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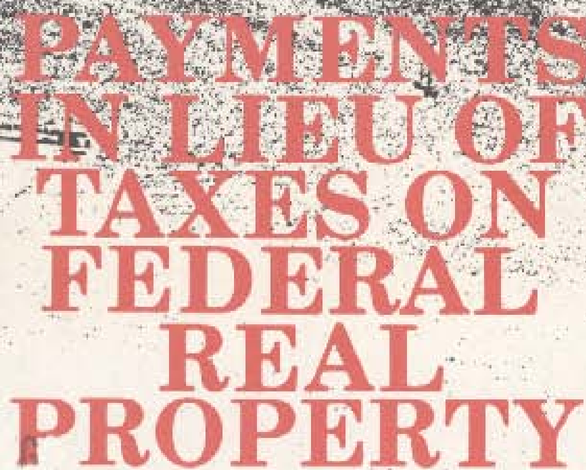
A COMMISSION REPORT



PAYMENTS IN LIEU OF TAXES ON FEDERAL REAL PROPERTY

Advisory Commission on Intergovernmental Relations

SEPTEMBER 1981 • WASHINGTON, D.C. 20575

A-90

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.

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Preface

This report focuses on one of the most distinctive features of the U.S. system of federalism—the federal government's immunity from state and local real property taxation. Specifically it examines whether it is time to modify or even eliminate the exemption and presents recommendations to the Congress to authorize a comprehensive system of payments in lieu of real property taxes designed to compensate, on a full tax equivalency basis, state and local governments for the revenues lost due to the exemption.

The call for a rationalization of the current system is not new. Public land ownership has been an issue of heated debate throughout this century. And the Kestnbaum Commission, the "early ACIR," addressed this subject in a 1955 report. The commission recommended that the national government inaugurate a broad system of payments in lieu of property taxes to state and local governments as "necessary to help preserve financially healthy local governments."

Since that time the scope and dimension of the issues associated with federally owned real property have grown. Not only has the federal government added billions of dollars of real property to its total holdings, but there is every indication that it plans to increase its real property holdings in the future. According to a 1979 report of the U.S. General Accounting Office, the federal government is authorized to acquire $4 billion of private land during the next 11 years. Accordingly, by examining the issue of the tax status of this federal property, the Commission is not only preserving a link to its past but, in addition, is adhering to its long-established practice of discussing at an early stage emerging policy problems that are likely to require remedial legislative action.

Except for a 1970 report of the Public Land Law Review Commission, which focused only on the narrow issue of the treatment of certain "open space" lands (recreation, watershed, national park areas), the federal government had not reexamined the payment in lieu of tax issue since the Kestnbaum report.

The 1976 *Payments In Lieu of Tax Act* and a 1978 report by this Commission again broke the ice in this very important area of federal-state-local taxation. Responding to P.L. 94–565, a general law which provides compensation to states and localities for National Forest and most other types of underdeveloped federal land, the Commission published *The Adequacy of Federal Compensation to Local Governments for Tax Exempt Federal Lands* (A–68). However, even that study still left unexamined the question of how "nonopen space" federal property should be treated in our intergovernmental fiscal system. Concern regarding the proper fiscal treatment of this property by both members of the Commission and members of Congress led the Commission,

at its fall 1978 meeting, to request that the staff undertake an examination of the intergovernmental implications of nonopen space federal properties with specific attention directed toward the question of whether Congress should enact some form of payment in lieu of tax program designed to compensate state and local governments for the property tax loss due to the federal presence.

The major conclusions, findings, and recommendations of the Commission's work are presented in *Chapter 1* of this volume. The remainder of the report provides a more detailed look at the entire issue of federal payments in lieu of taxes. A second volume of technical appendices will be issued soon.

From this analysis the Commission concludes that there is a persuasive case for a uniform payment, based on full tax equivalency of federally owned real properties, within the existing property tax structure of each respective taxing jurisdiction. The findings and conclusions are based upon extensive staff research, which is supported on firm equity grounds.

The equity issue is seen as at least a two-fold problem:

On the one hand, the federal government has not followed the traditional equity considerations of public finance, which would provide that "like properties be treated alike." This is manifest in the policy of directly or indirectly paying taxes for federally owned real property in many, but not all, instances. ACIR's own location provides one good example of this problem. Formerly located in the New Executive Office Building, where no taxes were paid for the building in which it was situated, it is currently located in a privately owned, government-leased building upon which taxes are paid, either through market rental payments to the lessor or through explicit tax escalation clauses (which are built into most GSA leases).

The second and perhaps more important of the major inequities that are mentioned briefly here is the ad hoc method of "compensation" for tax exempt properties, which the federal government has developed over time, as is evidenced by the existence of 57 different federal payment programs. None of these programs provides for a uniform payment for all types of federally owned property. Moreover, many of the payments are the result of negotiations with federal agencies at the local level, rather than being based on any guiding principles of fiscal economics.

Central to the report's analysis is a look at the quantitative aspects of a comprehensive payments in lieu of taxes program, including estimates of the cost of such a program to the U.S. Treasury and the geographic distribution of the payments. The report includes a complete discussion of the pros and cons of the proposal for Congress to authorize a broad-payment program. This discussion ranges from arguments that state and local governments may not actually "need" additional real property tax revenues to the viewpoint that a PILOT-type reform would generate significant economic and political benefits to the federal and state/local sectors alike.

Abraham D. Beame
Chairman

Acknowledgments

This report was coauthored by Robert D. Ebel and Joan E. Towles and prepared in the ACIR's division of Taxation and Finance directed by John Shannon.

The authors wish to especially acknowledge the comments and assistance throughout the writing of the report by Douglas Clark, Federal Provincial Relations Division of the Canadian Department of Finance; Edgar Estep and Virginia Collins, U.S. General Services Administration; John Behrens, U.S. Bureau of the Census; Robert Stein, Rice University; John Rackham, U.S. Postal Service; and ACIR colleagues Will Myers, and Frank Tippett.

In preparing this report the Commission followed its normal procedures of holding a thinkers' session to respond to the study outline, continually consulting experts in public economics throughout the research process, and formally presenting the draft report to critics for their review prior to sending the final report to the members of the Commission. Here it is difficult to adequately acknowledge everyone who helped in this effort. The list, however, would surely include the following: Richard Almy, Michael Bell, Barbara Boslego, Donald Boyd, Bob Breezee, Susannah Calkins, James Carberry, Henry Coleman, Peter Crane, Jerry Emrich, Anita Gaven, Susan Jacobs, I. M. Labovitz, Richard Levin, Harry Levy, John Lynch, Ted Masters, John Ross, Charles Stephenson, Jim Stine, and Matthew Watson.

Jacob Jaffe edited the final report and Lavinia Clarke and Ruth Phillips put in endless hours in typing several drafts of this study.

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Chapter 1

Introduction, Conclusions, and Recommendations

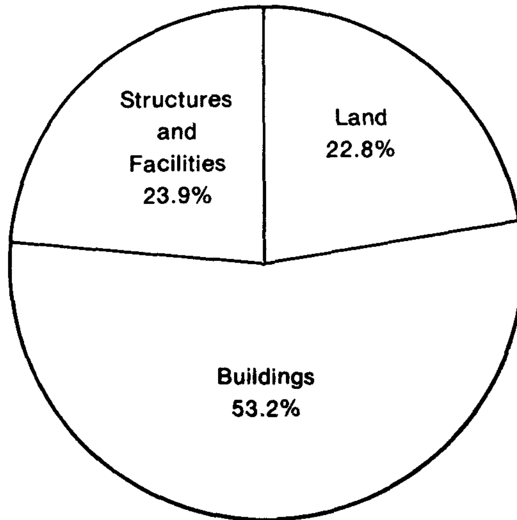
PURPOSE AND SCOPE OF THE REPORT

The federal government is the single largest owner of real property in the United States. It currently owns 775.3 million acres, more than one-third of the country's entire land area. In addition, it owns 23,988 installations, 2,598 million square feet of floor area, and various other buildings and structures and facilities. In 1978, the total value of U.S. real property was valued at approximately $279 billion, 23% in land, 53% in buildings, and 24% in structures and facilities. (See *Chart 1*.)

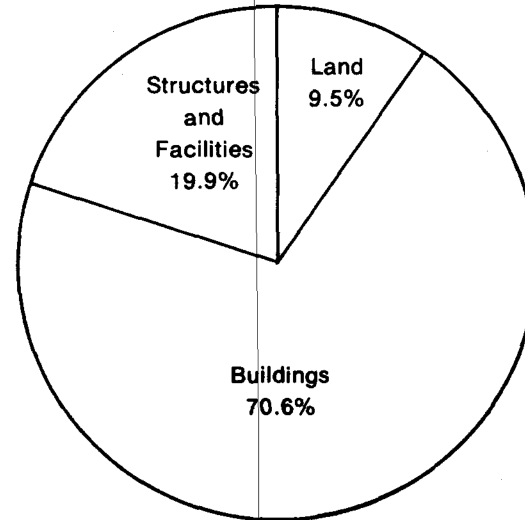
These holdings include forest reserves, office buildings, harbors, housing projects, grazing lands, waterways, airports, cemeteries, hospitals, defense bases, parks, power lines, utility systems, museums, industrial facilities, communications systems, railroads, navigation and traffic aids, monuments and memorials, and even islands used for military target practice. Moreover, the magnitude of these holdings can be expected to grow. At present the U.S. government is authorized to acquire up to $4 billion worth of private land during the next three years. In fact, a recent report of the U.S. General Accounting Office notes that the National Park, Forest, and U.S. Fish and Wildlife Services have been consistently following a gener-

Chart 1

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



All Federally Owned Real Property in the United States



Federally Owned Real Property in the United States Excluding Certain Usage Categories for "Open Space" Lands

SOURCE: Table 19.

al practice of acquiring as much private land as possible "regardless of need, alternative land control methods, and impacts on private landowners."[1]

The incidence of federally owned properties varies widely across the 50 states. They are located in both rural and urban areas, and are industrial and nonindustrial, residential and commercial, permanent and semipermanent. Some of them provide largely local services, while others are regionally or nationally oriented. Some profoundly affect the fiscal and economic base of their communities, while others have only the most minor of impacts.

The one generalization that can best be made regarding the array of federally owned property is that there is no guiding principle regarding the extent to which the federal government as a property owner should contribute to the financial support of state and local governments. Some local governments share in the revenues generated by federal establishments operating within their borders, primarily from mineral leasing or from the sale of grazing, farming, and forestry rights to private interests. On other properties, Congress has recognized a responsibility for a partial or full payment in lieu of taxes (PILOT) to state and local governments as compensation for property taxes foregone. For some of its instrumentalities, such as its various banking and credit institutions, the federal government has authorized the full range of direct state/local taxation. Most commonly, however, the Congress has declared the U.S. government exempt from both direct state/local taxation as well as from any in lieu of tax responsibility. This is true despite the fact that, over the years, its own committees and study groups have recommended enactment of some form of uniform payment system to compensate all states and localities for the effect of the federal presence on property tax revenues. Indeed, in 1969, the Joint Economic Committee of the U.S. Congress, arguing "only basic equity," urged that Congress make payments in lieu of real property taxes on property owned by both the U.S. government and foreign governments (embassies, consulates, missions) in the U.S.[2]

It should be recognized, of course, that the federal government already does "pay" property taxes—not in its role as a property owner, but as a lessee of private real estate. In fact, in 1978 approximately $320 million was paid in this manner, and distributed among various taxing jurisdictions according to the mix of leasehold vs. ownership decisions made by the separate U.S. government agencies and instrumentalities throughout the country.

In short, the federal payment and tax system is a patchwork of uncoordinated programs. The federal establishment could use similar amounts of real property in each of ten different localities and, depending on a host of different institutional factors, pay different amounts of tax revenues or in lieu payments—or no payment—to each of the ten jurisdictions.

This diversity of the federal government's definitions of its taxable (including payments in lieu of taxes) status relative to state and local jurisdictions creates critical policy questions. They concern not only the lease vs. own-type of considerations mentioned above, but also other major issues, such as (1) the equity of taxing private property owners while exempting federal agencies when both derive local public service benefits, and (2) the effect of the tax exemption on the federal government's use of land and on the local tax base.

In view of these issues, the ACIR has undertaken, in two separate studies, a detailed examination of the nature of the current system by which the federal government compensates—or fails to compensate—state and local governments for the presence of federally owned tax exempt properties.

The first of these Commission reports, published in 1978, was an analysis of the adequacy of federal payments to local governments for specific types of tax exempt federal lands administered by the Bureau of Land Management, the Forest Service, the Army Corps of Engineers, the Bureau of Reclamation, and the National Park Service.[3] Specifically, the study evaluated the payment programs directed largely toward the western U.S. counties under various receipts-sharing and guaranteed per-acre payment programs as provided for under the *Payments In Lieu of Taxes Act of 1976*. This law, P.L. 94–565, covers National Forest lands, as well as most other types of federal open spaces. P.L. 94–588, enacted shortly thereafter, expanded, from "net" to "gross,"

the income from National Forests subject to sharing.

Despite the breadth of coverage of that report—nearly 90% of federal public lands were included—it left unexamined the question of how "nonopen space" federal properties, including both land and improvements, should be treated in our intergovernmental fiscal system. This group of real properties includes office buildings, post offices, military bases, special purpose facilities, as well as the undeveloped lands not under the jurisdiction of the agencies cited in the 1976 act. These federal holdings present another set of issues regarding federal land acquisition and management practices, the adequacy of current compensatory payment programs, and the impact of these federal properties on our intergovernmental fiscal system.

Accordingly, the Commission requested that the staff undertake an examination of the intergovernmental implications of these additional federal properties with specific attention directed to the question of whether Congress should enact a broad-based system of payments in lieu of taxes (PILOT) designed to compensate state and local governments for the federal presence.

This report addresses that request. Specifically, it examines whether a federal payment should be made on the value of properties owned by the federal government and its agencies and instrumentalities, or whether it is preferable to maintain the current system. The study presents an analysis of the conceptual, quantitative, and administrative issues associated with existing and proposed payment programs.

Chapter 2 begins with a discussion of the judicial (taxable) status of federal properties, and then describes the nature of the special federal payment programs designed to compensate some states and localities for property tax revenues foregone because of exempt holdings.

The nature and scope of the base needed to design a uniform real property PILOT system is examined in *Chapter 3*. Because the study focuses solely on "nonopen space" real properties, the PILOT base is defined here to exclude land such as that used for flood control and navigation, historic sites, parks (including urban parks), forest and wildlife, reclamation and irrigation, grazing, roads or bridges (unless contained within a federal establishment), and monuments and memorials. The PILOT base also excludes land in the public domain (land which was originally placed in U.S. ownership by virtue of its sovereignty and which has never left federal ownership, including lands obtained by the government through exchange of public domain lands).

Once this base is determined, *Chapter 4* establishes a normative framework for evaluating alternative justifications given for a real property tax equivalency PILOT, and the PILOT proposal is evaluated according to various equity, efficiency, and adminstrative considerations. In addition, alternative bases for a tax-equivalency PILOT are discussed.

The main text of the report concludes in *Chapter 5* with a detailed discussion of the current methods employed by the government to inventory and value its real property holdings, and then presents information regarding the cost and geographic distribution of the PILOT if it were enacted on a property tax equivalency basis.

MAJOR CONCLUSIONS

A number of major conclusions have been drawn by the Commission staff based on the research findings associated with the broad scope of this study. These conclusions are:

> **A. *The federal government lacks any procedure that permits it to know the current value of its real property holdings in the U.S. Except for the estimates for 1978 made in this report, there is no inventory of the total value of tax immune federal property. In order to receive useful information for policy regarding the federal government's property wealth, Congress must require that the General Services Administration make major adjustments in its methods of collecting information.***

There is a great need to develop new policies and improve basic management practices for information relating to federal property holdings. In spite of the fact that it is the largest landlord in the country, the U.S. government

has not only failed to keep track of its facilities' locations; but, also, it lacks the necessary information to maintain properly and evaluate the condition of its holdings and their community impact. The General Services Administration (GSA), which has the primary responsibility for "ownership" and management of federal properties, does not maintain accurate information regarding the location, nature, or cost of federal real property. Because of this inadequacy in basic recordkeeping, additional employee and training resources should be allocated for the purpose of maintaining accurate, complete, and current information on each of the federal government's holdings.

In its present form, GSA's *Annual Inventory of Real Property Owned by the U.S. Throughout the World* is of questionable value to federal property management and planning efforts. Although it is the federal government's primary source of information on its real properties, inventory records are incomplete and include only historical cost data which are of little use for current property analyses. Systems analysts and data managers at GSA frequently do not receive accurate or timely information on federal holdings from other reporting agencies and do not have adequate staff resources to manage the computer systems which are used for federal property inventory.

Authority for preparing the GSA real property inventory is contained in the *Federal Property and Administrative Services Act of 1949* (63 Stat. 377), as amended, and is continued at the request of the U.S. Senate Committee on Appropriations. The GSA accordingly provides a detailed listing of real property owned and leased by the federal government inside and outside the U.S., including the cost to the U.S. government for each holding. Published at the end of each fiscal year, three GSA reports list those properties used by both military and civilian agencies at the end of the preceding fiscal year. They are:

1) *Detailed Listing of Real Property Owned by the United States and Used by Civil Agencies Throughout the World;*
2) *Detailed Listing of Real Property Owned by the United States and Used by Military Agencies Throughout the World;* and
3) *Summary Report of Real Property Owned by the United States Throughout the World.*

The third document condenses most of the information in the other two by reformatting tables and highlighting certain statistical summaries with appropriate narrative. Other real property inventories are also compiled annually by each branch of the armed forces.

The GSA is responsible for reporting on general purpose buildings (such as office buildings and warehouses) that are occupied by a federal agency or agencies upon determination by GSA, and are maintained and serviced by GSA. The other reporting agencies are those which have control of, and authority to assign and reassign the use of any portion of, federal property and, in the case of special purpose buildings, those agencies having control of building management and operation. As the agency responsible for inventory, however, GSA must file and code each agency report, yielding the hefty detailed inventories, with thousands of pages, as noted above.

The detailed inventory of federal real property is organized by federal agency and, within the U.S., by state and city. It lists the type of property, predominant usage class, and location (state, city, and county) for each installation, which is the reporting entity. Installations vary in size and type, ranging from a national park or a hydroelectric project to a single office or vacant lot, each property entry being identified as "land," "buildings," or "structures and facilities." An installation can also be a combination of these types of property without the use (usage code) of each parcel being coded separately. Following this basic organization, the report details other federal property management information, such as the year in which the installation was acquired or constructed, the floor area (by square feet), acreage (to the nearest tenth of an acre), and the original cost of each parcel of land, building, structure, or facility.

In conducting this research study, the ACIR staff used GSA's inventory extensively. It found that several major improvements and quality controls on the base are necessary if the data are to be useful in future analysis of current property holdings. In this regard, at least three substantive and procedural proposals can

be made to increase the accuracy and internal consistency of the reported data.

- Record current value of federally owned properties.

The most important requirement is for the inventory to provide current dollar value of the properties owned by the federal government. The positive administrative and public policy features of full disclosure of the value of taxable and tax exempt properties will become clear later; for the present, however, valuation is important in order to show accurately not only the acquisition cost of a property to the government (as required by law), but also an estimate of a property's current market value to facilitate planning and life cycle analysis at both the agency and aggregate federal levels.

The GSA cost figure is recorded in its present form because original Congressional requirements specified only that costs "to" the United States government be identified in the inventory. This has been interpreted to mean costs at the date of original acquisition or construction by the government, along with some adjustment for subsequent construction changes. When actual costs are not ascertainable, they are estimated on the basis of acquisition date. Major capital improvements—items that will require an outlay in excess of $500,000 and must be budgeted by specific Congressional appropriation—are also included in the inventory, frequently as separate line items. When costs are aggregated by total installation, agency, or jurisdiction, however, the costs are summed across the years. The result is that some line items may show an amount spent by the government in a particular year for one purchase or improvement, while others may show a set of historical costs summed over a period of years for one or more purchases and major or minor improvements.

Thus, the Congressional requirement to record costs to the government is satisfied only to the extent that total dollars spent over a period of years are summed and recorded. From a policy perspective, this total is almost meaningless. Moreover, because the GSA summary lists only an estimate of the total dollars paid over the years to acquire or construct federal real property, it gives no indication of the current dollar value or appraisal of this property.

In lieu of an in the field reassessment effort, certain techniques can be applied to the existing data base to provide an annual estimate of the current value of these properties. For example, a time series set of inflators and price indexes can be applied to the real property inventory to yield reasonably accurate data upon which to base an estimated PILOT. In fact, by working with local governments and other federal reporting agencies, GSA could improve its cost data rather quickly and easily. To improve on these trending-type data, the federal government could conduct field appraisal of its properties on a periodic basis.

- Develop internally consistent reporting requirements for all federal properties.

The GSA inventory should record the same data for all types of federal property or make its data consistent among the separate classes of federally owned property. Presently, the cost of properties acquired through donation, exchange, forfeiture, or judicial process is estimated at amounts the government would have had to pay for the properties if purchased at the date of acquisition. In contrast, no costs are included in the inventory report for public domain lands, whether unreserved or reserved for national parks, national forests, or military reservations, or for historical sites that were not originally acquired by purchase. However, the acreage of these lands and other descriptive data are fully listed, even with these cost omissions.*

In addition, complete data are not reported for lands, buildings, and structures and facilities which are not wholly owned by the federal government. Lands that are not owned in fee

* "Public domain" is defined to cover original public domain lands and those withdrawn from the original public domain for specific uses of the various federal agencies. The term "original public domain land" embraces all the area title which was vested in the U.S. government by virtue of its sovereignty. Public domain lands are thus both original public domain which have never left federal ownership and also lands within federal ownership which were obtained by the government in exchange for public domain lands or for timber on such lands. Original public domain lands which have reverted to federal ownership through the operation of public land laws are also included in the category.

simple are listed elsewhere in the inventory report, if at all. For example, data on properties held in trust by the federal government are limited to acreage and number of buildings and are shown separately in another section of the report. Moreover, the inventory excludes entirely the following items: lands administered by the U.S. under trusteeship for the United Nations; lands owned by the sovereign governments of the outlying areas of the U.S. (Guam, Samoa); easements, rights of way, and properties acquired (usually temporarily) in settlement of a claim by, or debt to the government. Costs for structural changes to buildings and facilities which are not owned by the U.S. are also excluded, although federally owned buildings and structures and facilities located on leased land are detailed. Information on real property and land that is leased by the federal government is contained in a separate set of inventory reports published by GSA.

The point here is that while GSA may acquire different types of information for different types of properties, it should avoid "mixing apples with oranges." The agency may, for good reasons, decide to separate the lands it owns from the lands it holds in trust and to list costs (or, preferably, current values) for the former rather than the latter. However, because they are properties which are wholly owned by the federal government, public domain lands might reasonably be listed with appraisals or estimated current values in the same manner as donated lands or lands acquired by means other than by purchase. In sum, refined or newly developed reporting requirements should go beyond a listing of the historical costs to the federal government and instead present uniform current value data for all federally owned properties.

- The GSA should maintain accurate records on the precise location of each of its facilities.

Considering the impacts of and interest in facility locations, the GSA should record the proper city and county jurisdictions in which each of its facilities is located. This proposal would require a redefinition of what constitutes an "urban" or "rural" location, as well as greater field accuracy for reporting to GSA.

As currently assigned in the real property inventory, the urban code of a federal installation provides no guarantee that the installation is actually located within that jurisdiction. The criteria for GSA urban or rural property classifications follow the rather meaningless delineation of either being located in or out of incorporated areas of 2,500 persons or areas with similar characteristics. Barring the use of these guidelines, an area could still qualify for urban status if it at least had a street address. However, the *coup de grace* remains: installations that are not in an urbanized area are given the GSA geographic city code of the nearest locality. Consequently, as many as 50% of the installations are not located within the jurisdictional boundaries of the city indicated by their GSA inventory code. The city code is therefore highly suspect and the efficacy of its use questionable.

The geographic dimensions of both city and county indicate a higher accuracy of county codes in the GSA detailed inventory. Because counties are larger than cities, the county location of an installation can usually be assigned in a relatively straightforward manner. When an entire installation is contained in more than one county, however, some other decisions need to be made. At present, some reporting agencies list the installation in the county with the larger holding. However, it is still common practice (and, until the 1979 inventory reporting forms, specified by GSA) to give multicounty and some multicity installations a "999" or "9999" (respectively) geographic code, which excludes that installation from the corresponding GSA county, city, or county and city-detailed listings.

As a result of this practice, the "999" parcels are clustered at the end of each state detailed inventory listing and can be used in national and state summary totals, but not in city or county totals or subtotals. These lands are held primarily by the Bureau of Land Management (e.g., administrative, recreation, sanitation, and camping stations, usually in the public domain), the Army Corps of Engineers (e.g., locks, dams, reservoirs, lakes), and the Department of Defense (e.g., large military installations).[4] Indeed, as much as three-fourths of the military holdings may be listed with this code. For this study's purposes, most of the "999"

problem was overcome by patching together alternative military data bases and by reporting real property values on a state-by-state basis rather than by places and types of local government.

A second caveat applies equally to the county and city geographic code listings; some installation codes reflect the location of a military command or regional office ("parent" code) rather than the city or county in which the subject land, building, structure, or facility may be situated. Although the extent of inaccuracy resulting from this practice is not known, the error appears to be confined to Army and Navy holdings. To correct this situation, there will have to be some manual checking and recoding of data records to separate installation location from its command name or location. The Navy is at present undertaking such a project; others should follow suit.

If these collective findings are addressed, the existing GSA data base would be improved immensely. In addition, it would become more consistent with the corresponding military inventories and would thus be a better check on the condition of each agency's holdings.

B. *The Nature of the Legal Framework for Property Tax Immunity Has Changed Over Time.*

There are no inherent constitutional barriers to either the direct imposition of nondiscriminatory state/local taxes on federal real property or an equivalent payment in lieu of taxes on real property owned by the U.S. government. In both cases, only statutory consent of Congress is required. Moreover, such statutory action, particularly in the case of actual taxing power, can be viewed as part of a continuing process of limiting the scope of the intergovernmental tax immunities doctrine.

The doctrine that the federal government may not be taxed by a state or local government had its origin in the U.S. Supreme Court's 1819 *McCulloch vs. Maryland* decision, which invalidated a State of Maryland tax directed at the Baltimore branch of what was then the United States Bank. The Maryland law was as strong as it was discriminatory against the federal bank. Accordingly, Chief Justice John Marshall, speaking for the Court, declared such special and discriminatory taxes on the federal government could make it dependent on the state government, thus violating the "great principle" of federalism that "the Constitution and the laws made in pursuance thereof are supreme." At the same time, however, Marshall also specifically noted that the *McCulloch vs. Maryland* decision did not extend to general and nondiscriminatory taxes which fell on the federal establishment.

During the next century, subsequent court decisions expanded the doctrine of federal tax immunity and, at one point, even extended the primary immunity of the governmental activity over its own operation to the derivative immunity of third persons, such as employees and lessees of the federal government.

Beginning in the 1930s, however, the judiciary began to sharply narrow the immunities doctrine to the point where, today, it is generally accepted that Congress has full statutory power to define the scope of state/local tax immunity for federal agencies and instrumentalities. The progression since the 1930s from a broad to a narrow application of the immunities doctrine is clearly illustrated. For example, in 1936 the Congress, through the *Hayden-Cartwright Act*, consented to state taxation of sales of gasoline and other motor vehicle fuels on federal enclaves when such fuels were not used exclusively by the federal government. That same year, the Congress also authorized the application of state workmen's compensation laws to federal areas. In 1939, it provided for the application of state unemployment compensation laws. *The Buck Act of 1940* permitted the states to impose sales, use, gross receipts, and gross and net income taxes on private persons within federal areas. Nine years later, the *Wherry Housing Act* authorized state and local governments to tax the interest of private individuals who lease land on military reservations, construct housing, and rent it to military personnel.

As the immunities doctrine was narrowed, Congress also began to recognize its fiscal responsibilities for compensating state and local governments for the effects of federal tax immunity. Currently, three principal methods are used by Congress to compensate state and local governments for the federal tax immunity: payments to states and localities of a specified per-

centage of revenues from federal operations; payments by the federal instrumentality of a tax equivalent out of revenue receipts or appropriations; and the waiver of federal property tax immunity. The waiver was first authorized on real property acquired by the Reconstruction Finance Corporation, on foreclosed properties, and on many war plants acquired during or after World War II. It is now authorized for the real property holdings of federally owned corporations and federal financial institutions (federal credit unions, Amtrak, the Federal Deposit Insurance Corporation, the Federal Home Loan Insurance Corporation, and the Federal Reserve Banks).

Thus, although considerable legal controversy remains over the exact status of the immunities doctrine, during the past half century there has been a clearly observable trend for Congress to reduce the effects of the immunities doctrine on state and local governments. Enactment of a comprehensive PILOT for U.S.-owned real property, or for that matter Congressional consent to direct state/local real property taxation of the federal government, would not be a radical departure from existing intergovernmental tax arrangements. On the contrary, it is a logical extension of those relationships.

C. *Federal tax exemptions erode a large part of state and local tax bases.*

Several arguments can be marshaled both for and against any type of institutional exemption from a comprehensive tax base. The justification given for exemptions range from the "need" to provide locational incentives to some private firms, to the simple fact that the exemption is mandated by a higher level of government and therefore is beyond local control. The arguments against exemptions usually center on the concerns for taxpayer equity and economic efficiency, and the erosion of the local tax base. Each of these topics has been examined in this report as it relates specifically to the immunity of the federal government from state and local taxation.

From an overall local policy perspective, perhaps the most important of these issues centers on the local government revenue loss from real property tax exemption. In the context of the federal immunity issue, this loss is, indeed, quite large. In 1978, the current dollar value of *all* federally owned property in the U.S. that was exempt from real property taxation amounted to $279 billion. If one excludes "open space" lands (as is proposed in *Chapter 3* of this study), the total erosion amounts to $210 billion. To put this in perspective, if this $210 billion were fully taxable, and no other adjustments were made in current property tax rates or federal payment programs, $3.65 billion would have been added to state and, primarily, local treasuries (96%).[5] This is equivalent to an increase in total local property collections of almost 6%.

If local governments could make up for this revenue loss by simply using nonproperty tax sources more extensively, the policy concern regarding this erosion of the revenue base might not be so important. However, the "open economy" * characteristic of subnational government virtually dictates that local governments must employ taxes on immovable property as the mainstay of their own-source revenues. Moreover, in the present fiscal environment, which provides for a growing local dependency upon outside—state and federal—aid to local governments, the maintenance of own-source revenues to meet both traditional and recently mandated costs at the local level has become more important.

Stated otherwise, if an accepted goal of U.S. federalism is to have a financially strong and independent local government sector that is able to carry out peculiarly local functions—such as the provisions of police, fire, and judicial protection, public education, and low to moderate income housing services—then a closer look at the policy of federal real property tax immunity is clearly warranted.

D. *The federal immunity from state and local taxes violates major equity principles of public finance.*

Because the federal government is exempt from paying state and local taxes on most of its activities and properties, a basic equity princi-

* An open economy is characterized by a high degree of mobility of goods and factor movements across jurisdictional borders—activities which a local government cannot constrain.

ple of public finance is violated: that "taxpayers" (herein, institutions) in similar circumstances should be treated similarly. This equity violation arises both when the direct property taxpaying status of private institutions is juxtaposed with that of federal government agencies and instrumentalities and when the indirect taxable status of federal leasehold activity is contrasted with the exempt nature of federal property ownership.

Private vs. Public Property Ownership

For practical reasons relating to the open structure of state and local economies, tax base accessibility considerations restrict the form of taxes state and local governments can use to finance public goods and services. As a result, there is a heavy reliance on the real property tax, especially among localities, to finance the entire range of public expenditures. For the same fundamental tax base accessibility reasons, local government must include in that property tax base institutions (e.g., business firms) as well as individuals. This is because the use of the institutional enterprise as a tax collecting intermediary is the only procedure available to subnational governments for assessing individuals—wherever they may reside—for the benefits of public services that accrue to them initially through the institution. It follows that, as a principle of taxation, the services of subnational governments should be treated as a factor of production, just as are the services of the private factors of land, labor, and capital. Moreover, this principle applies to private (e.g., business) and public (e.g., higher levels of government) sector activities alike.

Consider the case of the private business firm. The list of local public services accruing to firms is a long and familiar one, consisting of both direct and indirect expenditures induced by the business presence. The direct expenditures, which are fairly obvious, include services such as fire and police protection, the courts, and the bus or the transit authority which transports the firm's workers. Less obvious, but equally important, are the indirect costs incurred on behalf of the private business community—costs which may be quite significant for some communities. Examples include the government expenses incurred educating the children of the firm's work force, providing increased welfare and other social services, and expanding and maintaining its physical infrastructure (airport or harbor capacity, highways and streets, sewers) to meet additional demands placed on these facilities.

