IN BRIEF

Payments in Lieu of Taxes on Federal Real Property

Advisory Commission on Intergovernmental Relations, Washington, D.C. 20575 • October 1981

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FOREWORD

One of the most distinctive features of the United States system of federalism is the reciprocal intergovernmental tax immunities doctrine. According to this doctrine, which has engendered years of economic and political debate and judicial decisions (all of which have been characterized by heated dissent) state and local governments may not tax the federal establishment and, in turn, the federal government will not tax state and municipal government activities.

If the federal system were being newly designed today, the wisdom of the immunities doctrine would surely be an area for debate. The focus would be primarily on the doctrine's appropriateness as a policy with respect to its effects on revenue productivity, tax equity, efficiency, and fiscal accountability rather than on its original (and outdated) justification as a device to protect the federal government from being hampered in its mission by state or local taxation.

It was these four specific policy concerns of revenue productivity, equity, efficiency, and accountability that led several members of Congress and the full Commission to request, in the fall of 1978, that the ACIR staff undertake an examination of the major element of the immunities doctrine—the federal government's immunity from state and local real property taxation. Specifically, the Commission asked that the staff study the intergovernmental and economic implications of the property tax immunity accorded to "non open space" federal real properties (i.e., all federal real property other than grazing, forest, and park lands for which compensation is already provided) and, in addition, consider whether Congress should enact a uniform payment in lieu of tax (PILOT) program designed to compensate subnational governments for the property tax loss due to the federal presence.

This *In Brief* is a summary of that study and the Commission's response to the study findings. It was written by Robert D. Ebel and Joan E. Towles, authors of the full report, *Payments in Lieu of Taxes on Federal Real Property,* who worked with the ACIR's Taxation and Finance Section directed by John Shannon.

Abraham D. Beame
Chairman

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INTRODUCTION

Statement of the Problem

The property tax is the single most important revenue device used by state and local governments, accounting for nearly one-third of the total tax collections in 1980. Although the tax has only a minor impact on state treasuries, it has and will continue to have a central role in maintaining the fiscal integrity of local government in the United States. At present the property tax accounts for almost 78% of local tax collections, a feature which can be largely explained by the fact that, due to tax base accessibility problems, local governments have no better tool for effectively generating revenue sufficient for maintaining their provision of public goods and services.[1] At the same time, however, the property tax is also generating taxpayer discontent as sustained high rates of inflation exacerbate its inherent structural inequities—discontent that may increase if localities are forced to use it more extensively due to the decline in federal aid flows.[2]

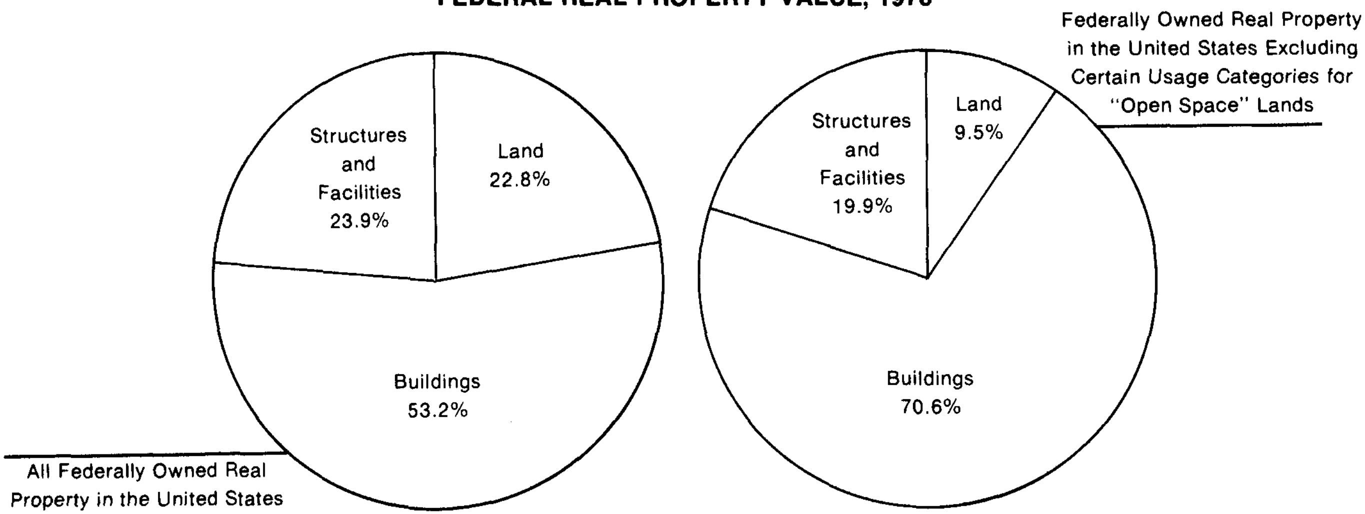
One of the most significant issues pertaining to the revenue yields and equity of the property tax is that the country's largest owner of real property, the federal government, claims a tax exemption for nearly all its holdings. The federal government currently owns one-third of the nation's entire land area, 23,988 installations, 2,598 million square feet of floor area, and various

[1]Because they operate in the most "open" of all economies—economies characterized by a high degree of mobility of goods and factor movements across jurisdictional borders—the real property tax base, which is for all practical purposes, physically immovable, is the only one which is really accessible.

[2]ACIR, *Significant Features of Fiscal Federalism, 1979–80 Edition*, M-123, Washington, DC, U.S. Government Printing Office, 1980, Tables 47, 52, 58, and 103.

Chart 1

VALUE OF LAND, BUILDINGS, AND STRUCTURES AND FACILITIES REPRESENTED AS SHARES OF TOTAL FEDERAL REAL PROPERTY VALUE, 1978



*Estimates of the value of federally owned properties were developed in five phases, reflecting different groups of federal holdings. These estimates reflect Phase I estimates, Table 19, ACIR, *Payments in Lieu of Taxes on Federal Real Property,* A-90, September 1981, p. 112.

* **Ibid*, these estimates reflect Phase II estimates, Table 19.

SOURCE: ACIR staff.

other structures and facilities. In 1978, the total value of U.S. real property was approximately $280 billion.

