The Finances of Nonprofits and Public Policy:
What Do We Need to Know – and Change – to Do Better?

A report from ARNOVA’s Symposium held in June 2011 with leading scholars, practice-leaders, policy makers and regulators who are experts on the nonprofit sector and public policy. The report describes the questions, discussions, and findings of their examination of the challenges now facing nonprofits in the realm of public policy, especially as they pertain to the financing of nonprofits presently and in the future. The report outlines an agenda for research needed to develop a better understanding these challenges and issues.
The Financing of Nonprofits and Public Policy: What Do We Need to Know – and Change – to Do Better?

A Report on the Proceedings & Findings of ARNOVA’s 2nd Symposium on Nonprofits & Public Policy

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The Financing of Nonprofits and Public Policy: What Do We Need to Know – and Change – to Do Better?

An Executive Summary & Invitation

Why Read this Report?

Nonprofit organizations in the U.S., particularly public charities, now confront difficulties more severe than any seen for decades. There are many reasons for this. Even before the recent “Great Recession” began, growing social problems, changing perspectives on the roles of charities, and mounting challenges in public finances were creating a context in which both aspirations for and concerns about nonprofit organizations were rising. In this context the financial challenges they face are especially daunting.

A few nonprofits have suffered scandals and occasional failures to fulfill their missions in recent years. But many provide critically important services in, and most provide some measure of valued benefits to, their communities. Most charities serve individuals and public needs in the communities where they work with care and passion for their missions, and so many are held in high esteem.

Now, however, nonprofits often find themselves severely stressed not only by increased demands for their services which are occurring simultaneously with shrinking resources, but also by changes in the public policy environment which shapes and generally has supported their work. That environment is evolving in ways that are exacerbating their difficulties.

The Symposium this report describes was convened in recognition of just how important public policy is in both shaping the roles and behaviors of nonprofits and supporting or undermining their abilities to serve their clients or patrons and the wider public in fulfillment of their missions. The participants in the Symposium – nonprofit leaders, policy makers and regulators, and scholars of nonprofits – gathered to ask, “What policy issues are most critical to nonprofits now, especially as they pertain to the financing of nonprofits?” In addition, they sought to identify where and how policies are being made or changed on the basis of inadequate information or incorrect assumptions; and then they began to frame a research agenda that could improve policy formation.

This report describes the areas of practice or categories of knowledge (topics) in which we need more and better information in order to frame and devise better policies related to the finances of nonprofits so that nonprofits can fill the beneficial roles they should fill in service to our society.

Financial Woes of Nonprofits *(Figures for 2009)*

<table>
<thead>
<tr>
<th>Revenue Sources from</th>
<th>Percent of Orgs. Showing Decreases</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investments</td>
<td>72%</td>
</tr>
<tr>
<td>Corp. Donations</td>
<td>59%</td>
</tr>
<tr>
<td>State Govts.</td>
<td>56%</td>
</tr>
<tr>
<td>United Ways</td>
<td>53%</td>
</tr>
<tr>
<td>Prvt. Foundations</td>
<td>53%</td>
</tr>
<tr>
<td>Individual Gifts</td>
<td>50%</td>
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</tbody>
</table>

* From Urban Institute: From a 2010 study of a random sample of almost 33,000 human service nonprofits w/ annual expenses in excess of $100,000.

New and Growing Financial & Public Policy Challenges for NPO’s *

- Reductions in government payments to NPO’s for the service the government wants delivered.
- Delays in payments for NPO’s for services already delivered.
- Growing demands for payments in lieu of taxes [PILOT’s] by governments, reducing NPO’s resources for mission.
- New “fees” nonprofits are being charged by local governments, also reducing resources for mission.

The topics explored and addressed in the Symposium and this report include questions about:

1. government financing for nonprofits and the forms it takes;
2. the nature, extent, and apparent erosion of tax-exemptions;
3. the value, effectiveness, and costs of tax incentives to encourage giving; and,
4. the new fees and charges governments are imposing on nonprofits in many places.

In addition, the participants found themselves compelled to discuss “the value proposition” for the nonprofit sector. That is to say, they looked repeatedly at the question of what goods and benefits these organizations should create for the larger society, what the public and government officials understand about that, and what we all need to understand and communicate about the value nonprofits provide before there are changes in policy that may undermine their benefits to society as a whole.

Headline Issues & A Research Agenda

Participants in the Symposium saw the following issues as critical for public policy and nonprofits now; and agreed that, in order to form better policy, more research was needed on the topics noted below.

❖ There are major challenges in the current government and nonprofit climate that are adversely affecting both sectors, many of which involve the levels of and mechanisms for financing nonprofits. In addition to delays in, as well as reductions of, government payments to nonprofits for services delivered, participants noted a growing change in forms of financing, from contracts and grants to vouchers and other “demand-side” forms of payment for services.

❖ There was agreement more research is badly needed about changes in both the levels and forms of government payments to nonprofits, documenting whether and how these changes are affecting nonprofits behaviors and vitality. If these changes are causing severe harm to nonprofits and those they serve, we would ask, “How should these policies be altered?”

❖ Major changes are being proposed to the tax system generally, and specifically to existing tax benefits intended to serve as incentives for giving. On what basis will changes in these policies be made if we do not have good knowledge – which seems to be the case – of how the present policies have worked or failed to work?

❖ There was a shared sense it is important to know more about both the costs and benefits of current tax policies designed to encourage charitable giving, a topic on which research needs to be deeper and sharper. Both practitioners and researchers also need to know more about the real benefits and costs of other tax policies intended to support nonprofits, such as the value and benefits of property tax exemptions at the local level.

❖ There is a growing trend among governments at the state and local level to seek ways to extract ‘tax-like revenue’ from tax exempt nonprofits. The expansion of programs of “payments in lieu of taxes” [PILOT’s] is the most visible of these. This trend, if it expands, will further reduce nonprofits’ resources for mission, and could threaten their vitality and services.
There needs to be more research now on the impacts of these programs on the provision of services and benefits nonprofits provide to their communities when PILOT’s are imposed. There is a trade-off here, where governments get more funding but nonprofits that provide important services to those communities have less. But what is not known is what the end result is likely to be for the welfare of the community as a whole in this bargain. From a policy evaluation perspective, surely that is critically important.

Finally, in addition to these more specific questions, Symposium participants shared a strong sense that nonprofits need to both better understand and better communicate an answer to the question: “What is the ‘value proposition’ for the nonprofit sector?” What benefits for the larger society has the sector claimed to create or provide over the years? What data exist and what data are needed to test and (if true) justify those claims? What benefits or value have these organizations delivered? Assuming those claims are substantially true, how can that information be made comprehensible to a broader audience of the general public and policy makers?

Who Should Read this Report?

This document can be valuable to a number of audiences.

♦ It may be especially useful to researchers and nonprofit leaders who need to understand the current environment for nonprofits better, and who will need to cooperate in framing and pursuing the research needed to help improve that environment.

♦ It should be useful and interesting to government officials and their staffs who already recognize the value nonprofits provide to their communities, and who want to be better informed about the trends and dynamics that may compromise the health of those nonprofits.

♦ It should be of value to foundation leaders who need healthy nonprofits as partners if they hope to pursue work to effect improvement in the quality of life for individuals and progress towards a healthier, more just and more democratic society.

♦ Finally, we hope it will foster and better inform a public conversation that needs to occur now about the significance and purposes of the nonprofit sector, especially charities, for the long term health and welfare of our country.

So we invite your attention to this Report, and welcome comments and discussion of the Symposium’s findings.

— Thomas H, Jeavons, Executive Director, ARNOVA
The Financing of Nonprofits and Public Policy: What Do We Need to Know – and Change – to Do Better?

The Background and Reason for this Report

In the U.S. Congress, and in states and municipalities around the country, legislators and their staffs are at work developing and enacting laws that shape or control the behaviors of nonprofit organizations. In offices of government at every level, officials who regulate and oversee nonprofits are involved in writing and implementing rules that determine what nonprofits can and cannot do as they seek funding, account for their resources, run their operations, and pursue their missions. While this has long been the case, we generally know very little about what information and reasoning undergird legislators’ and regulators’ decisions about how nonprofits should operate, how they should (or should not) be funded, or what activities they should be barred from or encouraged to pursue.

Simply put, nonprofit organizations, including the million-plus public charities in the U.S., are creatures of public policy. This has been the case since the origins of the modern “nonprofit sector.” Those origins, it can be argued, were in the creation of the income tax and development of the Internal Revenue Service in first half of the 20th century.

Indeed, there is a compelling argument to be made that the only thing all the organizations we typically call “nonprofits” have in common is their standing under the tax code, but actually even that is not true. All public charities are 501(c) (3)’s under the IRS Code. But associated “social welfare organizations,” which may often be advocacy organizations, are 501(c)(4)’s. Moreover, many smaller organizations, including some that are very important to our local communities, may not even be incorporated, and they have no tax code label at all. In addition to this confusion, organizations’ status as “nonprofits” in various states is controlled by the ways they are allowed to incorporate – a matter of state jurisdiction – in those different states.