The federal establishment, through its institutions, clearly generates the same sort of costs. In fact, it would be wholly reasonable to replace the words "federal institution" with "business firm" in most (if not all) of the examples cited above. Although the private firm has a different *raison d'etre* than does the federal government, from an intergovernmental perspective the role of the subnational government as a factor of production and provider of services (including the very provision of the marketplace) is the same for both institutions. Consequently, to the extent the local government must finance its resulting service expenditures from the property tax, all of the community's beneficiaries of these expenditures should make property tax contributions.

Thus, when the federal tax immunity is contrasted to the taxpaying status of the private business firm, the conclusion that a fundamental inequity exists is inescapable.

The nature of the fundamental equity violation, though valid, is not quite as neat and straightforward as this initial statement suggests. One might reasonably argue that even if the property tax should or will exist (a presumption which rules out solving the inequity by abolition of the property tax), other "real world" examples of the violation of the equity principle are so important that the violation of the equity goal cited here is primarily academic, rendering the differing treatment of private business and government an interesting but not convincing status. These other examples include (1) the fact that in some instances the federal government provides local services to itself; (2) the recognition that, although the federal government does create public service costs such as those noted above, it also creates significant economic benefits to the jurisdiction in which it is located; (3) the fact that the state and/or local governments grant numerous partial or full property tax exemptions to private profit and nonprofit businesses alike; and, (4) similarly, the fact that not only does a state

government usually declare itself exempt from local taxes, but, in addition, it may mandate a local tax exempt status for some private institutions.

Each of these arguments has merit. However, there are good reasons to reject each of them as a reason for not addressing the equity violation discussed above. The rationale for this conclusion follows.

1. Some federal facilities provide "local" services to themselves.

Any debate regarding the inequity of the federal property tax exemption must consider the fact that some federal agencies provide state/local government-type services for their own personnel which thus reduces their contribution to public budget costs to below what they otherwise would be. The strongest case for this argument is the military facility, which often has its own police, fire, sanitation, and on-base transportation services. A corollary to this is that the most significant direct service activity not provided by the base—education—does receive federal assistance under the Federal Impact Aid Program.[6]

Although the argument has some merit, a close examination also shows that it is not sufficiently persuasive to provide a basis for even a policy of partial tax exemption. This is true for two reasons:

First, the argument focuses entirely on a site-oriented direct cost-of-service concept, ignoring the reality that in the intergovernmental budget context the property tax is the primary own-source revenue by which local governments finance most property and service-related public expenditures.

Second, though the argument correctly notes that the federal government may provide some of its own services, it does not necessarily follow that those activities are supplanting similar state/local services. Indeed, it is equally plausible that the federal police or fire services only supplement readily available public services—much the same as many large private business firms that provide their own security forces, trash removal facilities, and site improvements.

2. Benefits are created by the federal presence.

In this discussion, the driving force behind the argument that there is an inequity between the private institutional taxpayer and the tax exempt federal establishment was that although both contributed to the cost of local government, only the private sector could be taxed to finance these public expenditures.

The other side of this economic equation is that institutions also create a stream of economic and financial benefits for the community. The presence of a federal office building or a military base means increased payrolls, retail sales, and personal incomes, which not only add directly to the overall economic well-being of the residents but also indirectly expand the private sector tax base. Again, the argument has considerable merit—a fact that is attested to each time state and local officials attempt to block the closing of a local federal facility. However, the same kind of benefit stream is created by major private business enterprises. Striking examples—such as the aircraft industry in Seattle, the tourist industry in Miami, and the financial center in New York—illustrate the obvious cases and can, for example, be compared to the also large benefits to the National Capitol area from federal office facilities or the many "military towns" throughout the country. Comparable smaller examples—such as the local grain elevator and the federal post office—also exist. The obvious point is that, just as the federal presence creates community economic benefits, so does the private sector's presence. It makes no more sense to provide property tax exemption for the Bolling Air Force Base in the District of Columbia than it does for the Boeing Airfield in Seattle. Indeed, if anything, this "benefits" argument emphasizes the economic similarity of the private and federal property owners and reinforces the "equal treatment of equals" case for taxation (or PILOT), not a case for selective exemption.

3. There are private institutional property tax exemptions and state government exemptions.

There is very little discussion in this report concerning locally granted institutional property tax exemptions for nonprofit religious, charitable, and educational institutions. Similarly, practically no discussion is devoted to the issue of whether exemptions as tax in-

centives for profit-oriented businesses "should" be made. The view adopted here is that not only have these topics been adequately discussed elsewhere,[7] but that the whole issue is simply outside the scope and purpose of this report—*viz*, to examine and evaluate the economics of the federal real property tax immunity. Thus, regarding the existence of private institutional exemptions, it is sufficient to note that there is an obvious and fundamental "home rule" distinction to be drawn between the locally voted private institutional tax exemption and the exemption that the federal government effectively mandates for itself. However, it is somewhat more difficult to rationalize the local property tax exemptions for state property or for private properties which enjoy immunity due to state laws or state constitutional provisions which mandate the local exemptions. The analogy between the inequities created by the federal immunity and these immunities of the states is clear; in each case a higher level of government is overriding "home rule" decisions.

Nevertheless, despite the linkages of federal and state-determined immunities from local real property taxation, the state-to-local-government issue is not examined at length here.[8] Suffice it to say that many of the arguments pertaining to the federal government's immunity from the local real property tax could also be made for the states.

Similar Federal Activities

In addition to the major structural inequity between the tax treatment of federal and privately owned real property, another equity problem is created by the fact that the federal government already does pay property taxes indirectly on some federal activities that are conducted in buildings leased from private owners, while others operate out of fully tax exempt federally owned real properties. When the federal government leases private property, it not only pays real property taxes as a result of "pass-through" agreements but also because of explicit tax reimbursement clauses in leases with private property owners. As noted earlier, in 1978 approximately $320 million in federal property tax payments was made in this manner. Moreover, this trend has been increasing in recent years. During the period 1957–77, the federal government increased its leased floor area by 148%, compared to a 17.5% increase in its owned floor area. Indeed, in the last ten years alone, the federal government has increased its rented building area by 50%—an increase that was accompanied by a 134% growth in annual rents.

A similar type of tax inequity is created by the federal government's decision to spend between one-fourth and one-fifth of its total budget in purchasing from the private sector products and services ranging from office supplies to the development of sophisticated weapon systems. When these items are purchased from the taxable business entity, the firm acts both as a supplier of the final commodity and as a conduit or intermediary between the tax collecting governments (federal as well as state-local) and the taxpaying purchaser of the final product. In contrast, when these same services are provided on an "in-house" basis out of tax exempt federal facilities, no "business" tax contributions are made. One way to alleviate this inequity, regardless of the in-house vs. procurement mix, would be to attach some form of PILOT to the in-house activity.

> E. ***Although Congress has recognized a responsibility to some local governments for making some form of in lieu of tax payment to "compensate" for the federal presence, the result has been a patchwork of uncoordinated and ad hoc federal payment programs that has developed over the years.***

The federal government has responded to some of the local governments wherein it holds tax exempt real property in several substantially different ways. The first of these is by consent to taxation, under the principles of uniformity, as if the federal government were a private, fully taxable entity. Federally owned corporations and financial institutions are included in this category. Another method of compensation is through "inkind" expenditures provided to communities with large amounts of federally owned land. However, the primary methods of compensatory payments to state and local governments for tax exempt fed-

erally owned real property are through provisions that authorize ad hoc payment programs for certain agencies' tax exempt property holdings.

Currently, there are three major forms of payments to local governments in this third category of federal response:

1) revenue or receipt-sharing payment programs;
2) payment in lieu of tax programs (PILOT); and
3) a variety of formula-based programs.

Of these, the components of the PILOT and formula-type programs are so diverse that, as a consequence, there are nine different program designs, all presumably intended to compensate to some degree for the reduced tax base and the corresponding reduction in local government revenues and/or the change in local government expenditures.

At present there are 57 different federal programs making direct payments to compensate for federally owned tax exempt real property. These programs contain provisions for 64 different payments to local governments, with a total budget authority in 1979 of $2 billion. There are 25 receipt-sharing payments, 18 PILOT-type payments, and 21 formula-based payments. The basic components of each are summarized here.

- Revenue or Receipt-Sharing Payments Program.

Programs with this mode of payment are designed to share the revenues and receipts a state or the national government derives from economic activities conducted on government-owned tax exempt lands 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 sharing of funds from activities on park lands—such as visitor and camping fees—is also widespread. Leases, fees, user charges, and severance levies may also be shared with the local governments in which the tax exempt lands are situated.

The payment programs designed with receipt-sharing provisions are typically the oldest of the operating programs and will specify that a certain percentage of a land fund or resource fund be allocated to the jurisdiction wherein the lands lay, were recovered, or were used. The required shares or percentages currently range from 10% to 90% of gross program receipts. In addition, unlike the typical PILOT or formula-payment program, the receiving jurisdiction is frequently required to use these funds for specific purposes, such as schools, roads, or environmental improvements.

- Payments in Lieu of Tax (PILOT) Programs.

A large number of payment programs relating to government-owned tax exempt property use a payment in lieu of tax approach, with several combinations of valuation and tax rate factors, to determine the amount of payment a locality is entitled to receive. Of the programs, 11 are of a fixed sum nature, three provide for full tax equivalency, and four provide for partial tax equivalent payments related to the value of the tax exempt property:

1. *Payments based on a fixed sum.* In this case, payment is a fixed, or flat, sum of money paid to a locality on an annual basis. The payment is typically an arbitrary amount although, in some cases, it may reflect a fixed amount of a tax liability as of a certain date, such as the date certain parcels of property were acquired.
2. *Full tax equivalency payments.* Payment here is made on the full amount of real property tax which would be due were the property fully taxable in private ownership. It provides 100% compensation for a property's tax liability, using the taxing authority's normal valuation or assessment practices, as well as the millage rates appropriate for that type of property.
3. *Partial tax equivalency payments.* These payments may be made on either a percentage of the full value of the tax exempt property or at a percentage of the rate of taxation for the tax exempt property, thus yielding a reduced effective tax rate (assuming normal assessment procedures), based on a smaller payment than would have been due were the

property fully taxable in private ownership.

This partial payment may be based (a) upon a percentage of the land (actual property) in a jurisdiction, or (b) upon a percentage of the value of real property in a jurisdiction. The actual percentage of either basis may reflect that proportion which is attributable to the federal government's current or past holdings in the locality that is to receive the payment. The percentage is usually quite arbitrary, however, with no firm conceptual basis.

Two additional measures frequently used in partial tax equivalency programs are thresholds (or minimums) and ceilings (or lids) on payments made to local governments. Presumably, the purpose of these devices is to minimize program costs, eliminate the administrative costs associated with smaller payments, or eliminate perceived windfalls to certain communities with large amounts of tax exempt lands. There are, however, serious equity and administrative defects in these rationales, as will be discussed in greater depth later.

- Formula-Based Programs.

The third major form of compensatory payment program consists of a variety of alternative bases for payment by using formula mechanisms. At least four types of formula-based programs can be identified among current programs that make in lieu of property tax payments:

1) a fixed fee per acre of government-owned land;
2) a fixed fee per federal employee;
3) cost-of-service computations, usually reflecting a portion of the operation and maintenance costs of a local government or service authority; and
4) various grants for community assistance, which are frequently targeted to certain local governments that are burdened with large amounts of capital expenditures due to rapidly expanding activities and service requirements on tax exempt government lands.

A common and distinctive feature of formula programs is their negotiated payment character: they typically do not reflect a sophisticated cost analysis nor do they purport to fully reimburse localities for community services. Instead, they represent a series of payments to help defray local government costs. More important, perhaps, is the abandonment of the property-related basis for payment. As a result, a property-based factor might be only one of several factors in a formula that is used to determine a community's entitlement. Thus, the formula-based compensatory payment becomes a form of intergovernmental transfer or grant, unrelated to its legislative intent as an in lieu of tax payment.

F. In general, existing federal grant programs are not designed to compensate subnational governments for revenue losses which result from the federal government tax immunity.

In fiscal 1980 the U.S. government provided $89.8 billion in grants-in-aid (categorical plus general revenue sharing) to state and local governments. That amount is approximately 31% of total state and local own-source revenue, and 16% of total federal outlays.[9] Given these magnitudes, the question surely arises as to whether this aid can be said to "make up" for the quantitatively much smaller state/local real property tax losses resulting from the tax exempt status of the federal government.

To answer this question, two others must also be asked. First, what are the purposes of federal aid? Second, do any of these purposes provide reasons for granting aid in the nature of a payment in lieu of tax designed to compensate states and localities for federally created real property tax erosion?[10]

Recognizing the difficulty of making distinctions between intended and actual purposes of grant programs, federal grants to state and local governments can be distinguished according to whether they provide for social, economic, or financial needs. The purposes of each of these categories is briefly discussed below.[11]

- *Social Need.* The purpose of "social need" grants is to allocate resources to state and local governments in order to

provide the mix of public goods and services Congress deems desirable and for which state and local governments are seen as the institutional units best able to meet the requirements of their residents. Indicators of social needs include the percentage of poor families and individuals living in a jurisdiction, the crime rate, per capita income, and measures of the quality of housing. The list of federal aid programs designed to address these social needs is enormous; grants are provided for such programs as historic preservation, educational television, acquisition and alteration of senior citizen facilities, civil defense and safety training, and housing rehabilitation and construction.

- *Economic Need.* These grants are provided for areas experiencing structural economic decline and are intended to ameliorate the effects in these areas of a declining *economic* base resulting from business and residential migration between cities and suburbs and/or between regions of the nation. Indicators of economic need include changes in population (losses), per capita income, and the employment composition (e.g., losses in manufacturing relative to the service sector) of the city. Community development grants (e.g., the Urban Development Action Grant, Community Development Block Grant), education, training, and technical assistance are examples of the federal assistance programs targeted to economic problems.

- *Financial Need.* Financial need-oriented grants are made to governments—usually urban—to help them cope with fiscal stress, which is manifested by indicators such as low liquidity, large debt, unusually high tax efforts, and unbalanced budgets. Federal programs targeted to fiscal need concerns include General Revenue Sharing, loan guarantees (New York City) and growth impact grants.

Clearly any classification of problems and, therefore, of the general purposes of grant programs, will be somewhat arbitrary, as social, economic, and financial needs may be closely related to one another. Just as these needs or problems are overlapping, so are the effects of the federal grant programs designed to address them. For example, both the General Revenue Sharing and the Local Public Works Programs target to both economic and financial need areas.

The important question for this discussion is whether any of these aid programs are also targeted to state or local areas on the basis of the property tax erosion effect due to the federal presence. The answer is *no* and is supported on both conceptual and empirical grounds.

First, the conceptual framework: although there is little doubt that many of the areas experiencing the economic, social, and financial problems are also those which provide the location for large amounts of nontaxable federal real property, there are numerous fundamental reasons for these "need" problems. Typically, factors such as reduced national population growth, reduced real costs of commuting within metropolitan areas, changes in consumer preferences, advances in consumption as well as product technology, and the consequences of federal policies which have promoted suburbanization (e.g., the interstate highway system, FHA mortgage insurance, and the deductibility of mortgage interest payments from the federal income tax) can be identified as contributors to problems of need.

Certainly, the presence of federal tax exempt activities would be expected to aggravate some of a community's problems—particularly those which are financial. Nevertheless, the fact remains that, except in a relatively few extraordinary situations where the federal government dominates a community tax base (e.g., Kitsap County, WA; Portsmouth, VA), the federal government's tax exempt presence is not a significant root cause of financial, social, or economic community distress.

These conclusions were borne out by an empirical testing of the hypothesis that the value of federally owned real property is not significantly related to a community's social, economic, or fiscal health. In slightly more technical jargon: indicators of the various community needs were not shown to have a positive or negative association with the amount of federal tax exempt property in those jurisdictions.

The major policy implication of this finding is that existing federal aid programs are not designed to address the problem of the erosion of the real property tax due to the federal immunity. Rather, they are designed to address other problems of fiscal, economic, and social need—just as Congress presumably intends. Thus, if one accepts the conclusions stated before—that there are important tax-base erosion issues and tax policy inequities resulting from the federal tax immunity—it follows that the solution to these problems is not found in federal grant programs as presently structured.

G. *Authorization for either full real property taxation of the federal government or a full tax equivalency system of payments in lieu of real property taxes is an appropriate policy response to the status quo.*

The foregoing conclusions regarding ACIR's examination of the characteristics of the federal government's real property tax exemption can be summarized as follows:

- The federal tax immunity is not Constitutionally guaranteed; rather, it could be modified or even completely removed by an act of Congress. Moreover, removal of the exemption, either through the direct authorization of local (and, where it applies, state) taxation or indirectly through the enactment of a federal payment in lieu of taxes would be a natural development rather than a radical departure from the evolving nature of the immunities doctrine.

- The exemption is quantitatively important from a tax base erosion or revenue loss point of view.

- If one accepts (a) the general equity principle of tax policy that taxpayers in similar circumstances should be treated similarly for tax policy purposes; and (b) the proposition that due to the inherent structural and fiscal constraints that characterize the local economy, local governments must rely heavily on the real property tax for general revenue purposes, then the existence of the federal tax immunity violates public finance equity criteria both when viewed as a private (e.g., business enterprise) vs. public (federal establishment) and from a federal leasehold vs. ownership viewpoint.

- The taxation of institutions (government agencies, business firms) is the most effective procedure available to local governments, both for assessing individuals, wherever they may reside—for the benefits of public services accruing initially to the institutional entity and for providing tax signals regarding property utilization decisions. It follows, therefore, that the services of local government should be treated similarly to the services of the private factors of production and that, in the interests of equity and efficiency, their costs should be incorporated into the institution's cost structure.

- Current federal grant-in-aid programs for subnational government do not address the tax base erosion and efficiency and equity concerns created by the federal real property tax immunity.

- Over the years, Congress has recognized a responsibility to some local governments for making some form of special payment or in lieu of tax contribution to compensate local government for the federal presence. Despite this recognition, however, most federal agencies do not make such payments. The result is a patchwork of uncoordinated and, quite often, arbitrarily negotiated payment programs. Currently there are 57 special payment programs, with a total 1979 budget authority of approximately $2 billion.

In light of these findings, ACIR's research leads to the conclusion that the appropriate federal policy response would be to authorize either direct local taxation of federally owned and used real property or enact a uniform system of payments in lieu of taxes (PILOT) based on full tax equivalency. The primary difference between a tax and a payment in lieu of tax is that the latter is technically designed as if it were an unrestricted grant.

With an in lieu of tax payment, the Congress acknowledges its fiscal responsibility for federal tax immunity but, at the same time, avoids formally acknowledging its status as a "taxpayer." However, if properly administratively structured, the fiscal and economic effects of an actual tax payment and a PILOT are much the same.

In the examination of the merits of using a full real property tax equivalency base for measuring the PILOT, several alternative payment bases were examined. All are found to be inferior to the full equivalency approach. These alternatives and their major characteristics are examined in *Chapter 4* and are summarized below:

- *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. These include the major problems of the treatment of public goods consumed by individuals and institutions, the measurement of the marginal public costs (operating and capital) made necessary by the federal presence, and the effects of federal expenditure mandates on state and local governments. Moreover, this "cost" view ignores the practical reality that the real property tax, as the mainstay of local own-source revenues, must be used to finance some services which may have few "cost-of-service" characteristics.

- *Discounting for Own-Provided 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 conceptual merit. However, there are also numerous conceptual and implementation problems. The most fundamental conceptual issue deals with 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 public costs.

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

  a. A benefits adjustment violates the guiding equity and efficiency principles which assert that, by acquiring federal property, the U.S. government has assumed responsibilities similar to those of a private property owner; application of the net benefit test to private taxpayers would destroy the entire state-local real property tax system.

  b. The observable net benefits may exist only in the short run and are generally comparable to those derived from similar private enterprises.

  c. Methodologically, the concept of a net benefit test for all federal facilities within local jurisdictions is not only so complex and speculative as to raise serious implementation problems, but, in addition, where the "federal establishment" can be said to have altered the entire structure of a community, the benefits-cost criteria are altogether inapplicable.

- *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-based options on the criterion of maximum Congressional control. However, the approach lacks any *a priori* framework; its arbitrary nature fails to address the equity (e.g., lease vs. ownership) concerns and fails to place a tax price on federal property holdings, thereby thwarting efficiency gains 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 a given set of small recipient local jurisdictions from the payment program. Beyond that, however, there is much to recommend against the threshold approach. Not only would this method of determining the federal payment base thwart attempts to correct the inequities discussed above, it would also create a whole new set of inequities. Thus, it is virtually impossible to arrive at a logical basis for establishing a threshold percentage.

H. ***Real property taxation of the federal government or a full tax equivalency system of payments in lieu of real property taxes is a workable policy response to the status quo.***

Although implementation problems need to be worked out in establishing a tax equivalency PILOT—as they would with any new levy—these problems are not a barrier to the establishment of a full real property tax equivalency, federal to state/local payment program. This conclusion follows from the state of the art of property tax administration in the U.S., the similarity of federally owned properties to taxable privately owned properties 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 involved in valuation and assessment procedures are not an impediment to establishing a PILOT that uses existing local government taxing systems. The types of federally owned properties (usage categories) are fundamentally no different from those of properties now taxable. Thus, the bulk of federal properties will not present any special valuation problems to the assessor. Indeed, the current national trend is to require local inventory and assessment of tax exempt, including government-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 such as the U.S. Postal Service. In Canada, the federal review process has worked remarkably smoothly through a federal real estate board.

The federal government could establish a new agency or office to determine the current value of each of the buildings, structures and facilities, and parcels of land it owns in the U.S. This is unnecessary, however. 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.

Moreover, this federal payment, whether it is an unconditional grant or an actual tax payment, can be absorbed into local revenue structures as easily as are current property tax revenues. From an economic policy and operational views, as well as from a Congressional workload and oversight perspective, the enactment of a comprehensive uniform PILOT would be best accomplished if, when authorized, it would at the same time replace several of the existing ad hoc federal payment programs.

RECOMMENDATIONS

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

Recommendation 1

Improvement of 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 a biennial estimate 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

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

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.*

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

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 Federal 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 any guiding principle for uniformity in 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.

FOOTNOTES

[1]U.S. General Accounting Office, *The Federal Drive to Acquire Private Lands Should Be Reassessed*, CED–8014, Washington, DC, U.S. Government Accounting Office, December 1979, Cover 1.

[2]U.S. Congress, Joint Economic Committee, *Joint Economic Committee Report on the 1969 Economic Report of the President*, Washington, DC, U.S. Government Printing Office, April 1969, p. 126.

[3]ACIR, *The Adequacy of Federal Compensation to Local Governments for Tax Exempt Land*, A–68, Washington, DC, 1978.

[4] Other properties without a county identification include some additional installations managed by the Tennessee Valley Authority and the Departments of Agriculture, Justice, Interior, and Transportation.

[5] Changes such as a downward adjustment of local tax rates and the replacement of the current $2 billion of in lieu of tax payments and special federal receipts/revenue sharing programs will reduce this esti-

mated payment. This is discussed in detail in *Chapter 5*.

[6] This program is discussed in *Chapter 2*.

[7] L. Richard Gabler and John Shannon, "The Exemption of Religious, Educational, and Charitable Institutions from Property Taxation," in *Research Papers Sponsored by the Commission on Private Philanthrophy and Public Needs*, Vol. IV, "Taxes," Washington, DC, U.S. Department of the Treasury, 1977, pp. 2535–2572; ACIR, *The Role of the States in Strengthening the Property Tax*, Washington, DC, 1963; Joan E. Towles, *Financial Plan for the Pineland's Comprehensive Management Plan, Vol. II*, Princeton, NJ, Government Finance Associates, Inc., 1980.

[8] See, however, a discussion and listing of state to local payment in lieu of tax systems in 37 states in *Volume 2* of this report.

[9] ACIR, *Significant Features of Fiscal Federalism, 1979–80 Edition*, M–123, Washington, DC, October 1980, p. 161.

[10] A possible third question as to whether this aid substitutes for or stimulates state/local spending is not addressed here. For a review of that issue, see ACIR, *Federal Grants: Their Effects on State-Local Expenditures, Employment Levels, Wage Rates*, A–61, Washington, DC, 1977.

[11] This generally accepted division is used by Peggy L. Cuciti, in *City Need and the Responsiveness of Federal Grants Programs*, a report to the Subcommittee on the City of the Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, 95th Congress, 2nd Sess., Washington, DC, U.S. Government Printing Office, 1978. The definitions used by Cuciti are essentially the same as those adopted here. These definitions have also been adopted in a forthcoming report, *Changing Conditions in Large Metropolitan Areas*, prepared by the Department of Housing and Urban Development, Office of Policy Development and Research, for the Interagency Task Force on Urban Data.

Chapter 2

The Intergovernmental Framework: The Current Status of Federal Payments to State and Local Governments

One of the most distinctive and politically sensitive features of the U.S. system of fiscal federalism is the reciprocal intergovernmental tax immunities doctrine. Under this doctrine—a doctrine which has evolved over years of economic and political debate and judicial decisions often characterized by heated dissent—it is generally held that state and local governments may not tax the federal establishment and that, in turn, the federal government may not tax the instrumentalities of states and municipalities engaged in governmental activities.

There is still a great deal of disagreement regarding both the extent to which this principle is abused by the Congress and the bureaucracy, and, also, the degree of "reciprocity" that actually exists in this arrangement. It is argued that, in practice, the doctrine protects the federal government against taxation by the states but does not equally shield the states against the taxing power of the federal government.[1]

If the federal system were being designed today, the desirability of the immunities doctrine would be a proper area for debate; however, the focus would be on the doctrine's usefulness as a legislated policy tool and its tax base and equity implications rather than on its original constitutional justification as a device to protect the federal government from being "destroyed" by subnational taxation.

Although a total redesign may be desirable,

it is not of primary concern here. Nor, in fact, is the validity or propriety of the immunities doctrine. What is of interest is an examination of the economic and fiscal effects of a major element of the doctrine—the exemption from real property taxation of federally owned properties. Specifically, this study examines the issue of whether the federal government should make payments in lieu of taxes (PILOT) for the state/local revenues foregone because of the real property exemption. Indeed, it should be noted at the outset that, for this study, a PILOT can be operationally viewed as a discretionary federal grant and not as a direct tax—a distinction which is necessary in order to avoid the issue of federal consent to taxation.

To reflect these concerns, this chapter provides the initial conditions for the remainder of the report. The chapter is divided into three sections.

The first section reviews the major features of the intergovernmental tax immunity doctrine as it applies to state and local taxation of the U.S. government. This provides a legal framework for understanding the underpinnings of the economic policy issues addressed in subsequent chapters.

The second part of the chapter discusses how Congress has acknowledged the adverse effects of federal property acquisitions and expansions upon local governments by enacting various statutory provisions which authorize some payments to these local governments.

Finally, the third section reviews several major reports that have examined the tax exempt status of federally owned properties and some in lieu of tax payment schemes.

JUDICIAL STATUS

McCulloch vs. Maryland

The doctrine that the federal government may not be taxed by a state or local government has its origin in the Supreme Court's 1819 *McCulloch vs. Maryland* decision.[2] In 1816, the Congress chartered the Second Bank of the United States and opened several branches throughout the states. In 1818, however, the Maryland Legislature imposed a special tax on all banks and branches in the State of Maryland not chartered by the legislature. The Maryland law was as strong as it was discriminatory. It provided that any bank operating in Maryland without authority from the state could only issue bank notes on state-furnished stamped paper upon which a fee varying with the denomination of the note was paid. Failure to comply subjected the offending banks' officers to fines of $500 for each violation.

The law was directed at the Baltimore branch of the Bank of the United States. The cashier of that branch, James McCulloch, was sued for issuing bank notes without complying with Maryland law. The Maryland courts upheld the state, but the U.S. Supreme Court reversed that decision. Speaking for the Court, Chief Justice Marshall wrote that in order to preserve the "great principle" that "the Constitution, and the laws made in pursuance thereof, are supreme," the states had no power to levy taxes that would "retard, impede, burden, or in any manner control, the operation of the Constitutional laws enacted by Congress."[3]

To Marshall, the central issue was the need for federal laws to take supremacy over state laws. Thus, one state cannot impose upon, or act to impair the legitimate actions of the federal government because that subjects the will of the entire country to the will of the people of one state.[4] To allow that subjection, wrote Marshall, would make federal laws subservient to state laws:

> [T]he power of taxation . . . is an incident of sovereignty, and is coextensive with that to which it is an incident. All subjects over which the sovereign power of a state extends, are objects of taxation; but those over which it does not extend are, upon the soundest principles, exempt from taxation. This proposition may almost be pronounced self-evident.[5]

Thus a state can tax those things under its sovereignty (which Marshall defines as "everything which exists by its own authority or is introduced by its permission . . ."), but cannot tax those things which are not under its power (such as federal operations). This conclusion raises two interesting points in the context of this study. First, inherent in this line of reasoning is that if federal installations are not under the sovereignty of a state or locality, a state or

locality is not responsible for the support of that federal installation.[6] And, second is the fact that, in *McCulloch vs. Maryland*, Marshall distinguished a tax on property and interests from a tax on the "operation" of the bank. Thus Marshall declared that his holding

> ... [did] not deprive the states of any resources which they originally possessed. It does not extend to a tax paid by the real property of the bank, in common with the other real property within the state, nor to a tax imposed on the interest which the citizens of Maryland may hold in this institution, in common with other property of the same description throughout the state.[7]

Subsequent court decisions expanded this doctrine of intergovernmental tax immunity to the states[8] and, at one point, from the primary immunity of the federal governmental activity itself to the derivative immunity of third persons who were in some way related to the governmental activities (e.g., federal employees and lessees).

Beginning in the late 1930s, however, the judiciary began to sharply narrow the intergovernmental immunities concept. The progression since the 1930s from a broad to a narrow application of the immunities doctrine is evident. For example, in 1936, Congress, through the *Hayden-Cartwright Act*, consented to state taxation of sales of gasoline and other motor vehicle fuels on federal enclaves when such fuels were not used exclusively by the federal government. In the same year, the Congress also authorized the application of state workmen's compensation laws to federal areas. In 1939 it provided for the application of state unemployment compensation laws. The 1940 *Buck Act* permitted the states to impose sales, use, gross receipts, and gross and net income taxes on private persons within federal areas. Nine years later, the *Wherry Housing Act* authorized state and local governments to tax the interest of private individuals who leased land on military reservations for the purpose of constructing housing and renting it to military personnel. Today, the direct primary immunity, as stated by Justice Marshall, remains, although it continues to be an area for legal controversy.[9]

Current case law recognizes two justifications for federal tax immunity.

The first is the Constitutional immunity as summarized above. At present, this Constitutional construction is narrowly restricted.[10]

The second basis for immunity is the Congressional power to legislate immunity in areas related to its Constitutional jurisdiction.[11] This amounts almost to a "discretionary" immunity, although it does ensure that a grant of Congressional immunity cannot be implied any more than a grant of Constitutional immunity.[12] In short, the federal government may be taxed in any manner for which Congress, within its Constitutional limitations,[13] consents. Thus the federal government's tax exempt status, though derived from the Constitution, is primarily statutory. It is not "unconstitutional" for states or municipalities to tax the federal establishment as long as that taxation is not discriminatory.* As a policy matter, however, Congress has shown little interest in giving its consent to the direct taxation of federal properties, limiting that consent to the taxation of federally owned corporations, federal credit and banking institutions, and properties that are held by the federal government pending disposition to private owners.

Indeed, a review of the statutory tax exemptions granted to several government corporations reveals no clear Congressional policy. Generally, privately owned, Congressionally created, "for profit" corporations (e.g., Conrail, COMSAT) have not been granted any tax exemptions. In addition, Congress has not, as a general rule, exempted government corporations such as Amtrak or the Federal Deposit Insurance Corporation from payment of state and local real property taxes. Where an exemption from real property taxes has been established, however, provision is frequently made for the corporation to make some payment to the state and local jurisdictions in lieu of real property

* This conclusion of nondiscriminatory treatment is implied from the Supreme Court decision in *New York vs. United States*, 326 U.S. 572 (1946), that Congress can tax state activities, but for it to tax these activities "while leaving untaxed the same activities pursued by private persons would do violence to the presuppositions derived from the fact that we are a nation composed of states." *Ibid.*, at 575–76.

taxes. Indeed, the U.S. Supreme Court has made it clear that Congress has almost total discretion in determining the extent of government corporations' tax immunity when it stated "it is not our function to speculate whether the immunity from one type of tax as contrasted with another is wise. That is a question solely for Congress, acting within its Constitutional sphere, to determine."[14]

With regard to other federally owned holdings, however, Congress has not granted consent to taxation. Moreover, no direct state/local taxation is permitted on the income, sales, or property of federal agencies and instrumentalities.