The value and location of this property varies widely across the nation. The properties are located in both rural and urban areas and include office buildings, housing projects, grazing lands, hospitals, defense bases, parks, industrial facilities, utilities, communication systems, airports, museums, and memorials. Although the public perception is often that the bulk of federally owned real property is largely in "open spaces" represented by national parks, forest reserves, and grazing or timber lands, the reality is that the bulk of the government's property value—$210 billion of the $280 billion or 75% of the total value—is accounted for by buildings and structures and facilities located in non open space areas. *(Chart 1)*

The Federal Response

The one generalization that can be made about the fiscal treatment accorded to the array of federally owned real property is that there is no guiding principle. Congress has recognized a responsibility to some local governments for making some form of tax or in lieu of tax payment to account for the federal presence, but the result has been the creation of a patchwork of uncoordinated and ad hoc special tax payment programs which have developed over the years.

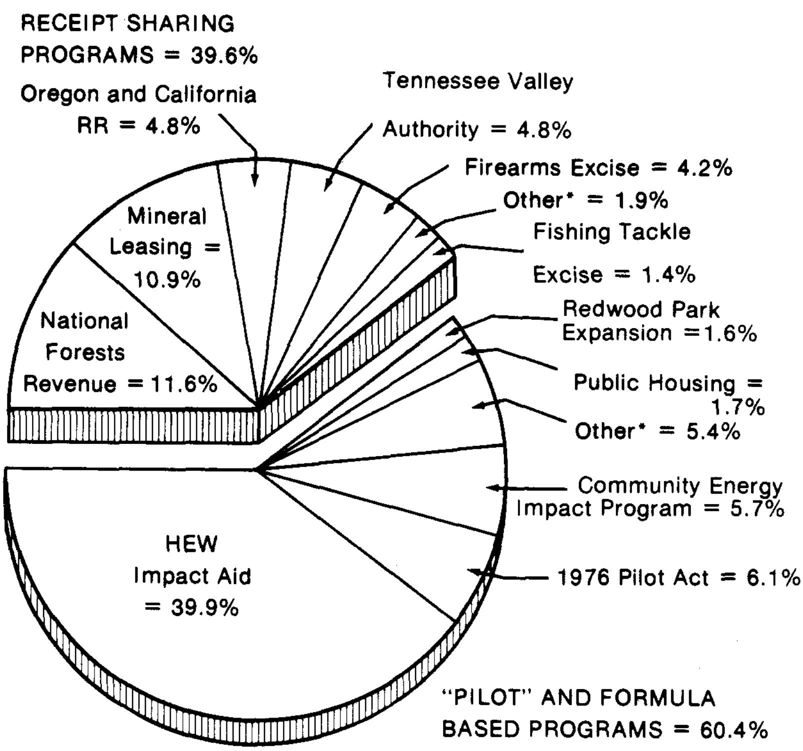
Perhaps one of the first points to be mentioned in a discussion of whether to treat the U.S. Government as a real property taxpayer is that there are no Constitutional barriers to either the direct imposition of nondiscriminatory taxes on federal real property or of an equivalent payment in lieu of tax (PILOT). The reason the federal establishment is not generally taxed on its property holdings is that Congress denies that power to the states and localities. Thus, all that is needed is the statutory consent of the Congress. And, such consent is possible. There are some cases for which Congress explicitly authorized the full range of state and local taxes on instrumentalities which it has created. Examples include properties of the old World War II Reconstruction Finance Corporation, AMTRAK, and the activities of federal financial institutions (the Federal Deposit Insurance Corporation, the Federal Home Loan Banks, the Federal Savings and Loan Insurance Corporation, the Federal Land Banks, and the Federal Reserve Banks).

A more significant part of this patchwork response by the Congress is the set of special payment programs which have been authorized to compensate certain states and localities for the tax exempt federal presence. At present there are 57 different federal programs with a combined budget authority of $2.04 billion in 1979. These programs contain provisions for 64 different payments to specified states and localities. Of these 64 payments, 25 are of the revenue or receipts sharing variety, 18 are special payments in lieu of taxes, and 21 are formula based. The nature of each of these three types of ad hoc programs is depicted in *Chart 2* and summarized below.

- **Revenue or Receipts Sharing.** These programs are designed to share the revenues and receipts that the national government derives from activities conducted on federal tax exempt property that lies within the boundaries of a state or locality. The sharing of receipts from natural resource recovery on mineral or forest lands provides the most common source of payment although the funds generated from activities on park lands or grazing land may also be included here. Other receipts from leases, fees, and user charges collected on the exempt lands may also be shared.
- **Payments in Lieu of Taxes (PILOT).** This set of 18 payments is specifically designed to compensate subnational governments for the presence of tax exempt federal properties which lie within their boundaries, regardless of whether receipts or revenues may be generated. The general idea is to relate the PILOT to the market value of the federal property; however, in practice the payment diverges from this norm. Only three payments provide for full tax equivalency (the amount the government would pay if it were actually fully taxable), four provide for partial tax equivalency (set at some percent of the tax value), and 11 are made on a fixed or flat sum basis, a sum that typically has been arbitrarily determined. The best example of this PILOT approach—as well as the most comprehensive of all federal payments programs—are the payments made to local governments which contain open space entitlement lands such as national parks, national forests, reservoirs, and wilderness areas. As enacted in 1976 and subsequently amended, this payment covers federal land in more than 1,500 counties (mostly in the western U.S.) and supplements nine different receipts sharing laws. This supplement guarantees that total federal payments to a county meet certain per acre minimums and maximums.

CHART 2

ESTIMATED FEDERAL PAYMENTS FOR RECEIPT SHARING, "PILOT" AND FORMULA-BASED PROGRAMS, PERCENT OF TOTAL PAYMENTS, 1979



ESTIMATED TOTAL PAYMENTS = $2.04 BILLION

*Payments of less than 1% each are included in "other."
SOURCE: ACIR staff

- **Formula Payments.** The third major form of compensatory payment consists of a variety of formula-based programs. A common and distinctive feature is their negotiated payment character. Although they help defray local government costs due to the federal presence, they do not reflect a sophisticated cost analysis nor do they attempt to reimburse localities fully for community services used. And, although a property value factor may be considered in justifying the payment, that factor is rarely used for determining the amount of the payment. The most important example of the formula approach is the Education Impact Aid Program which directs payments to school districts throughout the country. Other examples are the Community Energy Impact Formula grants and the Community Energy Impact Fund administered by the Department of Commerce through the Coastal Zone Management program.