Even when we limit our attention to “public charities” we have to recognize their work occurs in radically different fields, from sports to religion to education to health care. These 501(c) (3)’s range in size from huge to tiny, from the massive hospital or university to the local food pantry or church day-care center. They vary enormously in character. In some the work is carried only
by volunteers while others have only paid staff. Finally, if these organizations are incorporated and seek public or philanthropic funding, one trait they all share is that they subsist in a context created and defined by public policy.

At this moment we know with certainty that nonprofit organizations seeking to serve the public good now face obstacles unlike any seen since the Great Depression. As one might expect, these challenges are most obvious and readily measured in their finances.

So, for example:

(1) Studies of individuals’ giving for charitable purposes show this source of funding for nonprofits fell dramatically in 2008 and 2009, with only a very minor recovery in 2010. (See the box here.)

(2) Reports on foundation grant making show similar trends, though lagging by a year. According to the Foundation Center’s Growth and Giving Estimates, foundation grant making was $45.6b in 2008 which was 2.8% above 2007, but it fell to $42.9b in 2009, an 8.4% decline from 2008. Giving USA data shows another decline in this significant source of nonprofit funding in 2010.

(3) There is no reliable single data source on the monetary value of the endowments held by a broad range of nonprofits. But there are sources that give us a view of what generally happened to these types of funds. Many if not most nonprofit endowments are invested in equities and bonds; and we know the equity markets are not back to pre-recession levels, and the yields on bonds are generally very low. Foundation Center data shows foundation endowments with average decline of 9% in value from 2007 to 2010.

### Declines in Charitable Giving 2008 to 2010

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
</tr>
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<tbody>
<tr>
<td>By Individuals 2008-2009</td>
<td>-3.3%</td>
</tr>
<tr>
<td>By Foundations 2008-09</td>
<td>-2.4%</td>
</tr>
<tr>
<td>By Bequests 2008-2009</td>
<td>-38.5%</td>
</tr>
<tr>
<td>From All Sources between 2008 and 2009</td>
<td>-6.2%</td>
</tr>
<tr>
<td>From All Sources between 2008 – 2010 (cumulative)</td>
<td>-4.2%</td>
</tr>
</tbody>
</table>

*Source: Giving USA 2011*

### Foundation Endowments after 2007

- Foundations saw their endowments drop by 17% between 2007 and 2008
- Despite three years of slow recovery, those, in 2010 endowments remain 9% below 2007 levels.
- Prospects for near term endowment growth are poor given current market conditions.

*Source: Foundation Center, Growth & Giving Estimates, 2011*
Finally data shows public revenues for nonprofits in the forms of grants or contracts or payments of “vouchers” for services are declining as well. Given what is happening to state, local, and federal budgets those problems promise only to get worse. Budget cuts for all kinds of services at state and local levels began in 2008, and continue for most states and localities. Reductions in funding from governments to nonprofits in 2009 were documented by a recent Urban Institution study.

Moreover, all these losses of or threats to revenues have been unfolding while economic conditions over the past three years created much greater demands on nonprofits that provide charitable services to the most vulnerable, and have reduced the income of nonprofits that earned some revenues for their services – as with arts organizations. It has been obvious since 2008 that nonprofit and charitable organizations in the U.S. were facing times of severe stress. It was equally obvious at that point, and continues to be obvious now, that our society as a whole is going to need the services of nonprofits more critically than ever.

It is against this background that in 2010 ARNOVA organized and held a first Symposium on Public Policy for Nonprofits. That first Symposium, held in October 2010, looked broadly at the history, conditions and challenges of the nonprofit sector, and at the public policies that have formed and affect the sector as a whole. That group asked, “Where are the problems, obstacles to, or shortcomings in the performance of nonprofits now, and how are those related to public policies aimed at the sector?” Participants explored a wide array of issues ranging from public perceptions of nonprofits, to the frames for and practices of government financing of nonprofits, to the emergence of new forms of public service organizations and practices of social enterprise. That inquiry was pursued for the purpose of identifying the most important policy questions facing the nonprofit sector, and to determine what research questions need to be answered to enable the development of better policies. (A full report of the first Symposium was issued in March, 2011, and is available at www.arnova.org.)

From that first Symposium five topical areas were identified as holding questions needing new or fuller research in order to better understand difficulties facing nonprofits now. It was felt a better understanding of present practices, operations, and trends in those areas would be vital to generate knowledge that could shape better policies to strengthen the sector in the near future.
One of those topical areas was “the financing of the nonprofit sector,” considering revenue streams and sources; expenses; the forms, amounts, and conditions of government funding; and other financial practices. A second area of inquiry, which strongly impacts nonprofit finances, was tax policy – exemptions, deductions, incentives to give and such. These questions about “nonprofit financing” were agreed to be an area where new research was most urgently needed.

This set the stage for the 2nd Symposium on “Public Policy Issues in Nonprofit Financing,” which ARNOVA organized and held on June 2 & 3, 2011, in Washington, DC.

What follows is a report on this second conference and discussion. This report, like its predecessor, focuses on framing issues and then offering and explaining a suggested research agenda. The report summarizes and captures actual excerpts from the two days of presentations and discussion in order to give a sense of the way questions were raised and pursued, and to help the reader see how the conclusions spelled out were reached. The report closes with a brief summary of the kind of research – including some specific topics and projects – the Symposium participants hope will be pursued to help develop better policies.

We are enormously grateful to all the participants, who are listed at the end of this report. To the degree there is wisdom here it is “collective wisdom,” a product derived from the extraordinary expertise, thoughtful listening, insightful thinking, and genuine care for the common good that these people brought and contributed to our conversation.
Narrative Report & Findings
An Overview of the Agenda and Schedule

On June 2 & 3, 2011, ARNOVA’s second “Symposium on Public Policy for Nonprofits: The Finances of the Nonprofit Sector” convened in Washington, DC, at the Georgetown University Conference Center. This event grew out of the first Symposium held in October 2010. The plan for this meeting was shaped around recommendations for a research agenda issued by the first Symposium, but this gathering focused more narrowly on policy questions surrounding the funding of the nonprofit sector.

We were fortunate to engage the participation of an extraordinary group of eighteen scholars, practice leaders, policy makers, and regulators to explore the realities and effects of current policies at the federal, state, and local levels that are impacting nonprofit finances. The range of participants’ background ranged from an Assistant State Attorney General and an Assistant State Comptroller, to nonprofit leaders, to researchers from think-tanks and prominent universities. We are grateful for the support of the Bill & Melinda Gates Foundation, the Kresge Foundation, and the C.S. Mott Foundation which made this gathering possible.

Over the course of these two days the group explored the question, “What do we know now, and what do we not know that we need to know, about the realities and trends in nonprofits finances, in order to shape better policy?” This conversation was framed by an opening presentation about different understandings of and blurring lines around the query: “What are (or should be) private, public, and nonprofit spheres of activity, services and responsibilities in our society now, and how are they differentiated?”

A Central Query for the Opening Session
“What are (or should be) private, public, and nonprofit spheres of activity, services and responsibilities in our society now, and how are they differentiated?”

Since so much of the activity of nonprofits is funded by mixed revenue streams – commercial and governmental as well as philanthropic – and so many of these activities run parallel to or compete with activities of businesses and governments, it felt like an exploration of the placement, perceptions, and permeability of the boundaries between these spheres was important to framing the other questions we needed to explore.
This opening session and discussion was followed by three more sessions that involved brief presentations and longer discussions centered on three specific areas of nonprofit finance and policies. The group examined:

1. “Government Funding for Nonprofits and Service Delivery: How Have the Forms – as well as Levels – of Support Been Changing? What are Consequences Present and Future?”


3. “How Do Governments Extract Revenues from Nonprofits: What are the New Forms and Potential Impacts of this Phenomenon?”

The two days closed with a final session that included some exercises and focused reflection designed to clarify our perception of key elements of a research agenda that would help generate the data and insights needed now to create better public policies around nonprofits and their finances.

Opening Session

Locating the Line between Public and Private: Who is Responsible for Services?

In this opening session Andrew Stark of the University of Toronto explored how contemporary America understands where the line between public and private might be located now, and how the line between public and private has changed over time. Many scholars and commentators have remarked on the myriad ways in which the differences in the characteristics of government, business, and nonprofit organizations have blurred in recent decades. Without a doubt, the boundaries around those spheres are now less certain and harder to understand.

Stark observed that the usual “mental picture” of the institutional units of society is that they are arrayed along a spectrum from private to public. However, he noted that over the last 40 years differences among the various entities along that continuum have become more ambiguous, and increasingly we find entities displaying both public and private characteristics depending on contextual variables.
Stark offered the example of “business improvement districts” (BIDs). These are now common, and are formed as nonprofit organizations, but they are created largely by businesses and are authorized to charge property owners within the districts for services above and beyond those provided by government. Thus BIDs mix elements of all three “sectors” – government, business and nonprofits. Their purposes might ultimately be described as commercial, their form is nonprofit, and they carry out government-like functions, with the ability to charge fees to property owners in the districts much like property taxes. To add a measure of conflict to this confusion, Stark noted there are even BIDs which are considering taking nonprofit entities to court to challenge their nonprofit status in order to apply BID-required taxes or fees.