Derivative Immunity

Although controversy abounds on almost every aspect of the immunities doctrine, one of the most heated aspects of the debate pertains to those instances in which third persons, rather than the government as an institutional entity, derive the benefits of federal tax exemption. Perhaps the most familiar of these is the exemption from state/local income taxation of U.S. government bond interest paid to individuals and institutions. (A similar federal tax exemption exists for the interest paid on state and local bonds.)

There are, however, other similar cases worth mentioning, three of which are discussed below. They have been selected because they represent the broad range of federal actions that have been detrimental to the taxing powers of specific subnational jurisdictions.

SALES TAX LIABILITY OF PRIVATE CONTRACTORS

The federal government's use of private contractors on federal projects is enormous: in 1979 it procured $94.4 billion worth of goods and services from contractors, the bulk ($70.4 billion) by the Department of Defense.[15] The revenue implications for the states which have large amounts of these tax exempt activities would be substantial if state sales and use taxes were imposed. The key to whether or not those taxes may be imposed is the determination of the party on whom the tax is intended to fall, or a determination of the legal, as opposed to the economic, incidence.[16] The incidence test generally applied in the courts is a mechanical one: if the state tax legislation requires or urges that the tax be passed forward, the incidence is on the customer. Otherwise, the tax is on the vendor. Where the federal government is the customer, a sales or use tax cannot be levied in the former case. However, a nondiscriminatory tax on the vendor is permissible.

Faced with this interpretation, the U.S. government's response has often been to manipulate the terms of its contracts in order to shift the legal incidence of the contractor's taxes to the government—despite the fact that most contractors are private profit making businesses, which operate with little federal supervision.[17] Most commonly, this is accomplished by designating the contractor as the federal government's "agent"—something that can be done by any one of the thousands of contracting agents in the federal bureaucracy, either by arguing that formal regulations require it[18] or by ignoring their own departmental policies against such practice.

The controversy regarding the state tax liability of federal contractors has been, and will no doubt continue to be, an unsettled area as long as there is a case-by-case adjudication of the matter. Until Congress acts by passing legislation clearly defining the issue, the outcome of this issue will probably hinge on which side—federal or state—is the more creative in writing its contracts or its tax laws.

MILITARY PERSONNEL

The second representative case results from specific Congressional legislation combined with a bit of fiscal slight-of-hand. A provision in the *Soldiers' and Sailors' Civil Relief Act of 1940* states that military duty pay can be taxed only by the state in which the armed forces member is domiciled or is a legal resident.[19] The effect of the domicile-only jurisdictional rule is that it provides an avenue of tax avoidance that is unavailable to civilians. Recent examination of the effects of this rule clearly indicates that large numbers of military personnel simply declare themselves legal residents of one of the nonincome tax states or of a state which provides for full exemption of military pay.[20]

Figure 1

STATE INCOME TAX TREATMENT OF MILITARY PAY

Tax Treatment	States
1. No broad-based state income tax.	(nine states) Connecticut, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, and Wyoming.
2. States with a broad-based state income tax, but with a full exemption for military pay.	(five states) Alaska, Illinois, Michigan, Montana, and Vermont.
3. States with broad-based state income taxes, but which apparently do not tax military pay if the member is stationed outside the domicile state.	(nine states) California, Idaho, Missouri, New Jersey, New York, Oregon, Pennsylvania, Rhode Island and West Virginia.
4. States with a partial—e.g., first $1,000—military pay exemption.	(seven states) Arizona, Arkansas, Indiana, Minnesota, North Dakota, Oklahoma, and Wisconsin.*
5. States in which military pay is fully taxable.	(twenty states and the District of Columbia) Alabama, Colorado, Delaware, Georgia, Hawaii, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Mississippi, Nebraska, New Mexico, North Carolina, Ohio, South Carolina, Utah, and Virginia.

* Three other states with such a provision—California, Oregon, and West Virginia—are excluded from this category because they already appear in group 3.

Figure 1 separates the 50 states and the District of Columbia into five groups based upon their income tax treatment of military pay.

As noted, research has shown a statistically significant relationship between military domicile shifts and these tax status groups, as measured over 1974–78. These changes occurred in response to state actions expanding or contracting state jurisdictional rules, following the federal prohibition against withholding of state income taxes from military pay enacted as part of the *Tax Reform Act of 1976*.[21]

Military personnel are likewise exempt from state and local personal property taxes and automobile license fees in the jurisdictions to which they are assigned. The effect of this exemption is a subsidy to military personnel by local residents.

A somewhat similar tax immunity for a given class of federal employees also occurs with respect to state and local sales taxes. Here the problem is with the thousands of resale activities operated by the federal establishment. The largest of these are within the Department of Defense. In 1940, Congress passed the *Buck Act* which allows state and local governments to tax certain transactions that occur in federal areas (e.g., repair services performed on base by a private contractor), but which specifically excludes state and local taxation at commissaries (grocery stores), exchanges (department stores), clubs (restaurants), ship's stores, and package liquor stores.[22] Because of the nature of these resale activities, the benefit of the exemption accrues not only to persons on active military status and their dependents, but also to retired military career personnel and their dependents. The various economic dislocations of this mandated tax exemption have been adequately examined elsewhere.[23] Suffice it to say that not only does this exemption cause severe revenue loss and even crime problems (boot-

legging) for certain local communities; in addition it directly harms private sector stores which must compete with a military store.

DISTRICT OF COLUMBIA HOME RULE ACT

The third type of immunity—statutory—is directed toward the District of Columbia government under conditions of that city's limited "home rule" granted by Congress in 1975.[24] Under the act's terms, Congress specifically prohibited the city council from taxing the personal income earned in the city by nonresidents. Although this rule applies to federal and nonfederal employees alike (all residents of the District, including federal employees residing in DC, do pay the tax), *de facto*, the effect is to exempt 67% of the City of Washington's work force, which is made up primarily of suburban Maryland and Virginia commuters.[25] In addition to this exemption, the Congress has mandated Washington, DC income tax exempt status for its members, and their personal staffs if they maintain domicile in that member's state, and for the President and his appointees.

POSSESSORY INTEREST

There is no constitutional impediment to state and local taxation of possessory interests—the taxation of private interests operating on federal property—as long as it does not constitute a discriminatory tax against lessees of federal property. In 1958 the U.S. Supreme Court was asked to rule on a Michigan statute that imposed a tax on private lessees and users of tax exempt property when such property is used in business conducted for profit. The Court upheld the Michigan contention that any taxes due were the obligation of the lessee or user and that the U.S. government, as the property owner, was not liable for the tax payment; nor was the property itself subject to any lien if the tax remained unpaid. Thus, once again, the key issue was the identification of the eligible or "liable" taxpayer in the intergovernmental immunities debate, with the Court distinguishing between a tax for the beneficial use of property in contrast to a tax on the property itself.[26] However, the Court has invalidated, as a transparent discrimination against the federal government and its lessees, a Texas levy which exempted private leases of property owned by the State of Texas or its subdivisions but sought to tax private users of federal property.[27]

Despite the fact that it is legally permissible, there is some evidence that not all states have vigorously pursued this possibility. Indeed, in 1969, the Public Land Law Review Commission recommended that the states recognize the opportunity to supplement conventional property tax revenues by taxing those interests.[28] A similar view regarding private property on land under exclusive federal jurisdiction was recommended by the ACIR five years earlier. The Commission even went so far as to remind states that they are free to deny—and have denied—public services and facilities to persons living and working in areas under the exclusive legislative jurisdiction of the national government.[29]

CURRENT PAYMENT PROGRAMS

As a result of bureaucratic maneuvering, as well as delegated authority from Congress and, more narrowly, the U.S. Constitution, the federal government's status as a tax exempt institution is not only firmly intact, but that feature of our federal system is assured for the near future. To change the entire immunities doctrine would mean redesigning major parts of our system of fiscal federalism. It is also true, however, that the federal establishment's tax immunity is detrimental, in that it has a quantitatively significant effect of limiting the tax bases of state and local governments. If economic arguments warrant, Congress can preserve the doctrine and yet alleviate the state/local fiscal effects by legislative action.

Indeed, although the Congress has shown little interest in giving its consent to direct taxation of federal agencies and instrumentalities, over the years it has recognized a responsibility for reducing the direct effects of the federal tax immunity on some local government revenues by authorizing certain federal agencies to make ad hoc payments on their holdings of tax exempt properties. Nevertheless, most federal agencies are still without general authority to make such payments. Moreover, the existing

payment programs are diverse, resulting in different treatment for similar properties. The outcome is a patchwork of uncoordinated and, quite often, arbitrarily negotiated payment programs. Thus, although it has recognized the problem of making property tax related payments to state and local governments, the federal government has not developed a uniform policy regarding this matter.

Currently, six different forms of ad hoc payment programs address the problems created by the tax exempt nature of federally owned properties. They are:

1) revenue and receipt-sharing programs;
2) payment in lieu of tax (PILOT) programs;
3) a variety of formula programs;
4) property tax payments from federal corporations and financial institutions;
5) the annual federal payment to the District of Columbia; and
6) other payments, such as for administrative services.

Of these, the components of the PILOT and formula-type programs vary to the extent that, *de facto*, there are actually 12 different program designs, all intended to compensate, to some degree, for the reduced property tax base, the corresponding reduction in local government revenues, and the change in local government expenditures. Indeed, each program's legislative intent may specifically state its objectives as such. Some may even attempt to address or redress the more basic questions of equity and efficiency which are raised by self-imposed immunities. However, for reasons discussed at length in *Chapters* 3 and 4, true "equivalency" to full taxation rarely exists.

Major Federal Payment Programs

The lion's share of the payment programs, as well as their associated funding levels, are revenue and receipt-sharing, PILOT-type, and formula-based programs. The first type includes at least 25 programs (23 of which are currently funded), which paid approximately $800 million in FY 1979. There are 17 PILOT programs and 21 formula-based programs (25 were funded), accounting for an additional $1.2 billion of in lieu payments in 1979. The remaining payment programs are discussed later in this chapter, following a detailed analysis of the components of these first three sets of programs.

Shared Revenue and Receipts Programs

Programs with this mode of payment are designed to share the revenues and receipts the national government derives from economic activities conducted on government-owned tax exempt lands 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 use of funds from activities on park lands—such as visitor and camping fees or grazing land—is also widespread. Leases, fees, user charges, as well as severance levies, may also be shared with the local governments in which the tax exempt lands are situated.

The oldest type of federal state/local in lieu payment in the U.S., receipts-sharing, started in 1802 with the sharing of revenues generated by sales of federal land with those states that were gaining statehood and were located between the western boundaries of seven of the 13 original colonies and the Mississippi River. Those lands had been claimed by the colonies in their Colonial Charters and then ceded to the U.S. after the American Revolution. Then, in the 19th Century—operating under both the general philosophy that the federal government should play a small role in economic affairs and the need for revenue—the U.S. adopted a policy of transferring its lands to private owners and the states. This policy of land transfer ended in 1891 when the Congress enacted a system for holding land in the federal public domain.

Between 1908 and 1964, the "modern" receipt-sharing programs were enacted, their common denominator being that a certain percentage of a federal land or resource fund be allocated to the jurisdiction wherein the minerals were located, recovered, or used. Although some have been changed in the years since their enactment, the required shares or percentages typically range from approximately 10% to 90% of gross program receipts. The use of these funds also varies: some are to be used by the recipient local jurisdiction for specific pur-

Table 1

FEDERAL SHARED REVENUES AND RECEIPTS PROGRAMS (1978–80)

BA: Budget Authorization—BO: Budget Outlay

Agency	Program	Type	Year	Amount
USDA (FS)	National Grasslands, Payments to Counties (Part of the *Bankhead Jones Farm Tenant Act).* 25% of the revenues received from the use of national grasslands is paid to the counties in which such land is located, for school and road purposes. 50 Stat. 522; 7 USC 1012 (1937).	BA	78:	$ 1,228,000
			79:	1,258,000
			80:	1,300,000
USDA (FS) & DOI (BLM)	*Arizona and New Mexico Enabling Act.* Arizona and New Mexico are paid a 3% share of national forest receipts for school purposes, in designated school section lands located in national forests. 36 USC 557, 562, 673 (1910).	BA	78:	219,000
			79:	210,000
			80:	310,000
USDA (FS)	*National Forests Revenues Act.* With minor exceptions, 25% of all money received from national forests (both public domain and acquired), and certain amounts credited to timber purchasers for road construction, are paid annually to the states for public schools and roads of the county in which such forests are situated. 35 Stat. 251; 16 USC 500 (1908).	BA	78:	223,995,000
			79:	238,863,000
			80:	281,586,000
USDA & DOI (BLM)	Materials from Federal Lands, *Material Disposal Act.* Included in DOI "Payments to States for Proceeds of Sales," because BLM does not differentiate between the kinds of commodities sold if the receipt-sharing formula is the same. (Interior payment is based on same percent as sales of public lands, and agriculture percent will depend on statutes under which land is administered.) 61 Stat. 681; 30 USC 601-603 (1947).			—
DOD (COE)	Payments to States for Flood Control Lands. 75% of money received from lease of federal lands acquired for flood control, navigation, and allied purposes is paid to the state in which such property is situated, for public schools, roads, or other expenses of county governments. 33 USC 701C-3.	BA	78:	6,134,000
			79:	5,202,000
			80:	5,302,000
		BO	78:	4,656,000
			79:	6,134,000
			80:	5,202,000
DOD (COE)	Army Corps of Engineers 25–75% of gross revenues are paid. 55 Stat. 650; 35 USC 761 t-1 (1961).			
DOE (FERC)	*Federal Power Act.* FERC charges for the licenses it issues for hydroelectric projects which use federally owned lands. 37.5% of these revenues are then returned to the states in which these federally owned lands are located, disbursement being based on the number of acres of federal land used for these power purposes. The remaining revenues are allocated as follows: 50% to a reclamation fund and 12.5% to the U.S. Treasury (sections 10e and 77 in the *Federal Power Act*). 41 Stat. 1063; 16 USC 810 (1920).	*	78:	218,297
			79:	282,538

Table 1 (Cont.)

FEDERAL SHARED REVENUES AND RECEIPTS PROGRAMS (1978-80)
BA: Budget Authorization—BO: Budget Outlay

Agency	Program		Year	Amount
DOI (BLM)	*Taylor Grazing Act.* (a) States are paid 50% of grazing fee receipts from public domain lands outside grazing districts. 48 Stat. 1269; 43 USC 315, 315m (1936).	BA	78:	$ 1,159,000
			79:	1,245,000
			80:	1,483,000
		BO	78:	1,250,000
			79:	1,314,000
			80:	1,483,000
	(b) States are paid 12.5% of grazing fee receipts from these lands within grazing districts. 43 USC 315b, 315i (1936).	BA	78:	2,067,000
			79:	1,790,000
			80:	2,125,000
		BO	78:	1,782,000
			79:	1,779,000
			80:	2,125,000
DOI	Payments to States from Grazing Receipts, Etc., Public Lands within Grazing Districts, Miscellaneous. States are paid specifically determined amounts from grazing fee receipts from miscellaneous lands within grazing districts when payment on a percentage basis is not feasible. Payments to states and the range improvements fund are derived from statutory percentages of collection receipts in the prior fiscal year from grazing of livestock on public lands, and grazing and mineral leasing receipts on *Bankhead Jones Farm Tenant Act* lands transferred from USDA by various executive orders. On public lands, the grazing fee includes a range improvement fee which is available for range improvements and maintenance of range facilities when appropriated. 43 USC 315, 1701.	BA & BO	78:	5,000
			79:	-0-
			80:	-0-
DOI (BOR, BLM)	Payments to States for Proceeds of Sales, Various Statutes. The states are paid 5% of the net proceeds from sale of public land and public land products, shared with states in which land is located. Originally provided for admission of new states in the Union. 31 USC 711 (1802-1958).	BA	78:	547,000
			79:	579,000
			80:	607,000
		BO	78:	551,000
			79:	582,000
			80:	607,000
DOI	Oregon and California Revested Railroad Grant Lands, Payment to Counties. 50% of the receipts of Oregon and California land grant funds are paid the counties in which the lands are situated, to be used as other county funds. 39 Stat. 218. After administrative and general fund costs in Treasury are reimbursed by receipts, the remainder of the fund is paid to the counties in the same manner as the original 50% payment. 50 Stat. 875, 876, 43 USC 1131f; 43 USC 1701, *et seq* (1916).	BA & BO	78:	106,045,000
			79:	100,000,000
			80:	110,000,000

* Information not available concerning classification as BA or BO.

NOTE: Abbreviations used are: U.S. Department of Agriculture, Forest Service (USDA, FS); Department of the Interior, Bureau of Land Management (DOI, BLM); Department of Defense (DOD); U.S. Army Corps of Engineers (COE); Department of Energy, Federal Energy Regulatory Commission (DOE, FERC); Bureau of Reclamation (BOR); Tennessee Valley Authority (TVA); Department of Commerce, National Oceanic and Atmospheric Administration (DOC, NOAA); Farmers Home Administration (FmHA); National Park Service (NPS); Health, Education, and Welfare/Department of Education, Office of Education (HEW/DED, OED); Housing and Urban Development (HUD); Department of Transportation (DOT); and Veterans Administration (VA).

Table 1 (Cont.)

FEDERAL SHARED REVENUES AND RECEIPTS PROGRAMS (1978–80)
BA: Budget Authorization—BO: Budget Outlay

Agency	Program	Type	Year	Amount
DOI (BLM)	*Mineral Lands Leasing Act,* Payments to States. Alaska is paid 90% and other states 50% of the receipts from bonuses, royalties, and rentals resulting from development of mineral resources under the *Mineral Leasing Act,* and from leases of potash deposits on public lands. 40 Stat. 437; 30 USC 191, 285, 286, 292. Payments also include those collected under *Mineral Leasing on State-Selected Indemnity Lands,* for Arizona and Utah because of their small amounts ($240 and $2,000 respectively). 74 Stat. 1024.	BA BO	78: 79: 80: 78: 79: 80:	$ 175,134,000 202,043,000 238,579,000 188,478,000 224,000,000 238,629,000 |
DOI	Payments to Oklahoma. Oklahoma is paid 37.5% of the Red River oil and gas royalties in lieu of state and local taxes on Kiowa, Comanche, and Apache tribal lands, to be used for construction and maintenance of public roads and support of public schools. 65 Stat. 252; 44 Stat. 740-1; 42 Stat. 1448-9.	*	78: 79: 80:	-0- 18,714 20,000
DOI	Oil and Gas Lands Added to the Navajo Indian Reservation in Utah. 47 Stat. 1418.			—
DOI (BOR)	Boulder Canyon Project. The project makes a flat PILOT except for portions of the Colorado River development funds, derived from power sale revenues, which may be appropriated and spread equally among river basin states, also allowing New Mexico's share to be available for the San Juan transmountain diversion project. 45 Stat. 1957; 43 USC 617c, 618; and Secs. 2(c) and (d) of the *Boulder Canyon Project Adjustment Act of 1949* (1940).	Total development fund for: BA & BO	 78: 79: 80:	 500,000 500,000 500,000
DOI (BLM)	National Grasslands, Payments to Counties. Part of *Bankhead Jones Farm Tenant Act.* Of the revenues received from the use of these submarginal lands, 25% is paid to the counties in which such land is situated, for school and road purposes. 50 Stat. 522; 7 USC 1012 (1937).	BA BO	78: 79: 80: 78: 79: 80:	440,000 441,000 454,000 405,000 435,000 454,000
DOI	Revenue from Excise Tax on Certain Sport Fishing Tackle. No less than 92% of the 10% excise tax on certain sport fishing tackle is appropriated to the states, Puerto Rico, Guam, the Virgin Islands, and American Samoa. Additional funds may be appropriated for specified conservation and management activities and agreements between two or more states. 16 USC 777a-k.	BA	78: 79: 80:	22,656,000 29,580,000 30,780,000
DOI	Revenue from Excise Tax on Certain Firearms. No less than 92% of the 11% excise tax on sporting arms and ammunition, 10% excise tax on handguns, and 11% tax on certain archery equipment is appropriated to the states, Puerto Rico, Guam and the Virgin Islands, for wildlife restoration. 16 USC 669-669i.	BA	78: 79: 80:	73,084,000 87,730,000 90,305,000

Table 1 (Cont.)

FEDERAL SHARED REVENUES AND RECEIPTS PROGRAMS (1978–80)
BA: Budget Authorization—BO: Budget Outlay

Agency	Program	Classification	Year	Amount
DOI (Bureau of Sport Fish-eries and Wild-life)	*National Wildlife Refuge Act, Migratory Bird Conservation Act.* The *Refuge Revenue Sharing Act* authorized the distribution of 25% of the revenues from the sale of products from the national wildlife refuge system to be allocated to counties in which the refuges are located for the benefit of public schools and roads and for lands acquired in fee, either payment of 25% net receipts of same, or 0.75% of the current value less improvements of such areas (set at 5-year intervals), also for schools and roads. 78 Stat. 701; 16 USC 695m, 715s (1964).	BA	78: 79: 80:	$ 5,275,000 4,320,000 4,840,000
DOI (BOR)	*Klamath National Wildlife Refuge Act.* 25% of net revenues from leasing the Klamath reclamation project and the reserve federal lands within certain national wildlife refuges (including the Tule Lake National Wildlife Refuge) is paid to the counties in which the refuges are located. Payment per acre cannot exceed 50% of the average per acre tax levied on similar lands in private ownership in each county, may not reduce the credits or payments to the Tule Lake irrigation districts already committed, and must have third priority for disbursement after the latter and the Klamath Drainage District payments. 78 Stat. 850; 16 USC 695 (1964).	BA & BO	78: 79: 80:	177,000 140,000 150,000
DOI	Grants/Payments to States from Reclamation Fund Revenues. With approved reclamation programs and project plans, a state is entitled to a minimum of 50% of fund revenue derived from operating mines in the states. *Surface Mining Control and Reclamation Act of 1977.*	BA	78: 79: 80:	-0- 8,000,000 27,000,000
DOI (BLM)	Payments to States for Mineral Leasing on State Selected Indemnity Lands. 90% of rents and royalties on the selected lands are paid to the states. Payments are included in *Mineral Leasing Act* payments. 74 Stat. 1024; 43 USC 852 (1960).			—
DOI	Mineral Leasing on Acquired Lands. Provides for 65% of the receipts from miscellaneous minerals receipts acts to go straight to Treasury; 10% to the Forest Service for improvements on the leased lands; and 25% to state/county fund. 61 Stat. 915; 30 USC 355 (1947).	BA	78: 79 (est): 80 (est):	2,547,100 2,750,000 2,800,000

* Information not available concerning classification as BA or BO.

NOTE: Abbreviations used are: U.S. Department of Agriculture, Forest Service (USDA, FS); Department of the Interior, Bureau of Land Management (DOI, BLM); Department of Defense (DOD); U.S. Army Corps of Engineers (COE); Department of Energy, Federal Energy Regulatory Commission (DOE, FERC); Bureau of Reclamation (BOR); Tennessee Valley Authority (TVA); Department of Commerce, National Oceanic and Atmospheric Administration (DOC, NOAA); Farmers Home Administration (FmHA); National Park Service (NPS); Health, Education, and Welfare/Department of Education, Office of Education (HEW/DED, OED); Housing and Urban Development (HUD); Department of Transportation (DOT); and Veterans Administration (VA).

SOURCE: ACIR staff compilation.

Table 1 (Cont.)

FEDERAL SHARED REVENUES AND RECEIPTS PROGRAMS (1978–80)
BA: Budget Authorization—BO: Budget Outlay

Agency	Program	Amount
DOI (BLM)	Yellowstone National Park, Education Expenses for Employees' Children. *Short-term park recreation fees are used to provide educational facilities to pupils who are dependents of persons engaged in the administration, operation, and maintenance of Yellowstone National Park. Payments have been made to a special school district within the park since 1948.* 62 Stat. 338; 16 USC 40a.	BA 78: $ 298,000 79: 410,000 80: 410,000 BO 78: 410,000 79: 410,000
DOI	Payments for Use of National Forests and Public Lands. 37.5% of the revenues collected from the use of national forests and public lands (usually vacant public lands; those being withheld from development) are paid to the states in which such lands are located. These moneys, which are collected by BLM, are actually distributed the year after their payment is due (which is common for receipt-sharing programs). 16 USC 810.	77: 218,297.25 (collected in 1978) 78 (15% increase in funds estimate based on a change in the method of computation for the aggregate fund and an increasing amount of hydroelectric dams on these lands): 251,041.84 79 (10% increase est): 276,146.02 80 (5% increase est): 289,953.32
DOI	Payments to the Farmer's Irrigation District, North Platte Project, Nebraska-Wyoming. Payments are made to the Farmer's Irrigation District on behalf of the Northport Irrigation District for water carriage. The Interior Reclamation Fund covers these annual payments, the authority for which shall expire when the total of such payments is $479,602. (Parts of the payment are considered an annual construction charge installment.) The Northport District has relinquished to the U.S. its interest in power revenues and power facilities for those facilities constructed by the U.S., although the water carriage is owned by the farmers in the district. 62 Stat. 273, as amended.	78: 8,000 79: 8,000 80: 8,000
TVA	Payments from Proceeds from Power Sales. Section 13 of the *TVA Act* provides for TVA to pay annually to certain states and counties 5% of its gross revenues—not less than $10,000 to each state—from the sale of power in the preceding fiscal year, excluding revenue from power sold to federal agencies or a two-year average of state and local taxes last assessed prior to TVA acquisition. Payments to affected counties are made before making payments to states. 48 Stat. 58; 16 USC 831 (1933).	* 78: 78,721,461 79: 99,000,000

* Information not available concerning classification as BA or BO.

NOTE: Abbreviations used are: U.S. Department of Agriculture, Forest Service (USDA, FS); Department of the Interior, Bureau of Land Management (DOI, BLM); Department of Defense (DOD); U.S. Army Corps of Engineers (COE); Department of Energy, Federal Energy Regulatory Commission (DOE, FERC); Bureau of Reclamation (BOR); Tennessee Valley Authority (TVA); Department of Commerce, National Oceanic and Atmospheric Administration (DOC, NOAA); Farmers Home Administration (FmHA); National Park Service (NPS); Health, Education, and Welfare/Department of Education, Office of Education (HEW/DED, OED); Housing and Urban Development (HUD); Department of Transportation (DOT); and Veterans Administration (VA).

SOURCE: ACIR staff compilation.

poses such as schools, roads, or environmental improvements, while other provisions allow the states to determine their proper use and allocation. The concept behind the receipt-sharing programs was a common concern over the withdrawal of large amounts of land and its attendant economic activity from local tax bases. *Table 1* lists each of these programs, the authorizing statutes and administering agency, and presents a brief summary of the nature and size of payments.

Payments In Lieu Of Taxes

Another large group of payment programs relating to federally held tax exempt property uses a payment in lieu of tax approach, with several combinations of valuation and tax rate factors, to determine the amount of payment a locality is entitled to receive. This category includes many of the better known recent payment schemes, such as the *PILOT Act of 1976* (P.L. 94–565). In fact, there are at least 18 PILOT programs, their most common feature being their ad hoc, uncoordinated nature. These PILOTs are presented in *Table 2* and can be classified as reflecting one of three types of payment: 11 programs are of a fixed sum nature, three provide for full tax equivalency, and four provide for partial equivalent payments related to the value or amount of the tax exempt property. Understanding these three payment schemes is important to understanding the findings and recommendations of this report and its policy alternatives for achieving greater equities in federal payment programs for real property. Accordingly, each is briefly reviewed below.

Fixed-Sum Payments

In this case, a fixed, or flat sum of money is paid annually to a locality. The amount is typically an arbitrary one, although, in some cases, it may reflect a fixed amount of a tax liability as of a certain date, such as the date certain parcels of property were acquired.

One example of this flat fee approach is the Boulder Canyon Project, where Arizona and Nevada each receive $300,000 for each year of operation of the Hoover Dam. This fixed payment was specified in the PILOT's enacting legislation (1938) and is to expire in 1987.[30]

Full Tax Equivalency Payments

In this form, payment is made on the full amount of real property tax that would be due were the property fully taxable in private ownership. It provides 100% compensation for a property's tax liability, using the taxing authority's normal valuation or assessment practices as well as the millage rates appropriate for that type of property.

Only U.S. Department of Housing and Urban Development and Veterans Administration payments on acquired properties due to foreclosures and certain payments of federally owned corporations actually have "full" tax equivalency. In this situation, payments are made as if the federal government were a private taxpayer subject to state-local property taxation.

Partial Tax Equivalency Payments

These payments may be made on either a percentage of the full value of the tax exempt property or at a percentage of the rate of taxation for the tax exempt property, thus yielding a reduced effective tax rate (assuming "normal" assessment procedures) based on a smaller payment than that which would be due were the property fully taxable in private ownership.

This partial payment may be based (a) upon a percentage of the federal land to total land area in a jurisdiction, or (b) upon federal to total ratio of the value of real property in a jurisdiction. The actual percentage of either basis may reflect that proportion that is attributable to the federal government's current or past holdings in the locality that is to receive the payment. Usually, however, the percentage is quite arbitrary, often only reflecting a gap between a fully or partially funded program.

Two additional characteristics frequently found in a partial tax equivalency program are thresholds (or minimums) and ceilings (or lids) on payments made to local governments.

Thus, the payment may be a percentage of full current tax equivalency, ranging from 75% of appraised value (e.g., Superior National Forest land payments to Minnesota) to a set percentage of the property's value at the time of acquisition (e.g., as included in one section of the 1976 *Payments In Lieu of Taxes Act*). Or,

fixed fee lids may be combined with community assistance payments for special capital and operating costs (e.g., payments to atomic energy communities) or with components of revenue and receipt-sharing programs.

Presumably, the purpose of both of these devices is to minimize program costs, eliminate the administrative costs associated with small payments, or eliminate perceived windfalls to certain communities with large amounts of tax exempt lands. There are, however, serious equity and administrative defects in these rationales, as will be discussed later in greater depth (*Chapter 4*).

FORMULA-BASED PROGRAMS

The third major form of compensatory payment consists of a variety of alternative bases for payment by using formula mechanisms. At least four major types of formula-based programs can be identified among current programs that make in lieu of property tax payments:

- a fixed fee per acre of government-owned land (two programs);
- cost-of-service computations, usually reflecting a portion of the operation and maintenance costs of a local government or service authority (eight programs);
- a fixed-fee per federal government employee (one program); and
- various grants for loans and guarantees for community assistance, which are frequently targeted to certain local governments that are burdened with large amounts of capital expenditures for rapidly expanding activities and service requirements on tax exempt government lands (seven programs).

A common and distinctive feature of formula programs is their negotiated payment character: they typically are not guided by any general economic principles, nor do they purport to reimburse localities fully for the cost of public services. More important, perhaps, is the abandonment of the property-related basis for payment. Indeed, a property-based factor might be only one of several factors in a formula which is used to determine a community's entitlement. Thus, the formula-based compensatory payment becomes more a politically negotiated intergovernmental transfer or grant than an in lieu of tax payment.

The formula-based programs are frequently used in conjunction with other receipt-sharing or partial tax equivalency payment programs. However, the reasons for enacting these programs, as with all the other compensatory payment programs, have not been uniform or comprehensive. Because this group involves by far the largest expenditure of PILOT programs—almost $1 billion in FY 1979—several of the major operating payment programs are discussed in greater depth at this time. They are also included in *Table 2*.

Fixed Fee Per Acre

The most comprehensive of all federal payment programs are the fixed fee payments made under the *Payment In Lieu of Taxes Act of 1976* (P.L. 94–565, as amended in 1976, 1978, and 1979). This program covers federal land in more than 1,500 counties (mostly in the western U.S.) and supplements nine different receipts-sharing laws that provide compensation to these counties. The supplement guarantees that total federal payments to a county meet certain per acre minimums and maximums. P.L. 94–565 provides that each county will receive an additional 10¢ per federally owned acre over the combined payment under all payment programs, or 75¢ per federally owned acre, whichever is greater. The 75¢ and 10¢ per acre standards are modified for counties with small populations by setting a maximum per capita payment. Forty-five population categories are established. For counties with populations under 5,000, the limit is $50 per capita. At the other extreme, the limit is $20 per capita for counties with populations over 50,000. No payment under P.L. 94–565 may exceed $1 million. However, because the Bureau of Land Management has had to interpret vague terms and definitions of entitlement lands as well as use some state data which have been unreliable for computing state-local payments, large portions of PILOT payments have not been made in the last two years.

Despite such administrative problems, however, the *1976 PILOT Act* was supplemented in 1978 by the *Redwood National Park Expansion Act* and the *Refuge Revenue Sharing Act Amendments*, which added additional entitle-

ment lands to the payment program. The *Redwood Park Act* also included additional revenue benefits for persons affected by the removal of certain industries from the newly acquired park land. The changes effected by these two acts exacerbated the original act's administrative problems noted above. As can be seen in *Table 2*, the result of these interpretive problems has been a budget outlay somewhat larger than the program budget appropriation for the past two fiscal years.[31]

Cost-of-Service Computations

Eight of the current PILOT programs make payments to jurisdictions with federally owned real property for *some* of the operating costs of certain community facilities. These may take the form of general revenue contributions for services "above and beyond what would normally be rendered. . .," as TVA has made to Norris, TN. Alternatively, contracts and cooperative agreements can be arranged with localities to provide cost reimbursements for specific services. The Bureau of Land Management and the Forest Service have had this type of arrangement with several jurisdictions for law enforcement services for several years.