Scope of the Report

The variety of payment programs indicates that, although Congress has shown little interest in giving its consent to state or local taxation of federal agencies and instrumentalities, it has recognized responsibility for compensating some subnational governments for the presence of the tax exempt federal establishment by authorizing payments by certain federal agencies. Nevertheless, most federal agencies are still without the general authority to make such payments. Moreover, the compensatory programs which do exist are diverse, resulting in different treatment for similar federal properties.

Within this context, several critical policy questions arise: What are the undesirable consequences of the current uncoordinated system that can be largely characterized as providing a tax exempt status for most federal real property? Would a new, uniform payment program be redundant in view of the billions of federal grant-in-aid dollars already made available to state and local governments? If it is determined that a program for making the federal government "pay" real property taxes is justified, what form should it take? What are the consequences for the recipient governments and the cost to the U.S. Treasury? And, if enacted, could an in lieu of tax payment be effectively administered?

The full ACIR report examines each of these questions in detail. In order to make the required analysis, the study estimated

first the current dollar value of real property owned by the federal government in the United States (1978 was used as the base year) and from that basis the amount of taxes that the government would have to pay at current effective tax rates if it were fully subject to the real property tax. This hypothetical tax payment also gives the amount the government would pay to states and, primarily, local governments (96%) under a uniform payment in lieu of tax system (PILOT) based on full tax equivalency.[3] Although estimates of the value of federal holdings were derived for all federal real property in the U.S. as well as for only non open space properties, estimates of the tax payment or PILOT amount were made only for the non open space category. The PILOT projections were thus for all federal real property *excluding* (a) land used for flood control and navigation, parks and historic sites, forest and wildlife, reclamation and irrigation;
and grazing; and (b) structures and facilities such as navigation aids, roads and bridges, and monuments and memorials.[4] Specifically included in the scope of the PILOT are all other lands and structures and facilities, and all buildings, such as office buildings, military bases, post offices, and utility systems.

Once these federal property values and PILOT estimates were made, the tax equivalent PILOT was compared to the current combination of federal tax immunity plus ad hoc payments. Both federal approaches were evaluated for their differential effects relating to issues of cost to the federal treasury and revenue flows to the recipient subnational units, the degree to which the present exemption policy creates an economic burden on local governments, fiscal equity, economic efficiency, and fiscal accountability. The study concluded by looking at two more questions: Even if a PILOT makes conceptual economic sense, could it be effectively administered? And, are there forms of PILOT which have more merit than the full tax equivalency approach?

The remainder of this *In Brief* summarizes the findings of the study pertaining to each of these issues.

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[3] The difference between actually making the federal government subject to the real property tax and the in lieu of tax approach is largely one of timing and the greater administrative flexibility provided to the federal government under the PILOT.

[4] The major part of the effort of the full study was to devise a method to estimate the current replacement value of federal tax exempt real property and the cost and geographic revenue distribution of a compensatory PILOT program. However, before that could be accomplished, it was necessary to examine, in detail, the procedures by which the U.S. General Services Administration keeps records on federal holdings. These procedures were found to be deficient in several respects. For a discussion of the data issue and methodology procedure, see Volume 2 of the full report.

Table 1

Current Value of Federally Owned Real Property in the United States, 1978

Description	Current Dollar Value of Federally Owned Real Property and Percentage Composition[1]			
	Land	Buildings	Structures and Facilities	Total
	(in millions of dollars)			
All Real Property	$63,655 (22.8)	$148,365 (53.2)	$66,734 (23.9)	$278,754 (100.0)
Real Property Excluding Certain Categories of Open Space Lands and Structures and Facilities[2]	20,024 (9.5)	148,365 (70.6)	41,794 (19.9)	210,183 (100.0)
Non Open Space Real Property, Civil Functions Only	11,203 (14.0)	45,634 (57.0)	23,208 (29.0)	80,045 (100.0)
Non Open Space Real Property, Civil Functions in Central Urban Counties[3]	6,054 (18.1)	24,340 (72.8)	3,045 (9.1)	33,439 (100.0)
Non Open Space Real Property, Civil Functions in Nonurban Counties	5,148 (11.0)	21,294 (45.7)	20,164 (43.3)	46,606 (100.0)

[1] Percentage composition shown in ( ). Detail may not add to 100.0% due to rounding.

[2] All real property excluding land and structures and facilities used for flood control and navigation, parks, and historic sites, forest and wildlife, reclamation and irrigation, grazing, roads and bridges, and monuments and memorials.

[3] A central urban county is that single county which is determined (by the U.S. Bureau of the Census) to represent the most densely populated and developed area within a metropolitan area (SMSA).

SOURCE: U.S. Advisory Commission on Intergovernmental Relations.

PILOT BASE AND YIELD (COST)

Estimates of the aggregate value of federally owned real property in the U.S. are presented in *Table 1*. The table presents several interesting facts. First, the bulk of the value of the government's real property holdings is located in non open space areas. Of this non open space total of $210 billion, 38% ($80 billion) can be attributed to civil uses. The remaining 62% is military. Central urban counties, which include central cities, account for $33 billion or approximately 42% of total civilian holdings. The finding that the larger part of the total value of federal property is held outside the central urban county area is explained by the non urban location of structures and facilities and their various needs for space for special functions (e.g., utility systems, airfield pavements, transmission lines, railroads and storage facilities), and, of course, by the fact that many urban-related federal activities and properties are in metropolitan areas adjacent to the central core.

Charts 3 and 4 show the geographic distribution of the value of federal real property on a regional and a state-by-state basis, and the value of that federal property as expressed as a percent of the market value of the federal plus assessed private taxable property. As the *Chart 3* shows, the incidence of federal tax exempt property varies widely across the country, with the southeastern and far western part of the nation having the largest absolute amounts.