Stark also raised the example of private residential communities that require residents to pay homeowner dues for services in addition to paying municipal taxes. Residents in such communities might pay the nongovernmental, nonprofit homeowner associations for the maintenance and upkeep of roads within the communities in addition to paying the municipal government taxes that go to pay for roads maintained by the public sector. To some residents this feels like double taxation, and some claim that their homeowner dues should be deductible from federal taxes (like state and local taxes are) because the fees benefit the public as well as community residents. If homeowners’ association dues are seen as providing a service that benefits the public at large, they are government-like (and in theory might be considered tax deductible); if these dues are seen as user fees, assessed in market terms based on expected usage, the argument for deductibility fades.

Additional confusion around public and private may be fostered when government subsidizes through the tax exemption museums, universities, and other nonprofits. In one view this amounts to a flow of public money to nonprofits, and thereby creates obligations for the nonprofit to the state and/or taxpayers. A contrasting view is that the tax exemption simply assures the full value of private gifts will go to the charitable missions of these nonprofits, and so does not breach the boundary between private to public spheres. In these relationships with the state nonprofits can be interpreted as either public or private actors, or both.

While one can find examples of organizations that function with characteristics of both the public and public entities, the question remains whether there are some services and functions
that are more properly public and others that are more properly private – or, for the purposes of this discussion, more properly nonprofit? Put another way, and perhaps more narrowly, this might be to ask, “Are there services or activities that nonprofits provide the public that the state should neither fund nor regulate?”

An example of this difficulty comes with the debate around state aid through vouchers to parochial schools. Direct state aid to parochial schools is justifiable in some views like state support of police and fire services, so long as the aid is restricted to support of the secular educational activities of these religious schools, presumably serving public purposes. But government vouchers provided to families or individuals and used for religious schools support all the activities of those schools, including their private spiritual purposes. (Still, courts have allowed this, reasoning that the use of these vouchers is akin to private expenditures for education, much like Medicare funds can be used at any hospital to pay for legitimate medical needs and procedures.)

Stark sees opportunities in this blurring of boundaries for nonprofits striving to serve the public in that it opens up a space for innovating with approaches that embody the public and private spheres of activity rather than attempting to build an impermeable wall between the two sectors.

**Discussion of these Issues**

The group was much intrigued by the questions and ideas that Dr. Stark raised. The discussion that followed picked up on several issues from the presentation.

**Who is responsible for services?** It was observed that the fact there is a blurring of the boundaries between public and private, or between government and nonprofit, does not answer the public’s question of what services should be delivered and paid for by government and what should be delivered and paid for by nonprofits. In fact, the current ambiguity on these matters may only confuse things further.

Moreover, one participant noted this blurring is not an organic process; but rather in some cases governments are actively pushing services from the public to the private (nonprofit) realm in an effort to divest themselves of costs and responsibility. And nonprofits frequently accept this,
even when the funds offered are not adequate pay for these services, because their commitment
to deliver services is often mission-driven. By withholding moneys in government contracts, by
abandoning some programs, and by allowing entities like “public education foundations” to
compete for private philanthropic resources even though they are not serving private charities,
governments are leaving mission-driven nonprofits to absorb more service functions with
shrinking foundation grants and individual donations during the recession.

These blurred boundaries contribute to the public’s basic lack of understanding of nonprofits.
People may see many nonprofits only as entities drawing government funds, but not as groups
delivering – or even making up for the loss of – government services with earned or donated
resources as well. If that is so, then they do not understand one reason why the nonprofit sector
is tax exempt, because (among other reasons) they do not see how the work of some nonprofits is
“relieving the burden of government.”

Beyond not understanding the reason for the tax exemption, there is another area of public
confusion. This is around the question of what value the nonprofit sector should be delivering to
society and what benefits from nonprofit organizations should offer to the public. One root of
this confusion is that the public see nonprofits as being much like other businesses in their use of
tax breaks as subsidies. (Many for-profits do this; it just involves different tax break, or
abatements that local and state governments often offer.) For example, nonprofit universities
provide some services or benefits much like their proprietary competitors. For-profit hospitals
often appear indistinguishable from nonprofits. Why, then, some ask, should some be exempt
from taxes and others not? What value do these and other nonprofits add to the community?

There are warning flags here for those who see distinctive social and civic values and benefits in
the work of nonprofits that we want to sustain. We need to be careful about how we describe
and document the contributions of nonprofits to their communities. If the value nonprofits
provide is really to be defined in private, market-based terms, then in some perspectives many
nonprofits do not merit a treatment or incentive structure different than that provided to
businesses. And a purely economic description of the value nonprofits add to society misses
their distinctive roles as generators of social capital and civic engagement.
One participant suggested that the state may have played a key role, perhaps unwittingly, in leading to an excessive emphasis on the privatized dimension of nonprofit services. The provision of “vouchers” (of some sort or another) for many services – from Medicare to Medicaid to housing vouchers to student financial assistance, for example – has shifted the form of much of the government funding for health and social services from payments to nonprofit institutions to payments to individuals, who then purchase services individually. An important question surfacing here is whether these changes in the way nonprofits “get paid” for what they do has altered, or just confused, the public perceptions of them. An equally important question would be if or how this change in forms of funding may have changed the ways these organizations behave?

Diversity of nonprofits: Several people noted that all this explaining and justifying of nonprofit distinctives and privileges is made more difficult by the character of the nonprofit sector. One participant said that “It’s getting hard to ask any question at all about nonprofits because of the diversity of the sector.” Another suggested that nonprofits are encouraged by government and foundations to distinguish themselves, to be different, to the point where “we keep subdividing so that we’re so siloed…that we don’t see the commonalities.” The differences in functions are exacerbated by issues of size, where “smaller nonprofits see the world differently, especially from the ‘eds and meds.’” Within the nonprofit sector, another said, “Harvard University bears almost no connection to the ‘Friends of the Library’.” Calls for the nonprofit sector to “come together to say to policy makers that ‘if we didn’t exist, you [the public] would lose,’” are hard to effectuate when nonprofits are so diverse and, in some cases, such as nonprofit hospitals, hard-pressed to distinguish themselves from for-profits.

Nonprofits as business: Someone noted that as the discussion of nonprofits shifts away from their redistributive purposes – with a focus on giving help to those in need, often with resources provided by those with much – toward the delivery of services more broadly, “the more nonprofits become like any other business.” It is often hard to make the case that a redistributive function is central to large and wealthy nonprofits, like universities, and so a good defense of their nonprofit status. Then they become much more like businesses judged by the public and government for their employment or economic development benefits. (One participant reminded
us that governments often give tax breaks to businesses for the economic development benefits they promise.)

Universities now typically justify their special tax status in economic development terms, in bringing business to the state, not for any charitable functions. The same applies to nonprofit hospitals, as very few nonprofit hospitals are wont to defend their special treatment based on their charity care benefits. One person observed that if the nonprofit sector were explainable, or to be justified, based on its redistributive functions, then it would follow that there would be more nonprofits in or serving poor communities, but that is not the case.

For government funding, increasingly the issue may not be whether the nonprofit sector should deliver a particular service or function, but rather which entities or sectors are best able to do so given the increasing revenue constraints government faces. One participant suggested that the warrant for and future of (government) funding of the nonprofit sector hinges on three issues: 1. Who benefits (or should benefit) from the nonprofit services in question? 2. Does society want to pay for the provision of the specific services in question? (Or does society or government need to provide for them?) 3. The efficiency question: Which organizations (or which sectors) are in the best positions to deliver those services with the greatest impact at the lowest cost?

This discussion closed with one participant observing that these questions apply to foundation grant making as much as government funding. One asked, “Why should there be [government] encouragement of people to give away their fortunes, especially when [foundations and wealthy donors] often serve the ‘PLUS’ population—‘people like us’?” Questions like these have been and will continue to be asked about who benefits from giving like that, and whether the tax policies that support such giving are worth the cost in lost revenues.

2nd Session

Government Funding for Nonprofits and Service Delivery: Changes in Levels & Forms of Support and Their Impacts on Nonprofits

To begin this discussion Elizabeth Boris and Erwin de Leon presented the results of the Urban Institute’s first national survey of government contracting and grant making for human services
nonprofits. They noted at the outset that their survey, conducted in cooperation with the National Council of Nonprofits,\(^1\) was conducted in 2010 based on 2009 data as the impacts of the recession began to reverberate through state budgets and the service delivery needs of people began to “go through the ceiling.” The data Boris & de Leon presented made clear how dependent many human service nonprofits are on government funding, and how dependent governments are on these arrangements for the provision of social services.\(^2\)

Against this background nonprofits have to deal with multiple agencies with different levels of grant reporting and conflicting due dates for grant applications and reports. More than half of the human service nonprofits report that they have to match or share the costs of services on government contracts and accept limitations on the administrative or overhead expenses on their contracts. In more than half of the cases those limitations apply to the entire recipient organization’s administrative overhead. More than half report that government agencies make changes to their contracts midstream. Two out of five human service organizations ended 2009 with an operating deficit.

In addition, even though much of the funding for human services nonprofits ultimately comes from federal sources or programs, it is experienced by nonprofits as coming from state and local government agencies. This means there are a number of government contracting agencies, sometimes dealing with the same federal funding, but administering it to nonprofits with sharply different policies on timing, reporting, and administrative costs. This, of course, raises the administrative costs to nonprofits and reduces the efficiency of the entire system.