As was true for formula-type programs, payments designed as "cost-of-service" programs are often negotiated rather than reflective of any cost analysis; nor do they purport to fully reimburse localities for community services. Rather, they represent a series of voluntary payments from certain agencies which expect "heavy" service provision. No attempt is made to determine, or even address, the question of the quality or quantity of community services a tax-free entity can expect.

Fixed Fee Per Person

Only one program provides federal payments on a fixed fee per employee basis—the Federal Impact Aid Program administered by the Department of Education. The Impact Aid Program, also the largest and probably most controversial of the existing payment in lieu programs, was enacted through Public Laws 81–815 (construction aid based on increases in enrollment) and 81–874 (maintenance and operation aid based on numbers of federally connected children). Initiated in 1950, it was originally intended to help compensate school districts for the imposed expense of educating the children of federal employees where the local tax base is reduced because of federal property ownership and where enrollments are raised by the presence of a federal installation. The principal basis on which these payments are made is a function of the number of public school children who reside on tax exempt federal property and who live with a parent who is employed on that land. In 1970–71, this definition of federal property was amended to include low rent housing (whether or not owned by the U.S. government), which is part of a low rent housing project assisted under the *United States Housing Act of 1937*.*

There are three payment provisions under P.L. 874, the maintenance and operation portion of the impact aid program: section 2 deals with real property acquired by the federal government; section 3 addresses the number of school-age children whose parents live on federal land and/or work for a federal employer; and section 4 addresses sudden and substantial increases in school attendance. However, payments have not been made under section 4 for several years and section 3 payments, by far the largest component of the program, are dispersed through a complicated three-tiered "priority" process. Moreover, total program outlays are being reduced by large amounts each year as a matter of federal policy.

The section 3 payments distinguish between two broad categories of children: 3a children, whose parents live *and* work on federal property; and 3b children, whose parents live or work on federal property. Each of these categories also contains subcategories of children eligible for impact aid, such as military and low rent housing childen. These categories are then used to establish different entitlement rates in the program's authorized funding level, ostensibly to reflect the relative amounts of tax revenues foregone by local school districts. For example, entitlement on the basis of 3a children's entitlement rates ranges from 90% to 150% of the local contribution rates, whereas entitlement on the basis of 3b children ranges from 40 to 50%. Authorized funding levels are

* This authorization was provided through P.L. 81–874, which is broader than P.L. 81–815.

Table 2

FEDERAL PAYMENT IN LIEU OF TAX AND FORMULA BASED PROGRAMS (1978–80)
BA: Budget Authorization—BO: Budget Outlay

Agency	Program		Year	Amount
USDA (FS)	Lands Acquired for Certain Public Works, Primarily Designated Watersheds. The 1944 act, P.L. 534, provides for the construction of post-World War II public works on rivers and harbors for flood control purposes. Provision is made for payment to the county in which lands acquired under this law may lie, of a sum equal to 1% of their purchases price or, if not acquired by purchase, 1% of their valuation at acquisition. 58 Stat. 387, 905; 33 USC 701-1; 16. No payments have been made under this program. USC 1006.			
USDA (FS)	*Superior National Forest Land, Payment to Minnesota.* At the close of each fiscal year, Minnesota is paid 0.75% of the appraised value of certain Superior National Forest Lands in the Counties of Cook, Lake, and St. Louis for distribution to these counties. Land is reappraised every ten years. 62 Stat. 568; 16 USC 577z, (1948).	BA	78: 79: 80:	$ 259,000 262,000 262,000
USDA (FS)	Payments to Local Governments. The Forest Service has a long-term policy of paying for cooperative law enforcement (with local governments) on land it administers.	*	77:	4,900,000
USDA & DOI	*Case-Wheeler Act* Lands. This act establishes the authority of the Secretary of the Interior over certain lands, contracts, water rights, etc. (and their acquisition, exchange, and disposition) and includes these lands as part of the USDA forest fund and bird wildlife refuge funds although their respective receipts (and receipt-sharing programs) are not collected under this specific authority. 54 Stat. 1125; 16 USC 590z-8.			—
DOC (NOAA)	Community Energy Impact (CEI) Formula Grants. In response to federally owned Outer Continental Shelf resource development which will not benefit the states through any lease bonuses or royalties from resource recovery, the *Coastal Zone Management* (CZM) *Act* was amended to provide grants to eligible states for state and local public infrastructure development, correction of environmental damage caused by offshore energy development and compensation for onshore public facilities built to meet anticipated community needs resulting from planned, short-term or long-term energy development and resource activities. The formula for distribution has been based upon each year's private lease sales and the amount of employment development in each state. A 2% floor (threshold) and 35% ceiling (of costs) are to be provided to each state. Appropriation under the program has been slow because states have been slow to utilize the funds, which must be based in part upon each state CZM plan, energy plans, and approved environment impact statements (EIS) for onshore and offshore energy activities. As a result, the FY 80 outlays are actually old appropriations from the previous two years. Section 308, *CZM, Amendments of 1977.*	BA	77: 78: 79: 80:	10,000,000 15,000,000 17,500,000 27,500,000 27,500,000
		BO	77: 78: 79: 80:	— 10,000,000 20,000,000 53,000,000 carried into the FY; probably will use 25,000,000.

Table 2 (Cont.)

FEDERAL PAYMENT IN LIEU OF TAX AND FORMULA BASED PROGRAMS (1978-80)
BA: Budget Authorization—BO: Budget Outlay

Agency	Program	Type	Year	Amount
DOC (NOAA)	Community Energy Impact Fund (CEIF). Also passed, as part of Section 308 of the *CZM Amendments of 1977:* a separate fund for loans, guarantees, and grants earmarked for specific research or government use.			
	Loans and guarantees at reduced rates of interest are made to states for public facilities built in response to on and offshore impacts of Outer Continental Shelf (OCS) development. Here again, the states have been very slow in using the funds made available for this program, due to CZM and environmental impact statement requirements and to slower than anticipated development of offshore activities. The same formula for distribution is used here as that used in the CEI Formula Grants described above.	BA	77: 78: 79: 80:	$110,000,000 110,000,000 no funds, using old appropriations. old appropriations. (Est. 70,000,000 to be used in 80)
	OCS State Participation Grants are also part of the CEIF, although they were new in 1979. Under this program, states receive matching grants to work with the federal government on their lease sales, study the problems associated with OCS development, and anticipate the need for and program for public facilities. Presently there is no appropriation for this program; balances carried over from the loan program will be used instead, up to $3,000,000.	BA	80:	3,000,000
•	*Planning grants* are also provided in the CEIF to assist state and local governments in the use of their loan and grant moneys. State and local governments are to use the planning grants to analyze the impacts of site specific energy activities. Again, the FY 79 and 80 appropriations are reprogrammed from loan appropriations, which are carried over.	BA	77: 78: 79: 80:	3,500,000 3,500,000 3,500,000 3,500,000
	Environmental grants are provided under section 308(d)(4) of the CEIF, although the formula for the distribution of the funds was changed in 1979 so that the planning and environmental grants are considered together. The recent changes have refocused the grants for those states which have no other community energy impact funds; the practical effect of this is to target the funds to the Great Lakes states and Hawaii. The FY 80 and 81 appropriations under this program are also from the unused loan appropriations.	BA	77: 78: 79: 80:	1,500,000 1,500,000 1,500,000 1,500,000
	A program management grant for OCS impacts is also provided as a separate line item under Section 318, to be funded from unused loan funds in FY 80.	BA	78: 79: 80:	1,000,000 1,000,000 1,000,000
	TOTAL CEIF While actual outlays may vary due to funding through 77-78 loan "carryovers," total budget authorizations are actually substantial.	BA	77: 78: 79: 80:	115,000,000 116,000,000 116,000,000 119,000,000

1* Information not available concerning classification as BA or BO.

NOTE: Abbreviations used are: U.S. Department of Agriculture, Forest Service (USDA, FS); Department of the Interior, Bureau of Land Management (DOI, BLM); Department of Defense (DOD); U.S. Army Corps of Engineers (COE); Department of Energy, Federal Energy Regulatory Commission (DOE, FERC); Bureau of Reclamation (BOR); Tennessee Valley Authority (TVA); Department of Commerce, National Oceanic and Atmospheric Administration (DOC, NOAA); Farmers Home Administration (FmHA); National Park Service (NPS); Health, Education, and Welfare/Department of Education, Office of Education (HEW/DED, OED); Housing and Urban Development (HUD); Department of Transportation (DOT); and Veterans Administration (VA).

SOURCE: ACIR staff compilation.

Table 2 (Cont.)

FEDERAL PAYMENT IN LIEU OF TAX AND FORMULA BASED PROGRAMS (1978-80)
BA: Budget Authorization—BO: Budget Outlay

Agency	Program		Year	Amount
DOE	Atomic Energy Communities. Atomic energy communities (primarily Los Alamos, NM, Oakridge, TN, and Richland, WA) receive community assistance payments for capital and operating costs, "special burden," and lump sum payments, as well as limited PILOT for their original residential/commercial areas which were taken by the federal government. Payments to state and local governments were authorized under Section 9b of the *AEC Act of 1946 and 1954* and Section 91 (a) of the *AE Community Act of 1955* (P.L. 84-221) and are made at the department's discretion. 60 Stat. 765; 42 USC 2208 (1946).	*	79: 80: 81:	$ 9,079,000 8,672,000 —
DOE USDA (FmHA)	Energy Development Impact Assistance Program. Section 601 of the *Powerplant and Industrial Fuel Use Act of 1978* authorizes this program by reallocating funds for the federal government or certain local governments to purchase land and make the necessary improvements on it, with certain community facilities, to meet national energy needs. Most recent appropriations are for planning. The President's energy legislation would replace this program with Inland Energy Impact Assistance, at a proposed budget of $150,000,000 per year from 1981-85. Appropriation is to DOE and then transferred to USDA.	BA	79: 80: 81:	20,000,000 50,000,000 150,000,000 (assumes new legislation)
DOI (BOR)	Colorado River Dam Fund, Boulder Canyon Project. Annual payments of $300,000 each are made to Arizona and Nevada from operation of the Boulder Canyon project. 43 USC 618a and Sec. 2(c)(d) of the *Boulder Canyon Project Readjustment Act of 1940* (1940).	*	78: 79: 80:	600,000 600,000 600,000
DOI (BLM)	Columbia Basin Project Lands. Annual PILOT to state or substate jurisdiction for lands situated therein, from funds derived from leasing such lands, not to exceed the taxes due were the property not tax exempt. These lands are subject to assessment and taxation, although the U.S. has no obligation to pay such taxes. However, if these lands are under contract of sale, they may be taxed in the same manner as privately owned lands of a similar character. GAO notes that the basis of the payment is the result of negotiation between the Secretary and local officials. 54 Stat. 14; 16 USC 835(c) 1 (1937, 1961).	*	75: 76: 77: 78: 79:	9,792 8,364 8,294 10,768 14,793
DOI (NPS)	Payment for Tax Losses on Land Acquired for Grand Teton National Park. Revenues received from fees collected from visitors are used to compensate the State of Wyoming for tax losses on Grand Teton and Yellowstone National Park lands, not to exceed 23% of receipts of the park in any one year. 64 Stat. 851; 16 USC 406d-3 (1950).	BA BO BA & BO BA & BO	78: 78: 79: 80:	24,000 23,000 25,000 25,000
DOI (BLM)	Payments to Local Governments. BLM is authorized to enter into contracts and cooperative agreements for law enforcement in BLM-administered lands. The payments shown reflect cost reimbursement from cooperative agreements only. *Federal Land Policy and Management Act of 1976* (1977).	*	78: 79:	62,000 150,000
DOI (NPS)	Payment to Harper's Ferry, WV. Assistance is provided to the Town of Harper's Ferry, WV, for Police Force Use.	*	79: 80:	105,000 105,000

Table 2 *(Cont.)*

FEDERAL PAYMENT IN LIEU OF TAX AND FORMULA BASED PROGRAMS (1978–80)
BA: Budget Authorization—BO: Budget Outlay

Agency	Program	Type	Year	Amount
DOI (BLM)	Reconveyed Coos Bay Wagon Road Grant Lands. Out of receipts from the Coos Bay Wagon Road grant lands in Oregon, payments in lieu of taxes are made to Coos and Douglass Counties for schools, roads, highways, bridges, and park districts out of the first 75% of receipts. Local tax rates are applied to the value of lands which are appraised every ten years by one county representative, one DOI representative, and one nonaligned third party.	BA	78: 79: 80:	$ 1,927,000 2,500,000 2,800,000
		BO	78: 79: 80:	1,856,000 2,532,000 2,800,000
DOI (BOR)	Trinity River Basin Project. Payments are made to Trinity County, CA, for additional costs of road improvements during construction of Trinity River division attributable to such construction; and for an annual PILOT from the project's operating revenues equal to the tax on the value of the real property and improvements taken for project purposes at the time it was removed from the tax rolls. 69 Stat. 720 (1955).	*	75: 76: 77: 78: 79:	13,695 13,274 10,342 11,473 15,151
DOI (BLM)	*Payments In Lieu of Taxes* (PILOT) *Act of 1976.* Payments are made to local governments which contain entitlement lands (national forests, national parks, wilderness areas, COE and BOR reservoirs). Payments have an unrestricted use and are based on a 75¢ per acre payment (maximum) but will vary by population of eligible local government (to a population ceiling) and the amount of revenues derived from these entitlement lands. In addition to this flat payment schedule, section 3 of the act provides that, for the lands acquired since 1971, 1% of fair market value at time of acquisition shall be paid to the local government where such lands are located. However, this payment amount is not to exceed the amount of taxes which were paid on the land before acquisition and is to be made to the jurisdiction for only five years. 31 USC 1601, P.L. 94-565.	BA	78: 79: 80:	100,000,000 100,000,000 115,000,000
		(Note: Due to early administrative and entitlement definitional problems, BO was estimated at $125–$135,000,000 for FY 79-80.)		
USDA & DOI	*Redwood National Park Expansion Act.* This act essentially extends the *PILOT Act of 1976* to cover certain additional redwood lands specified in the act. In fact, this payment is appropriated through the DOI PILOT and reflected in the amount shown above. Section 3 of the *PILOT Act* is referenced here as well (and is another cause of the delays in the PILOT payments). In the *Redwood Expansion Act*, however, an ambiguous clause follows this provision which states that any amount in excess of the prior tax payments should be paid in later years. This implies that section 3 payments may clearly extend beyond a five-year period, but that the annual payment amount may not exceed that amount paid under local taxation. The latter amount has yet to be established because of the time delays and land speculation involved throughout the legislative taking process.			

1* Information not available concerning classification as BA or BO.

NOTE: Abbreviations used are: U.S. Department of Agriculture, Forest Service (USDA, FS); Department of the Interior, Bureau of Land Management (DOI, BLM); Department of Defense (DOD); U.S. Army Corps of Engineers (COE); Department of Energy, Federal Energy Regulatory Commission (DOE, FERC); Bureau of Reclamation (BOR); Tennessee Valley Authority (TVA); Department of Commerce, National Oceanic and Atmospheric Administration (DOC, NOAA); Farmers Home Administration (FmHA); National Park Service (NPS); Health, Education, and Welfare/Department of Education, Office of Education (HEW/DED, OED); Housing and Urban Development (HUD); Department of Transportation (DOT); and Veterans Administration (VA).

SOURCE: ACIR staff compilation.

Table 2 (Cont.)

FEDERAL PAYMENT IN LIEU OF TAX AND FORMULA BASED PROGRAMS (1978–80)
BA: Budget Authorization—BO: Budget Outlay

Agency	Program	BA/BO	Year	Amount
	Title II of the act provides for unemployment compensation benefits to persons affected by the removal of certain industries from the acquired land, ensures these persons layoff and vacation replacement benefits, makes payments to applicable pension, welfare and insurance funds, and provides employees' severance pay and certain moving expenses. Economic impact studies and mitigation programs are also ensured for the affected jurisdictions (two counties). P.L. 95-250, 92 s(1978).	*	79:	$ 33,000,000
DOI	*Refuge Revenue Sharing Act* Amendment. This act extends coverage of the *PILOT Act* of 1976 to national fish hatcheries and similar refuge areas not previously covered and provides for revenue sharing payment to each county in which fee areas are situated (as discussed earlier). The amendments also extend PILOT coverage to those lands on which are located semiactive or inactive installations, not including industrial installations, retained by the Army for mobilization purposes and for support of reserve component training. However, it excludes PILOT coverage on those lands acquired from state and local governments which were not previously taxable (unless they were donated). These payments are reflected in the totals for PILOT payments and refuge revenue sharing, listed earlier.			
HEW/DED (OED)	Education Grants in Federally Affected Areas. Payments are made directly to school districts to assist in the construction and operation of schools where enrollments and the availability of revenues from local sources have been adversely affected by federal activities. P.L. 81-874 (1950).	BA	78:	805,000,000
			79:	816,000,000
			80:	528,000,000
		BO	78:	766,349,000
			79:	799,584,000
			80:	619,456,000
HUD	PILOT for Public Housing Authorities (PHA). Payment is for 10% of the shelter rent received by PHA's (less some of the utility payments made by tenants) for low cost housing constructed by the housing authority. Payments reflect an extrapolation of the actual expenses of 80% of the PHAs. All are as of June 30 of each year. 42 USC 1413 (c).	BA & BO	78:	33,305,634
			79(est):	35,470,500
			80(est):	37,598,730
HUD	*Slum Clearance and Community Development.* 42 USC 1456 (c)(3). Payments included in total for public housing listed above.			—
HUD	Defense Housing, Etc. Erected under the *Lanham Act* During World War II. 42 USC 1546. Payments included in total for public housing listed above.			—

1* Information not available concerning classification as BA or BO.

NOTE: Abbreviations used are: U.S. Department of Agriculture, Forest Service (USDA, FS); Department of the Interior, Bureau of Land Management (DOI, BLM); Department of Defense (DOD); U.S. Army Corps of Engineers (COE); Department of Energy, Federal Energy Regulatory Commission (DOE, FERC); Bureau of Reclamation (BOR); Tennessee Valley Authority (TVA); Department of Commerce, National Oceanic and Atmospheric Administration (DOC, NOAA); Farmers Home Administration (FmHA); National Park Service (NPS); Health, Education, and Welfare/Department of Education, *Office of Education* (HEW/DED, OED); Housing and Urban Development (HUD); Department of Transportation (DOT); and Veterans Administration (VA).

SOURCE: ACIR staff compilation.

Table 2 (Cont.)

FEDERAL PAYMENT IN LIEU OF TAX AND FORMULA BASED PROGRAMS (1978–80)
BA: Budget Authorization—BO: Budget Outlay

Agency	Program		Year	Amount
HUD	Payments on Foreclosures. Property taxes are paid to the appropriate tax collecting authority for HUD's single family and multifamily-acquired inventory; properties which HUD owns because of FHA foreclosures.	Single Family, BA & BO	79:	$ 11,509,232
		Multifamily, BA & BO	79:	9,150,000
DOT	*St. Lawrence Seaway Act.* The St. Lawrence Seaway Development Corp. is authorized to make payments to state and local governments for property which was subject to local taxation before acquisition by the corporation. Payment is at the corporation's discretion and is not to be more than the taxes payable for such property in the condition when acquired. Approximately 2,800 acres are owned, most of which is held in open space. 68 Stat. 93; 33 USC 986 (1954).	*	77:	7,100
			78:	7,500
			79:	7,400
			80 (est):	7,500
GSA	Payments for Surplus Real Property. Administrator makes PILOT on real property declared surplus by government corporations, pursuant to *Surplus Property Act of 1944.* 63 Stat. 377; 40 USC 490(a) (1949).			—
DOD	Trident Community Impact Assistance Program. Due to the rapid military growth for the Pacific home port of the Trident submarine and the associated developmental impacts within the Puget Sound region, Kitsap County, WA, receives capital construction grants for certain construction projects. Section 608 of P.L. 93-552 (1974).	*	75-80:	55,500,000 (or roughly 11,000,000 annually)
VA	Payments on Foreclosures. Property taxes are paid to the appropriate tax collecting authority for properties which VA owns because of VA mortgage foreclosures. These payments come from a revolving fund as there are no appropriations for this as a program. The taxes, which vary yearly, are a lien on the property ahead of the mortgage and therefore are paid to reduce VA holding time and enhance property resale.		78:	6,876,285
			79 (est):	7,692,821
TVA	Mitigation Payments. TVA makes negotiated payments to certain local governments (usually urban communities) which are heavily impacted by the authority. Payments are earmarked for certain community services for the Hartsville, Yellow Creek, and Phipps Bend nuclear projects until 1985 as well as five other Tennessee development districts and the State of Tennessee.	*	78:	6,589,000
			79:	4,381,900
			80:	2,783,000
			81:	2,135,200

1* Information not available concerning classification as BA or BO.

NOTE: Abbreviations used are: U.S. Department of Agriculture, Forest Service (USDA, FS); Department of the Interior, Bureau of Land Management (DOI, BLM); Department of Defense (DOD); U.S. Army Corps of Engineers (COE); Department of Energy, Federal Energy Regulatory Commission (DOE, FERC); Bureau of Reclamation (BOR); Tennessee Valley Authority (TVA); Department of Commerce, National Oceanic and Atmospheric Administration (DOC, NOAA); Farmers Home Administration (FmHA); National Park Service (NPS); Health, Education, and Welfare/Department of Education, Office of Education (HEW/DED, OED); Housing and Urban Development (HUD); Department of Transportation (DOT); and Veterans Administration (VA).

SOURCE: ACIR staff compilation.

Table 2 (Cont.)

FEDERAL PAYMENT IN LIEU OF TAX AND FORMULA BASED PROGRAMS (1978–80)
BA: Budget Authorization—BO: Budget Outlay

TVA	Payment to Norris City, TN. While it is a one-of-a-kind payment, this program reflects the fact that Norris is essentially a TVA town. The annual payment covers the costs of specified community services "above and beyond what would normally be rendered" by the city government were TVA not part of the community. Internal agreement and contract no. TV 504-79A.	*	79: 80: 81:	$ 50,000 50,000 50,000

* Information not available concerning classification as BA or BO.

NOTE: Abbreviations used are: U.S. Department of Agriculture, Forest Service (USDA, FS); Department of the Interior, Bureau of Land Management (DOI, BLM); Department of Defense (DOD); U.S. Army Corps of Engineers (COE); Department of Energy, Federal Energy Regulatory Commission (DOE, FERC); Bureau of Reclamation (BOR); Tennessee Valley Authority (TVA); Department of Commerce, National Oceanic and Atmospheric Administration (DOC, NOAA); Farmers Home Administration (FmHA); National Park Service (NPS); Health, Education, and Welfare/Department of Education, Office of Education (HEW/DED, OED); Housing and Urban Development (HUD); Department of Transportation (DOT); and Veterans Administration (VA).

SOURCE: ACIR staff compilation.

then computed by multiplying the number of children in a subcategory by their respective entitlement. Following this determination, a three-tier payment structure adds another element of difference between various entitlement rates by paying only a certain variable percentage of a district's authorized entitlement. In the first payment tier, 100% of entitlement is paid to school districts on the basis of section 2 and 25% of all districts' funding levels is paid for all subcategories of 3a and 3b children. The second-tier payments are then made, paying from 36.85% to 60.93% of a district's authorized funding level for 3a students and from 28 to 32% for 3b students. The third-tier payment arrangements can only be entered after tier 2 payments are completed, but appropriations have never been large enough to permit payments under the third round.

The substantial payments under the impact aid program go directly to the applicant school districts. In FY 1976–77 alone, local districts claimed 8,781 owned or leased tax exempt federal properties, including low-rent housing projects, as a basis for applications under both the 815 and 874 parts of the program. Payments are made to the local educational agency if the parent is employed on federal property which, if not in the applicant agency's county, is totally or partly located in its state. Eligible "impact" lands also include Indian lands, even though they are held in trust rather than owned by the federal government. However, there are no state/local taxes on Indian lands either. At present, Indian lands are considered separate nations and are therefore accorded tax exemption similar to an embassy or foreign government building.[32]

The payments under P.L. 81–815 for school construction in federally affected areas account for only 4% of the total payments under the school impact aid program. Initiated after the post-World War II baby boom, this part of the program has consistently had hundreds of annual applications. However, it has never been sufficiently funded to meet the demand for school construction assistance, with major shortfalls in appropriations occurring since FY 67. For example, with program requests of approximately $80 million, FY 78 appropriations totaled only $30 million. As a result, there has been a backlog of eligible, unfunded applications exceeding $450 million. Moreover, recent proposals to reduce the 1980 U.S. budget, if implemented, will cut the FY 80 budget appropriation in half.

Because of the magnitude of the impact aid payments, which in FY 79 were $816 million (appropriation), three tables have been prepared and appear here, disaggregating annual budget appropriations and outlays by each state (*Table* 3), for the 45 largest U.S. cities (*Table* 4), and for selected cities and counties throughout the U.S. (*Table* 5).

Payments with Special Grants and Loans

Special grant and loan programs represent another large amount of the federal to state/local expenditures. Seven such programs, which are either growth impact grants or energy (growth) impact funds, are included in this group. Other formula payments are distinguished from those described here primarily because they promote essentially universal, as opposed to targeted, assistance to communities throughout the U.S.

Growth impact grants—usually capital grants—have been provided to some local governments to help defray the costs of new infrastructure construction (such as highways, schools, sewers, administrative facilities) incurred by the locality as a result of a new and/or expanded federal activity. The Trident Community Impact Assistance Program, established under section 608 of P.L. 92–552, is one such grant.[33] Under this program, between 1975 and 1981, $55.5 million of construction and construction-related grants will have been channeled to the State of Washington (38.5%) and to the three Washington Counties of Kitsap (58.1%), Jefferson (2.5%), and Mason (0.9%). These grants will fully cover the added state and county infrastructure costs arising from the construction of the Navy's West Coast Trident Submarine Base in the Hood Canal off Puget Sound (but not operating costs). In addition to these funds, the Kitsap County area enjoyed a special $6 million allocation for school aid during the 1976–78 fiscal years, through P.L. 94–94. * After 1981, however, the state and counties will not receive any special added funds to defray the ongoing operating costs of servicing the expanded submarine base and its personnel or of maintaining Trident-induced infrastructure facilities. There appears to be little potential at this time for Congressional approval of this type of grant to help defray future operation and maintenance costs induced by this or similar federal development.

Other large amounts of grant funds for federal or federally induced impacts are provided in community assistance programs for special capital and operating costs, as in atomic energy communities, or through formula grants, such as those administered by the Department of Commerce.

Currently, the Commerce Department, through its Coastal Zone Management Program appropriations, has developed a coastal impact program which includes both Community Energy Impact Formula Grants and Community Energy Impact Fund (CEIF), the latter includes special loans and guarantees, state participation grants, planning and environmental grants. Begun in 1976, this program was designed to provide entitlement money to states "which have experienced net adverse impacts . . . resulting from exploration and production of energy facilities."[34] It was initiated following the 1975 U.S. Supreme Court decision in *United States vs. Maine*, which held that the federal government had sole jurisdiction over resource development beyond the three-mile offshore limit. Thus, it was determined that the states would have no part in any decision concerning development on the Outer Continental Shelf (OCS) nor would the states benefit from any lease bonuses or royalties from resource recovery in their offshore areas. The absence of a receipts-sharing provision similar to the *Mineral Lands Leasing Act*—coupled with a recognition that the problem of onshore impacts from offshore development was a large financial burden for states to shoulder—led to the development of a formula for the distribution of program funds based on a measurement of need using the amount of new energy development, and new employment in the coastal zone. A precise formula has not yet been developed; however, the actual funding formula has, instead, been based on each year's OCS lease sales and the amount of employment accruing to each state and community. The on and offshore impacts of OCS development should continue to rise, as will the federal government's oil and mineral receipts from private leases.

* This special payment is not included in *Table 2* because it has expired.

Table 3

EDUCATION IMPACT AID PAYMENTS TO U.S. STATES AND TERRITORIES UNDER P.L. 81–815 AND P.L. 81–874, FY 1978–80

State or Territory	Appropriations 1978[1]	1979[2]	1980 Estimate[3]
Total	$802,128,682[1]	$815,584,756[2]	$495,000,000[3]
Alabama	12,799,396	13,444,939	4,850,000
Alaska	47,277,835	52,788,100	55,003,000
Arizona	26,201,702	35,425,590	28,791,000
Arkansas	3,835,727	3,976,300	2,313,000
California	96,943,084	96,881,174	61,704,000
Colorado	14,285,723	14,042,000	6,053,000
Connecticut	4,887,789	5,123,700	3,179,000
Delaware	3,372,254	3,569,200	3,619,000
District of Columbia	4,668,376	4,411,700	1,219,000
Florida	22,595,508	22,668,300	11,920,000
Georgia	22,569,507	24,808,200	12,044,000
Hawaii	15,070,717	15,710,600	13,598,000
Idaho	4,834,159	5,007,000	2,993,000
Illinois	14,274,317	14,795,200	8,465,000
Indiana	3,299,378	3,426,900	1,551,000
Iowa	965,510	1,087,200	413,000
Kansas	8,753,785	8,816,000	6,689,000
Kentucky	15,823,796	17,595,359	13,771,000
Louisiana	7,280,941	7,679,112	3,149,000
Maine	3,322,383	3,608,200	2,691,000
Maryland	30,193,664	29,014,974	9,558,000
Massachusetts	14,402,155	13,151,200	7,352,000
Michigan	7,097,566	7,832,400	5,556,000
Minnesota	4,438,294	4,282,100	2,851,000
Mississippi	5,555,325	4,521,900	2,374,000

[1] Includes outlays from P.L. 81–815, totaling $26,797,348.
[2] Includes outlays from P.L. 81–815, totaling $29,484,756. Approximately $27,000,000 of total is undistributed.
[3] Does not include appropriations or outlays from P.L. 81–815. Approximately $12,000,000 of this total is undistributed.
[4] Includes some Trident funds.

SOURCE: U.S. Department of Education and ACIR staff computations.

Table 3 (Cont.)