Chart 4 shows the relative importance of federally owned tax exempt property to the sum of the value of the private taxable plus the federal real property base. These data indicate that if the federal government were subject to the real property tax, federal holdings in the U.S. would account for approximately 5% of the national property value. More important, although the regional disparities do not differ as greatly as *Chart 3* data initially suggest might be the case, the relative impacts do vary widely when

Chart 3

VALUE OF FEDERALLY OWNED REAL PROPERTY IN THE UNITED STATES, BY STATE AND REGION, 1978

State and Region	Value of Property ($Thousands)	Percent of Federal
UNITED STATES	$210,182,600	100%
NEW ENGLAND	7,390,600	3.52%
Connecticut	1,336,000	.64%
Maine	1,224,500	.58%
Massachusetts	3,402,200	1.62%
New Hampshire	301,100	.14%
Rhode Island	992,900	.47%
Vermont	133,900	.06%
MIDEAST	33,526,900	16.00%
Delaware	549,900	.26%
District of Columbia	7,557,500	3.60%
Maryland	7,859,900	3.74%
New Jersey	4,372,800	2.08%
New York	8,581,500	4.02%
Pennsylvania	4,605,200	2.19%
GREAT LAKES	17,744,500	8.44%
Illinois	6,531,300	3.11%
Indiana	2,324,500	1.11%
Michigan	1,995,800	.95%
Ohio	5,566,900	2.65%
Wisconsin	1,326,000	.63%
PLAINS	13,644,000	6.50%
Iowa	834,300	.40%
Kansas	3,868,600	1.84%

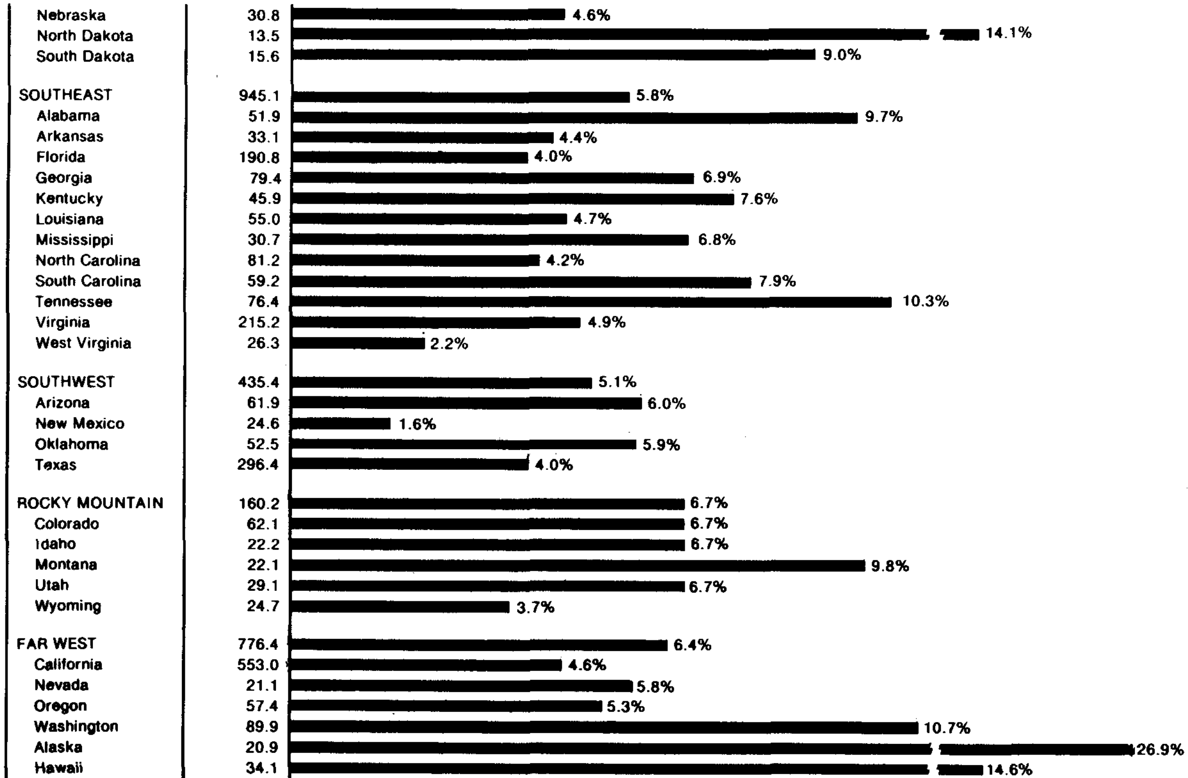
Minnesota	933,700	.44%
Missouri	3,260,300	1.55%
Nebraska	1,429,000	.68%
North Dakota	1,905,200	.91%
South Dakota	1,413,000	.67%
SOUTHEAST	55,033,200	26.18%
Alabama	5,032,300	2.39%
Arkansas	1,473,300	.70%
Florida	7,689,700	3.66%
Georgia	5,516,300	2.62%
Kentucky	3,508,900	1.67%
Louisiana	2,583,100	1.23%
Mississippi	2,083,400	.99%
North Carolina	3,388,200	1.61%
South Carolina	4,703,800	2.24%
Tennessee	7,860,800	3.74%
Virginia	10,615,300	5.05%
West Virginia	578,200	.28%
SOUTHWEST	22,328,600	10.62%
Arizona	3,689,200	1.76%
New Mexico	3,820,200	1.82%
Oklahoma	3,079,800	1.47%
Texas	11,739,500	5.59%
ROCKY MOUNTAIN	10,690,900	5.09%
Colorado	4,155,500	1.98%
Idaho	1,496,600	.71%
Montana	2,170,100	1.03%
Utah	1,963,900	.93%
Wyoming	904,800	.43%
FAR WEST	49,823,900	23.71%
California	25,384,100	12.08%
Nevada	1,223,400	.58%
Oregon	3,016,200	1.44%
Washington	9,611,100	4.57%
Alaska	5,612,600	2.67%
Hawaii	4,976,500	2.37%

Note: Detail may not add to totals due to rounding.
SOURCE: ACIR staff.

Chart 4

VALUE OF FEDERAL REAL PROPERTY AS PERCENT OF MARKET VALUE OF FEDERAL PLUS ASSESSED PRIVATE TAXABLE PROPERTY, BY STATE AND REGION, 1978

State and Region	Value of Property ($Thousands)	Percent Federal
UNITED STATES	$4,304.1	4.9%
NEW ENGLAND	213.8	3.5%
Connecticut	56.7	2.4%
Maine	19.4	6.3%
Massachusetts	90.7	3.8%
New Hampshire	14.8	2.0%
Rhode Island	13.4	7.4%
Vermont	18.8	.7%
MIDEAST	725.0	4.6%
Delaware	11.6	4.7%
District of Columbia	21.7	34.8%
Maryland	89.1	8.8%
New Jersey	127.9	3.4%
New York	324.7	2.6%
Pennsylvania	150.0	3.1%
GREAT LAKES	720.3	2.5%
Illinois	203.1	3.2%
Indiana	85.9	2.7%
Michigan	132.6	1.5%
Ohio	220.1	2.5%
Wisconsin	78.6	1.7%
PLAINS	327.8	4.2%
Iowa	68.3	1.2%
Kansas	51.0	7.6%
Minnesota	69.1	1.4%
Missouri	79.5	4.1%



Note: Details may not add to totals due to rounding.
SOURCE: ACIR staff compilations.

viewed state by state, ranging from the District of Columbia,[5] where more than a third of the property base is federally owned, to states such as Vermont, Iowa, Michigan, Wisconsin, Minnesota, and New Mexico where there is relatively little impact.