Boris and de Leon observed that there are improvements that could be made in these granting and contracting systems that could greatly improve efficiencies and allow nonprofits to direct more time and money to service delivery rather than administration. Such improvements would include: (1) standardized and simplified application and reporting formats, (2) requiring prompt payments by government agencies to nonprofits, (3) formal feedback mechanisms for nonprofits.
on how they interact with state governments, and (4) giving nonprofits a “seat at the table” in negotiations with state agencies to help determine how policies and practices might affect government funded human service nonprofits – and, most importantly, improve delivery of services to those in need.

Several points were made regarding needed research to generate knowledge to improve policy. Better data is needed on the differences between grants and contracts regarding their impacts on human service nonprofits. It also now seems vital to compare the impact of these funding mechanisms to the impact of vouchers. (This should include examining whether vouchers result in the problems of late payments the way so many state grant and contract regimes do.) Present research looks at the issue from the nonprofit human service provider perspective; but there is not as much from the government viewpoint asking what needs to be strengthened on the part of nonprofits to make the grant making and contracting process work more effectively.

Nonetheless, as state agencies face increasing challenges in raising their own revenues, and simultaneously face greater problems with their ability to rely on flows of federal resources, it seems very likely there will be increasing problems of delayed government payments to nonprofit service providers. If so, that will inevitably result in more financial and operating troubles for these already fragile nonprofits. Some of the solutions, such as prompt payment requirements, are not hard, one person noted, but simply take “will and time.”

Les Lenkowsky then presented some of the research findings on one aspect of government funding not included in the Urban Institute research, which is the growing use of voucher (or voucher-like) programs to distribute government funding for human and social services. Including programs such as payments through Medicare, Medicaid, and Pell, for example, the amount of government funding reaching nonprofits through vouchers exceeds that of money from grants and contracts.

Lenkowsky suggested that “vouchers” is a both too conceptually narrow and too politicized a term, preferring to include vouchers within a concept of “demand side” government funding versus supply side funding. “Supply side” funding is the range of grants and contracts that increase the supply of what nonprofits provide as services and programs. Demand side funding
are those funds that go to consumers for what consumers might want to purchase as services from nonprofits. (Nonprofits are usually the “supply side” here, but it was noted this trend also increases the potential for consumers to go to for-profit providers in some cases—e.g., childcare, education, and medical services.) In addition to the Medicare, Medicaid, and Pell grant programs, other kinds of demand side funding can be found in some aspects of HUD housing programs (housing vouchers and Section 8), transportation, charter schools (with the bulk of their funding driven by the number of children that enroll), and others.

It is assumed the positive attributes of demand side funding to consumers (as opposed to grants and contracts for nonprofits) may include advantages of market mechanisms. In theory these programs may create greater efficiency and greater accountability, in that the providers of services that do not meet the “demands” of funded consumers will not be able to compete (or will be forced to change) while those providers that are good at what they do (or offer programs and services well attuned to consumers’ demands) will generate or attract more demand. These are, however, theoretical assumptions. Research that determines whether these advantages actually follow from demand side funding, or not, would be most valuable.

Questions to be asked about the limitations of demand side funding can be seen in some of the problems described in the Urban Institute research:

- Does the use of vouchers generate reimbursement delays for nonprofits? Are there problems with whether the payments to and through consumers actually cover the full cost of services?
- Are the complexities in establishing consumer eligibility, and in determining what services will and will not be covered by government funding, major hurdles to an efficient system?
- For the service areas where there is strong and effective demand, will vouchers stimulate increased and potentially unproductive competition among nonprofits, or between nonprofits and other providers?
- Finally, can we determine whether or not demand side funding actually makes services more widely available, or if it simply allows providers to increase the cost of their services? (It is possible that vouchers essentially allow providers to incorporate the demand subsidy into their service cost structure.)
According to Lenkowsky, demand side funding emphasizes the “privateness” of the experience. So if a consumer is paid to purchase a nonprofit’s services, it is up to the consumer whether the he or she wants to use the service, and if so purchase a service that some might consider inferior. For example, in this system it is the consumer’s choice whether to use a housing voucher with one or another housing provider; or an education voucher with one school or another.

Government can publicize the availability of vouchers, but cannot mandate the use of vouchers. This “privateness” extends to the faith-based arena, where the courts have permitted vouchers to be used to purchase services from (and consequently provide support to) faith-based organizations. The courts have determined vouchers to be private expenditure decisions, therefore that the use of vouchers as private expenditures does not violate the separation of church and state. Nonetheless, as government programs, vouchers are often attached to conditions that might be as or more stringent than those attached to supply side subsidies.

Given the claims made on its behalf, it is important to study whether or not “demand side funding,” public money being channeled through consumers rather than through grants and contracts to nonprofit “suppliers,” is generating better outcomes from the services it pays for because of the reliance on the advantages of market mechanisms. In the charter school arena, for instance, the results to date are mixed; and there is little data from other areas or services. It was also observed that the various conditions attached to demand side funding now – limitations on how vouchers can be used – may weaken the market aspect of the consumer-oriented decision-making, rendering the differences between these approaches insignificant. This also seems quite likely to be the case where a choice of providers is very limited.

**Discussion of these Issues**

The variety of issues surfaced in these presentations generated an exceptionally lively and very complex discussion. That discussion began with particular questions from these presentations.

**Other “Demand” Programs:** While Lenkowsky’s presentation focused on demand side funding as more or less like voucher payments, some seminar participants suggested other government funding mechanisms for social goals may have similar qualities. For instance, some tax expenditures are like vouchers, such as education tax credits or the low income housing tax
As opposed to direct government expenditures in the forms of grants, contracts, or vouchers, there is this other avenue for government funding flowing through tax credits that in many ways functions like both demand and supply side funding mechanisms. These also often involve nonprofits in major ways.

**Impacts of Government Funding**: One participant cited research from the Nonprofit Finance Fund that suggests nonprofits that are heavily reliant on government grant and contract funding have weaker organizational balance sheets. Those weaknesses will necessarily be exacerbated if governments delay contract and grant payments, as is now being reported. Such delays require nonprofits either borrow funds or float the nonpayment periods against their own fund balances. Worse yet, if government agencies, facing their own financial exigencies, can simply change contract terms mid-course, nonprofits may find their reimbursements further delayed, or even denied.

Several participants wondered out loud why nonprofits accept being treated like this in contractual relations. Others noted nonprofits are constrained in being able to challenge those governmental actions for several reasons: First, it may be because the kinds of services they provide – e.g., medical services or child care – are of a type that cannot just be stopped because the people and families needing them will be left at risk. For others, government may be the only major funder for what they do. Another participant noted these nonprofits are mission-driven entities, where “the commitment to the clients and the mission is not [just] rhetorical.”

Evidence of what that means is visible in Massachusetts, for example, where two-thirds of nonprofit human service providers were running deficits in their business with government, and at the end of the year had less than 30 days of cash in reserve. As another person observed, “What’s the alternative? Mission-driven organizations will do just about anything to continue their services.”

But this behavior is also conditioned, as another observed, by “raw fear”. For example, in some states nonprofits (like some for-profit vendors) might be allowed to charge government agencies
the cost of interest on funds they have to borrow or float to cover government funding flows. But in other states that is not true, and nonprofits “won’t bite the hand that feeds us, because if we challenge, they [the government] will take the contract away.” Another pointed out that in many cases, agencies cannot refuse clients, even if the funding is late or insufficient, because according to some government contracts, “if they send you a client, you [the nonprofit] have no right to reject the client; you don’t have to play, but there will be repercussions.” (In an extreme case, we learned that in New Hampshire, all government contracts with nonprofits include a clause that will excuse the government from paying entirely if the government decides it cannot afford to.)

Can There Be Real Collaboration? Frequently, because nonprofits are not included in the policy deliberations to structure programs to work efficiently for nonprofit service providers, there is no negotiation between government and nonprofits about how services will be delivered. “The state says, here’s the way we’re going to do it. Take it or leave it.” said one participant. These are “contracts of adhesion,” another noted, because one side—the state—“has all the power” and will not, or perhaps cannot negotiate. Once government programs are defined, and administrative regulations and procedures decided, the states often have little or no staff capacity to negotiate individual implementation variations with different nonprofit vendors. But this means improvements that could be made as a result of “learning on the ground,” and which might save money or improve services, can never be made.

The recent creation of a cabinet level office in Connecticut focusing on the needs of nonprofits is a new step toward building in the voice of nonprofits in the design of programs so that they work well for human service providers. There are indications that improvements are occurring in Connecticut. But observers suggested the limited political power of nonprofits, constrained by their tax status from engaging in the electoral process, restrains them from vying for influence with elected decision-makers.

Impacts on Nonprofit Employees: Human services providers are labor-intensive. The constraints on nonprofit finances take their toll not just in potential cuts in services, but on those who do the work. One participant said the stress of budget cuts is borne by “the employees, not the organizations…. The last thing that gets cut is services, it’s all being done on the backs of
individual [nonprofit] employees.” As labor-intensive organizations, human service providers try to sustain their level of service delivery by not giving raises, or by cutting the budget on staff training and support. In some cases, nonprofit employees bear the brunt of nonprofits’ adjustments to late payments and budget cutbacks, and they may not then be able afford health care because of their low salaries and wages. The nature of payments to nonprofits can result in nonprofit employees who cannot meet the basic costs of living.