EDUCATION IMPACT AID PAYMENTS TO U.S. STATES AND TERRITORIES UNDER P.L. 81–815 AND P.L. 81–874, FY 1978–80

State or Territory	Appropriations 1978[1]	Appropriations 1979[2]	1980 Estimate[3]
Total	$802,128,682[1]	$815,584,756[2]	$495,000,000[3]
Missouri	9,605,271	9,701,600	5,316,000
Montana	13,005,759	9,815,600	9,630,000
Nebraska	8,770,756	9,102,100	7,494,000
Nevada	4,922,787	5,067,100	3,483,000
New Hampshire	2,367,008	2,562,071	1,530,000
New Jersey	14,966,552	15,342,720	7,560,000
New Mexico	25,097,712	23,233,200	20,762,000
New York	39,050,704	39,904,902	13,237,000
North Carolina	24,823,169	24,740,900	19,075,000
North Dakota	6,105,566	6,643,200	6,819,000
Ohio	11,295,079	11,801,800	3,574,000
Oklahoma	17,539,976	18,385,900	13,602,000
Oregon	3,839,812	4,430,100	2,319,000
Pennsylvania	11,420,880	11,555,300	3,269,000
Rhode Island	3,966,994	3,592,200	1,468,000
South Carolina	14,183,390	14,881,697	10,693,000
South Dakota	8,823,773	8,945,400	9,057,000
Tennessee	9,045,939	8,580,200	1,120,000
Texas	39,753,505	41,617,674	19,007,000
Utah	11,336,122	12,988,050	3,253,000
Vermont	219,635	235,000	66,000
Virginia	46,853,933	45,943,206	19,974,000
Washington[4]	28,205,959	21,686,613	11,993,000
West Virginia	549,437	687,400	113,000
Wisconsin	3,970,364	44,444,700	2,603,000
Wyoming	3,886,430	3,962,700	2,373,000
Guam	2,037,325	2,111,200	1,755,000
Puerto Rico	11,296,513	12,342,675	10,144,000
Virgin Islands	439,439	398,700	5,000

Table 4

EDUCATION IMPACT AID PAYMENTS TO THE 45 MOST POPULATED U.S. CITIES, 1978 AND 1979

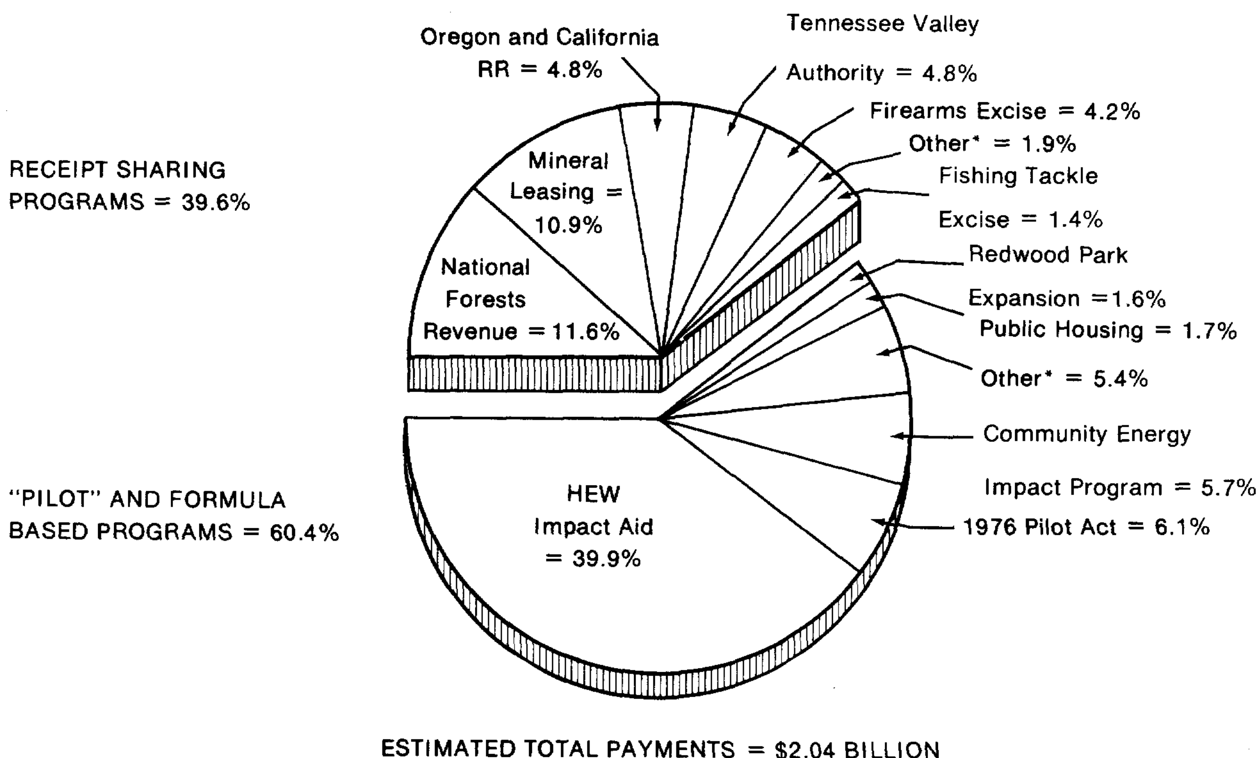
City	Payments 1978	Payments 1979
1. New York, NY	$20,700,091	$17,733,855
2. Chicago, IL	2,849,584	3,209,438
3. Los Angeles, CA[1]	3,040,671	2,736,458
4. Philadelphia, PA	3,470,413	3,100,843
5. Detroit, MI	741,885	369,388
6. Houston, TX	372,554	382,250
7. Baltimore, MD	1,534,896	1,386,891
8. Dallas, TX	613,815	193,661
9. Indianapolis, IN	356,557	359,815
10. San Diego, CA	13,313,936	14,454,924
11. San Antonio, TX[2]	1,479,350	1,297,330
12. Washington, DC	5,307,954	5,464,427
13. Honolulu County, HI	15,327,545	15,722,364
14. Milwaukee, WI	350,515	352,730
15. Phoenix, AZ	57,379	101,740
16. San Francisco, CA	1,853,495	1,874,024
17. Memphis, TN	1,138,225	989,488
18. Cleveland, OH	845,448	792,133
19. Boston, MA	1,711,644	1,478,125
20. Jacksonville, FL	2,662,059	3,074,485
21. New Orleans, LA	1,494,826	1,379,056
22. San Jose, CA	Nonapplicant	
23. Columbus, OH	853,810	763,685
24. St. Louis, MO	321,446	*147,480
25. Seattle, WA	337,497	*261,830
26. Denver, CO	2,617,126	*2,027,546
27. Kansas Cityn MO	295,439	*176,471
28. Pittsburgh, PA	725,449	601,756
29. Nashville-Davidson, TN	284,759	*239,139
30. Atlanta, GA	1,516,638	1,156,512
31. Cincinnati, OH	691,676	475,927
32. Buffalo, NY	269,606	270,648
33. El Paso, TX	3,447,134	3,589,255
34. Minneapolis, MN	215,685	*155,148
35. Omaha, NE	528,667	*477,259
36. Toledo, OH	208,385	255,070
37. Oklahoma City, OK	443,635	454,233
38. Miami, FL	2,421,261	1,990,764
39. Fort Worth, TX	1,421,426	*1,411,354
40. Portland, OR	182,638	132,391
41. Newark, NJ	904,271	657,952
42. Louisville, KY	807,385	732,001
43. Long Beach, CA	1,347,869	1,177,897
44. Tulsa, OK	348,419	383,694
45. Oakland, CA	1,645,789	1,339,579

[1] Unified
[2] Independent school district
* Indicates only partial payment of entitlement as of January 7, 1980.

SOURCE: U.S. Department of Education.

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.

Table 5

EDUCATION IMPACT AID PAYMENTS TO SELECTED CITIES AND COUNTIES 1978 AND 1979

State/City/County	Payments 1978	1979
Alabama		
Madison County	$ 221,688	$ 194,922
Huntsville City	2,184,350	2,128,541
Arizona		
Maricopa County	2,422,050	2,965,078
Phoenix City	57,379	101,740
Pima County	3,080,333	3,183,746
Tucson City	1,992,022	1,978,799
California		
Los Angeles County	6,465,513	6,111,949
Los Angeles City	3,040,671	2,736,458
Long Beach City	1,347,869	1,177,897
San Francisco County	1,853,495	1,874,024
Colorado		
Denver County	2,617,126	2,027,546
Boulder County	658,853	592,967
Loveland City	[1]	[1]
Connecticut		
Groton City	2,514,335	2,772,741
New London County	3,509,972	3,558,176
Delaware		
New Castle County	180,673	4,703
District of Columbia	5,307,954	5,464,427
Florida		
Jacksonville City/ Duval County	2,662,059	3,074,485
Brevard County	3,077,654	2,817,890
Melbourne City	[1]	[1]
Melbourne Beach City	[1]	[1]
Cape Canaveral City	[1]	[1]
Georgia		
Atlanta City	1,516,638	1,156,512
Fulton County	282,020	293,407
Columbus (Muscogee Co.)	1,169,044	1,309,498
Chatham County/Savannah	742,147	665,912
Camden County	[2]	[2]
St. Mary's City	[1]	[1]
Glynn County/ Brunswick City	272,012[3]	257,829[3]
Liberty County/ Hinesville City	707,585	789,551[4]
Long County	40,451	36,848
Bryan County	103,486	104,128[4]

Table 5 (Cont.)

EDUCATION IMPACT AID PAYMENTS TO SELECTED CITIES AND COUNTIES 1978 AND 1979

State/City/County	Payments 1978	1979
Hawaii		
Honolulu County	$15,327,545	$15,722,364
Illinois		
Cook County	3,218,847	3,670,082
Chicago City	2,849,584	3,209,438
Peoria County/	112,603[3]	119,677[4,3]
Peoria City		[3]
Iowa		
Black Hawk County	[1]	[1]
Waterloo City	[1]	[1]
Cedar Falls City	[1]	[1]
Maryland		
Baltimore County	1,004,202	982,805[4]
Baltimore City	1,534,896	1,386,891
Montgomery County	4,979,308	4,424,973[4]
Massachusetts		
Boston City	1,711,644	1,478,125
Essex County	708,115	832,798
Middlesex County	4,734,389	4,687,485
Suffolk County	1,874,943	1,687,449
Michigan		
Detroit City	741,885	369,388
Wayne County	799,958	819,963
Missouri		
St. Louis County	1,143,087	1,045,840
St. Louis City	321,446	147,480[4]
Nebraska		
Douglas County	628,653	712,037
Omaha City	528,667	477,259[4]
New Jersey		
Essex County	1,035,102	782,786
Newark City	904,271	657,952
Somerset County	[2]	[2]
New York		
New York City	20,700,091	17,733,855
Bronx County	[5]	[5]
Kings County	[5]	[5]
New York County	[5]	[5]
Queens County	[5]	[5]
Richmond County		

Table 5 (Cont.)

EDUCATION IMPACT AID PAYMENTS TO SELECTED CITIES AND COUNTIES 1978 AND 1979

State/City/County	Payments 1978	1979
North Carolina		
Durham County	$ 277,242	$ 319,805
Wake County	250,826	279,685
Raleigh City	[2]	[2]
Durham City	114,519	26,616[4]
Tarboro City/ Edgecombe County	10,472[3]	12,574[3]
Ohio		
Cuyahoga County	973,635	1,191,345
Cleveland City	845,448	792,133
Franklin County	1,698,840	1,739,260
Columbus City	853,810	763,685
Urbana City	[2]	[2]
Champaign County (Graham)	18,716	16,845
Oregon		
Multnomah County	239,577	263,550
Portland City	182,638	132,391
Reedsport City	[2]	[2]
Douglas County	203,577	238,840
Pennsylvania		
Philadelphia City and County	3,470,413[3]	3,100,843[3]
South Carolina		
Charleston County/ Charleston City	2,841,306[3]	2,553,973[4,3]
Richland County/ Columbia City	918,757[3]	819,333[3]
Tennessee		
Montgomery County/ Clarksville City	795,918[3]	757,918[3] [3]
Hopkinsville City	[2]	[2]
Davidson County/ Nashville City	284,759[3]	239,139[3,4]
Davidson County	[2]	[2]
Texas		
Dallas County	1,011,322	1,055,681
Dallas City	613,815	193,661
Fort Worth City	1,421,426	1,411,354[4]
Tarrant County	2,684,405	2,761,023
Harris County	573,306	606,205
Houston City	372,554	382,250
Nueces County	1,225,119	1,183,127
Corpus Christi	646,938	466,456

Table 5 (Cont.)

EDUCATION IMPACT AID PAYMENTS TO SELECTED CITIES AND COUNTIES 1978 AND 1979

State/City/County	Payments 1978	1979
Vermont		
Burlington City/ Chittenden County	$ 40,748[3]	$ 60,241[3]
Virginia		
Fairfax County	12,101,227	11,149,085
Portsmouth City	1,165,184	1,063,976
Norfolk City	4,674,954	4,532,471
Virginia Beach City	6,211,702	6,185,518
Richmond City	571,350	501,272
Washington		
Bremerton City	679,733	564,697
Kitsap County	2,901,011	2,964,989
Olympia City	33,663	35,756[4]
Thurston County	304,566	292,644

[1] Not an identifiable applicant.
[2] Nonapplicant.
[3] One applicant.
[4] Indicates only partial payment of entitlement as of January 7, 1980.
[5] Included in New York City; not identifiable separately.

SOURCE: U.S. Department of Education.

SUMMARY OF MAJOR FEDERAL PAYMENT PROGRAMS

Tables 1 and *2* detail each of the revenue and receipt-sharing programs which have been discussed to this point. *Chart 2* provides a summary of the programs, both by type and by size of the major program components. The identification of these programs is merely illustrative of the history and depth to which in lieu of tax programs have become part of the current system of intergovernmental transfer payments. Using 1979 budget data, total budget authorization for these programs is:

Receipt-Sharing Programs	$ 784,643,398
PILOT and Formula Programs	1,209,412,797
Total Payment Programs	$ 1,994,056,195

Moreover, if a mix of 1979 budget authorizations and outlays is used to compute the total, using the budget outlay only when it was larger than the corresponding authorizations (usually reflecting cost overruns or payments carried over from prior years' appropriations), the following sums are computed:

Receipt-Sharing Programs	$ 807,615,398
PILOT Programs	1,234,444,797
Total Payment Programs	$2,042,060,195

Where a 1979 appropriations figure is not shown on a program listing, the 1979 budget outlay or corresponding figure from the year closest to 1979 was used for both computations.[35]

Every attempt was made to determine the correct budget and funding levels, an effort

that often required a lengthy search with an OMB budget officer or program analyst. However, because they were not listed as budget line items, some of the payment programs required a more detailed financial analysis. These "hidden" funds—usually a receipt-sharing fund or one of the small PILOT-type programs—were typically found in a larger revenue account or as part of a broadly authorized program area. (Some, as can be seen, were never found.) Nevertheless, in all cases, the payment figures were obtained from reliable sources working within that program area.

Receipt-sharing or PILOT programs that have been repealed or have expired are not included in *Tables 1* or *2*. One example of such a program is the payment program for properties—primarily old military industrial plants—owned by the Reconstruction Finance Corporation (169 Stat. 721; 40 USC 521-4), which was repealed in 1970 by P.L. 91–466 (84 Stat. 990).* This program had provided for GSA and other "holding" agencies to pay the respective property taxes on these properties to affected state and local taxing jurisdictions, using the local assessment at the time of the acquisition of the property to establish the base figure upon which to apply the local tax rate. Another example of an expired program is the specific legislation passed in the 1960s to alleviate the impact of the "SAFEGUARD" project in North Dakota. Although plans for this new installation were subsequently dropped, special legislation had permitted the Department of Defense to pass funds through to local governments to develop the local infrastructure. It should be noted, however, that this program and the special legislation for Kitsap County are the only cases of specific legislation assigning federal funds to address the impact of new defense installations.

Other Federal Payment Programs

FEDERAL CORPORATIONS AND FEDERAL FINANCIAL INSTITUTIONS

Federally owned corporations and federal financial institutions make direct tax payments to local governments for federal holdings throughout the U.S. by virtue of Congressional consent to state and local taxation of the property of these institutions. The taxable properties owned by several Congressionally created corporations include the real and personal property of the federal credit unions and Amtrak, and the real property of the Federal Deposit Insurance Corporation (FDIC), the Federal Home Loan Banks (FHLB), the Federal Savings and Loan Insurance Corporation (FSLIC), the Federal Land Banks, and the Federal Reserve Banks.*

Each of these institutions was surveyed to obtain the amounts of property taxes it regularly paid throughout the U.S. Typically, the individual banks of these financial institutions report to their central authorities in Washington, DC, which usually collected this survey information. However, no information was obtained on federal credit unions and federal land banks, which are spread throughout numerous communities in the nation, because no central authority collects data on the aggregate tax paid by these groups. The total real property tax paid in 1979 was estimated at about $20 million. A description of each of the other payments follows.

FDIC: The Federal Deposit Insurance Corporation owns only one of its buildings, the headquarters building in Washington, DC, upon which it paid the District of Columbia approximately $180,000 in real property taxes for fiscal 1979. All other regional and field offices and training centers of the FDIC are operated out of privately leased facilities.

AMTRAK: Amtrak owns property in many states and has no federally mandated tax exemption. In 1979, Amtrak paid $5,095,446 in real property taxes.

FHLB: There are 12 Federal Home Loan Banks in the United States, operating under the authority of

* 1971 military appropriations actually extended these payments to a few communities for two years beyond this repeal.

* Various other tax bases (e.g., sales or income) may also be taxed, depending on the specific institution.

the Washington, DC, Federal Home Loan Bank Board (FHLBB). Although the bank board is considered an executive agency and thus is not taxed on its property in the Nation's Capital, its 12 member banks have no property tax immunity. As a practical matter, however, the lack of immunity status makes little difference as 11 of the 12 banks operate out of leased buildings, upon which a regular property tax is levied. The San Francisco FHLB is the only one of the 12 which owns its office quarters. Four of the leased buildings shift their tax directly to the banks, however. Thus, the total tax from these five cities is estimated to have been $252,200 in 1979. Of that total, the San Francisco Bank's real property tax bill in 1978 was estimated at $73,700. *Table* 6, prepared by ACIR staff, documents these actual and estimated tax payments.

FSLIC: The property of the Federal Savings and Loan Insurance Corporation, which is supervised by the Federal Home Loan Bank Board, would also be subject to direct real property taxation by state and local authorities if it owned its own offices. But, as is true for most of the rest of the bank board's system, FSLIC leases space in privately owned buildings for its field office activities. Lease information was not obtained for these holdings.

Federal Reserve Bank System: The Federal Reserve System (FED) includes the Board of Governors, located in the District of Columbia, and 12 federal reserve banks with 25 branches operating in 52 cities across the United States. As was true for the bank board (FHLBB), the building that houses the Board of Governors—the FED's supervising authority in Washington, DC—enjoys immunity from local (e.g., District of Columbia) taxation. The buildings in 39 other cities in the country are taxable, however, and in 1978 the FED paid $13,900,000 in state and local real property taxes. In the 12 other U.S. cities in which the FED is located, the system's operations are carried out under leasehold arrangements.

At least one other federal agency has consented to state and local taxation of the property it owns and uses. In 1980, after months of negotiations, the Tennessee Valley Authority (TVA) agreed to reimburse the State of Wyo-

Table 6

FEDERAL HOME LOAN BANK PROPERTY TAX PAYMENTS FOR REAL ESTATE TAXES (in dollars)

City	1977	1978	1979
Boston	$ 30,800	$ 35,100	$ 39,200
New York	55,800	55,800	55,800
Pittsburgh	49,000	49,000	32,800
Atlanta	42,900[a]	44,400	50,700
San Francisco	170,000	73,673[b]	73,673[b]

[a] Estimated from 1978–79.
[b] Reduced because of Proposition 13.

ming for its uranium mining activities there, according to state law rather than through the traditional TVA PILOT programs. In a significant departure from agency policy, TVA and all of its contractors in Wyoming now face the same procedures and requirements applicable to private companies in the state, including state regulations. In addition to clarifying the often abused policy of derivative federal immunity, this departure from principles governing the existing TVA payment programs listed in *Table 1* and *2* also serves to illustrate the highly discretionary nature with which agency payment decisions can frequently be made. Because the agency will be subject to the same excises as a private company undertaking the same operations, Wyoming has agreed to return all compensatory payments "made by TVA pursuant to the *TVA Act* in connection with TVA's uranium projects in Wyoming and will agree not to claim later that these payments are due."[36] The precedent is clearly set for other agencies and federal property holdings to be treated similarly.

FEDERAL PAYMENT TO THE DISTRICT OF COLUMBIA

Each year the Congress makes an annual lump-sum payment to the District of Columbia. This payment, a unique form of intergovernmental grant-in-aid in the federal-state/local relationship, was initiated in 1790 when the District—Washington, DC—was designated as the nation's Capital City. The unique nature of this payment, and the controversy surrounding it, stems from the special characteristics of the jurisdictional status of the District of Columbia itself. Limited in its geographic size by the U.S. Constitution,[37] the District is the only U.S. city which is not part of a state but, rather, is bordered on all sides by other states (Virginia and Maryland). Although most legal experts agree that most of what is now known as "Washington, DC," could become part of one or both of these two states, such an event is most improbable. The fiscal result is that the District must behave as if it were both a city and a state. Accordingly, it has state as well as local expenditure responsibilities. And, although it utilizes most of the revenue tools associated with both state and local governments, the city is still at a net fiscal disadvantage as it is unable to benefit from the opportunity to shift certain expenditure functions (e.g., highways, education at all levels, welfare) to a state.

It is within this general framework that the federal payment is determined annually.[38] Although there is no disputing the fact that the federal presence creates significant financial, social, and environmental costs for District residents and that the Congress should somehow be held accountable, there is no consensus regarding the "correct" way to conceptually measure, and therefore determine the level of, the federal payment. Currently, at least four arguments are considered as part of the debate between Washington city officials and the Congress regarding the proper rationale: (1) the additional expenditures, including direct mandates, placed on the city as a result of the special nature of the federal presence and its related activities; (2) taxes forgone due to the tax immunity of the federal government; (3) revenues lost as a result of the Congressional prohibition on municipal taxation of locally generated nonresident incomes, and (4) the fiscal result of the Constitutional restrictions on the District which define its legal and geographical status—a status that causes the city to be denied state takeover of "local" services commonly available to other municipal governments.

Although each of these arguments has some merit, the most plausible reason for making an annual federal payment to the District rests on the fourth—that the federal government should act as if it were the city's state. Only when seen in this "state surrogate" framework is the annual federal payment (authorized at $300 million in FY 1980) uniquely justified. The problem with the first three arguments is that the fiscal problems which result are simply not unique to the Nation's Capital.* They apply to a Cleveland, an Albuquerque, or a Portsmouth, as well as to Washington. Indeed, in the case of real property taken off the local tax rolls as a result of actions by a higher level of govern-

* Moreover, extraordinary federally related expenses to the city can be, and often are, paid separately. Thus, in 1977 $650,000 was added to the federal payment to help defray costs of the Presidential inauguration. In 1979, there was a $2.6 million payment because of the farmer demonstrations on the Mall.

ment, Washington, DC, is not even the most severely impacted of U.S. localities.[39]

An even more complex problem concerns the process by which the annual federal payment is made. Indeed, this process serves as an example par excellence of the intergovernmental entanglements that can occur under an ad hoc payment approach. The stage for these entanglements is set by the fact that each year the determination of the level of the payment involves at least six governmental groups: the Office of the Mayor of District of Columbia, the city council, the U.S. Office of Management and Budget, the appropriations subcommittees of both the U.S. Senate and House of Representatives, and the Office of the President. The primary result is that pros and cons of the conceptual arguments for a payment are essentially ignored, and the payment level is politically negotiated, with Congress having most of the negotiating strength. This, in turn, creates two types of problems: fiscal uncertainty for the recipient and unnecessary interference into local matters by the grantor.

The uncertainty results from the fact that there is no advanced funding mechanism for the payment. Although the District's home rule act[40] authorizes $300 million annually, the appropriation has always fallen below that figure. For example, in FY 79 the payment was $250 million, or only 83% of the authorization. In FY 80 that figure rose to $267 million or 89% of the authorization.

These gaps, though large, do not in themselves create the fiscal uncertainty. That problem stems from the fact that Congress usually does not agree on the appropriation figure until the end of the fiscal year for which the payment was budgeted to be expended by the city. (In 1979 the federal government gave the city its payment only four days before the next budget year began.) The practical effect is obvious—the city's budget planning better reflects an episode of the *Perils of Pauline* than a well laid out document for public service delivery. In order to eliminate this fiscal uncertainty, the negotiation process itself should be eliminated, or, at a minimum, the payment level should be appropriated in advance of the fiscal year in which it is to be spent.

Second, as long as the payment process remains on an ad hoc, negotiated basis, the opportunity for unnecessary federal-state/local entanglement exists. Because the payment level must be negotiated annually, top-level District officials may have to divert their attention to policy matters which become "issues"—often at the whim of a particular member or group of members of Congress. For example, during recent Congressional hearings on the federal payment for the District, one Congressman took the opportunity to use the city's budget process to formally register a complaint about the conditions for dogs at the city's animal shelter. The "dog issue" may be a legitimate one, but it hardly deserves to be part of the federal payment debate. The point is that the negotiated nature of the payment opens up the entire fiscal process to the possibility of such abuse.

In short, viewed from city hall, the federal-to-District payment process simply does not "work." However, from the Congressional vantage point, perhaps, the ad hoc approach is just as it should be: it leaves little doubt that with federal money, the federal government still can ultimately dictate the intergovernmental relationship.

OTHER PAYMENTS

The federal government also employs a broad array of "inkind" payments for community economic adjustment and, in one case, monetary grants to help defray the cost of local infrastructure development. Specifically, the Office of the Assistant Secretary for Manpower, Reserve Affairs and Logistics within the Department of Defense contains an Office of Economic Adjustment (OEA), the objective of which is to assist communities—through a concerted utilization of existing federal, state, local, and private sector resources—to overcome adverse economic impacts resulting from program changes of the Department of Defense (e.g., base closings, contract changes, personnel reductions, and growth impacts).[41] The office is small, with a staff of only 20 people and a budget of $700,000, which is used for inhouse studies and contracting with private consultants. OEA assistance is limited to communities and substate regions that are expected to suffer, or have suffered, significant adverse economic impacts from DOD activities, and ranges from advice and technical analysis

to coordinating local applications for various federal programs involving grants and loans. At least 265 community projects have received major assistance from the office since its inception in 1961.*

Communities that are experiencing adverse economic impacts because of rapid buildups, or existing high levels of defense activity, such as Kitsap County, WA, the Fort Stewart area of Georgia, and Camden County, GA, are among those currently receiving OEA assistance. Like Kitsap County, the southeastern Georgia areas are experiencing rapid growth with expansion of military base activity (the U.S. Army's Fort Stewart expansion around Bryan, Liberty, and Long Counties, and the Navy's Atlantic Polaris-Poseidon submarine port in Camden County). In all three cases, technical assistance has been available and, more important, planning and economic development money (usually project grants) has been obtained for local government use.

The Department of Defense has also mobilized the resources of other federal, state, and local agencies and the private sector through an economic adjustment program operated by the Economic Adjustment Committee under the chairmanship of the Secretary of Defense. Strengthened in 1978 through Executive Order 12049, the Economic Adjustment Committee includes members of the major cabinet-level departments, thereby serving as a forum in which the impacted community—through OEA, which actually serves as its staff—can obtain coordinated federal program assistance. Since the committee only deals with a handful of jurisdictions each year, its main value is its ability to provide federal sensitivity to the local consequences of its actions, to channel funds to a targeted area, and to cut some of the red tape and other delays that typically accompany federal program assistance or joint funding arrangements.

The committee was highly successful in securing funds for the Kitsap County area, and over a five-year period managed to obtain a total of $104 million, including $55 million in special DOD assistance, $26 million from domestic agencies, and $22 million in defense access highway funds. The recipient governments will not continue to receive this same level of funding in most programs. They will, however, be eligible for increased funds from the education impact program for school districts and some other existing federal grants which are based on a per capita formula.

In the case of the Georgia communities, in FY 80, approximately $12 million was earmarked for federal assistance to the areas which have been severely impacted by military activities.* However, these funds are the federal share of state and local assistance to these impact areas and their receipt is contingent not only upon the submission and approval of formal applications, but also on the availability of local matching contributions—a difficult matter considering the current inadequacy of the tax base to support the required revenues. The bulk of the total, $11.4 million, is provided for the Fort Stewart, GA, area and is divided between the Cities of Ludowici, Hinesville, and Glenville, and Liberty, Long, and Bryan Counties. The remaining $1 million is for Camden County, which also includes the Cities of Kingsland and St. Mary's. The total assistance package is only one part of the large amount of public facility costs these jurisdictions are presently absorbing and must continue to try to absorb due to their "boom-town" situations.[42]

The Economic Adjustment Committee and OEA's inkind assistance and packaging of other federal assistance for a federally impacted jurisdiction establishes responsibility within DOD to correct its own impacts. However, this method of federal assistance can only partially respond to problems as they arise. Such problems are rarely anticipated in budget forecasts, multiyear capital improvements programming, or long and short-range planning. The program is by definition "special" and provides only for "adjustment assistance." It does not, and cannot, deal with comprehensive federal, state, or local solutions to intergovernmental tax immunity.

* This number reflects communities receiving several types of assistance, not just communities experiencing rapid military buildups.

* A total of $45 million in loans and grants has been "identified" for federal assistance needs.

REVIEW OF EARLIER STUDIES

As the foregoing discussion indicates, over the years Congress has recognized a responsibility to some state and local governments for making a variety of in lieu of tax payments to "compensate" for the federal presence. However, the result has been the buildup of a patchwork of uncoordinated and ad hoc payment programs. Accordingly, one of the major questions this study will address is whether, given this environment, the federal government should enact a uniform system of payments in lieu of taxes in order to rationalize its payments system.

The call for rationalization of the current system of payments in lieu of taxes is not new; indeed, it has spanned the history of this country. In 1969, the Congressional Joint Economic Committee (JEC), arguing "only basic equity," urged that Congress make payments in lieu of real property taxes on property owned by both the U.S. government and foreign governments (embassies, consulates, missions) in the U.S.[43] However, as early as 1896 a public uproar was raised regarding the fiscal consequences of President Cleveland's decision to create 13 new U.S. forest reserves out of primarily western lands—a reversal of the 19th Century policy trend to transfer federal property to private owners and to the states. One federal response to this outcry was the *National Forest Revenues Act* (1908), providing for the federal sharing of revenues generated by the new National Forest System. In 1938, focusing on the concern of the impact of all federally owned real estate on state and local taxation, President Roosevelt designated a committee of the National Emergency Council to make a study of the extent of U.S. real estate holdings.

The first major effort by an agency of the federal government to establish some sort of uniform system of payments to state and local governments on federal real property was conducted between April 1949, and August 1951, by the Bureau of the Budget (BOB).[44] At that time the Budget Bureau, foreshadowing the basic recommendations of the 1955 "Kestnbaum Commission," recommended federal to local in lieu of tax payments on a property tax equivalency basis.[45] However, the base for measuring the PILOT, as recommended by BOB, was eroded by provisions for cutoff dates (property acquired prior to 1946 was to be excluded) and by exemptions for federal properties used primarily for services to the local (as distinct from national) public. Although a detailed draft bill accompanied the Budget Bureau's recommendations, no legislative action was taken.

Three other major reports dealing directly with the question of federal property tax compensation to local governments for tax exempt federal lands have been issued in the last ten years. All focused largely on "open space" lands.

In a 1970 report, the Public Land Law Review Commission (PLLRC)—a 19-member Congressional and executive commission—studied a wide range of issues (outdoor recreation, development of mineral resources, protection of watersheds, hunting and fishing regulations), including tax immunity of federal lands administered by the Bureau of Land Management, the Forest Service, the U.S. Fish and Wildlife Service, the National Park Service, and the Department of Defense.[46] The major PLLRC recommendations regarding the tax immunity issue were:

- If the national interest dictates that lands should be retained in federal ownership, the burden of that policy should be borne by all the people of the United States and not only by those states and governments in which the lands are located. Accordingly, "fairness and equity demand" that the federal government should make payments in lieu of taxes to compensate state and local governments for the tax immunity of federal lands. A PILOT system was specified as a better standard for determining payments than a system of sharing revenues.
- These payments in lieu of taxes should be made to the state governments for distribution to localities according to state-established criteria. However, rather than provide full tax equivalency with *ad valorem* revenues that would be received if the property were in private ownership, a discount of from 10% to 40% should be provided to recognize "intangible benefits that some public lands provide." This general and wide-ranging discount policy was intended to give

"recognition to the intangible benefits that some lands provide." No hint was given, however, of the criteria for determining what point of the range might be appropriate for a given parcel. Moreover, the commission also concluded that even this range would not be appropriate for situations of extraordinary benefits and burdens, the quantitative extent of which might be determined by state/local and federal negotiation.

- State and local governments were encouraged to tax private possessory interests on federal land.
- The "threshold concept," under which payments in lieu of taxes would be made only to the extent that federal lands represent more than some percentage of total land in a particular state or locality, was rejected. Two reasons were cited for failure to endorse this threshold approach: First, it is "virtually impossible to arrive at a logical basis for establishing either a percentage of land or land values," and, second, the uneven distribution of federal land among the states makes the threshold "impractical."

A second major report is the 1978 ACIR study on the adequacy of federal compensation to local government for certain tax exempt lands. The major focus of the ACIR study was on the question of whether or not the extensiveness of a denied tax due to federal land within a county explains (a) local tax burdens or (b) local expenditures. The study found that the answer to both of these questions was "no"—that, in general, the burden and expenditure characteristics did not vary systematically with the extensiveness of public land. Accordingly, the Commission recommended that Congress maintain its receipts-sharing programs pertaining to "federal open lands," but that provision be made for additional compensation to counties which met various "hardship" criteria.[47]

The third recent study of this issue was conducted by the U.S. General Accounting Office in 1979.[48] Again, the focus was on the land payment programs in the western states and, like the PLLRC, it found inequities and other administrative problems stemming from the role of the states in determining the size of the federal to local payments, as well as computational problems. Accordingly, the GAO reviewed several alternatives to the current payment system, including the five basic methods or rationales for making the payment: cost of federally imposed expenditures; comparable tax burden; net burden of the federal presence; fixed formula; and property tax equivalency. Of these choices, the GAO endorsed the tax-equivalency approach as "the most logical rationale for making payment,"[49] and recommended that this method be phased in over several years at the same time the receipt-sharing programs were being eliminated.

This ACIR report builds on each of these studies, but arrives at its own set of findings and recommendations independently. The scope of the report is larger than that of any of the earlier reports and has come at a time when the federal presence is more pervasive than at any other time in our nation's past.

FOOTNOTES

[1] See discussion in Jerome R. Hellerstein and Walter Hellerstein, *State and Local Taxation: Cases and Materials*, 4th ed., St. Paul, MN, West Publishing Co., 1978, pp. 921–24.

[2] *McCulloch vs. Maryland*, 4 Wheat 316 (1819).

[3] *McCulloch vs. Maryland*, at 433.

[4] For a discussion, see the legal analysis provided by Judith Jacobsen in supplemental documentation to accompany the *Interim Report of the Commission on the Review of the Federal Impact Aid Program*, submitted to the President and to the Congress, May 6, 1980, especially Appendix A.

