely voluntary) and "service charges" (enforceable levies, but calculated according to actual cost of governmental service) was discussed, as was the fact that the current service charge statute is so narrowly focused on certain low income rental properties that it is not useable in most municipalities.

A question was asked about property taxation policy in Maine's Constitution, and the constitutional provision was discussed that requires all property taxes to be assessed and apportioned equally, according to "just value".

Sales taxation. The presentation on the sales tax exemptions provided to nonprofit institutions included a review of the pertinent statute (36 MRSA, section 1760), which includes over 90 listed categories of exemption, at least a half-dozen of which pertain to nonprofit organizations (e.g., subsections 16, 17, 18, 18-A, 28, 42, etc.). Task Force members were provided the so-called "Red Book", which identifies all the state's "tax expenditures", including the nonprofits' sales tax exemptions, and attempts to ascribe a value of foregone tax revenue to each category. The system of providing and managing the tax exempt certificates was discussed, as was the point that all the retail purchases made by the tax exempt institutions have to be for products pertinent to the exempt institution's purpose or mission in order to be legitimately exempt.

Questions after the presentation included whether it would be legitimate, legally, for a state to provide an income and sales tax exemption to a nonprofit organization but not a property tax exemption, or some other mix of exemption and non-exemption among the major tax categories. The general answer to that question was yes.

MMA presentation. The Task Force entertained a brief presentation by MMA, which involved the distribution of responses to a 2013 survey MMA conducted among the municipal leagues throughout the U.S. in an effort to assist the Task Force in the part of its charge to "*consider how other cities and states treat nonprofit organizations for purposes of service charges, payments in lieu of taxes and property taxes"*. The handout included the responses from 20 state leagues describing the tax exempt policies in those states, and providing the pertinent statutory language or guidance documents related to those states' programs. Task Force members were invited to review that material at their leisure. In summary, the material suggests the structure and scope of tax exempt policy in

Maine is not that dissimilar from the other respondent states, with some variation in (e.g.) Connecticut, California, Pennsylvania (at least formerly), etc. MMA explained that one of its goals in providing the information is to assist in completing the "other state practices" element of the statutory charge to allow Task Force members to focus in the short time remaining on the rest of the task before them.

Conclusion. Future meeting dates were discussed. Task Force members seemed to agree that their work could be accomplished in three more meetings, and four potential dates for those meetings were laid on the table, with all potential meetings being held from 1:00 – 4:00 p.m.

- Thursday, November 7th
- Friday, November 15th
- Wednesday, November 20th
- Monday, November 25th

All Task Force members, including those absent from today's meeting, will be polled to determine the best three dates to convene.

As to the focus of the next meeting, it was agreed that Maine Revenue Services would assemble some data for the Task Force to review that should assist with the directive to determine which nonprofits have the capacity to contribute to public charges and how those charges should be structured. Stratified information from 990 forms, Maine-based information from IRS sources, and the National Center for Nonprofit Statistics were all identified as possible resources, and it was suggested that an experienced tax lawyer for nonprofit organizations might be able to frame the methodology to determine fiscal capacity-to-contribute based on the nonprofit's publicly-reported financial data.

Task Force members also discussed the underlying goal of Part AA of the state budget, and whether it was to generate revenue to solve a state budget problem or get at the more localized, municipally-based issue of concentrated nonprofit organizations in service center communities with limited tax bases.

The discussion concluded with the observation that the purpose of Part AA began with the former (a need for revenue to balance a state budget) but has appropriately evolved to the latter (the opportunity to get inside the issue of the nonprofit's capacity to contribute to public charges), primarily because the state budget revenue relief was provided in a different way (temporary two-year increases to sales tax rates).

It was generally agreed that the statutory charge to the Task Force contained enough flexibility of language to allow a recommendation to be developed that addressed the public policy issues somewhat differently than may have been envisioned when the Task Force charge was written.