In making comparisons, two points should be kept in mind. First, the data are based on nonopen space areas only—large tracts of open land and large numbers of monuments and memorials do not explain the differences. The variations are largely attributable to structures and facilities and, for a place like D.C., office buildings within the jurisdiction. Second, due to the nature of the raw data used in deriving these estimates (see Volume 2 of the full report), *Chart 4* does not show that some localities may be very severely impacted—indeed even more than Washington, DC. Places like Norfolk and Portsmouth, VA, with their naval shipyards and army towns around the Fort Stewart, GA, area are good examples.[6]

Table 2 shows the results that would occur if Congress were to authorize a full tax equivalency payment in lieu of real property taxes (effective rate multiplied by the tax base). Again, although recognizing that this PILOT would be paid largely to local governments (96%), the data are presented here on a statewide basis. The gross liability to the U.S. Government would have been approximately $3.7 billion in 1978—a figure that may also closely represent the 1981–82 amount in view of the fact that, for the U.S. as a whole, average effective property tax rates have been falling during the past three years.[7] For a given locality, of course, the amount of payment received is determined not only as a function by the value of the U.S. Government's property, but also by its local tax rate policy.

What would this cost the U.S. Treasury? The estimates, including the $3.7 billion federal outlay, are based on the assumption that all the existing specific payment programs shown in *Chart 1* would be continued. However, one of the great benefits of the nationwide PILOT would be the ability to use that uniform PILOT as an opportunity for rationalizing the entire federal payment program by eliminating a number of smaller payment

[5]Because public domain lands and monuments and memorials are excluded from the PILOT base, the D.C. numbers do not reflect the value of the Mall, the Capitol, or the many national memorials located throughout the city.

[6]The data base limitations were largely due to the differences between city and county wide property listing, a function of the form in which records are kept by GSA.

[7]For 1980 the average effective rate derived from existing family homes with FHA-insured mortgages is 1.56%.

programs and reducing the Congressional workload. Although several different replacement strategies could be considered,[8] the most logical one would be to eliminate all those programs which now provide PILOTs for the real property tax on the non open space areas. There are 13 such overlapping programs (including federal Impact Aid for Education) with a total cost of approximately $1 billion—thus, the net cost to the federal government of a uniform PILOT could be reduced to $2.7 billion.

Moreover, for at least two very practical reasons, even the $2.7 billion may overstate the initial net federal budget cost. First, even if Congress were to grant its consent to a PILOT, it is quite possible that some local governments will opt not to assess the federal properties. At present only 17 states and the District of Columbia require that federal real property be assessed. Thus it is reasonable to expect that many localities in the other 33 states (and, indeed, probably some in the 17 assessing states) will not have adequate staff resources to assess federal property and join the PILOT program.

Second, the estimates in *Tables 1 and 2* have not been subjected to the inevitable pressures for downward adjustments that would occur in the "taxable" arena. These adjustments could occur due to several factors ranging from the nature of the assessment and billing cycle (relatively few localities have annual cycles) and the accuracy of assessments (appeals can be expected) to the local budgeting process and the politics of the local tax rate setting process. (If all exempt federal property were to become part of the revenue base, the overall effective property tax rate would presumably fall due to the expanded tax base; this effect would be particularly strong in areas heavily impacted by federal property.)

Finally, what is the net cost of the PILOT to the taxpayers? Although a specific dollar amount is difficult to predict, it will be below the net dollar cost to the U.S. Treasury. This follows from one of the points just made: that for a given flow of public expenditures, as the federal government joins the local real property "tax" base, effective property tax rates should fall. Thus, if there are no other changes, though taxpayers will experience an increase in tax costs in their role as federal taxpayers, their tax costs will fall at the local level.

Is There a Burden?

The U.S. Government currently provides approximately $87 billion in grants-in-aid to state and local governments. In real

[8] See Chapter 4 of the full report.

Table 2

EFFECTIVE PROPERTY TAX RATE USED TO COMPUTE ESTIMATED FEDERAL PROPERTY TAX PAYMENTS,[1] 1978

States	Effective Property Tax Rate (percent)	Estimated PILOT Liability (in thousands of dollars)	States	Effective Property Tax Rate (percent)	Estimated PILOT Liability (in thousands of dollars)
United States, Total	1.74%	$3,657,060[2]			
Alabama[3]	0.74	49,316	Missouri	1.59	51,839
Alaska[4]	1.73	97,097	Montana	1.31	28,428
Arizona[3]	1.72	91,492	Nebraska	2.48	35,438
Arkansas	1.49	21,952	Nevada	1.71	20,920
California	2.21	560,989	New Hampshire[5]	2.38	7,167
Colorado	1.80	74,799	New Jersey	3.31	144,739
Connecticut	2.17	28,990	New Mexico	1.65	63,033
Delaware	0.88	4,839	New York	2.89	248,004
District of Columbia[4]	1.78	134,524	North Carolina	1.35	45,740
Florida	1.13	86,894	North Dakota	1.26	24,005

Georgia	1.27	70,058	**Ohio**	1.26	70,143
Hawaii	0.95	47,277	**Oklahoma**	0.95	29,258
Idaho	1.46	21,851	**Oregon**	2.25	67,865
Illinois	1.90	124,095	**Pennsylvania**	1.85	85,197
Indiana	1.66	38,587	**Rhode Island**[5]	2.27	22,539
Iowa	1.76	14,684	**South Carolina**	0.82	38,571
Kansas	1.37	53,000	**South Dakota**	1.79	25,292
Kentucky	1.25	43,861	**Tennessee**	1.40	110,051
Louisiana	0.61	15,757	**Texas**	1.84	216,007
Maine	1.65	20,205	**Utah**	1.03	20,228
Maryland	1.69	132,832	**Vermont**[5]	2.21	2,959
Massachusetts	3.50	119,076	**Virginia**	1.21	128,445
Michigan	2.63	52,488	**Washington**	1.75	168,195
Minnesota[3]	1.39	31,745	**West Virginia**[3,4]	0.78	6,361
Mississippi	1.10	22,917	**Wisconsin**	2.22	29,438
			Wyoming	0.87	7,872

Note: Detail may not add to total due to rounding.