[5] *McCulloch vs. Maryland*, at 434–35.

[6] Jacobsen, *Interim Report of the Commission on the Review of the Federal Impact Aid Program*, Appendix A, p. 51.

[7] *McCulloch vs. Maryland*, at 439.

[8] *Collector vs. Day*, 11 Wall 113 (1871).

[9] For an overview of this issue through 1966, see U.S. Advisory Commission on Intergovernmental Relations, *State and Local Taxation of Privately Owned Property Located on Federal Areas*, Summary of Commission Report A–6, August 1965, and *Property Taxes on Federal Enclaves*, Hearings Before the Subcommittee on Intergovernmental Relations of the Committee on Government Operations, U.S. Senate, 89th Congress, 2nd Sess., July 1966, pp. 1–4.

[10] *American Oil Co. vs. Neill*, 380 U.S. 451 (1965); a detailed discussion of this issue is presented in Daniel H. Friedman, "The State Tax Liability of Federal Contractors," *Revenue Administration*, 1977, pp. 65–77.

[11] Friedman, "The State Tax Liability," *op. cit*; p. 69. Also, "(i)n the exercise of (its) power to protect the lawful activities of its agencies, Congress has domi-

nant authority which necessarily inheres in its action within the national field." *Pittman vs. Home Owners Corporation*, 208 U.S. 31 (1939).

[12] *Oklahoma Tax Commission vs. Texas Co.*, 366 U.S. 342, 356–66, (1949).

[13] Congressional consent to taxation which destroys the federal system would be unconstitutional. See, for example, *Schechter Poultry Corp. vs. United States*, 294 U.S. 495 (1935).

[14] *Federal Land Bank of St. Paul vs. Bismark Lumber Co.*, et al, 314 U.S. 95, p. 4 (1941).

[15] Data provided by the Office of Federal Procurement Policy.

[16] *James vs. Dravo Contracting Co.*, 302 U.S. 134, 1937.

[17] Friedman, "The State Tax Liability," *op. cit.*, p. 67.

[18] As the Energy Research and Development Administration—now absorbed into the Department of Energy—used to do routinely. *Ibid.*, p. 63, 73n.

[19] ACIR, *State Taxation of Military Income and Store Sales*, A–50, Washington, DC, U.S. Government Printing Office, 1976, 110 pages.

[20] John D. Bowman, "Federal Restrictions on State Taxation of Military Pay Revisited—A Note on Tax Avoidance Through Domicile Shifting Following Removal of the Withholding Prohibition," *National Tax Journal*, March 1979, pp. 41–9.

[21] Bowman, "Federal Restrictions," *op. cit.*, pp. 42–45.

[22] *U.S.C.* 105–10 (1970).

[23] De facto services also go untaxed because of specific state/local statutes regarding interjurisdictional taxing of certain economic activities. ACIR, *State Taxation of Military Income and Store Sales*, A-50, *op. cit.*

[24] For a discussion, see Michael E. Bell and Robert D. Ebel, *Financing an Urban Government*, The Final Report of the District of Columbia Tax Revision Commission, Washington, DC, 1978, Ch. 1.

[25] *Ibid.*

[26] *U.S. of America and Borg-Warner Corp. vs. Alex G. Detroit*, 355 U.S. 466, 78 S. Ct. 474 (1958).

[27] *Phillips Chemical Co. vs. Dumas Independent School District*, 361 U.S. 376, 80 S. Ct. 474 (1960).

[28] EBS Management Consultants, Incorporated, *Revenue Sharing and Payment In Lieu Of Taxes On The Public Lands*, a report prepared for the Public Land Law Review Commission, 1970, Washington, DC, National Technical Information Service, 1970, p. 126–27.

[29] ACIR, *State and Local Taxation of Privately Owned Property Located on Federal Areas*, *op. cit.*, pp. 15.

[30] Several similar programs have expired over the last few decades and thus are not included in this discussion.

[31] A more detailed analysis of P.L. 94–565 is contained in a Commission report, *The Adequacy of Federal Compensation to Local Governments for Tax Exempt Federal Lands*, A–68, July 1978. The subsequent problems with the acts are also discussed in depth in a fall 1977 General Accounting Office report to Congress, *Alternatives for Achieving Greater Equities in Federal Land Payment Programs*, Washington, DC, U.S. Government Printing Office, 1979.

[32] It is interesting to note here that in 1980 the State of Maine passed an act to implement the Maine Indian Claims Settlement, which provides for Indians to make PILOTs on all real and personal property for county, district, state, etc., taxes (subject to some exemptions).

[33] For a background and case study of the Trident program, see Robert A. Levin, *Fiscal Burdens on Kitsap County*, a report prepared for the Trident Coordinating Committee, Port Orchard, WA, September 1979.

[34] U.S. Senate, Interior and Insular Affairs Committee, *Legislative History of the Coastal Zone Management Act*, Washington, DC, U.S. Government Printing Office, 1977, pp. 579–80.

[35] These groupings were used only to make the data as complete as possible because a better figure was not available.

[36] Ernie Beazley, "TVA to Pay Wyoming for Uranium Mineland," *Journal*, Knoxville, TN, June 24, 1980.

[37] U.S. Constitution, Article I, Sec. 8.

[38] To date the most thorough treatment of this District of Columbia payment has been presented in Michael E. Bell, "The Federal Payment to the District of Columbia," in *Technical Aspects of the District's Tax System: Studies and Papers Prepared for the District of Columbia Tax Revision Commission*, a volume submitted to the Committee on the District of Columbia, U.S. House of Representatives, 95th Congress, 2nd Sess., December 1978, pp. 261–98.

[39] See Bell, "The Federal Payment," *op. cit.*, p. 272. In cities like Portsmouth, VA, the federal exemption is even greater than in DC.

[40] *District of Columbia Self-Government and Governmental Reorganization Act*, 93rd Congress, 1st Sess., Washington, DC, 1973.

[41] The available federal government resources are listed and described in *Catalog of Federal Domestic Assistance*, Washington, DC, U.S. Government Printing Office, 1978, p. 147.

[42] 1978 internal memorandum from the Georgia Department of Community Affairs, "Department of Community Affairs Impact Area Budget Package."

[43] U.S. Congress, Joint Economic Committee, *Joint Economic Committee Report on the 1969 Economic Report of the President*, Washington, DC, U.S. Government Printing Office, 1969.

[44] U.S. Bureau of the Budget, *Executive Communication No. 722 Regarding Payments in Lieu of Taxes*, Washington, DC, August 16, 1951.

[45] *Payments in Lieu of Taxes and Shared Revenues*, a report submitted to the Commission on Intergovernmental Relations, Washington, DC, U.S. Government Printing Office, 1955, 197 pages.

[46] Public Land Law Review Commission, *One Third of the Nation's Land: A Report to the President and to the Congress by the Public Land Law Review Commission*, Washington, DC, U.S. Government Printing Office, 1970.

[47] ACIR, *The Adequacy of Federal Compensation to Local Governments for Tax Exempt Federal Lands*, A–68, Washington, DC, U.S. Government Printing Office, 1978, 204 pages.

[48] U.S. General Accounting Office, *Alternatives for Achieving Greater Equities in Federal Land Payment Programs*, PAD–79–64, Washington, DC, U.S. General Accounting Office, September 25, 1979.

[49] *Ibid.*

Chapter 3

Statutory and Administrative Considerations

The federal government, acting through its agencies and instrumentalities, is exempt from state and local taxation on almost every activity it undertakes or item it owns. Moreover, the immunity may even be extended to third parties, with recipients of interest on the federal debt and construction contractors being the most significant examples from a state/local perspective. Accordingly, in examining the federal PILOT issue from a practical public policy standpoint, the first requirement is to determine which state/local revenue bases are operationally usable for designing a broad progam of federal payments designed to compensate states and localities for the negative effects of federal tax exemption. Once that determination is made, the next task is to examine whether that "tax" or PILOT base is one that *should* be adopted. To answer this policy question, the PILOT will be evaluated against generally accepted normative criteria for judging a revenue change.

At the outset, it should be noted that there are two basic approaches to designing a broad federal payment system. The first would be for Congress to enact a payment in lieu of tax system. The second involves federal consent to state/local real property taxation. For discussion purposes, the first approach is adopted here. Nevertheless, it should be noted that analytical determination of the payment base does not require maintenance of this PILOT vs. tax distinction; that is, the PILOT can be viewed as

having all the economic attributes of a tax payment. At the same time, by viewing the PILOT as a type of grant, one can focus more readily on substantive economic questions such as those regarding (1) whether a PILOT is just another grant-in-aid device being added to the long list of existing grant programs, and (2) how the PILOT might best be administered.

CONCEPTUAL CLASSIFICATION

Theoretically, a payment in lieu of tax could encompass nearly every state and local tax that is foregone because of the federal presence. As a starting point, one could accept the extreme theoretical case that if all federal property were privately owned and in its highest and best use, additional sales, income, property, inheritance and estate, and other taxes would be collected by states and localities. There would be only two broad areas for tax base erosion: (1) those activities or property use categories to which states or local units have accorded full or partial exemption, even when in the private sector;* and (2) those properties and activities under state/local government control. However, it should be noted that a case can certainly be made for some form of in lieu payment on properties which are off the tax rolls due to either ownership of, or mandates by a higher level of government (e.g., federal mandates to a subnational government, such as those in the District of Columbia, or the much more common case of state-mandated exemptions from the local tax base). Indeed, several states already make compensatory in lieu of tax payments to local governments. (See *Volume 2.*)

Despite its academic attractiveness, however, attempts to design a PILOT by such a comprehensive view of the tax exempt base would be operationally impractical and, in some cases, simply not worth the administrative effort in terms of its revenue generation. Moreover, a comprehensive tax base approach would require a high degree of speculation regarding the eventual property owners and what their incomes and wealth might be under this alternative economic structure.

*Examples are: full exemptions, such as those for museums and educational institutions, and partial exemptions, such as those provided to agricultural and conservation lands and to various businesses through development tax incentives.

Institutions, Not Persons

Like a tax, a PILOT might be classified and designed in a variety of ways. The two broadest classes could be derived first from the distinction between a PILOT that is based on persons using, or indirectly associated with, a government service and the government as an institutional entity separate from the employees and the consumers of its services; and, second, a PILOT that distinguishes between general and specific payment programs.

For purposes of examining a uniform, broad-based federal PILOT program, the "persons" vs. "institution" division is straightforward and disposed of rather easily. Because the intergovernmental tax immunities doctrine is, with the exceptions noted in *Chapter 2,* no longer manipulated to include persons who have a derivative relationship with the U.S. government,[1] no in lieu payment need be considered for major third-party direct taxes such as the individual income and estate and inheritance levies. Thus, in discussing a uniform PILOT, the justification, if any, must focus on the government as an institution.

General vs. Specific

The classification distinction for PILOT is somewhat more difficult to make in the "specific" vs. "general" context. As a guide, a *specific* PILOT would be one that addresses a particular set of circumstances, whereas a *general* payment would be designed to achieve comprehensive coverage of all (or most) like governmental institutions or activities. Thus, the distinction here is based upon the scope and uniformity of the payment rather than the form of payment.

Of all the existing payment programs listed in *Chapter 2,* the only programs that can be placed in the "general" category are some of the receipts-sharing programs and, perhaps, the Federal Impact Aid Program for local education. The former group is so defined because the purpose of the payments is to recognize that the federal government is uniformly using certain broad classes of property for commercial purposes. The Federal Impact Aid Program might also be put in this "general" classification, as the payments are based on categories

which are generally uniform nationally.

This study examines the nature and characteristics of a general PILOT that would be uniformly paid on nearly every type of federal real property to compensate subnational governments for the federal presence.

PROPERTY TAX EQUIVALENCY

By narrowing the PILOT base to one that can be applied generally to private and federal institutions alike, it is still theoretically possible to argue that at least the three major state and local tax bases could be constructed—*viz,* the sales, receipts (income), and property bases. However, designing a PILOT that corresponds to the first two of these is fraught with difficulties which stem from the tax base accessibility problems derived from both the economic function of government as a provider of public goods and the unitary administrative nature of commodity procurement practices. For example, although the federal government does generate income or receipts from its leasing of public lands to commercial interests and then provides for receipts-sharing with local governments, receipts-sharing is simply not applicable to the bulk of federal activities. This feature follows from the simple fact that most government agencies either do not generate receipts, or, what revenue is generated is usually in the form of a cost-of-service fee. The price paid for government publications, various business operating licenses, permits, airport landing fees, entitlement fees, EPA licenses, and park entrance charges are examples of the latter. The problem with setting aside part of these fee receipts as a form of receipts sharing is twofold: first, many fees are generally designed as regulatory or public service rationing aids, not as revenue generators, and second, those that are nonregulatory usually fail to produce even the revenue necessary to cover the costs-of-services provided by an agency.

The federal "sales" tax base is even more illusory. Theoretically, one could look at the federal government's current expenditure share of GNP and come up with some sort of total sales or expenditure activity. But beyond this point, the apportionment or allocation task becomes unmanageable and unmeaningful. In addition, even defining the "sales" of public goods "purchased" by a system of compulsory taxation is a practical dead-end. Indeed, it is those cases in which sales of goods and services can be easily identified and apportioned among individual users that are used to delineate private from public sector activity.

The one general tax base that attaches to the federal government and is readily accessible to local government because of its immobility, and for which valuation procedures are already developed, is the government's real property.* Accordingly, this base provides the most practical framework for designing a general federal to state/local PILOT.

COMPUTATION AND SCOPE OF THE PAYMENT

The PILOT to be examined here is based on a real property tax equivalency approach. That is, the amount of the proposed PILOT is equal to the dollar amount which the federal government's real property would yield were it fully taxable under a jurisdiction's state and local real property tax structure. The definition of real property—i.e., levies designed to defray all or part of the costs of specific public improvements, such as street paving, sidewalks, and sewer lines that serve the government property.[2] In adopting this framework for the PILOT, it is explicitly understood that the U.S. government is to be treated *as if* it were a real property taxpayer. Thus, its property holdings are subject to the same definitions and state/local tax rates that apply to similar taxable private properties and, where appropriate, to one or more of the market valuation approaches endorsed by the American Institute of Real Estate Appraisers.** These valuation methodologies include:

1. *Cost Approach:* the current cost of reproducing a property minus depreciation from deterioration and functional and economic obsolescence;

*The tangible personal property component of the property tax base is not considered here.

**The definition of what constitutes "real" property or real estate varies among jurisdictions. For example, jurisdictions which do not levy a personal property tax tend to define real property more broadly than do those governments which levy both real and personal property taxes. Usually the issue focuses on whether or not to include various fixtures in the real property tax base.

2. *Market Approach:* the value indicated by recent sales of comparable properties on the market; and
3. *Income Approach:* the value which the property's net earning power will support.

In view of the data requirements needed for valuation, more than one of these methods may be used. Of course, there will be certain circumstances for which one or more of these approaches are not applied. Indeed, for purposes of valuing government-owned properties, the income approach could rarely be applied (although, in the case of office buildings, the income approach valuations of comparable private buildings may be appropriate "checks" for an appraiser to use). On the other hand, the market data approach may prove quite useful for the many urban properties, including vacant land. The most commonly used method, however, will be the cost approach. These cost-valuation problems are discussed later in this chapter and again, in detail, in *Volume 2.* For now it need only be understood that the state of the art of real estate appraisal is such that the "valuation problem" is not an obstacle to designing or implementing a PILOT based on real property tax equivalency.

Similarly, conventionally accepted methods for valuing special assessments and apportioning that value according to benefit may be adapted to government holdings. Clearly, as is the case for any aspect of the PILOT, the special assessment must be nondiscriminatory. Thus, for example, the special assessments should fall uniformly on all owners who benefit from the improvement, probably eliminating special levies established by negotiations between the municipality and individual owners.

Exclusions From the Base

The following categories of real property are specifically excluded from the base of the PILOT being examined in this report:

- *Land* exclusions include: property in the public domain, property held in federal trust; flood control and navigation; parks and historic sites; forests and wildlife; reclamation and irrigation and grazing lands.
- Among the excluded *structures and facilities* are: flood control and navigation; roads and bridges; reclamation and irrigation; and monuments and memorials.
- No *buildings* are excluded from the PILOT base.

Together, these exclusions account for approximately $68.6 billion, or only about one-fourth of the total value of all federally owned property in the U.S.

Except for the historic sites, monuments and memorials, and the roads and bridges categories, all of these categories are excluded because they are presently subject to the government's only broad-based payment program as administered under the "open-space" land, receipts-sharing, and guaranteed, per acre, minimum payment laws.

Excluding such open-space usage categories has the practical advantage of permitting the study to focus on payments for the federal government property holdings which have not been examined before. In addition, there is some substantive justification for these eliminations in that much of this excluded property can be made subject to direct taxation of the possessory interest, or to nonproperty taxation. Without cavil, however, it should be clearly stated that the exclusion of these open-space properties from this study should not necessarily be interpreted as a rejection of arguments for applying a tax equivalency approach to all federal real property usage categories. Indeed, there are good arguments both for maintaining this exclusion indefinitely or eventually including open lands in a PILOT base. As noted in *Chapter 2,* the case for inclusion has been made by both the Public Land Law Review Commission (PLLRC) and the U.S. General Accounting Office.

The reasons for excluding historic sites, memorials, and monuments can best be justified by ACIR's judgment that these "unusual" properties are likely to be excluded by Congress for purposes of administrative expediency; accordingly, it is acknowledged that a case can be made for including these types of properties in the base. The judgment to exclude was also made on research grounds that, in order to provide the most reliable and practical estimates of the current value of federal property for this report, parcels such as the Arizona Battleship

Memorial or the United States Capitol have such a special purpose character that they could be eliminated. Although this exclusion is not a serious one from an overall tax base perspective, it does, of course, erode significantly the PILOT base in some local jurisdictions (Washington, DC, is the extreme example). However, other real properties of a monumental nature, such as various ornate "federal buildings" (e.g., some old central city post offices, courthouses, and the Congressional office buildings), can—and should—be easily valued without regard to their ornamental features. Indeed, assessors commonly deal with this sort of problem with respect to both currently taxable and (when they are to be assessed) exempt properties. Regarding the latter, a practical solution is to have the owner of the exempt property provide to the assessor a statement that shows the original cost of the structure and of any remodeling. These costs can then be inflated to reflect current value.[3]

Public domain lands were also excluded from this PILOT base for practical reasons.

The first and most important is that, although there have been some isolated attempts to measure the value of the public domain, even the most basic acquisition cost data are nonexistent with respect to these lands (see discussion in *Volume 2*). This lack of cost data arises from the unique judicial status of the public domain itself—i.e., all the area title which was vested in the U.S. government by virtue of its sovereignty and, thus, which has never left federal ownership or was obtained in exchange for public domain lands or timber on such lands.[4]

Second, an examination of the inventory of the lands that constitute the public domain shows that most of this property (forests, parks, historic sites) falls under the open space categories, which, for reasons discussed above, are already excluded from the PILOT base considered here.

Roads and bridges are excluded for some of the same practical reasons noted above. The "unusual" characteristics of this usage classification include its permanence as well as its utility. Once constructed, it is no longer "vacant land;" yet it is really without market value as it cannot be developed. Although air rights over transportation rights-of-way are one exception, they are marketed only in special situations. Moreover, most "U.S." highways are either in national park areas or under state/local jurisdiction (e.g., the interstate highway system) and could easily be excluded for other reasons.

Finally, because of their quasi-federal status and the lack of usable cost data, trust properties in custody of the federal government (e.g., the Smithsonian Institution and land of the Indian nations) are also specifically excluded. Once again, however, a case can be made for including some trust properties in a PILOT base.*

The Tax Rate

Property tax discussions usually distinguish between "uniform" and "nonuniform" taxes. Generally, the uniform tax is one for which the effective rate (the legislated or nominal rate times the assessment-sales ratio) applies to all taxable real property. In contrast, nonuniformity is introduced when different types of property are classified and taxed at different rates.

Technically, few, if any, of the 13,439[5] primary real property assessing jurisdictions in the U.S. adhere to uniformity. This is because, when a specific class or type of property is singled out for preferential nominal rate or assessment treatment (or when a special definition is applied to "real property"), the effective rate on such property is lowered below that on other classes. These preferences vary, ranging from various forms of residential tax relief (e.g., circuit breakers and homestead exemptions) to mechanisms designed to benefit specific business activities (e.g., preferential assessment for farmland and tax exemptions or moratoriums on land and/or capital improvements).

In addition to these "technical" considerations, however, some jurisdictions have moved, either by statute or constitutional amendment, to explicit classification of different property-

*The Smithsonian Institution clearly appears to present a special case of abuse of the tax exempt status typically accorded federal and like private institutions (e.g., museums). The institution's museum shops sell books, gifts, and souvenirs through both over-the-counter and catalog mail operations. Although this activity competes directly with like private institutions (including private operations which may lease space in one of the museums), they pay no state, local, or federal taxes.

types in order to influence the proportion of total taxes allocable to each of the various classes. Usually the objective is to raise the tax on business properties above other types. At present, 11 states and the District of Columbia have comprehensive classified property tax systems.[6] These include (with the date of implementation): Minnesota (1913), Montana (1917), Arizona (1968), Alabama (1972), Tennessee (1973), South Carolina (1976), Louisiana (1978), the District of Columbia (1979), and Massachusetts and Ohio (1980). West Virginia (1934) achieves somewhat the same effect by specifying rate limits for different classes of property based on their residential character or geographical (municipal vs. nonmunicipal) location. In 1971, Illinois amended its constitution to allow counties of 200,000 or more persons to adopt their own classification schemes, and in 1973 Cook County did so. Legislation or constitutional amendments for classification are also introduced periodically in other states. Finally, a site value tax might also be considered a form of classification since it achieves a multirate structure by varying legal assessment ratios and levies by type of property.[7]

These classified tax systems raise the issue of which tax rate to apply to the federal establishment in designing a PILOT program—an issue on which reasonable people may legitimately disagree. The view adopted here is that, as long as the rate is applied generally to a class of property most like the type owned by the federal government (i.e., usually commercial as opposed to residential or agricultural), that rate should be used. This rate policy is not in any way designed as a fiscal expediency measure—e.g., an attempt to "soak" the federal establishment. Rather, the reasons follow from adherence to the principle of treating the federal government as if it were a normal taxpayer—discriminating neither for nor against it vis-a-vis similar properties. Thus, if the government facility is an office building or warehouse in Cook County, it would be treated the same as the office buildings or warehouses located elsewhere in the county and taxed at the commercial rate. On the other hand, if the government owned a veterans' hospital or sewage facility, there might be a case for using a lower (or zero) rate if similar private properties enjoyed a partial (or full) tax exemption. At the same time, when there are established legal criteria and administrative processes for differentiating between similar properties—some of which are taxable and others exempt—the federal government should also be subject to these tests. Thus, whereas the social club in the local YW-YMCA may be exempt, the private Elks Club is probably taxable on the grounds that the "Y" and the Elks social functions are, in fact, dissimilar. Such criteria for a local differentiation then can be applied to determine whether a nonprofit Army-Navy Club on federal property may or may not be exempt from the PILOT base.

An argument for always applying the higher tax rate in those jurisdictions that classify their real property tax follows from the point raised in both *Chapter 2* and the first part of this chapter—*viz*, the fact that the federal government exempts itself (and in some special cases, third parties) from nearly every other form of state or local tax. Thus, relative to other (real property taxable) institutions, the U.S. government already has preferential treatment.

It would be incorrect, however, to leave the impression that there are no arguments for uniformly using the lowest (e.g., residential) rate. Perhaps the most important is that it would create pressures for real property tax uniformity. For example, tax reformers—who point out that much of the special preference legislation (e.g., business tax incentives) only creates dead weight revenue losses for a local jurisdiction—might argue that, by having to provide the U.S. government with the lowest common denominator of such tax breaks, special preference legislation would be more difficult to enact. Thus, any time some type of business received special legislative consideration that reduced its effective property tax rate, so would at least one other taxpayer—the federal government.

Conceivably, of course, this tax reform argument could cut another way. If one adopts the view that more significant strides toward uniformity in real property taxation can be achieved by providing disincentives to states to classify their property taxes, then putting the federal government in the higher class as an aggrieved taxpayer adds clout to the anti-classification group. At this point, the likelihood of this political result can not be predict-

ed. Much may depend on how mobile or powerful the U.S. government as taxpayer becomes if the PILOT is enacted.

There is a third possible solution to this rate-determination issue. A weighted average of all the classified property tax rates could be computed and then applied to the government's property. This exercise would eliminate any likely problems of discrimination and yet enable localities to derive some revenue benefits from their classified systems. However, other than for these two reasons, there is little to recommend the weighted average approach. Not only would the principle of the federal government as a normal taxpayer be abandoned; the administrative tasks, particularly for jurisdictions with overlapping taxing districts, would be formidable. Moreover, the tax rate paid by the federal government would now vary according to the commercial-residential mix of the jurisdiction rather than by any adherence to equity principles.

One final point needs to be made. The use of the rate applied to similar private taxable properties focuses on the level of effective tax rate before the private taxpayer deducts property taxes paid in computing the federal income (corporate or noncorporate) tax due. Technically, one might argue that the PILOT rate should be discounted by a certain percentage in order to take into account the fact that the federal government cannot give itself a federal income tax offset. This is an interesting argument and, once again, there is some room here for legitimate disagreement. The view taken here, however, is to reject such discounting. This decision is based on the counterarguments that deductibility provisions are, fundamentally, not property tax or, as extended here, PILOT issues. It is true that under these offset arrangements the U.S. Treasury currently "pays" part of the property tax bill of private taxpayers who file federal tax returns. However, the purpose of this deductibility provision is to give subnational governments incentives to use certain types of taxes (e.g., income, property, sales) more intensively than others (e.g., user fees, gasoline excises), as well as to provide certain investment incentives to individuals. Not only does this incentive system strengthen fiscal federalism; it does so in a way that Congress feels is desirable. Presumably, if the Congress changes its outlook on how these incentives should be working, it will change the *Internal Revenue Code* as it pertains to the tax offset. Indeed, it did just that when the itemized deduction allowable to individuals for state and local gasoline taxes was repealed for tax years beginning after 1978.

Furthermore, rather than being a property tax or payment in lieu of tax issue, the federal offset provisions are fundamentally related to overall federal income tax and expenditure decisions. If the Congress wished to make up its revenue "loss" from the state/local tax deductibility, it could raise the federal income tax rate. But those decisions to raise or lower overall federal rates are made primarily with respect to their (1) stabilizing effects on the national economy, and (2) distributional concerns, such as the equity adjustment required to offset the "inflation tax" effects.[8] For these reasons, the argument for adjusting the tax rate to equal the average private taxpayer's federal offset is rejected.

OTHER ADMINISTRATIVE CONSIDERATIONS

Although there are implementation problems which need to be worked out in establishing a PILOT—as there are with any new levy—these problems would not be a barrier to the use of a PILOT in the United States. Both the state of the art of property tax administration in the U.S. and the practical workings of the 30-year old Canadian system of real property tax equivalency PILOTs for federally and provincially owned real property attest to this. What does need to be discussed here, however, is the implementation mechanism for a federal PILOT.

Valuation

The bulk of federal properties will not present valuation problems with which assessors are not already familiar in regard to private taxable properties.* At present, the usage catego-

*According to one expert practitioner at the state level: "Valuation of state-owned property according to the same standard applicable to taxable property has proved to be a realistic basis for determining state aid payments." See remarks by Sidney Glaser, Director of the New Jersey Division of Taxation, "In Lieu Payments—New Jersey's Program," a paper presented to

ries of most federal real property are fundamentally no different than those of taxable properties. General Services Administration (GSA) estimates show that, as of 1978, the federal government owned 406,949 buildings in the United States with a gross area of 2.6 billion square feet, 89% of which is used for housing (92% of that is for military personnel). services, office buildings, storage, industrial and research work, and other institutional structures.[9] Schools, prisons, and hospitals make up the remainder.

The nature of the federal land holdings is much the same. Nearly all of the approximately 310 million acres covered in the scope of this PILOT are in uses (e.g., industrial, military base, power development and distribution) for which an assessor can readily apply the estimating techniques used for private land. The bulk of the structures and facilities the government owns can be categorized as in power development and distribution (e.g., TVA), utility systems, storage, and industrial use.

As noted in the earlier section on property tax equivalency, the usual valuation procedures could be employed—recognizing, of course, that reliance would be placed on the cost approach.

Certainly, there are going to be problems with some special purpose buildings and facilities. However, these properties are only a relatively minor part of the total property requiring assessment. Moreover, numerous special-purpose private properties also exist, and are assessed, in jurisdictions throughout the country.

Federal or Local Assessment?

The U.S. government could set up a new bureaucracy to determine the value of federal property throughout the country. Such a plan would place maximum control in the federal establishment, but that is about all there is to recommend federal assessment.

The obvious alternative is to rely heavily on the existing local assessors and auditors to determine the value of federal property at the same time that private property is being assessed. Under this arrangement, each taxing authority would submit to the federal government (to a central office or to individual agencies) a PILOT bill—in the form of a grant application—stating the amount of the local assessment, applicable "tax" rate, and expected payment. If the federal government felt that the payment was too high, one of two appeal processes could be used. The first would simply employ the normal local administrative and judicial appeal procedures available to any taxpayer. This approach is attractive, as it continues to use existing bureaucratic and judicial mechanisms. However, it also has disadvantages: (a) normal judicial remedies, such as the threat of tax sales of the property of tax delinquents *may* be difficult to enforce in the courts (and possibly unthinkable to Congress); and (b) it may overload some local courts in areas with a large amount of federal property subject to the PILOT, thus undermining the purpose of its enactment.

The word "may" is emphasized in the above paragraph because the federal government can now be subject to property tax delinquency penalties. Real property owned by the U.S. Department of Housing and Urban Development (HUD) serves as an excellent illustration. HUD often ends up owning single and multifamily (two to four) housing units when FHA income properties are foreclosed.* As owner of this property, HUD pays real estate taxes and special assessments which were liens on properties at the time of conveyance to HUD, or which are levied on HUD-acquired properties after conveyance. HUD then continues to pay real estate taxes and special assessments until the property is sold to a new owner. In those areas that have homestead exemption privileges, local HUD offices are to assure the continuation of that exemption.

If tax bills and special assessments are not paid within the time required by law, HUD becomes subject to delinquency penalties. Ultimately, if the delinquent tax bill and/or special assessment and the resulting penalty are not paid, the property may be sold by the local

the Annual Meeting of the International Association of Assessing Officers, Detroit, MI, September 30, 1980. Also see the formal testimony by Jerry Emrich and Douglas H. Clark before the ACIR, June 19, 1980. (Witness statements, this volume.)

*HUD-owned single-family properties, due to foreclosures on FHA single-family properties, numbered 26,653 in 1978 and 20,728 in 1979.

taxing authority to recover these debts. When a HUD property is sold for tax delinquency, internal HUD regulations require that the local HUD officials determine whether the value of the property makes it "economically advantageous to recover the property" by issuing a voucher for tax payment.[10] These regulations also state that, in order to prevent tax sales and the resulting court costs, local area offices must maintain close contact with the local taxing authority to determine if delinquent taxes and/or special assessments are outstanding.[11]

An alternative approach would be to follow the Canadian example by setting up a special federal real estate board (or office) to review the local governments' assessments. If, upon review, the board felt the properties in question were being overassessed, a downward adjustment, to which there could be no local appeal, would be made.

For those who would oppose establishing a federal real estate board as evidence of a further buildup of the federal bureaucracy, four points should be made to allay fears that it *has* to be that way.

First, at surprisingly little cost, it is possible for the U.S. to have a parcel-by-parcel and agency-by-agency accounting of the current value of its properties—even though such records are not now maintained. Using an inventory of the location and original cost of each federal building, structure and facility, and land parcel, ACIR has developed a cost-trending method that could be used to establish a file of the value of U.S. government real property holdings on a property-by-property basis (see *Volume 2*). Of course, this trending approach would eventually be replaced by superior actual field (assessment) data.

Second, the idea of the federal government reviewing and, when necessary, appealing, the property tax it would pay is already an ongoing process. Perhaps the best example is that carried out by the U.S. Postal Service (USPS). Currently, the USPS operates out of approximately 31,500 buildings (from post offices to storage and bulk mailing operations) in which there are often elaborate structures and facilities for distributing the mail. Of the total, 3,500 of the USPS buildings are government-owned and thus tax exempt. The remaining 28,000 are leased. All of these leased buildings pay the real property tax (but not special assessments) indirectly through rental agreements. Although most of these—23,000—operate under simple market rental arrangements, 5,000 of the buildings (the large ones which account for more than half the total square footage of all USPS buildings) operate under automatic property tax escalation clauses, a practice which began in the 1950s.