Administrative Costs: Another issue in this complex of issues is the question of administrative costs. Several people noted how these are increased when nonprofits have to deal with multiple levels and different agencies of government with a variety of programs with different rules and myriad reporting schemes and forms. Even if governments do not delay payments, change contract terms, or require service providers to provide matching funds, many government funding programs—supply side as well as demand side—simply do not provide nonprofits sufficient funding for the full cost of the services they deliver when one includes support costs, as nonprofits eventually must.

What is a reasonable figure for administrative costs? These obviously will vary by type of program or service, locale, and other factors. Provisions for appropriate negotiations on these rates would seem reasonable. But evidence suggests the way funding agencies arrive at these numbers may be arbitrary, at best. For example, another participant pointed out the case of one program which as administered in Wisconsin allows nonprofits to recover 14 percent of overhead costs, the same program in Louisiana allows nine percent, and in Maryland (for the same funding and the same contract size) allows no overhead at all.

Another participant suggested that governments treat nonprofit service providers this way because “government funders just don’t respect the sector, [so delays in payments, and such] have become standard operating procedures that predate the recession.” But at what cost?

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The Other Costs of Poor Contracting Systems

“Nonprofits experiencing payment problems must divert scarce resources to juggle payments to employees, vendors, creditors, and others as they await government payments. [This] inevitably impedes the delivery of services to those most in need, and deprives the nonprofit of valuable resources.”

From: National Council of Nonprofits, Costs, Complexification and Crisis.
In order to survive these government practices, nonprofits often lose staff—or will lose staff when the recession breaks and the job market opens up. In some cases, when nonprofits find themselves in financial trouble, they may do “silly things and get into trouble by commingling funds and other practices that don’t play well with…auditors.”

Again, the numbers on how many organizations cannot run these programs without losing money, and how many agencies are running deficits because they are trying to deliver these services anyhow, are disturbing. A recent report from the National Council of Nonprofits observes how, in the end, these contracting and payment practices impede nonprofits’ abilities to serve those people they exist to serve.³

**Impacts of the recession**: While some of these government practices predate the recession, the recession adds urgency to a crisis at the intersection of government funding and nonprofit service delivery described in the Urban Institute research. The current condition of state budgets is the worst seen since the Great Depression, with many years ahead before this is sorted out, and not only for states. Many, many counties, cities, and special districts are also financially troubled. There are some indications that tax revenues are recovering slowly as the economy shows signs of recovery, but it was noted that the positive trends are fragile and could be reversed easily by another shock to the economy.⁴

Finally, one ‘recession-fed trend’ is that some states, much like private foundations, are promoting nonprofit mergers. State governments cannot compel nonprofits to merge. But in one state the government is saying that it will not finance several organizations to provide the same service and is making funding available only if service providers merge. Other states are looking at ways that nonprofits can free up restricted endowment funds to be used in organizational operations, for purposes different than they were originally received or designated. Still others states are keeping for their own purposes portions of federal pass-through funding that could and should go to nonprofit service providers. While strategies and details vary widely, we know governments at all levels will continue to try to shift costs of services to nonprofits as one way of coping with the worsening crisis of public finances that is unfolding in this recession.
3rd Session
Tax Exemptions, Deductions, and Incentives for Giving:
Rationales, Effectiveness & Costs

Leading off this conversation, economist and policy researcher Joseph Cordes walked the group through some of the studies and literature on the charitable deduction regarding the effects and costs of this incentive to increase charitable giving. Dr. Cordes said there is much we know – but also much we do not know – about charitable deductions, tax credits, and other incentives to encourage the flow of individual and family wealth to nonprofits. This is a matter of elevated concern now because there is increasing scrutiny of the charitable deduction at the federal level.

Lawmakers are assuming that charitable organizations are where some portion of budget balancing monies might be found. Cordes believes they overestimate the potential funds to be gained this way, but notes the attractiveness of eliminating the federal tax incentives for giving to charities is that it is “a mechanism to raise revenues without having to raise taxes.” Proposals for modification of the charitable deduction include President Obama’s proposed cap of itemized deductions at 28%, the Congressional Budget Office’s recommendations for simplification, and the proposal from Democrats that would convert the charitable deduction to a flat rate tax credit. The most dramatic proposal comes from the Simpson Bowles commission. It would replace the charitable deduction with something like the British approach for supporting gifts to charities, where they are reported to the government and the government provides a match.

Cordes says research suggests charitable contributions have been fairly insensitive to business cycles (or recession cycles), but this recession may very well be different, “not like your grandfather’s recession.” Beyond the large drop in charitable giving in 2008 due to the recession, Cordes predicts that 2009 will show another drop. (This was confirmed in Giving USA figures released after this Symposium. See the box on page 2.) Cordes notes this was due in part to less giving per tax return, concentrated at the upper end of the income level. One vital question is, “Do we really know what explains why higher income giving has plunged in this recession?”
This may be a particularly significant question now, because the simpler proposals for modifying the charitable deduction – President Obama’s 28%, or the 12% flat tax credit—would have the biggest impact on the out-of-pocket costs of higher income taxpayers. If there was a notable negative impact, it would likely affect different elements of the nonprofit sector differently. We know, for instance, that higher income taxpayers give less to religion and more to education and hospitals than donors in other income classes. Therefore, modifications of the charitable tax deduction that reduce higher income giving might well alter the distribution (as well as amount) of giving to different categories of nonprofit recipients.

Some argue charitable giving is relatively inconsequential as a revenue component of the nonprofit sector as a whole. That may be so. But if hospitals and universities are taken out, charitable contributions account for more like 25% of nonprofit revenues. For small nonprofits, often concentrated in social services, a significant drop in 25% of their income would be a serious blow to their finances. Cordes presentation shows how proposed changes in tax deductions need to be informed by a careful analysis of good data if we hope for better policy.

Jon Bakija, another economist who has researched these matters, especially questions of the effectiveness of tax incentives on encouraging giving, was asked to add to our perspectives. What do we know about whether and how much tax incentives cause people to give more to charity? Dr. Bakija described what the research indicates regarding the responsiveness of the tax incentives to tax rates or possible changes in allowable deductions.

Simply put, the way the system works now the higher one’s marginal tax rate, the lower the price of giving. So the question is, “If one increases the cost of giving, for instance by lowering the amount of the deduction or the tax rate, how much does giving decrease?” And if changes occur, what is the value of what the government gives up in order to lower the price and increase the amount of giving?

This is not a question as simple as measuring price elasticity. Bakija reminded us part of the rationale for government’s subsidization of the charitable giving incentive is that there are additional “positive externalities” (in economists’ language) in terms of benefits to society. This is to say, there are some things that nonprofits are better at than government, and some things
that government cannot do that we want nonprofits to do. So the purpose of incentives to give is 
not just to create ‘x’ dollars of services, but also to have nonprofit or voluntary groups engaged 
in these activities because we think there are additional benefits – e.g., more compassionate 
service delivery, or heightened citizen engagement, or a growth in social capital – to having them 
do this.

However, Bakija also pointed out we do not know how exactly to quantify the value of these 
kinds of public benefits of nonprofits on an empirical basis. Furthermore, the studies on the 
impact of lower tax rates on different givers are not, according to Bakija, believable. For 
example, studies of charitable giving in the 1980s suggest that charitable giving did not go down 
notably in response to lower tax rates, but that research did not use reliable treatment and control 
groups. (For example, those studies did not control for taxpayers who might have timed their 
giving in advance to adjust to prospective changes in the 1986 tax act.) Bakija concluded by 
noting he and a colleague (Bradley Heim) have a new study about to be published that they think 
provides much better data and insight.6

**Discussion of these Issues**

**Restricted giving:** It was noted that we actually do not know much about the relationship 
between giving that might or might not be tax-motivated and giving for restricted gifts. What 
motivates restricted or donor-directed giving? If this kind of giving is structured by a nonprofit’s 
development office, to do something that the nonprofit wants to do, the restricted gift is not a 
problem. But restricted gifts that emanate from donors’ priorities can sometimes have different 
costs and impacts – potential mission drift, inefficient donations, the “edifice complex,” etc. 
(Fund raisers have long reported a growing tendency to restrict gifts, and we know that large 
donations are much more likely to be restricted than smaller gifts.)

Within practices of restricted giving category there is variation among donors regarding how 
strongly they will push for enforcing their restrictions as almost the equivalent of a contract 
between the donor and the recipient charity. What does society lose when restricted gifts are 
treated as enforceable contracts? Society may be losing something in the “movement [as one 
participant described this] of charitable giving from donations to quid pro quo transactions.”
Recipient costs: What do charitable gifts from individuals cost nonprofits in terms of compliance with IRS tax rules? While there may be no hard data, one participant noted that the Urban Institute report highlights two concerns stated by nonprofits were the ‘complexification’ of applications for government funding and of reporting requirements. These create costs that use resources a nonprofit then has to devote to reporting to regulators or the community to maintain its status as an exempt entity.