[1] The effective property tax rate is the percentage that tax liability is of the market or true value of the house. The average effective property tax rate is derived from existing single family homes with FHA-insured mortgages. The rate is for 1977.
[2] This figure differs slightly from that shown in *Table 24* due to rounding.
[3] Tax classification systems in the following states were adjusted with their respective effective property tax rates: Alabama, .98; Arizona, 2.48; Minnesota, 3.0; West Virginia, 1.10. These rates were supplied directly to the ACIR by tax officials in the states.
[4] Rate is for 1975; 1977 rate not available.
[5] Rate is for 1974; 1975 and 1977 rates not available.

SOURCE: ACIR staff computations; ACIR, *Significant Features of Fiscal Federalism, 1978-79 Edition*, M-115, Washington, DC, U.S. Government Printing Office, 1979, Table 36, p. 56.

terms, federal aid has doubled since 1967–68. In view of this record, the obvious question arises as to why the Congress should enact another federal payment program—such as a PILOT—which would cost the U.S. Treasury another $2 to $3 billion. If the PILOT were only a back door way to increase federal aid, it could hardly be justified in a period of federal budget restraint. To address this question, it was necessary to first identify the purpose and scope of existing aid arrangements and then determine whether the PILOT would be redundant.

Without attempting to make distinctions between intended and actual purposes of federal aid programs, federal grants can be distinguished according to whether they address social (poverty, crime, deteriorated housing), economic (a declining industrial structure), or financial (fiscal stress) needs of state and local governments.[9] Given this framework, the analytical question to be addressed is: As a general rule, does the presence of federal tax exempt real property significantly explain the existence of *economic, social, or financial problems in local jurisdictions.* If the answer is "yes," then one could legitimately conclude that by providing the existing set of aid arrangements, which are *intended* to address these needs, Congress had done enough; PILOT would be a redundant program. If the answer is "no"—i.e., that a PILOT does not overlap with the purpose and scope of the set of federal aid programs—then the redundancy argument against a PILOT collapses.

Indeed, the answer is "no" and is supported on both theoretical and empirical grounds.

Although there is little doubt that many municipalities experiencing social, economic, and financial problems are also those with large amounts of tax exempt federal property, the fundamental reasons for the "need" problems are not related to the presence of federal real property in the jurisdiction. The problems can instead be traced to such factors as reduced population growth and a changing age distribution, new technologies, the changing composition of the private industrial base and, even, federal government policies.

These theoretical expectations were supported by ACIR's empirical testing of the hypothesis that the value of federally-owned real property is not significantly related to the same concerns which are the focus of existing federal aid programs. In

[9] Peggy L. Cuciti, *City Need and the Responsiveness of Federal Grant Programs*, a report prepared for the Subcommittee on the City, Committee on Banking, Finance, and Urban Affairs, U.S. House of Representatives, 95th Congress, 2nd Session, Washington, DC, 1978.

more technical language: the community needs cited above are not shown to have a significant association, either positive or negative, with the amount of federal tax exempt property.

In order to make these empirical tests, regression techniques were applied to the value of federal property and various need indicators for two sets of cities: the 45 largest cities and a random sample of 40 communities having a population greater than 25,000. No significant relationship between the three need categories and federal tax exempt property was shown to exist. Fuller discussion of these tests is presented in Chapter 4 of the full report.

EQUITY, EFFICIENCY, AND ACCOUNTABILITY

Three classic public finance principles of equity, efficiency and fiscal accountability can be applied to the issue of federal exemption from real property taxation.

Equity

The federal immunity from real property taxation violates the equity principle of public finance that "taxpayers" (here, institutions) in similar circumstances be treated similarly. This equity violation arises in three cases.

Unreimbursed Service Costs. Viewed as an institutional entity or as a group of workers, the federal establishment benefits from a wide range of local services. The direct services are familiar; they include police and fire protection, the bus system which transports workers and clients or consumers, public health and sanitation facilities and the courts. Less obvious, but certainly equally important, are the indirect costs incurred on behalf of the federal establishment—costs that for some communities may be quite significant. For example, the local government may have to add to the capacity of its physical infrastructure (e.g., sewers and roads). It may incur additional expenses for its transportation authority or have to increase its education and social services budget to facilitate the federal government's mission, including providing for the needs of the federal workforce and its families.

Of course, the same argument can be made regarding private business institutions and residents. In Miami, the tourist industry creates significant local service costs. The same can be said of Boeing in Seattle, General Motors in Lansing, and the steel firms of Pittsburgh. However, these private industries and firms are not immune from the real property tax. One can argue that by acquiring real property the government has assumed a responsibility borne by private taxable property owners. Thus, the equity criterion of "equals being treated equally" requires like property tax treatment.

Leasehold vs. Ownership Decisions. A second, more subtle (though certainly not unimportant) set of inequities arises because some federal activities are carried out on property leased from private landowners while others are conducted on federally owned real properties. When the federal government acts in the role of a leasee, its real property taxes are included in its rental payments. In fact, there are numerous property management regulations and arrangements entered into by the federal government (primarily through the General Services Administration) which stipulate that real property taxes be paid to landlords as part of a fair market rental rate. These include annual escalation clauses, "pass through" agreements, reimbursable percentage clauses, and renewable contract arrangements.

The inequity arises since the federal government exempts itself from those tax contributions when it operates out of its own tax exempt facilities. Thus, not only can the federal government mandate its own local tax exemptions, but it can also create different degrees of the practical effect of that tax exemption among localities due to its lease vs. ownership decision.[10]

Federal Contracting and Procurement. Each year the U.S. government solicits billions of dollars in private sector contracts for the purchase and development of products and services. If, as is the usual case, the contract is with a private taxable firm, the firm will include in its final contract price the usual costs of production, including property taxes. Thus, again, by sometimes employing the private sector the federal government arbitrarily pays property taxes in some localities while exempting itself elsewhere.