Obviously, the Postal Service wants to be sure that local assessors do not make a practice of overassessing the private buildings that happen to house their service. This is particularly true for the buildings that are rented under a pass-through tax escalation arrangement. Accordingly, the assessments on these leased facilities are reported to the USPS offices in Washington, DC, where they are reviewed. If deemed necessary, appeals are filed. Of course, the very fact that it is widely known that this review is made has the effect of influencing some local jurisdictions (which might otherwise not be so inclined) to maintain impartiality in assessing two similar private buildings—one used by USPS and the other for private activities.

Third, not only has the federal government, through the USPS, had experience with paying, reviewing, and appealing local property taxes; so have many multistate and multinational business firms which might also be viewed by some as targets for high tax assessment. Yet these circumstances have not led to large real estate bureaus within these firms. The American Telephone and Telegraph Co. is a good example. Although AT&T has leased and owned properties throughout the nation, all property tax appeals are simply dealt with in the locality where the property is located. To date, AT&T has not seen the need to set up a central real estate tax office even though it pays millions of dollars in real property taxes annually.

Finally, there is the Canadian experience. Although the Canadian intergovernmental framework admittedly is far simpler and less overlapping than is the American system (the Canadian federal government has to deal with only about 2,500 taxing authorities—one-fifth of the number of primary assessing authorities in the U.S.), the federal review process is generally considered to have worked smoothly in

that country. Some federal vs. local difference of opinion has occurred regarding the dollar valuation of federal property, but these differences represent a very small proportion of the total number of federal properties included in the Canadian PILOT program.[12] In cases of continuing disagreement, the Minister of Finance receives a formal appeal and then either relies on the advice of his valuation officers or calls in an outside consultant. This latter procedure has been used only three times since the inception of the program in 1950.[13]

Timing

If a PILOT is enacted, it should be made clear early in the legislative process that the federal government will be a prompt payer of the grant, and that the grant process will be simple enough that it can benefit large and small jurisdictions alike. This point is not made just to belabor the obvious. Recent research on the nature of federal categorical grant programs concludes that a major reason for the federal government's failure to get grants to many of the needy communities, in accordance with Congressional intent, is the "myriad of costs involved in seeking and receiving federal grant assistance"—costs which communities with the greatest need and smallest fiscal and planning capacity simply cannot afford.[14]

The obvious policy implication here is that a PILOT, if enacted, can and should be designed to be implemented at a minimum of cost to both the U.S. government and the recipient state/local jurisdictions. The evidence is that this would require an unconditional "no-strings" payment.

Regarding the timeliness of the payment, there should be no doubt in the minds of local officials about the federal government's authority to fund the program. Currently, about 70% of federal spending is already determined by some kind of advance funding decision. According to a recent report of the Congressional Budget Office, Congress provides those moneys in the current year which may have been funded "anywhere from 12 months in advance of the start of the fiscal year to 130 years beforehand."[15]

Jurisdiction Receiving the Grant

Real property taxes in the U.S. may be levied by any one of several jurisdictions. Two general procedures are available for distributing any federal PILOT: All payments either go to the state for its determination of the distribution formula or directly to the local government. The exact nature of this second procedure will vary according to the state/local intergovernmental and property tax systems. For example, if the second approach is taken in a state where the county assessor, clerk, or auditor is the chief collecting official, the county would collect the PILOT and then—just as is done for all property taxes—parcel out the PILOT to cities or townships, school districts, park districts, county, and the like. The distribution would be made in amounts of the payment level voted upon at each local unit (assessed value x township rate for townships; assessed value x school districts levy for schools, etc.). In states with a single taxing authority (e.g., Hawaii's counties), the payment would simply be made to that level of government alone.

Such a mechanism would keep the PILOT within the "as if it were a property tax" mode. Nevertheless, a case can also be made on federal administrative grounds (reducing the number of recipient taxing authorities to 51) that the entire PILOT amount—the sum of that calculated at each local taxing unit (township share + school share + county share, etc.)—be paid directly to the state government for distribution according to factors ranging from the nature of state school aid formulas, circuit breakers financing, and the like. It might be noted, however, that if this state redistribution method is adopted, it will somewhat weaken the argument that the PILOT must be in the form of an unconditional grant in order to reach small and large local government jurisdictions alike.

FOOTNOTES

[1]*Graves vs. New York ex. rel. O'Keefe*, 306 U.S. 466, 59 S. Ct. 595 (1939).

[2]Tax Foundation Inc., *Special Assessments and Service Charges in Municipal Finance*, Washington, DC, Tax Foundation Inc., 1970. For a general review of the economic and legal status of special assessments, see Oliver Oldman and Ferdinand P. Schoettle, *State and Lo-*

cal Taxes and Finance, Mineola, NY, The Foundation Press, 1974, pp. 412–42.

[3] William S. Goodyear, "Assessment Problems Created By Exemption," *The Proceedings of the Seminar of Property Off the Tax Rolls*, National Conference of State Legislatures and The International Association of Assessing Officers, Denver, CO, June 2–3, 1980.

[4] Original public domain lands that have reverted to federal ownership through operation of public land laws are also included in this definition. The definition used here is that provided in the General Services Administration's *Summary Report of Real Property Owned by the United States Throughout the World as of September 30, 1978*, Washington, DC, U.S. Government Printing Office, 1979, p. 2.

[5] U.S. Department of Commerce, Bureau of the Census, *State and Local Ratio Studies, Property Tax Assessments and Transfer Taxes*, Fall 1980, Table 1.

[6] International Association of Assessing Officers, Research and Information Services, *Bulletin*, "*Classified Property Tax Systems*," Chicago, IAAO, 1979, 18 pages. In November 1980, Ohio voters approved a constitutional amendment permitting the two classifications of (1) agriculture and residential and (2) all other property.

[7] A review of the various forms of classification is provided by Steven David Gold, *Property Tax Relief*, Lexington, MA, Lexington Books, 1979, 331 pages.

[8] The U.S. Bureau of the Census reaches a similar conclusion. In its definition of the effective property tax rate it reduces that rate to reflect homestead exemptions but not circuit-breaker tax credits or rebates, since the "latter are commonly associated with administration of the income tax." U.S. Department of Commerce, Bureau of the Census, *Taxable Property Values and Assessment—Sales Price Ratios*, Vol. 2, 1977 Census of Governments, Washington, DC, U.S. Government Printing Office, November 1978, pp. 24–25.

[9] GSA, *Summary Report of Real Property Owned by the United States Throughout the World as of September 30, 1978*, GSA Office of Administration, various tables.

[10] U.S. Department of Housing and Urban Development, *Property Disposition Handbook, One to Four Family Properties, Processing of Tax Bills*, July 1978, 4310.2 Rev., pp. 1–3.

[11] Ibid., p. 2.

[12] Communication from Douglas H. Clark, Assistant Director, Federal-Provincial Relations Division, Department of Finance, Canada. A similar federal-local property tax payment for federally owned land is also common in some European countries—for example, in Sweden, the Netherlands, and the United Kingdom.

[13] Unpublished memorandum provided by Douglas H. Clark, Assistant Director, Federal-Provincial Relations Division, Department of Finance, Canada.

[14] Robert M. Stein, "Federal Categorical Aid Equalization and the Application Process," a paper presented at the Annual Meeting of the American Society of Public Administration, Baltimore, MD, April 1979, p. 16.

[15] See the report of the Congressional Budget Office, *Advance Budgeting: A Report to the Congress*, Washington, DC, U.S. Government Printing Office, 1977; and the discussion by Margaret J. Moore in Michael E. Bell, "The Federal Payment to the District of Columbia," in *Technical Aspects of the District's Tax System*, Committee on the District of Columbia, U.S. House of Representatives, 95th Congress, 2nd Sess., Washington, DC, U.S. Government Printing Office, December 1978, pp. 291–93. The 130-year reference is quoted verbatim from the CBO report, p. 9.

Conceptual Issues: Rationale and Alternative Forms of Measuring the Payment Base

THE BASIC FRAMEWORK

In fiscal 1980, the U.S. government provided an estimated $89.8 billion in grants-in-aid (categorical plus General Revenue Sharing) payments to state and local governments. In addition, $4.1 billion of tax expenditures will accrue to states and localities in the form of subsidies resulting from the federal tax exemption for interest paid on state and local debts.[1] In total, that is $93.9 billion in federal assistance, an amount that equals an estimated 30.5% of own-source revenue collected by state and local governments.[2]

Because the federal aid role has become so large in the state/local context (in current dollar terms it doubled during the decade of the 1970s), there must be strong economic justification to enact another federal payment program, such as a tax equivalency payments in lieu of taxes program which, in 1978, would have cost the U.S. Treasury another $3.65 billion. In economic terms, if a payments in lieu of taxes program simply adds dollars to the federal government's existing aid structure without being justified on its own merits as an entirely new program, the PILOT payments would do little more than add to the complexity of the intergovernmental fiscal system. Politically, such a finding would and, in fact, should, keep the payments in lieu of taxes from receiving serious Congressional considera-

tion—particularly in an era of budgetary constraint in which federal aid programs in general, and unconditional grants in particular, are receiving a cool reception on Capitol Hill.

Within that policy context, this chapter first summarizes the nature of the existing grant-in-aid programs and then examines the proposed payment in lieu of taxes. The finding is that a payments in lieu of taxes program would not overlap the scope and purpose of existing federal aid arrangements. Given this conclusion, the conceptual justification for a tax equivalency program and the alternatives to this method of determining the payment base are examined more closely.

Nature of Existing Grant Programs

There are two basic types of grants-in-aid—conditional (or categorical) and unconditional (or block). The former is by far the larger of these two divisions (aproximately 90% in FY 80), and comes with a series of use restrictions designed to encourage the states and localities to expand the supply of certain public services. Thus, the recipient government gives up considerable fiscal independence, which is reduced even further if, as is usually the case, matching requirements are included in the grant.

The unconditional grant may be spent in any way the recipient government chooses, including supplementing program services, providing financing revenue, covering expenditure gaps, or enacting tax cuts. Included in the unconditional category is the General Revenue Sharing (GRS) program ($6.9 billion in FY 80) and some of the ad hoc payments in lieu of taxes listed in *Chapter 2*. If a uniform tax-equivalency payment program for property taxes were to be enacted, administrative and theoretical considerations would argue that it, too, should be unconditional.

Identifying federal assistance programs as conditional or unconditional, however, does not provide enough information to determine whether the payments in lieu of taxes would simply duplicate other grant programs. The classes of problems that grants are intended to address should also be examined, so that a determination can be made regarding which, if any, of these areas would also be addressed by payments in lieu of taxes.

Recognizing the difficulty of distinguishing between intended and actual purposes of federal grant programs, grants can additionally be classified according to whether they provide for social, economic, and/or fiscal needs. Each of these purposes is discussed briefly below.[3]

- *Providing for social needs:* allocating resources to state and local governments in order to provide the mix of public goods and services which Congress deems desirable and for which state and local governments are seen as the institutional units best able to meet the requirements of their residents. Indicators of social need include the percentage of poor families and individuals living in a jurisdiction, the crime rate, per capita income, and measures of the quality of housing. The list of federal aid programs designed to address these social needs is enormous, ranging from historic preservation grants, aid for educational television, and acquisition and alteration of senior citizens facilities, to civil defense and safety training programs and a variety of housing rehabilitation and construction programs.
- *Providing aid to areas experiencing structural economic need:* grants intended to ameliorate the effects in such areas of a declining economic base resulting from business and residential migration between cities and suburbs and/or between regions of the nation. Indicators of economic need include changes in population (losses), per capita income, and the employment composition (e.g., losses in manufacturing relative to the service sector) of the area. Community development grants (e.g., the Urban Development Action Grant, Community Development Block Grant), education, training, and technical assistance programs (e.g., Comprehensive Employment Training services, Technical Assistance Research), and special community impact grants (e.g., Special Economic Development and Adjustment Assistance) are examples of the federal assistance programs targeted to alleviate economic problems.
- *Meeting financial need:* providing relief

to governments, usually urban, to help them cope with fiscal stress as manifested by indicators such as low liquidity, large debt, unusually high tax effort, and unbalanced budgets. Federal programs targeted to fiscal need concerns include General Revenue Sharing, loan guarantees (New York City), growth impact grants, and some of the in lieu tax payments discussed in *Chapter 2*.

Clearly any classification of problems and, therefore, the general purposes of grant programs, will be somewhat arbitrary, as social, economic, and fiscal needs may be closely related to one another. For example, as the central cities in the U.S. continue to experience both population and job loss—an economic decline problem—social problems of crime, poverty, abandoned housing, and the like may be exacerbated. At the same time, fiscal stress will worsen as the tax base shrinks and costs will rise because of a rigid public personnel system and a growing proportion of low income residents in the population. Fiscal ills may, in turn, give added impetus to the population and job loss phenomena.

Just as these problems are cyclical and overlapping, so are the effects of the federal grant programs designed to address them. For example, the Antirecession Fiscal Assistance Program, initiated in 1976 but not extended in 1978, was found to be effective in targeting funds to cities with serious problems of economic base decline, as well as to those cities experiencing severe budgetary difficulties. Not only were these grants substantially larger in areas with high unemployment rates (the economic problem); they also tended to go to the large city governments that were experiencing severe fiscal strain.[4] A similar conclusion can be reached regarding the Local Public Works Program.[5] The purpose of this grant, authorized in 1976 ($2 billion) and then again in 1977 ($4 billion), was to stimulate the national economy by funding small-scale, quickly completed local government public works projects. The distribution of this aid was based on factors of both economic and fiscal need. Although the funds were initially targeted toward cities with high unemployment, a study by the U.S. Treasury found that the largest per capita grants also went to large cities experiencing severe financial difficulties.[6]

Similar findings have been made with respect to the General Revenue Sharing (GRS) Program. Because these funds are initially distributed under either one of two formulas, both of which specifically take into account fiscal and economic indicators (e.g., tax effort, urbanized population, and state personal income tax collections), the GRS program is most responsive to city fiscal need—as was intended.[7] But GRS funds are also well-targeted to municipalities which have high index of economic need.

Nature of Proposed PILOT Grant Program

The obvious question that follows is whether a payment in lieu of taxes program would also have these conditional or unconditional grant characteristics. Analytically, the question to be addressed is: as a general rule, does the presence of federal tax exempt real property significantly explain the existence of social, economic, or fiscal problems in local jurisdictions?

The answer is *no*, and is supported on both theoretical and empirical grounds.

An explanatory relationship between the incidence of the value of federal real property in a given jurisdiction and the various community "needs" cited above should not be expected for several reasons. There is little doubt that many of the municipalities experiencing the economic, social, and fiscal problems are also those in which there are large amounts of nontaxable federal real property. The fundamental reasons for the "need" problems, however, can be traced to factors such as reduced national population growth, reduced costs of commuting from suburb to city, changes in consumption as well as product technology, the changing composition of the private industrial base, and the consequences of federal government policies that have promoted suburbanization (e.g., the interstate highway system, FHA mortgage insurance, and the deductibility of mortgage interest payments from the income tax).

Certainly, the presence of federal tax exempt activities would be expected to worsen some of a municipality's problems—particularly financial. Nevertheless, the fact remains that, except in a relatively few extraordinary situations where the federal government dominates a community tax base (e.g., Kitsap County, WA;

Portsmouth, VA; New London, CT), the federal government's tax exempt presence is not the significant root cause of financial or social and economic community distress.

EMPIRICAL ANALYSIS

The foregoing conclusions are borne out by an empirical testing of the hypothesis that the value of federally owned real property is not significantly related to a community's social, economic, or fiscal health. In slightly more technical jargon: these community needs are not shown to have a positive or negative association with the amount of federal tax exempt property.

Municipalities

In order to test the hypothesis, correlation coefficients (product moment) between the value of all federal real property (land, buildings, and structures and facilities) and need ("municipal characteristics") were estimated for two sets of data: the 45 largest U.S. cities and a random sample of 40 communities having a population of more than 25,000. The results of these correlations are presented in *Table 7*.[8] In this table two numbers, one listed above the other, appear with each of the municipal characteristics.

The first is the (linear) correlation coefficient, which provides a measure of closeness of the relationship between the value of federal property and the municipal characteristics. Note that all of the coefficients are quite small and the associated relationship is either positive (+) or negative (-).

The second number, in parentheses, is the "significance level" associated with the correlations, measured at a "95% confidence level." What this says is that any time the number in the parentheses is greater than, or equal to .05, there is only one chance in 20 (or five out of 100) that the finding here—a lack of a meaningful relationship between federal property value and the municipal characteristics—is nonrandom. That is, whenever this number in the parentheses is greater than, or equal to .05, one can conclude, with a 95% degree of confidence, that no statistically significant relationship is observed. Conversely, when those numbers are less than, or equal to .05, one can conclude that there is a significant (though not necessarily functional) relationship. These "significant" relationships are noted by an asterisk (*).

One must be careful not to place too much reliance on the interpretations of these statistical findings. Nothing is "proved" by them, and, when a statistically significant relationship is shown to exist, this does not necessarily mean that there is a functional or cause-effect relationship. Given these caveats, *Table 7* does provide some important findings. Overall, it supports the original hypothesis that there is no significant relationship between the value of federal property within municipal boundaries and indicators of social-economic need (the first three municipal characteristics listed). The lack of a relationship between the three fiscal need indicators and federal property is somewhat less clear. There is a significant association between municipal debt and federal property in the 45 largest cities, although this relationship fails to show up in the sample of all U.S. cities with populations greater than 25,000. Of particular interest here is the finding that for both sets of cities examined, per capita property tax burdens are not associated with the amount of federal tax exempt property within a jurisdiction's boundaries.* This finding is consistent with those provided in the 1978 ACIR study—that the extensiveness of public land within a jurisdiction does not significantly influence the tax burden of the people who reside within that jurisdiction.[9]

What are the policy implications of all this? First, and most important, a payments in lieu of taxes based on the value of federal real property would *not* be just another grant program. It is not designed to substitute for existing programs, including General Revenue Sharing. The only reason for referring to the payments in lieu of taxes as a "grant" is to distinguish it legally from a tax so that by its enactment the U.S. government may avoid admitting a legal taxpaying obligation.

Second, and a point closely related to the first, the argument presented in *Chapter 3* for an unconditional payment in lieu of taxes is still based on the administrative advantages of

*Since debt generally finances capital improvements, debt burden can be viewed as similar to "tax" burdens. If this view is accepted, the data indicate there is, at least for the largest cities, some federal property-fiscal need association.

Table 7

CORRELATION BETWEEN SELECTED MUNICIPAL CHARACTERISTICS AND THE TOTAL VALUE OF ALL FEDERAL REAL PROPERTY WITHIN MUNICIPAL BOUNDARIES FOR THE 45 LARGEST U.S. CITIES AND A RANDOM SAMPLE OF 40 U.S. CITIES WITH A POPULATION GREATER THAN 25,000, 1978

Municipal Characteristics	Correlation Coefficient	
	Largest 45 Cities	Sample of 40 Cities
Percent of families below poverty level	.016 (.457)	–.139 (.196)
Percent of individuals below poverty level	.171 (.129)	–.002 (.494)
Percent of households without adequate plumbing	–.230 (.064)	–.199 (.109)
Percent of general revenue from the federal government (dependence on federal aid)	.032 (.416)	–.139 (.196)
Per capita property taxes	.019 (.449)	.230 (.079)
Per capita municipal debt	.312* (.020)	–.177 (.238)
Median value of owner-occupied homes	.063 (.338)	–.357* (.013)
Median gross rent, renter-occupied units	.060 (.346)	.022 (.445)
Total federal employees	.728* (.000)	.098 (.276)
Civilian labor force	.168 (.135)	.104 (.264)

* Indicates a statistically significant relationship exists at the .05 level.

SOURCE: ACIR staff computations.

this approach and a recognition that the payment in lieu of taxes permit the federal government to act *as if* it were a local real property taxpayer.

And, third, although the state or local revenues generated from a payment in lieu of taxes will certainly help some cities meet their fiscal and public service needs, the payment in lieu of taxes cannot be justified on these grounds. If Congress is concerned about such problems, and it has shown that it is, then it should continue to focus on existing types of aid programs, unconditional as well as conditional. As far as the payment in lieu of taxes goes, it needs and has its own justifications, which are addressed below.

Urban Counties

The lack of a meaningful relationship between the value of federal real property and the two sets of U.S. municipalities indicates that it is important in order to understand not only the likely economic characteristics of a proposed PILOT paid on the basis of these property values, but also its urban policy implications. Accordingly, to provide a check on these results, a similar empirical analysis was conducted for all of the nation's 315 "central urban counties."

A central urban county is that single county determined by the U.S. Bureau of the Census to represent the most densely populated and de-

veloped area within a standard metropolitan statistical area (SMSA). In nearly all cases this central urban county is the one county associated with the central city of the SMSA.

The data are presented in *Tables 8* and *9*. *Table 8* provides the simple correlations (zero-order relationship) between the value of federal real property and various socioeconomic variables.* Note that in this analysis (*Table 8*) the relationship is tested at both the 90% and 95% significance levels.

Table 8 shows that, except for the "percent individuals poor" and "percent [county] general revenue from federal government," the relationship between the value of federal real property and various socioeconomic indictors is significant.

This finding of a large number of significant bivariate relationships required that the data be examined in greater detail. Thus, *Table 9* reports the results of a regression analysis with the value of federal real property as the dependent variable and the socioeconomic indicators as the independent variables. The resulting "standardized regression coefficient" is the same as the partial correlation coefficient: it defines the relationship between the real property value and each of the socioeconomic measures when the effects of all the variables in the model other than that one being tested are held constant. The results reported in *Table 9* thus offer a clearer understanding of the relationship shown in *Table 8*. Four of the six previous significant relationships (i.e., density, housing without plumbing, median gross rent, and per capita debt) are seen to be statistically insignificant when controlling for the effect of other socioeconomic indicators—i.e., when the statistical effect of each of the other indicators listed in *Table 8* is accounted for. This finding suggests that the relationships in *Table 8* were due to the whole set of socioeconomic indicators and not just the particular one being tested.* Put another way, if each of the nine indicators in *Table 8* is examined for its relationship with federal real property, while at the same time eliminating the effects of the other eight indicators, the significance of the relationship is diminished. Only the number of

*These variables are similar to those presented in *Table 7*. Civilian labor force and percent of poor families were not reported on the computer tapes provided by Census; thus they are excluded from this analysis.

*This second test for partial correlations was not necessary when the municipal date (*Table 1*) were run, as there was little evidence of a significant relationship between property values and each indicator even when the other indicators were not accounted for.

Table 8

CORRELATION BETWEEN SELECTED URBAN COUNTY CHARACTERISTICS AND TOTAL VALUE OF REAL FEDERAL PROPERTY WITHIN COUNTY BOUNDARIES

Need Indicator	Correlation
Population per square mile	.348**
Civilian labor force	N.A.
Percent families poor	N.A.
Percent individuals poor	.007
Percent households without plumbing	−.165**
Median owner-occupied home value	.345**
Median gross rent, renter-occupied units	.230**
Percent general revenue from federal government	.000
Per capita property tax	.114*
Per capita debt	.212**
Total federal employees	.873*

* P ≤ .05
**P ≤ .01
SOURCE: ACIR staff computations.

Table 9

REGRESSION MODEL AND ESTIMATES FOR TOTAL REAL FEDERAL PROPERTY

Variable	Standardized Regression Coefficient
Population per square mile	.050
Percent individuals poor	.004
Percent household without plumbing	−.009
Median owner-occupied home value	.170*
Median gross rent, renter-occupied units	.039
Percent general revenue from federal government	.072
Per capita property tax	−.101*
Per capita debt	−.035
Total federal employees	.814*

*P ≤ .05
SOURCE: ACIR staff computations.

federal employees retains its robust relationship with federal property value. This lack of a statistically significant relationship when urban central county data are used is consistent with the findings presented for municipalities in *Table 7*.

CONCEPTUAL JUSTIFICATION FOR ENACTING A PAYMENTS IN LIEU OF TAXES

Because the PILOT has the economic characteristics of a tax payment, it is not surprising that the criteria for evaluating whether it should be made a permanent part of the intergovernmental fiscal system conform to the criteria one would apply when judging the merits of other forms of broad-based state or local taxes. Within this framework, the critical questions focus on issues of equity, efficiency or neutrality, revenue productivity, fiscal accountability, and feasibility of administration and compliance. The last of these, the administrative and compliance issue, was addressed in *Chapter 3*, with the conclusion that the tax equivalency payments in lieu of taxes program could be implemented within existing property tax administration systems. From the state/local viewpoint, not only has the required administrative mechanism long been in place; local officials have generally demonstrated an ability to handle the sort of problems (e.g., valuing tax exempt as well as special purpose properties) likely to arise in assessing the federal property base.[10] As for compliance, the federal government would have to establish certain review mechanisms; but, as has already been pointed out, unless the federal establishment were to follow the path of setting up its own assessment mechanism, the whole federal program could be carried out at little cost.

The other four concerns—equity, efficiency, revenue productivity, and accountability—are discussed below. The discussion of the revenue productivity topic is confined to the conceptual role the payments in lieu of taxes would play in the intergovernmental system. The detailed quantitative analysis is the subject of *Chapter 5*.

Equity

When a private individual or business acquires and/or uses real property in a jurisdiction, taxes are paid to that jurisdiction as the price for a set of public services. The exact nature and rationale of the tax payment and the relationship between the taxpayer activity and the type of service received will vary according to the mix of revenue sources used by the government and the institutional characteristics of the beneficiary of the public sector activity. Thus, public policymakers must attempt to set tax prices according to the cost of providing a service, the fiscal needs of the taxing authority, and/or some normative policy decision regarding how the tax burden ought to be distributed. At the national, or even state, level, the range of tax tools available to accomplish these policy goals is fairly wide. It includes broad-based levies, such as the payroll, personal income, and corporate profits levies, and the narrower special excise, employment, and import taxes. The accessibility to this range of taxes follows largely from the fact that for tax purposes a national government—with its authority to restrict the flow of economic activity across its borders (through devices such as migration controls, investment regulations, tariffs, quotas, and import licenses)—operates in an essentially "closed" economy. As a result, factor and goods mobilities have not become a major consideration of national tax policy. *

For the state and, especially, the local, government, however, the range of available tax sources is greatly restricted because of the high degree of "openness" of the economy. Unlike the national government, a subnational economy cannot employ the sort of devices listed above in order to constrain the interjurisdictional movement of the factors of production and goods and services across its borders. Consequently, this resource and product mobility changes the character of subnational (local) tax policy from that of structurally similar national policies. * *

One obvious implication of this openness is that nonresident individuals and institutional

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*This feature also explains why policies designed to change personal income distribution through a tax system (e.g., with personal income, inheritance and estate taxes) are more appropriately a national than a state or local concern.

* *Although this open economy argument extends to the state level, the remainder of this discussion pertains to local government.

entities (business and government) cannot be taxed effectively on their income, wealth, or wealth transfers. Similarly, residents (persons and institutions) can engage in spending outside the local jurisdiction—including purchases of goods originally produced in the locality—and therefore avoid direct payments under conventional sales and other consumption taxes.

As a result, the local government is forced to rely largely on revenue devices for which there are not only some identifiable benefits received or *quid pro quo* relationship between the taxpayer and the jurisdiction, but which are also readily accessible (e.g., immovable). Thus, taxes traditionally identified with benefits and accessibility have become the mainstay of local revenue systems. Examples include user fees, incorporation fees, specific privilege levies—and that classic of the immovable tax base, real property taxes.

Unreimbursed Service Costs

Whether the real property tax is a truly benefit-type levy in the narrow sense of having a *quid pro quo* relationship to site-oriented local public services is a legitimate topic for debate (the basis for discussion varying from city to city). Certainly, the nature of the flow of property tax financed services varies between recipients by type and size. For example, regarding the former, it is worth observing that, whereas judicial, police, fire, education, and general government services tend to be provided to residential and nonresidential property owners alike, some localities may limit an easily "divisible" service such as trash collection or taxpayer advice to residential property owners. Similarly, the *quid pro quo* relationship may be affected by a tax service size variable. Thus, for example, one expert has reported that in Prince George's County, MD —one of the tax jurisdictions of the Washington, DC, metropolitan area—only a house priced at $85,000 or more "pay(s) its way at the prevailing property tax and assessment rates."[11] Generalizing from this sort of relationship, it may be that, as a class, residential property owners benefit disproportionately from local property tax-financed services.

The critical point here is that even if real-property tax collections are shown not to have a site congruence with the tax-financed services, the fact remains that, as now structured in the U.S., local government might not even exist without the property tax. Adopting this view—which is wholly legitimate, given the importance of real property taxation to local government—the property tax-service benefit relationship should be interpreted in a much broader framework than is implied by a narrow *quid pro quo* between the real property tax paid and site services received directly.

Given these considerations, two questions arise regarding the tax exempt status of the federal government—*viz*, can the benefit criteria, as broadly interpreted, be used to justify a federal to local "tax" (i.e., PILOT) contribution? Does the federal government receive the benefits of state/local government services? The questions are merely rhetorical: of course the federal establishment, as a property owner, receives a wide range of services. Moreover, the bulk of services received are the same as for the private taxpayer.

Viewed either as an institutional entity or as a group of workers, the U.S. government enjoys the benefits of local government supplied police and fire protection, public health, and sanitation facilities. Less obvious, but certainly important, are some of the indirect costs incurred on behalf of the federal establishment—costs which for some communities may be quite significant. Examples abound: the local government may have to add to the capacity of its physical infrastructure (e.g., airport, highways, roads, sewers), incur additional expenses in its transportation authority, or increase its education and social services budget, just to facilitate the federal government's mission, including providing for the needs of the federal work force.

Of course, the same argument can be made regarding groups of private local residents and business firms. In Honolulu or Miami, for example, the tourist industry creates significant local public service costs. The same can be said of Boeing in Seattle or General Motors in Lansing. Indeed, that is just the point—the Waikiki hotels, Miami restaurants, and the Boeing and G.M. manufacturing plants are not property tax exempt. Quite simply, there is an inequity here. One beneficiary of state/local government services—the U.S. establishment—is receiving the services free because it can mandate, and has mandated, a local tax ex-

emption to itself. In general, other service beneficiaries have no such mandating power and, thus, if it is so determined under local administrative procedures, will pay the property tax or face a judicial proceeding and possibly a tax sale.*

The argument to eliminate the federal property tax exemption is quite straightforward. *By acquiring real property, the government has assumed a responsibility borne by private taxable property owners.* Thus, it should make payments in lieu of taxes on much the same basis as owners of private property pay real estate taxes. Failure to treat the federal government in this manner violates the horizontal equity canon of public finance, that "equals be treated equally," with the index of equality here being the value of the real property that is owned.

Leasehold vs. Ownership

In addition to the major structural inequities between the federally exempt and privately taxable owners of real properties discussed above, local governments must contend with another set of inequities created by the federal presence. Specifically, the federal government has, over time, institutionalized certain inequities regarding property it owns and leases, thereby creating an even more confused situation of federal tax immunity. The problem arises because some federal activities are carried out on property leased from the private sector while others are conducted on federally owned properties. A dichotomy in tax policy exists because the federal government, through its operations on leased property, pays local real property taxes by way of its rental payments. However, if the federal agency happens to be located on federally owned property, no real property tax is paid, even indirectly. Indeed, this situation is so arbitrary that the federal government's property tax bill would appear to be an accidental by-product of the largely nontax decision to lease rather than own.

Numerous property management regulations apply to rental arrangements and are entered into by the federal government primarily through the General Services Administration (GSA). For example, the *Economy Act of 1972* stipulates that rents paid cannot exceed 15% of the established fair market value of the rented premises, nor can they exceed the appraised value of the rented building.[12] Also, leases over $2,000 must have an appraisal of the fair rental value for the premises. The value of alterations to the rented premises cannot exceed 15% of the first year's net rent and/or 25% of the amount of the rent for special major improvements and alterations. All of these leases are updated as the leased properties are reappraised (typically about every three years). In practice, the base contract rent is usually established below the commercial rate for comparable private space, and then a standard-level user charge (SLUC)—which can reflect the cost for maintenance and operation and security of the rented property—is added to that base. The sum yields a general market rental rate.

Thus, in its bid for rental space, the federal government must agree to pay market rental prices in order to assure the private owner(s) a fair rate of return on their property investment. These rental rates will reflect—and of course include—the private owner's state and local real estate taxes. The federal government's payments on account of taxes here may not actually be by design, but de facto, they are just as important and variable as many of its other payment programs that have been discussed.

ACIR has estimated the real estate tax payments made by the federal government through its rental payments by using information on annual rental costs and square feet leased by the federal government each year, as contained in the GSA *Summary Report of Real Property Leased to the United States Throughout the World as of September 30, 1977*. It has also obtained information on property taxes actually paid for commercial properties, as included in the Building Owners and Managers Association (BOMA) annual report, *Downtown and Suburban Office Building Experience Exchange Report*.* The BOMA report contains ex-

*The exception is, of course, the state government-mandated exemption from local real property taxation. Although these state and state-mandated exemptions for some private institutions are every bit as legitimate a concern as is the federal exemption, they are not within the scope of this report.