While some oversight of nonprofits is necessary, some nonprofits are being required now to do more for their nonprofit status. And more accountability mechanisms are being proposed. For example, in some states – and prospectively at the federal level – nonprofit hospitals now devote or will have to devote resources to community needs assessments. There are also now expanded 990s and other compliance tasks. There is “expensive” data being generated for oversight purposes. However, it is not clear whether the public or government agencies are getting or making use of the data in forms that allow greater clarity about how nonprofits create public benefits for their communities, or not. It seems important to ask, “Are there sufficient improvements in accountability – and eventually nonprofit performance – to justify the costs to nonprofits’ of compliance with these regulations?”

Crowding out: Does government funding at some levels “crowd out” charitable giving? At what level of government funding does a nonprofit have a greater incentive to go for government grants and contracts as opposed to soliciting private donations? There may be an elasticity here to be calculated and better understood, especially if proposed changes in the charitable tax deduction reduce the potential amount of charitable giving that might be available. If changes in the charitable giving incentive result in decreases in giving at the same time nonprofits face reductions in government grants and contracts due to federal, state, and local budget difficulties, then the negative consequences for nonprofits and those they serve would be amplified.

From Deductions to Exemptions: The conversation about deductions and incentives to give inevitably connects to a discussion about exemptions, because deductions can only be claimed (as a rule) for gifts to exempt entities. So we also began to ask about the implications of growing challenges to or erosions of the privileges of tax-exempt status. In addition, moving from the
question of deductions to the matter of tax exemptions required refocusing the conversation more on the state and local level. That is where this conversation went next.

Like federal incentives for giving, the value and costs of local property tax exemptions may vary with the state of the nation’s economy. However, the pressure on exemptions and possibilities for generating new revenues from nonprofits also ebbs and flows with the varying circumstances of different communities, and with the particular revenue situations of local governments.

What seems clear is that there is a broad, though not uniform movement among local governments to re-examine, and in many cases challenge, the property tax exemptions of nonprofits. This now appears most frequently in requests by these governments to nonprofits for “PILOTs,” an acronym for “payments in lieu of taxes”. The phenomenon is not new. The tendency for economically distressed communities to seek new revenues this way goes back (at least) to the 1980s. However, broader-based efforts affecting more nonprofits are becoming more common.

The Boston, Massachusetts, PILOT program instituted this last year provides some consistency to property tax assessments of nonprofits, which may be a virtue compared to the variable institution-specific payment in lieu of taxes deals that many cities negotiate with nonprofit property owners. Other cities such as Providence (RI) appear interested in replicating the Boston program. The property tax exemption appears to matter more to older cities, typically in the Northeast, and less to other parts of the nation. It matters more to cities than suburbs. So for now these efforts are largely concentrated in the northeast, but they are spreading.

PILOT’s – Numbers & Distribution

“In recent years, local government revenue pressures have led to heightened interest in PILOTs, and over the last decade they have been used in at least 117 municipalities in at least 18 states. Large cities collecting PILOTs include Baltimore, Boston, Philadelphia, and Pittsburgh.”

These are highly concentrated in Massachusetts, where more than 80 municipalities collect PILOTs. Only three other states have as many as eight localities collecting these payments.

Source: Lincoln Land Institute, Payments in Lieu of Taxes.
An important difference about the property tax exemption compared to other tax incentives (or tax-subsidies) for nonprofits is that it really only benefits a handful of nonprofits, as most do not own property. As a nonprofit subsidy the property tax exemption it is inefficient, not only because of the small proportion of charities that own property, but because nonprofits record the book value rather than the market value of their property holdings. The value of the property, and hence the exemption, is often a pretty small proportion of their bottom line.

**Issues of Quality and Efficiency:** There are multiple examples of nonprofits that provide services that government does not or cannot, or nonprofits that are considered by some elements of the public or consumers as more trustworthy providers. These may be organizations the public in that community would consider worthy of “subsidy by tax-exemption.” But Joe Cordes reminded the group that the empirical evidence is mixed both about whether the quality of their services is better, and about whether they actually save money compared to government or private for-profit sector service provision. Even for the more limited population of tax exempt property owners, the research on the community benefit they deliver in return for their exemptions is thin. This observation drives the conversation back (again) to the need to know more about these claims; to recognizing the difficulties in making claims for the values of nonprofits as if all types and sizes are basically similar; and to doubts about the wisdom of basing the case for exemption entirely on the economic value of nonprofits roles and services.

This discussion of PILOT’s also led quite logically the next session focused on issues surrounding new efforts by governments to get new revenues from nonprofits.

**4th Session**

**Forms and Potential Impacts of Governments**

**Extracting Revenues from Nonprofits**

Alan Abramson of George Mason University provided a more detailed overview of the issue of payments in lieu of taxes, of what we know and what we do not know. He observed this is another area where we have neither the quantity nor quality of data we need to do a fully reliable and detailed analysis of what is happening. For instance, he noted cities and counties rarely
assess the value of exempt properties, making it very hard to say what taxes are foregone because they are exempt.

Dr. Abramson suggested we can, nonetheless, safely assume that (roughly) one-third of nonprofits own property, especially larger institutions such as “eds and meds,” and (of course) housing development organizations. Even in cities where there are many nonprofit property owners, and that varies widely, they still hold a small percent of the cities’ taxable property value. Government property, also tax exempt, is generally much larger than nonprofit tax exempt property.

Abramson pointed out there are significant differences among nonprofit institutions and among cities in how they treat tax exempt properties for the purposes of calculating and negotiating payments in lieu of taxes. In many cases, PILOTs are ad hoc negotiations between the individual institutions and the local governments, resulting in substantial horizontal inequity. And, as Cordes noted before, there is a striking geographic concentration of this issue. Of the 118 cities in one study cited by Abramson where PILOTs were assessed, 82 were in Massachusetts.

We invited Michael Weekes, President of the Providers Council in Massachusetts, a network of nonprofits in that state, to present the perspective “from the ground” of nonprofits. Mr. Weekes is in the midst of this fray, as many municipalities in that region are now exploring whether to follow the lead of Boston’s program of a standardized or structured model for assessing PILOTs. He suggested that “what always seems to be missing [in the discussions there] is the value these nonprofits bring to the community” in return for the tax exemption they possess.

In addition to that problem, the failure to differentiate among various nonprofits creates huge issues. For instance, lawmakers focus on the assets of tax exempt institutions such as Harvard University, whose endowment of over $27 billion could pay for the state’s entire budget for a year; and they make the mistake of thinking of highly endowed institutions like Harvard as “typical” for all nonprofits. Lawmakers then err in thinking that all nonprofits can afford to pay PILOTs.

Mr. Weekes explained that the original charge to the task force examining in Boston the potential of a more standardized structure for PILOTS was meant to focus only on universities and
hospitals (“eds and meds”). As a result smaller nonprofits and human service providers did not participate in the mayor’s task force, thinking that the issue was only going to apply to a relatively small and wealthy slice of nonprofit property owners. However, the educational and medical institutions working with the task force made the argument that there should be no exclusions. They advocated that the PILOT program should be a voluntary calculation, but it should apply to all nonprofit property owners.

The perspective of nonprofits affiliated with the Providers Council (mostly human service providers) is that the mayor’s program is a “slippery slope.” The task force program calls for payments of 25% of what a private commercial property owner would pay as property taxes for the same property. But a future mayor might change that percentage or alter definitions of community benefit that might be deductible from the PILOT calculation.

This is not just a slippery slope within Boston, but for other cities as well. Once PILOTs are accepted it legitimizes municipal initiatives to seek payments from nonprofits for services that might be (or were) covered by taxes. For example, nonprofit group homes in Newton, Massachusetts, now have to pay a fee for having trash picked up, and unlike Boston’s PILOT program, religious institutions were not excluded from the trash fee.

In addition, while PILOTs are ostensible voluntary, pressures can be brought to bear for payment. Many nonprofits that might seek building permits for construction or rehabilitation could find themselves compelled to pay the PILOT or risk not being given the construction permits. In this sense, the PILOTS are not truly – or at least not fully – voluntary for nonprofits that need municipal approvals for certain activities.

**Discussion of these Issues**

**Value of nonprofits:** One participant picked up what became a recurring theme, and suggested that the sector needs to document ‘nonprofit value,’ to be able to describe how nonprofits contribute significantly to the general welfare of our communities. At the moment, government officials and much of the public increasingly see nonprofits only as a tax expenditure. Without data on the value of nonprofits to their communities, it will be difficult to defend nonprofits against the slippery slope of taxation in multiple forms: PILOTs, excise taxes, usage fees (such
as trash fees, water fees, and St. Paul, Minnesota’s highly publicized street pole fee); and permit fees. One participant argued that by assessing taxes and fees against nonprofits, governments are breaching the social compact that nonprofits have with the public sector. He contended that nonprofits agree to higher transparency, limitations on excessive compensation, and restrictions on political activities in exchange for the tax exemption with the assumption these organizations will focus their resources and energy on serving the wider society in a variety of ways.

PILOT drivers and targets: In general, PILOTs seem to be a large, older city phenomenon. The big drivers are government needs for revenue, especially where tax-bases are shrinking because industrial and commercial properties are disappearing. So attributes that make nonprofits targets are their age and size. As one observer noted, “once a nonprofit organization gets to be of a certain age and size, it will own tax exempt properties,” therefore “you’ll see more of this located in the [older] cities.”