Efficiency

In public finance theory, effiency or neutrality requires that fiscal policy be designed to accomplish certain intended objectives, but beyond that should minimize interference with other private economic decisions. Extending this concept of the least

[10]Nor is the lease vs. ownership decision based on any principle regarding the nature of the federal government's mission. Many military and national security groups, for example, are located on property privately leased to the government.

unintended distortion to collective decisions, such as PILOT, is a complex task requiring careful interpretation. One obvious distinction to be made is that the government's concept of cost minimization differs from that of a private entity. Keeping such caveats in mind,[11] at least two arguments can be made that PILOT would force the federal government to manage its property holdings more efficiently.

The tax exemption encourages a wasteful use of property. Because the government is free from paying a tax (or PILOT) on the real properties it owns, it will underestimate the value of that property in alternative economic uses. For example, consider the federal government's decision regarding its space requirements when it retains large tracts of underutilized properties, perhaps in the form of office or housing facilities in prime metropolitan areas or vacant valuable shoreline recreation lands. One of the major ways to provide the property owner an economic signal regarding a higher or best use for the property is to do what is done with most private property—value it and tax it.

What sort of effects would this tax signal have for the federal government? If the PILOT were a small portion of operational costs, there would probably be no change in property management behavior. However, if the PILOT were seen as significant, two changes, both contributing to the efficiency goal and neither interfering with the federal government's mission—might occur. First, in order to minimize unnecessary holding costs, the government might lease or sell some of its property, perhaps even relocating some facilities. Alternatively, the government may simply become more efficient in its own property use by employing that property more intensively and, in the process, disposing of (or not acquiring) other properties. That either or both of these results could occur is attested to by the behavior of the U.S. Postal Service. Because it generally leases its facilities and therefore pays local property tax through various escalator or pass-through agreements, the Postal Service often moves its facilities (such as bulk mail operations) to minimize property tax costs.

The exemption from property tax gives the federal government a competitive edge in bidding for property and at the same time distorts land prices. Assuming a given set of state and local government services and that local taxes are capitalized into

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[11] There are several. For a discussion, the reader should consult the complete report, Chapter 4.

prices of real property, the tax exempt status of the federal establishment allows it to offer higher prices for a given parcel of property than a nontax exempt (e.g., private business) competitor. In addition to being at a competitive disadvantage, the private taxpayer may also find that his land will decline in value from what it otherwise would be if the government were taxed. This second effect will occur as effective property tax rates are increased in order to maintain the level of public services. These increased taxes, when capitalized, will reduce the value of tax properties.[12]

Fiscal Accountability

The issue of fiscal accountability is raised by the equity argument which states that by acquiring real property the federal government has tacitly assumed a "taxpaying" responsibility similar to that of private property owners. If a PILOT were authorized, the Congress would eliminate a federally mandated subsidy from the state/local to the federal sector. Moreover, because this subsidy is hidden—that is, it does not receive the periodic budget review given to other types of direct subsidies or expenditures—it violates principles of sound public administration.

[12]Interestingly, this property tax capitalization can also have the effect of increasing central city-metropolitan disparities as the federal government continues to follow its recent policy of requiring its agencies to give central cities priority in location decisions (per Executive Order 12072).

HOW TO DO IT: FULL TAX EQUIVALENCY AND THE ALTERNATIVES

The full tax equivalency method—where the payment in lieu of taxes is equal to the amount the government would pay if the property were fully taxable—best meets the requirements of equity, efficiency, and fiscal accountability. This follows from the basic premise that the federal government, as a property owner, assumes the same set of responsibilities as private taxpayers. However, in coming to this conclusion, ACIR examined several alternative payment bases and found them inferior. These alternatives and their major characteristics are summarized below:

- **Net Benefits.** The most common of the PILOT base alternatives to tax equivalency, designing a payment on some benefit-cost criterion (such as discounting for the benefits which result from the presence of the federal establishment) completely falls apart when closely examined. There are at least three major reasons for this conclusion:

  a. A benefits adjustment violates the equity and efficiency principles. Moreover, the theoretical absurdity of the benefits argument is clear when it is taken to its logical conclusion. If a benefits test was applied evenhandedly to the government and private institutions alike, it would destroy the entire state-local property tax system. Should Boeing Aircraft be tax exempt because of the significant benefits it creates for Seattle? The financial industry in New York? The technological firms in Houston?

  b. Methodologically, the concept of a net benefit test for all federal facilities within local jurisdictions is so complex and speculative as to raise serious implementation problems. In addition, where the "federal establishment" can be said to have altered the entire structure of a community, a benefits-cost test is almost impossible to apply.

c. The observable net community benefits may exist only in the short run; benefits derived from the government's presence are generally comparable to those derived from similar private enterprises.

- **Cost-of-Services.** The narrowest prescription for determining a PILOT, the cost-of-services approach, which would compensate subnational governments for the cost of federally used local services, entails significant measurement and conceptual problems. This "cost" view ignores the practical reality that the real property tax is the mainstay of local own source revenues, and must be used to finance some services for which allocation of costs is not practical.

- **Discounting for Own Services.** The argument for discounting the PILOT by some percentage because the federal government supplants some local services by providing its own public services has some merit. However, there are also numerous conceptual and implementation problems. The fundamental conceptual issue deals with the difficulty of drawing a line between activities which supplant and those which supplement local services, a division that is likely to be quite arbitrary. Methodologically, one is again faced with the problems of defining and measuring marginal costs.

- **Fixed Formula or Fee.** The fixed formula, whereby the PILOT would be made according to a flat fee per employee (or some similar observable base), scores highest of all PILOT base options on the criterion of maximum Congressional control. However, the arbitrary nature of this approach fails to address adequately the equity concerns. It also fails to place a tax price on federal property holdings, thereby thwarting the efficiency aims of a PILOT.

- **Threshold.** The adoption of a "threshold approach," under which a federal payment would be made only if total federal property values in a community exceeded some specified percentage of total (or total plus federal) real property value, has the administrative merit of disqualifying small recipient local jurisdictions from the payment program. There are serious flaws, however, in the threshold approach. A fundamental problem is that it is virtually impossible to arrive at a logical basis for a threshold percentage. In addition, use of a threshold would arbitrarily create a whole new set of inequities.

ADMINISTRATION AND COMPLIANCE

28 Although the federal government could establish a new agency or office to determine the current value of each of the buildings, structures, facilities, and parcels of land it owns in the U.S. and then remit the PILOT to the taxing authority, such an approach would be unnecessary and cumbersome. The obvious and currently viable alternative is to rely on local governments to determine the level of the payment due, and then have the state-local unit send a tax or PILOT "bill" (in the form of a grant application) to the federal government. This conclusion follows from the state of the art of property tax administration in the U.S., the similarity between federally owned properties and taxable privately owned properties (in general the nature of federally owned properties is fundamentally no different from the range of properties now taxable), and the practical workings of the 20-year-old Canadian system of real property tax equivalency PILOTs for federally and provincially owned real property.

Administrative considerations regarding assessment reviews and appeals may present some operational, but not unusual, difficulties. In fact, the notion of the federal government reviewing and, when necessary, appealing the property tax (or in lieu payment) it would pay is not only not new; it is already an ongoing process in some agencies which now pay property taxes through lease arrangements. Again, the U.S. Postal Service provides an excellent example. In Canada, the federal review process has worked with remarkable smoothness, and with little administrative overhead, through a federal real estate board.[13]

[13] Similar assessment review operations also operate smoothly in private companies which have large amounts of real estate holdings throughout the U.S.

WHAT DOES THE FEDERAL GOVERNMENT HAVE TO GAIN?

While the societal arguments for enacting a PILOT may be laudable, the real test will be in persuading the Congress. There are at least three good reasons for its enactment.

First, by eliminating the overlapping features of the existing patchwork of programs, Congress would not only reduce its own workload but also streamline the federal-state-local relationship.

Second, it would simplify the patchwork of federal payment policies. At present there is no guiding principle as to how federally owned properties are to be treated for purposes of compensating local governments for the federal presence. A uniform PILOT would provide this guidance.

Third, such a payment would be superb intergovernmental relations. According to Douglas H. Clark, assistant director of Federal Provincial Relations for the Department of Finance of Canada, the Canadians' 20-year-old federal to local PILOT program creates more goodwill with the citizenry than any other federal program or activity. Why? Because people see the federal government as accepting its fair share of property taxpaying responsibility; it is simply "good neighbor" politics.

ACIR RECOMMENDATIONS

In light of these findings and conclusions, the Commission has made the following recommendations regarding the tax exempt status of federal and state-owned real property:

Recommendation 1

Improve the Inventory of Federal Real Property Located Within the United States

The Commission finds that there is a great need for the U.S. government to develop procedures which will permit the government as well as the citizenry of this country to have biennial estimates of the current value of federally owned real property in the United States. The Commission, therefore, recommends that the U.S. General Services Administration (or other agency designated by the Congress) establish permanent procedures to:

- **record the current value of all federally owned properties;**
- **require internally consistent reporting requirements of all federal agencies, civilian and military; and**
- **improve its recordkeeping on the actual physical location of all government facilities.**

Recommendation 2

Congressional Authorization for a Tax Equivalency System of Federal Payments in Lieu of Taxes on Federal Real Property

The Commission finds that the current federal immunity from the real property tax not only leads to a significant erosion of the total state and local own source revenue base but that it

also leads to gross violations of the equity principle in public finance that taxpayers in equal circumstances be treated equally. The Commission, therefore recommends that the Congress authorize a program of payments in lieu of real property taxes to state and local governments in an amount equal to that which would be paid if the federal government were actually subject to the real property tax. The payment base should be restricted to those federal holdings not associated with open space properties which are at present covered under existing general receipts-sharing programs which the Commission recommends be continued. *

The Commission further recommends that the adoption of such a policy should be viewed as replacing rather than supplementing the existing patchwork of in lieu of real property tax payments, except for payments such as are made on the basis of the exclusions noted above.

The Commission also recommends that this policy be administered under established state-local procedures, including all provisions for administrative and judicial review of assessments, tax rules, and levies.

The compensatory objective of the payment in lieu of tax program is separate from all other federal programs which provide general and categorical assistance. It, therefore, should not be linked to policy decisions regarding these other aid forms.

Recommendation 3

State Government Enactment of a Tax Equivalency System of Payments in Lieu of Taxes on State-Owned Real Property.

The Commission finds that the state programs which do compensate local governments for the real property tax immunity of state-owned property are, like those of the federal government, typically of a patchwork nature and lacking of any guiding principle for uniformity determining the level of a payment. Accordingly, the Commission recommends that each state examine its own real property tax immunity and consider authorizing programs designed to fully compensate local governments for the revenues lost due to the exemption of state-owned real property.

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*Congressman Fountain did not participate in this recommendation because this is a matter within the legislative jurisdiction of the subcommittee he chairs.

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What is ACIR?

The Advisory Commission on Intergovernmental Relations (ACIR) was created by the Congress in 1959 to monitor the operation of the American federal system and to recommend improvements. ACIR is a permanent national bipartisan body representing the executive and legislative branches of Federal, state, and local government and the public.

The Commission is composed of 26 members—nine representing the Federal government, 14 representing state and local government, and three representing the public. The President appoints 20—three private citizens and three Federal executive officials directly and four governors, three state legislators, four mayors, and three elected county officials from slates nominated by the National Governors' Association, the National Conference of State Legislatures, the National League of Cities/U.S. Conference of Mayors, and the National Association of Counties. The three Senators are chosen by the President of the Senate and the three Congressmen by the Speaker of the House.

Each Commission member serves a two year term and may be reappointed.

As a continuing body, the Commission approaches its work by addressing itself to specific issues and problems, the resolution of which would produce improved cooperation among the levels of government and more effective functioning of the federal system. In addition to dealing with the all important functional and structural relationships among the various governments, the Commission has also extensively studied critical stresses currently being placed on traditional governmental taxing practices. One of the long range efforts of the Commission has been to seek ways to improve Federal, state, and local governmental taxing practices and policies to achieve equitable allocation of resources, increased efficiency in collection and administration, and reduced compliance burdens upon the taxpayers.

Studies undertaken by the Commission have dealt with subjects as diverse as transportation and as specific as state taxation of out-of-state depositories; as wide ranging as substate regionalism to the more specialized issue of local revenue diversification. In selecting items for the work program, the Commission considers the relative importance and urgency of the problem, its manageability from the point of view of finances and staff available to ACIR and the extent to which the Commission can make a fruitful contribution toward the solution of the problem.

After selecting specific intergovernmental issues for investigation, ACIR follows a multistep procedure that assures review and comment by representatives of all points of view, all affected levels of government, technical experts, and interested groups. The Commission then debates each issue and formulates its policy position. Commission findings and recommendations are published and draft bills and executive orders developed to assist in implementing ACIR policies.