Some participants argues that, if this [PILOT’s and fees] is going to be done as a general practice, it should be done in a more transparent way than through the now typical practice of bilateral negotiated agreements. One person suggested a different model could be to calculate and assess “impact fees,” but like PILOT negotiations, the question would be how to assess impacts in ways that make sense for nonprofit institutions.

Accepted/appropriate taxes: In contrast to the resistance to PILOTs and fees assessed by local governments, it was noted there are some taxes that nonprofits have long accepted as legitimate and valid. For example, beginning in 1986, nonprofits were required to pay payroll taxes (FICA). Nonprofits also pay taxes on some securities and bonds that end up in nonprofit endowments. Some endowed institutions pay excise taxes on investment income. The controversy for these taxes is not whether the nonprofit should be required to pay the tax, but whether the tax is properly constructed. One question, therefore, is whether there is a defensible reason for nonprofits to resist being taxed on real property when they accept tax requirements on payrolls, endowments, and more.

The politics of PILOTs: In PILOT programs such as Boston’s, as one seminar participant observed, the public sector doesn’t ask nonprofits about their ability to pay PILOTs (treating all
nonprofits as though they meet a Harvard kind of standard). But it might be indefensible for nonprofits to resist paying local government PILOTs by arguing that they are exempted simply because of their IRS tax status. “The nonprofit community will want to think long and hard about how to frame the argument [against PILOTs],” a seminar member said. “Pretending that you don’t have to do anything won’t get you very far.” Moreover, using the proposition of the community benefit of nonprofits to resist PILOTs might not be an effective strategy, as the content of community benefit generated by nonprofits varies by context, mission and type of institutions. As we have learned in recent years, providing a clear, coherent description of the “value added” to communities by nonprofits that seems truly to apply to such a wide range of institutions is a huge challenge in communications and public relations.

5th Session
Concluding Exercises:
Refining the Issues and Framing a Research Agenda

After a break the group returned to engage in a series of reflective and conversational exercises aimed at clarifying the central insights from this exceptionally rich but long and complex discussion. Participants focused on framing questions they thought it most important for researchers to address first to create a more reliable foundation for decisions to be made in developing public policy. The purpose of these discussions was not to reach any final conclusion on any policy issue, but to lay out themes and issues warranting improved research that would lead to improved policy-making about the now struggling and the often poorly understand nonprofit sector.

In closing conversations participants identified headline issues emerging from the deliberations of this seminar as follows:

- There are major challenges present in the current government and nonprofit climate that are adversely affecting both sectors. Some of those challenges derive from, and in turn are having an impact on, public policies. These dynamics can be plainly seen in the financial relationships and policies connecting nonprofits and governments.
• Faced with shrinking revenues and growing expenses of their own, governments are increasingly trying to reduce what they pay nonprofits to deliver services. At the same time they are pressuring – or at least exhorting – nonprofits to maintain or even expand their program service delivery in light of continuing (or growing) economic and social distress of many types in their communities.

• Governments are (thus) expecting nonprofits to use more of their own resources to subsidize the delivery of social services, rather than governments increasing their subsidization of these services delivered by nonprofits. One result visible in the limited data we have is that under these terms the nonprofits are more likely to be in financial difficulty themselves, with many approaching a level of distress where they may have to close down operations for lack of resources.

• While it is unclear exactly how many nonprofits of which kinds are at risk of failure due to governmental policies that shift burdens of subsidizing services to nonprofits, it is clear the numbers are significant. It is apparent that the relationships between nonprofits and government that may have benefitted both in good financial times are changing and now problematic for both. It also seems likely that if many nonprofits fail, the communities they serve will learn a painful lesson about the value of their nonprofit service deliverers; and the social problems and human suffering in those communities will surely get worse.

• If that occurs, governments’ challenges in meeting the needs of their citizens and sustaining the health of their communities will only grow more difficult.

- Changes in the forms of government funding for social or human services may have been more significant than generally understood, and their impact may be as important to how nonprofits operate as changes in the amount of funding.

• The most significant and least understood changes in government funding of nonprofits has occurred in the increasing governmental openness to and reliance upon vouchers – or other forms of demand-side financing – paid to users, customers, or constituents, as opposed to contracts and grants paid to nonprofit agencies.

• Voucher payment systems have put nonprofits in the position of needing to market their services and compete for “customers;” and not only with other nonprofits but in some
cases for-profits, who usually have easier access to capital. In a demand-side funding environment where market pressures are influential nonprofits may be induced or compelled to drop services that might be needed, but are not competitive or profitable.

- Among the many things that we do not know about the impact of increased demand-side financing is how nonprofits’ organizational behaviors and service delivery quality may change in a more market-sensitive environment, and particularly the impact of the market on nonprofits that are strongly mission-driven. (For instance, if they have to devote more funding to marketing their services, and those resources have to be taken from the quantity or quality of services, what will happen?)

- Moreover, it may be only in this difficult financial environment that we may see what the winnowing effect this competition may be on nonprofits. If many go out of business, and the result is an absence of needed service providers in the ‘least profitable’ – likely the poorest – communities; then will other agencies replace them, or will those communities simply have to go without services? The absence now of good data collection on the closing of nonprofits would make it very difficult to determine this.

- **Very significant changes are being proposed to the tax system generally, and more specifically to the structure and manner of existing tax benefits that are supposed to serve as incentives for giving. Yet we do not know with confidence how effective the current incentives are, or what they finally cost various governments. On what basis will changes in these policies be made if we do not have good knowledge of how the present policies have worked – or failed to work – in generating the outcomes desired?**

- Despite several studies, our knowledge of the specific value and operational impact of tax incentives is still insufficient.

- Discussions are unfolding now about tax reforms that could not only change tax rates for individuals and corporations, but change the nature of the charitable deduction. Some proposals would prioritize or privilege giving to certain kinds of favored or desired charitable activities, while others would cap the charitable deduction for some higher income classes – and other ideas are being floated. Given the inadequacy of our knowledge of the effects of current policies on donor behavior and of the impact of tax
incentives for charity, how should the nonprofit sector weigh in helpfully and effectively in these policy discussions?

- There is a limited but growing and worrisome trend among governments at the state, county, and municipal level to seek ways to extract ‘tax-like revenue’ from tax exempt nonprofits. This, if it expands, could further reduce nonprofits’ resources and so threaten their vitality and services.

- There is emerging information about an increasing appetite on the parts of local and state governments to exact revenues in the forms of payments in lieu of taxes (PILOTs) or user fees from nonprofit property owners. However, we know little about the impact to date of these strategies on nonprofit property owners.

- Nonprofit property owners have paid some fees for some services as a matter of course. Now municipal and county policymakers are looking to increase fees and PILOTs required of nonprofits with little apparent understanding of how present policies or arrangements were intended to serve the public good. In this context we know very little about what the ultimate impact on a community’s overall welfare will be if or when public revenues are pursued in this way.

- The core question of “the value of the nonprofit sector” surfaced repeatedly throughout the course of this Symposium. Even when the discussions focused on a relatively technical matters – like how one can determine or demonstrate the impact or efficiency of charitable deductions – the conversation often circled back to this central problem of, “How can we explain why it matters that we have nonprofits, and that they are supported and empowered to pursue their missions?” There seemed to be an implicit understanding among Symposium participants that absent the ability to make a clear and compelling case for the social and practical value nonprofits create no arguments that can be made for specific policies about deductions and exemptions are likely to carry the day.

- Despite a large and increasing number of nonprofits around the nation, lawmakers and the public frequently have flawed (if any) understandings of how nonprofits function, how they are financed, and what they contribute to society.
• Despite awareness of the problem of public perceptions, the nonprofit sector has not focused on or developed strategies for more effectively explaining itself to the wider public in order to overcome errant ideas, misperceptions, and a general confusion about what nonprofits are and do.

• Many times in this Symposium the diversity of nonprofits organizations in terms of type, size, and mission was cited as a serious obstacle to such an effort; but even so the urgency of this work was generally recognized.

• If the nonprofit sector and those who study it cannot develop research, analysis, and explanatory materials that demonstrate the compelling value of nonprofit activity for the good of society as a whole, and for its most vulnerable members, the nonprofit sector may be at risk of losing something of its special status and those privileges and advantages that may enable it to do a kind of work for the public good that neither government or business can.
Findings and a Suggested Research Agenda

The Research Needed to Better Understand the Sector and to Develop Better Policies

Against this background, the final exercise of the Symposium invited members to individually identify and collectively affirm priorities for the kinds of research and research projects they would like to see pursued to generate the data and perspective needed to shape better public policy influencing nonprofits and their finances. There was not sufficient time for the group to complete a collective prioritization exercise at the level of specific topics or projects, so where projects are recommended here they do not carry a consensus endorsement from the participants.

There was, however, a general unity around the framing of key areas that need more and better research. Moreover, there was some excitement around the prospect of leaders in the practice and policy making arenas working collaboratively with academics to frame research projects from their inception so the results would take the form of immediately useable knowledge that could be available to the field and policy makers to begin creating positive change.

Key Topics for Research – Three Places to Start

1. **What is the “value proposition” for the nonprofit sector?** What benefits for our larger society has it been claimed to create or provide over the years? What data do we have, or need to get, to test and (if true) justify those claims? And, assuming those claims are substantially true, how can that information be made comprehensible to a broader audience of the public and policy makers?

It was noted that for this research to be meaningful and powerful it needs to address a potentially wide range of benefits – social, cultural, and political, as well as economic and service benefits – and that the findings need to be “broadly empirical.” It needs to employ qualitative as well as quantitative methods to generate solid data. Finally, as noted several times, this research will need to recognize the diversity of organizations in the sector.
2. How are changes in government—nonprofit relations evolving? Particularly how are changes in the forms as well the amounts of funding from governments for nonprofits driving changes in the behavior of nonprofits, or changes in the results of their work? It was observed there is a range of issues here we need to know more about; from questions about how different forms of funding engender or relieve financial and operational stresses for nonprofits; to questions about the true costs of compliance for nonprofits associated with various contracting schemes; to questions about whether (and if so, how) different forms of funding are associated with better or worse services and outcomes for clients? If the ultimate goal here for both parties involved, governments and nonprofits, is to improve the quality of service delivered and the quality of life in communities, then it would seem a focus in this research on who finally benefits – or is harmed – in these communities by these changes is vital.

3. Can we develop a better understanding of states’ roles, functions and impacts in all of this?

In the complex flows of funds from government to nonprofits, most dollars originate at the federal level, but then move through contracting, grant, or voucher programs that are operated by states and municipalities. Thus we know states’ rules and procedures around program enrollments, contracting schemes, regulations and compliance are crucial in shaping nonprofits’ experiences of program funding and management.

In this context, participants agreed, we need more data collection and studies that differentiate the research by state. Comparative studies that look not only at funding and management processes for, but also at nonprofits’ and clients’ experiences in, various programs seem essential. Such studies could indicate which kinds of policy choices are more likely to lead to better outcomes for all parties involved, and help distinguish which policies work best in various contexts.

In addition to the three larger set of issues that arose as holding greater urgency in the comments of many participants, other suggestions were made – and often affirmed by several participants – for other foci for research needed now. These proposals were put forward in the final session and on the sheets participants were given to frame and prioritize issues. On those sheets Symposium participants were invited to state the goals to be met in terms of improved policies and outcomes that could be enabled by the research suggested.
Those recommendations follow here below, and are presented in priority order according to the number of participants that mentioned each.

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**Specific Research Goals and Projects**

These goals and projects are presented here as:
- **Needs or Goals to be Met** –
  - By research focused on:

  - **Determine the “value proposition” for the nonprofit sector** – the description of the ways these organizations benefit the wider community, and why these are important – and how this can be verified and more effectively presented to the larger public.
    - By research focused on:
      1. How the public sees or understands nonprofits now, what misperceptions exist, and how a truer and clearer picture can be communicated.
      2. Clarifying the meaning of “social impact” or “community benefit”.
      3. Developing more and clearer empirical data regarding both the immediate and secondary services and benefits nonprofits provide in their communities.

  - **Finds ways to improve and streamline the contracting systems between nonprofits and governments at every level**, so that both parties can reduce costs to allow more of the funding available to go to service provision and create community benefits.
    - By research focused on:
      1. Examining and analyzing federal, state, and local contracting practices with input from nonprofits to see where problems, inefficiencies and inequalities now exist. (This will require comparative studies of various states and localities, as well as of the operations of different agencies at the federal level.)
      2. Analyzing how vouchers (or demand-side payment) programs may or may not have similar issues or problems as contracts and grants.
      3. Determining what current payment and rate setting models are in these contracting regimes across jurisdictions; consider the pros & cons of each; and test empirically for what may be best practices based on outcomes.
      4. Determining what the true costs for compliance with contracts and regulations are for different kinds of nonprofits operating under various approaches. Consider these questions for voucher systems as well. Explore the ways these costs could be reduced. Analyze for the total benefits that could accrue to all parties – clients, nonprofits and governments – if these costs could be reduced.
Understand the ways various tools are used or systems are implemented by governments to extract revenues from nonprofits, and the impacts that the implementation these new regimes are having (or are likely to have) on nonprofits financial health and ability to fulfill their missions

- By research focused on:
  1. Assembling a comprehensive database of PILOTs, user fees, and other revenue generating schemes directed at nonprofits to map current implementation and see trends.
  2. Doing local, regional or case studies of the finances of nonprofits affected by these new fees imposed on nonprofits to assess real impacts now.

Determine the ways in which exemptions for property and sales taxes have been granted at the state and local levels, and how those rules and procedures may be changing, and examine the costs and benefits of those arrangements.

- By research focused on:
  1. Examining current and former practices regarding the granting of exempt status to organizations by states and municipalities, and looking for trends in the grants, renewals, or withdrawals of exemptions.
  2. Surveying jurisdictions to determine how they assess the taxable value of currently exempt property, and analyzing how states and municipalities arrive at figures for the “cost of exemptions” as lost revenue to those jurisdictions.
  3. Also examine practices across jurisdictions regarding sales tax-exemptions.

Understand better the ways in which current incentives to give placed in the tax code have succeeded or failed to stimulate charitable giving, by whom, and at what costs. And be able to consider in a more informed way the likely results proposed changes in the tax code for these purposes.

- By research focused on:
  1. More and better empirical research on effects of current (and previous) rates and regimes for deductions as incentives for charitable giving. Look at both income and inheritance taxes in these studies.
  2. Modelling of projected effects on charitable giving (based on this better research) of proposed changes in the tax code.

Improve the ability of federal funding for nonprofits to help them achieve their goals in serving and improving their communities.

- By research focused on:
  Identifying differences in private or public cultures and the values they reflect; and exploring how different forms and sources of funding might be more or less compatible with or supportive of different kinds of nonprofit missions or services in different contexts.

Endnotes follow ………
End Notes


[4] At the time of the Symposium, early June 2010, some signs of economic recovery were still visible. At the time of the final editing of this document, 3 months following the Symposium, a further decline in the health of the economy seems to be occurring.

[5] Many of the papers and articles on these subjects that Joe and Jon Bakija, another presenter here, references are cited in the attached bibliography.


[7] A detailed analysis of this phenomenon, Payments in Lieu of Taxes: Balancing Municipal and Nonprofits Interests, was produced by the Lincoln Land Institute. (Found at: https://www.lincolninst.edu/pubs/dl/1853_1174_PILOTs%20PFR%20final.pdf)
Suggested Readings


Participants in the 2nd ARNOVA Symposium on Nonprofits & Public Policy
“The Financing of Nonprofits and Public Policy”

Alan Abramson  George Mason University  Professor of Government & Politics
Jon Bakija  Williams College  Professor of Economics
Elizabeth Boris  Urban Institute; Center on Nonprofits and Philanthropy  Center Director
Evelyn Brody  Kent College of Law  Professor of Law
Jesse Buggs  City of Bowie, Maryland  Contracts Manager
Joseph Cordes  George Washington University  Professor of Economics
Tim Delaney  National Council of Nonprofits  President & CEO
Erwin de Leon  Urban Institute; Center on Nonprofits and Philanthropy  Research Associate
Suzanne Garment  State of New York  Former Special Counsel to the Lt. Governor of NY
Deborah Heinrich  State of Connecticut  Nonprofit Liaison to the Governor
Terry Knowles  State of New Hampshire  Asst. Attorney General
Leslie Lenkowsky  Indiana University  Professor of Public Policy
Cindy Lott  Columbia University  Director, National Attorney’s General Project
Elliot Pagliacco  State of New York  Deputy Comptroller for State Government Accountability
Andrew Stark  University of Toronto  Professor of Public Policy
Michael Weekes  Providers Council of Massachusetts  President & CEO
Darin McKeever  Bill & Melinda Gates Foundation  Senior Program Officer, Charitable Sector
Nick Dewchaciwsky  C.S. Mott Foundation  Program Officer; Civil Society
Rick Cohen  Reporter for the Symposium  Executive Director, ARNOVA
Thom Jeavons  Facilitator for the Symposium
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Second, this event was made possible by generous gifts of time and expertise from the Steering Committee for this project – specifically, Elizabeth Boris of the Urban Institute, Leslie Lenkowsky of Indiana University, and Tim Delaney of the National Council of Nonprofits. Their active contribution to shaping both the first symposium and this follow-up event was vital to this project and this report. They played key roles in finding the right people to have in the room in both in Baltimore and again in Georgetown, and helped to refine the agenda for this second Symposium.

Third, I owe a second debt of gratitude to Rick Cohen who did a masterful job of pulling together the wide ranging discussion at the first Symposium to create the coherent narrative from that event, and whose comprehensive notes laid the foundation for this report.

Finally, I am grateful to all the participants who brought to this conversation a real passion for the improvement of our society and the roles nonprofits can play in that; as well as remarkable expertise, inquisitive minds, and a commitment to probing but civil discourse of the kind that can generate new vision and deeper insights. If this report can contribute in any way to the improvement of the nonprofit sector and the policies that shape and support it, it will be because of the collective wisdom they brought to this conversation.

Thomas H. Jeavons
Executive Director
ARNOVA