*Although the commercial property is primarily office space it also includes properties with retail stores, storage, and special-purpose activities (such as clubs and restaurants), which can be located in an office complex.

pense and income data for a large national sample of office buildings and is widely recognized as a reliable and, indeed, the only source of information in this property management area.*

The *Experience Exchange Report* does not report in as great a detail for government-owned buildings; national samples, as reported by GSA to BOMA, are listed as a total and disaggregated by downtown and suburban geographic regions only. The expense and income data on government buildings are also more limited, including only the operating and maintenance costs and the vacancy and occupant rental space information. Nevertheless, information on private sector costs, such as average private property tax payments, can easily be applied to the government data, where necessary, to fill these gaps. In computing these rental tax payments, data on both private and government buildings were used.

Based on 1977 data in the BOMA report (the most recent available), the average amount of property tax per square foot of private buildings is:

	Total	*Downtown*	*Suburban*
Land	$ .31	$ .34	$.149
Buildings	1.07	1.12	.787
Total	$1.38	$1.46	$.936

Totals are the weighted average of downtown and suburban samples. Some totals may be rounded.

The estimated average property tax per square foot of government-owned buildings can be similarly derived by applying the percentage of operating expenses attributable to property taxes in private buildings to the corresponding operating expenses that were listed for government buildings. The procedure yields:

*It contains considerable detail in its statistical tables, including: operational and maintenance expenses, construction expenses, fixed charges, other miscellaneous expenses, and rental incomes for each office building sample. Vacancy ratios, as well as average square feet per tenant and total building occupants, are also detailed. This information is presented for all buildings in the national sample, and is disaggregated by downtown and suburban location, and geographic regions. The national samples are also separately detailed by certain building size, building age, story height, and/or city size categories. The operating and income characteristics, including average property taxes, are listed for each of these categories.

	Total	*Downtown*	*Suburban*
Land	$ .30	$ .33	$ .17
Buildings	1.07	1.10	.92
Total	$1.37	$1.43	$1.09

The amount of property taxes paid on space the federal government was leasing can thus be estimated by multiplying either of these sets of figures by the number of square feet leased by the government in 1977.* However, the use of the private buildings' data would establish the widest parameters of the imputed federal property tax payments. Considering that 219,100,000 square feet and 1,633 acres of land (or an additional 71,133,480 square feet) were leased by the federal government at the end of FY 77, depending upon the location of the leased property, property tax payments might have ranged as follows:

219,100,000 ($1.38)	=	$302,358,000	(Weighted Average)
(1.46)	=	319,886,000	(Downtown)
(.936)	=	205,077,600	(Suburban)
71,133,480 (.31)	=	22,051,379	(Weighted Average)
(.34)	=	24,185,383	(Downtown)
(.149)	=	10,598,889	(Suburban)

This would yield respective totals of $344,971,383, were all the leased property in the central city area; $215,676,489, were all of it in the suburban area; and an estimated $324,409,379, were it an average mix between downtown and suburban locations.[13]

A second estimate can also be computed based upon BOMA documentation of the property tax as a percentage of rental income from privately owned buildings. The 1977 property taxes as a percentage of the 1977 rental income for buildings are computed as:

	Weighted Average	*Downtown*	*Suburban*
Land	3.56%	4.78%	2.34%
Building	14.04	15.71	12.37
Total	17.60%	20.49%	14.71%

Thus, if the corresponding percentages are taken from the 1977 total rental payments of the federal government—$709,400,000—another set of estimated property tax payments is derived:

*The figures for private buildings should probably be used here, as government-leased space is privately owned; however, the estimates for government buildings are useful for comparison.

(Downtown)	$143,511,960
(Suburban)	103,028,840
(Weighted Average)	123,270,400

Again, the estimated taxes paid through federal rent payments will vary according to the actual locations of the leased facilities.

Another set of "pass-through" property-tax payments can be added to this total from the leases paid by the Federal Home Loan Bank (FHLB). The taxes it pays on its leased buildings (which are not documented by the bank) can be reasonably estimated as 20% of this rental amount, based upon the downtown location of all their facilities. *Table 10* details these estimates.

At least three additional types of rental arrangements, which also facilitate federal payments of real estate taxes, are used in federal leases. Unlike the rental "pass-through" payments, however, these are actually charged against the federal lessees and included in their leases by specially designed tax clauses.

The first type of rental clause was initiated to facilitate long-term, multiyear leases, which have become more popular with many federal agency lessees. In this situation, a real estate tax and operating cost escalator clause has been used to cover some of the lessor's multiyear costs that are rising rapidly because of highly inflated and other inordinately high utility and operational costs. In fact, as of 1977, GSA adopted policies to include in its leases annual escalation clauses which provide for both tax and operating costs.* Prior to that time, the government had entered into one or both of these provisions, depending upon the

*The method for computing the rise in operating costs varies from that employed with the taxes. The additional annual amount is determined by multiplying the total first year's estimated cost of the following items (if not provided by the government), as negotiated and established for the first lease year prior to award of the lease contract: cleaning services supplies and materials; elevator maintenance; trash removal; landscaping; water and sewer charges; heating; electricity; administration expenses for building engineers and/or building managers, by the percentage of increase, if any, in the *cost of living index* over and above the *cost of living index* at the commencement of the lease term. Such increases in the *cost of living index* are measured by the U.S. Department of Labor's *Revised Consumer Price Index for Wage Earners and Clerical Workers* (CPI-W), as published by the Bureau of Labor Statistics of the U.S. DOL.

Table 10

ESTIMATED PROPERTY TAXES PAID THROUGH FEDERAL HOME LOAN BANK BUILDING LEASES AND (AMOUNT OF RENT), 1977–79

	1977	1978	1979
Total	$ 270,000	$ 264,500	$ 241,480
	(1,350,000)	(1,322,500)	(1,207,400)
Cincinnati*	62,280	58,080	45,820
	(311,400)	(290,400)	(229,100)
Indianapolis*	31,300	37,260	38,340
	(156,500)	(186,300)	(191,700)
Chicago*	74,440	58,840	49,540
	(372,200)	(294,200)	(247,300)
Des Moines*	41,160	45,840	41,400
	(205,800)	(229,200)	(207,000)
Topeka	7,120	9,660	9,660
	(35,600)	(48,300)	(48,300)
Seattle	31,840	31,400	32,000
	(154,300)	(157,000)	(160,000)
Little Rock	28,900	23,420	24,800
	(114,500)	(117,100)	(124,000)

*These four banks had to divest part of their holdings, this tends to lower real property tax payments.
SOURCE: ACIR and Federal Home Loan Bank Board staff computations, 1979.

rental market pressures in a particular jurisdiction or region.

This tax payment is made to the lessor as a lump sum, the proportion of the tax increase being based on the area occupied by the government in the building relative to the total rental area in the building (the same as for leased land). The clause also reserves to the government the right to contest the amount of any valuation for general real estate taxes by appropriate legal proceeding, either in the name of the government or in the name of the lessor, or in both names. These reimbursements to the lessor for increases in real estate taxes are limited by the *Economy Act* provisions stated earlier; however, in the event of any decreases in the taxes (or operating costs), the government's rental amount would also be reduced accordingly.

The U.S. Postal Service (USPS) has probably made the most extensive use of real estate tax clauses or riders in its rental leases over the past decade. As of mid-1979, the USPS leased approximately 28,000 buildings or building areas, 5,000 of which had a tax clause in the lease.[14] The exact form of the clause varies, however, as USPS regulations allow "(a)ny clause reflecting an arrangement as to taxes which is most advantageous to the Postal Service in the particular circumstances (to) be included in a lease solicitation or in a negotiated lease contract."[15] Thus, four alternative tax arrangements have evolved:

1. *Zero Tax Clause (or rider).* Under this arrangement, the Postal Service pays all general real estate taxes applicable to the leased premises.
2. *Reimbursable Percentage Tax Clause.* Here, the Postal Service obligates itself to reimburse the lessor for only a specified percentage of any increase in taxes.
3. *Adjustment of Rental Rates Under Renewal Options.* This type of tax arrangement provides that the annual rental rate for each renewal option period will be adjusted upward or downward, when the option is exercised, by an amount representing the difference between taxes paid by the lessor during the first and the last full tax years of the basic lease term.
4. *Tax Escalation Clause.* This provision generally requires annual adjustment of the rental rate, as described earlier.

Because the tax clauses in a lease can be protection for the lessor and lessee alike, a "zero" tax clause is generally viewed by USPS to be the most useful in eliminating a lessor's inclination to pad bids or assessed values. USPS has developed regional tax and rental parameters as well as appeals procedures for over-assessment in response to such problems.* Conversely, a tax clause providing for partial or full tax compensation can obviously provide to the private lessor some protection against inflationary assessments and tax rates.** The type of tax arrangment in use is thus evidence that the USPS—and the federal government—leasing process may involve bilateral, negotiated considerations.

The specific cost of GSA real estate tax escalation clauses can be estimated from the aggregate budget figures reflecting both GSA tax and operating cost escalator clause payments. Based upon conservative—and incomplete—estimates of the magnitude of each of these subtotals by GSA staff, some rough estimates of these tax payments were made. Assuming that one-fourth of the escalation clauses include both tax and escalation costs in one escalation figure, and, of the remaining three-fourths about 33% is attributable to increases in taxes, a rough estimate of at least part of the amount paid on account of rising taxes on leased property can be derived. These figures are presented in *Table 11.*

* See also the discussion in *Chapter 3* regarding assessment appeals. Even simple administrative responsibilities that accompany tax escalation clauses may be avoided here if zero tax clauses are used.

** The lessor's continued interest and participation in local proceedings on tax matters is desirable yet hard to maintain in this situation. The USPS *Realty Acquisition and Management Handbook* notes at least two cases where the tax clause is typically a preferable alternative to the zero tax clause arrangement: (1) leasing a new facility in an area where delayed commercial growth is anticipated with a potential increase in taxes to cover expanded public service to the area; and (2) leasing a facility in an area where prior experience with this type of tax clause has proven more beneficial than the zero tax clause. USPS, *Realty Handbook*, at 6–203.2.

Table 11

ESTIMATED GSA REAL ESTATE TAX PAYMENTS THROUGH TAX ESCALATION CLAUSES IN LEASES, PARTIAL LISTING, 1978-80

	1978	1979	1980
Amount needed this year to annualize the cost of rental rates escalators occurring in the previous year.	$1,150,000	$1,875,000	$2,575,000
Half-year cost of rental rate escalators occurring in this year.	2,750,000	3,000,000	3,500,000
Prior year liability (prior year claims, tax and/or operating clause escalators which were not previously budgeted).*	—	2,400,000	—
Totals	$3,225,000	$7,275,000	$6,750,000

*Refers to old negotiated fees, prior to new GSA policy, which provides that lessors can enter an amount for obligation (estimated) before making a firm rental agreement. These types of expenditures will probably not appear again because they are basically cleanups from prior years' arrangements.

SOURCE: ACIR staff computations.

A second type of federal leasing arrangement has become increasingly common in federal government leases in the western states. It provides for a tax rider on improvements made to the leased property by the lessee, and may be used in conjunction with one of the tax clauses described above. Under this arrangement, the owner or lessor is relieved of the responsibility for real estate taxes based on the assessed value of the property's improvements. Again, this provision might be especially appropriate for Postal Sevice use as its leased facilities may frequently require major alterations to accommodate bulk mailing or other special purpose activities. Under this lease agreement, then, the additional tax liablity is passed through to the government for specific renovations, alterations, or new construction.

The third method of federal property tax payment included in federal leasing arrangements is perhaps the most dramatic example of the major structural inequities between federally exempt and privately taxable owners of real properties. These payments are included as part of GSA's purchase-contract agreements for the construction of a backlog of approved, but unfunded, projects.* Under this package arrangement, GSA makes semiannual payments to the contractors for interest, real estate taxes, and amortization of principal. At the end of the contract period, which is usually 30 years, title to the building vests with the government. An alternate "dual contract arrangement," with separate contracts for the construction and financing of building projects, is part of the purchase-contract agreement, and it also stipulates that GSA pay the project's real estate taxes "to help ease the burden of the federal presence on the local community during the purchase-contract term."[16]

The reasons for developing a federal building, tax payment program such as this are numerous. Foremost among them, however, is that it is an expedient alternative to the present method of financing federal construction and the Congressional delays in appropriating large

*The *Public Buildings Purchase Contract Act of 1954* (P.L. 83-519) and the *Public Buildings Amendments of 1972* (P.L. 92-313), contain the short-term, three-year authorizations for these agreements which, in the private real estate market, are also referred to as "owner-leaseback" agreements.

lump sums. For years, funds for construction either through direct Congressional appropriations or from the General Services Federal Building Fund (a type of revolving fund, partially funded by receipts from GSA lessees and standard-level user charges) have not been sufficient to meet even the major federal building plans. Moreover, in recent years, this disparity has only increased, giving rise to alternative construction financing techniques as well as increased use of leased space to meet the dramatically increased space demands from a larger-than-ever federal government. The growth in federal leasing will be discussed at greater length below; for now, however, it is important to note that both of these patterns have undoubtedly been in response to the current federal government budget austerity. Rental fees and lease-back payments are obviously less noticeable in the federal budget than are the large, and rapidly growing, up-front capital costs associated with all types of construction.*

More relevant to the concerns of this ACIR report, however, is the fact that current estimates of real estate taxes on the 43 buildings constructed under the "dual" method and the 23 buildings under the "single" method of purchase-contract through the year 2004 are $1.3 billion.[17] Rough calculations alone establish these tax payments at an average of $43 million a year.

Provisions similar to the purchase-contract agreements are also used by the USPS due to the special purpose nature of most of its buildings. The specific guidelines, which the USPS has set out in its realty acquisition and management handbook, state that tax clauses usually need not be included when leasing a building of less than 2,000 square feet to be constructed for the Postal Service and leased for less than ten years—"except," the handbook continues, "it may be more advantageous to include a tax clause in leasing such property in an area where lessors, as protection for mortgage liens, are likely to, or will, *require* that taxes be paid by the Postal Service."[18] Here again, construction is being undertaken for government use and to the government's specifications, for which the federal government has agreed to make the property tax payments.

Thus, the question of whether or not the federal government pays local property taxes is a function of the government's leasehold or ownership decision. Moreover, the amount of rental activity in the federal government is rising:

- In the last ten years, the federal government has increased its rented building area (square feet rented) by 50%—amounting to an annual rental increase of 134% for that period.
- The comparable figures for a 20-year period yield a 148% increase in leased floor area or a 542% increase in annual rental paid from 1957–77.
- The trend toward increased federal rental activity can be further illustrated by contrasting the growth in floor area *owned* by the federal government, which is only 17.5% for the same 20-year period.

To be sure, acquisition costs of real property owned by the federal government have increased substantially over this same period—169% for all federal property and 150% for buildings alone. Yet, the figures point to a clear trend of decisions to lease rather than own. *Tables 12* through *17* document these trends with data gathered from GSA records for both military and civilian rental properties.

Table 12. All Real Property Leased by the Federal Government in the U.S., 1957–77.

Table 13. Real Property Leased by the Federal Government for Civil Agencies in the U.S., 1957–77.

Table 14. Real Property Leased by the Federal Government for Defense Activities in the U.S., Civilian Functions Only, 1957–77.

Table 15. Real Property Leased by the Federal Government for Defense Activities in the U.S., Military Functions, 1957–77.

Table 16. Percentage Growth in Real Prop-

*U.S. GAO, *Costs and Budgetary Impact, op. cit.* Because they include interest payments, and real estate tax payments spread over what is essentially an amortization period, purchase-contracts do carry a higher financing cost than direct appropriation; yet at least one analysis has suggested that the purchase-contract route is less expensive in the long term than is leasing a comparable facility.

erty Leased by the Federal Government in the U.S., in Five-Year Intervals, 1957–77.

Table 17. Table 16, at Ten-Year Intervals.

Several factors have contributed to this pattern, not the least of which are the rising capital costs associated with all types of construction in this country. Again, a primary contributor is likely to be the current federal government budget austerity, rental fees obviously being less in the short-term than the large initial capital costs required for federal construction. Moreover, the greater the fiscal stress at the federal level, the more likely it is that federal facilities will be leased rather than acquired.

The GSA's Public Buildings Service (PBS) is responsible for providing office space for federal agencies across the country. Certain federal agencies are also delegated authority to obtain (rent or purchase) their own facilities but are to use GSA procedures in doing so. The Federal Property Management Regulations identify those agencies and the situations in which leasing exceptions are granted; they are typically limited to agricultural experiment stations, military stations, and other special-purpose space. Authority is also generally delegated to agencies for building and leasing in areas that are not in major urban centers. However, even in these situations, GSA is to have a supervisory role. Nevertheless, the *Public Building Acts* have mandated that GSA always survey the need for additional space or construction in an area prior to authorizing such activity. For PBS, this process has involved reviewing all costs associated with owning and operating a building over time—i.e., a life cycle cost analysis.

The GSA Life Cycle Planning and Budgeting computer model, set up to assist PBS in this life cycle planning decision, does not account for property taxes. However, a recent GAO report, which examined alternative methods of financing federal building space acquisitions, has recommended that federal cost analyses include real estate taxes "as an imputed cost of government ownership under the rationale that other federal support may be required to compensate the state and/or local governments for real estate revenues lost."[19]

In conclusion, the leasehold vs. purchase decisions made by the federal government and the resulting location of leased or owned federal facilities illustrate the federal/local and public/private inequities. The arbitrary decisions to lease or own federal real property distort a jurisdiction's property tax base and result in property tax payments that clearly are made without adherence to those principles of tax equity discussed throughout this report.

Federal Contracting (Procurement)

Each year, as the result of various statutory requirements, executive orders, and circulars, the U.S. government solicits billions of dollars in private sector contracts for the purchase and development of products and services. Thousands of items (both of regular stock and special design) and services are acquired from the private marketplace through "procurement" expenditures. This procurement activity is justified for a variety of reasons. The reasons range from a desire—expressed by a number of Congressional committees, national study commissions, and administrations of both political parties—to implement a long-established goal of using the federal government as a consumer to strengthen private enterprise, to attempts to use the government's budget as a tool to achieve various social and economic goals. Through its contracting provisions the government can require suppliers to maintain fair employment practices, provide safe and healthy working conditions, help handicapped persons attain a more productive role in society, require industry to refrain from polluting the environment, and encourage small and minority-owned business.[20]

In 1979 the U.S. government spent $94.4 billion on contract procurement—19.2% of total federal outlays that year.* This is a particularly formidable amount, especially when combined with the billions spent on procurement-type grants to the private sector.

*Eight agencies account for $90.1 billion or 95.4% of the total: Department of Defense ($70.4 billion), Department of Energy ($5.8 billion), National Aeronautics and Space Administration ($3.9 billion), Tennessee Valley Authority ($3.5 billion), General Services Administration ($2.7 billion), Veterans Administration ($1.6 billion), Department of the Interior ($1.2 billion), and Department of Transportation ($1.0 billion). (Information provided by Robert Drake of the Federal Procurement Data Center, Washington, DC.)

Table 12

ALL REAL PROPERTY LEASED BY THE FEDERAL GOVERNMENT IN THE UNITED STATES, 1957–77

Year	Number of Leases	Acres of Land (in thousands)	Building Floor Area (in millions of square feet)	Annual Rental (in millions of dollars)
1957	43,378	1,642	88.1	$109.1
1958	44,583	1,883	91.4	121.5
1959	46,217	1,414	95.3	136.0
1960	46,959	1,676	96.4	144.4
1961	48,124	1,692	101.6	160.2
1962	49,089	1,704	108.7	184.6
1963	50,210	1,613	116.7	214.3
1964	53,380	1,542	122.8	229.8
1965	56,128	1,673	125.4	238.1
1966	58,660	1,798	132.8	262.3
1967	59,858	1,742	138.8	279.6
1968	59,251	1,675	146.0	298.9
1969	59,224	1,637	152.7	331.3
1970	59,752	1,530	162.1	362.9
1971	60,013	1,440	169.6	413.8
1972	61,317	1,371	179.8	463.8
1973	61,104	1,469	190.5	519.3
1974	59,912	1,446	196.9	564.6
1975	58,450	1,226	193.8	592.4
1976	60,405	1,153	213.6	666.3
1977	60,805	1,633	219.1	700.4

SOURCE: U.S. General Services Administration, *Summary of Real Property Leased by the United States Throughout the World,* published annually, Washington, DC, U.S. Government Printing Office, selected years.

Table 13

REAL PROPERTY LEASED BY THE FEDERAL GOVERNMENT FOR CIVIL AGENCIES IN THE UNITED STATES, 1957–77

Year	Number of Leases	Acres of Land (in thousands)	Building Floor Area (in millions of square feet)	Annual Rental (in millions of dollars)
1957	34,202	50	78.1	$ 92.4
1958	34,965	70	79.3	101.5
1959	36,130	80	83.8	115.5
1960	36,443	84	85.7	124.0
1961	37,565	86	91.5	140.1
1962	38,474	89	99.2	165.3
1963	39,816	63	108.7	196.2
1964	44,970	84	114.4	214.2
1965	48,019	143	118.1	222.6
1966	48,011	143	125.4	244.8
1967	47,412	155	130.9	259.7
1968	47,192	151	137.8	278.4
1969	47,808	168	144.9	310.8
1970	48,674	171	154.7	342.5
1971	49,127	201	161.3	391.8
1972	49,480	186	171.2	435.9
1973	49,481	187	181.2	488.6
1974	48,757	181	188.6	533.9
1975	47,265	192	180.9	560.0
1976	49,863	185	194.6	632.1
1977	50,526	188	192.2	667.2

SOURCE: U.S. General Services Administration, *Summary of Real Property Leased by the United States Throughout the World*, published annually, Washington, DC, U.S. Government Printing Office, selected years.

Table 14

REAL PROPERTY LEASED BY THE FEDERAL GOVERNMENT FOR DEFENSE ACTIVITIES IN THE UNITED STATES, CIVILIAN FUNCTIONS ONLY, 1957–77

Year	Number of Leases	Acres of Land (in thousands)	Building Floor Area (in millions of square feet)	Annual Rental (in millions of dollars)
1957	184	47	0.2	$ 0.4
1958	179	26	0.2	0.5
1959	184	25	0.2	0.5
1960	229	22	0.2	0.5
1961	240	22	0.3	0.6
1962	282	23	0.3	0.6
1963	289	22	0.2	0.5
1964	205	26	0.2	0.5
1965	255	13	0.2	0.5
1966	408	7	0.3	0.6
1967	429	10	0.3	0.7
1968	420	16	0.3	0.6
1969	408	9	0.3	0.6
1970	420	67	0.2	0.6
1971	414	2	0.2	0.6
1972	437	2	0.2	0.6
1973	471	5	0.2	0.7
1974	468	5	0.2	0.7
1975	574	21	0.3	0.8
1976	629	3	0.2	0.9
1977	642	214	0.2	—

SOURCE: U.S. General Services Administration, *Summary of Real Property Leased by the United States Throughout the World*, published annually, Washington, DC, U.S. Government Printing Office, selected years.

Table 15

REAL PROPERTY LEASED BY THE FEDERAL GOVERNMENT FOR DEFENSE ACTIVITIES IN THE UNITED STATES, MILITARY FUNCTIONS, 1957–77

Year	Number of Leases	Acres of Land (in thousands)	Building Floor Area (in millions of square feet)	Annual Rental (in millions of dollars)
1957	7,992	1,545	9.8	$16.3
1958	9,439	1,787	11.9	19.5
1959	9,903	1,309	11.3	20.0
1960	10,287	1,570	10.5	19.9
1961	10,319	1,584	9.8	19.5
1962	10,333	1,592	9.2	18.7
1963	10,105	1,528	7.8	17.6
1964	8,205	1,432	8.2	15.1
1965	7,854	1,517	7.1	15.0
1966	10,241	1,648	7.1	16.9
1967	12,017	1,577	7.6	19.2
1968	11,639	1,508	7.9	19.9
1969	11,008	1,460	7.5	19.9
1970	10,658	1,292	7.2	19.8
1971	10,472	1,237	8.1	21.4
1972	11,400	1,183	8.4	27.3
1973	11,152	1,277	9.1	30.0
1974	10,687	1,260	8.1	30.0
1975	10,611	1,013	12.6	31.6
1976	9,913	965	18.8	33.3
1977	9,637	1,231	26.7	32.3

SOURCE: U.S. General Services Administration, *Summary of Real Property Leased by the United States Throughout the World*, published annually, Washington, DC, U.S. Government Printing Office, selected years.

Table 16

PERCENTAGE GROWTH IN REAL PROPERTY LEASED BY THE FEDERAL GOVERNMENT IN THE UNITED STATES, IN FIVE-YEAR INTERVALS, 1957–77

Five-Year Intervals	Number of Leases	Acres of Land	Building Floor Area	Annual Rental
1957–62				
Civil Agencies	11.1%	45.8%	21.3%	44.1%
Defense:				
Military Functions	29.3	3.0	– 6.1	14.7
Civil Functions	53.3	– 51.0	50.0	50.0
1963–67				
Civil Agencies	16.0	59.4	17.0	24.5
Defense:				
Military Functions	18.9	3.2	– 2.6	9.1
Civil Functions	48.4	54.5	50.0	40.0
1968–72				
Civil Agencies	4.6	18.8	19.5	36.1
Defense:				
Military Functions	– 2.1	– 21.6	6.3	37.2
Civil Functions	4.0	– 87.5	– 33.3	—
1973–77				
Civil Agencies	2.1	0.5	5.7	26.8
Defense:				
Military Functions	13.6	3.6	193.4	7.7
Civil Functions	36.3	4280.0[1]	—	28.7

[1] Reflects major increase between September 30, 1976 and September 30, 1977.

SOURCE: U.S. General Services Administration, *Summary of Real Property Leased by the United States Throughout the World*, published annually, Washington, DC, U.S. Government Printing Office, selected years.

Table 17

PERCENTAGE GROWTH IN REAL PROPERTY LEASED BY THE FEDERAL GOVERNMENT IN THE UNITED STATES, SELECTED PERIODS, 1957–77

Selected Periods	Number of Leases	Acres of Land	Building Floor Area	Annual Rental
1957–67				
Civil Agencies	38.6%	210.0%	67.6%	181.1%
Defense:				
Military Functions	50.4	2.1	22.4	17.8
Civil Functions	133.2	– 78.7	50.0	75.0
1968–77				
Civil Agencies	7.1	24.5	39.5	139.7
Defense:				
Military Functions	– 17.2	18.4	23.8	62.3
Civil Functions	52.9	1,237.5	– 33.3	50.0
1957–77				
Civil Agencies	47.7	– 0.5	146.1	622.1
Defense:				
Military Functions	20.6	20.3	172.4	98.2
Civil Functions	248.9	355.3	—	125.0

SOURCE: U.S. General Services Administration, *Summary of Real Property Leased by the United States Throughout the World*, published annually, Washington, DC, U.S. Government Printing Office, selected years.

Although the federal government procurement process includes legal, procedural, and social program requirements not generally applicable to other customers, the basic process is the same as that for any contracting arrangement agreed upon between two parties, *viz*, a dollar sum is set and a production service delivery is required. If, as is usually the case, the contract is with a private taxable firm, the firm will allocate the government payment to the usual costs of production (wages, rents, interest, and profits), including taxes. As a result, the federal government is indirectly paying real property taxes as a cost that will certainly be included, either explicitly or implicitly, in a firm's "overhead" cost component of the contract arrangement. The more the federal government uses private contracting-procurement in fulfilling its mission, the more the local property tax and economic base benefits. Alternatively, of course, as federal procurement gives way to "in-house" production (as appears to be the case since 1972), these real property tax contributions decline accordingly.* Thus an inequity somewhat similar to the lease *vs.* ownership issue discussed above, is created here. One way to alleviate this inequity would be to attach a real property tax contribution to the "in-house" work through the PILOT system.

Efficiency/Neutrality

In public finance, fiscal efficiency or neutrality requires that the tax system be designed to accomplish certain intended policy objectives, but that beyond this it should minimize interference with other economic activities. Extending this concept from private economic decisions (the context in which it is usually applied) to collective decisions regarding a PILOT is a complex task requiring careful interpretation. One obvious distinction that must be kept in mind is that a federal agency has a different concept of cost-minimization behavior than does an individual or a manager of a private institution. Another distinguishing feature involves a question relating to the nature of the institutional geographic location decision: because a PILOT would mean that similarly valued properties in different taxing jurisdictions would pay different amounts in lieu of tax payments (perhaps *quite* different, if some communities offered to continue the exemption to the federal government), is there a concern that if the federal government were to minimize costs, it might become "footloose"—i.e., searching as some private businesses (taxable and exempt) now do, for low tax (PILOT) jurisdictions?

Keeping these caveats in mind (they will be addressed below), a strong argument can be made that, from an efficiency/neutrality viewpoint, the federal government's tax exempt status tends to have the following three nonneutral implications:

1. *The tax exemption encourages utilization of real property owned by the government.* Because the government is relieved of paying tax on the real properties it owns, it will underestimate the opportunity costs of real property it utilizes in performing its functions. Moreover, the degree of this underestimation will increase proportionally as the amount and value of the property held increase. Consider, for example, the federal government's decision regarding its space requirements, which is implicit in determining whether or not to hold large tracts of underutilized properties, perhaps in the form of office facilities in prime metropolitan or metropolitan fringe areas; or, a not uncommon example, the holding of valuable shoreline or other recreation land. There is an "opportunity" cost to this property—i.e., a value of that property measured against its highest and best alternative use—a very real cost which must be taken into account in order to determine its best or most efficient use. However, because the government is not in the business of maximizing financial returns, it does not have to consider these additional costs. If it were, it would be forced to take into account society's alternative uses for its holdings. The only way to provide the government with any meaningful economic signal regarding the valuation of its holdings is to do what is done with most private property—value it and tax it (i.e., levy a payment in lieu of taxes). Although this only provides one "signal," that is one more than the government receives now.

* The Commission on Government Procurement reported that in fiscal 1972 procurement represented 24.3% of federal outlays. See *Report, op. cit.*, Vol. 1, p. 3.

Giving the federal establishment this information does *not* mean that the government will abandon its "mission" or even reduce its delivery of services made from that property. In order to minimize its holding costs, however, it may lease or sell some of that land, perhaps even for purposes of future private development.[21]

Alternatively, the federal government may simply become more efficient in its own land use by employing that property more intensively and, in the process, disposing of (or not acquiring) other properties. Of course, in some cases there would be no change in the nature of the property utilization, either because the government is already using its facilities with the appropriate intensity or because the economic "signal" given by a payment in lieu of taxes would not be large enough. Indeed, the single most important argument against reliance on the PILOT as an opportunity cost signal is that the PILOT amount may not be enough to induce an agency to reevaluate its property uses. It is worth noting, for example, that even private business firms, which are profit maximizers, tend to base real property use and location decisions on the basis of nontax determinants. What is critical here is the government's objective: if it is merely cost minimization in the absence of the profit motive, the tax factor grows in its importance in the land use decision.*

Finally, mention should be made of the fact that the force of this opportunity cost argument is weakened to the extent that federal agencies simply do not care about keeping costs down. Certainly, when one observes agencies rushing to spend their appropriations at the end of each fiscal year in order to at least maintain their share of the total government budget, there is reason for concern here. On the other hand, government agencies, or the officials who run them, frequently do have as an objective increasing their services to their constituents and of maintaining or even increasing their employment levels. Both these objectives have the effect of building political constituencies outside as well as within the government—constituencies which, in the world of bureaucracy, can be used to justify a given program's continued existence and growth. Indeed, if a PILOT came directly out of each agency or office budget (or were even computed as a shadow price by a central disbursing office), there would be an incentive for officials to improve the efficiency of their property use in order to minimize the PILOT, and thereby free funds for agency programs.* If the payments in lieu of taxes were paid directly out of general Treasury funds, rather than on an agency-by-agency or office-by-office basis, there might still be an incentive to minimize them—particularly in a period of budget restraint, as part of an overall Congressional attempt to hold down costs on an item (PILOT) that is not perceived to be part of the government's service "mission." Aside from these examples, however, there is really no other practical political incentive to making a payment in lieu of taxes.

Would the payments in lieu of taxes induce the U.S. government to become footloose in its location search? If it takes its cost minimization seriously, there could be situations where this might have some bearing. The U.S. Postal Service, for example, usually considers real property tax levels along with total rent requirements when it leases a private building for an operation such as a bulk mail distribution center, requiring a large amount of floor area, usually on one level, but not necessarily in a heavily populated area. However, there are at least two important reasons for believing that the federal government will not make a location decision on PILOT grounds. Both have been noted above in different contexts, and thus only need be mentioned briefly here.

The first is that the difference in PILOT levels between jurisdictions will probably not be large enought to have much, if any, influence on the location decision—even if we assume that the federal government becomes a cost-minimizer *par excellence*. As is true for private businesses which tend to minimize or ignore

*That is, the risk taking factor which is inherent in the private profit-making decision process outweighs the disincentive effect of property tax differentials. Accordingly, since the profit objective is not applicable to the public sector, the public sector location decision may merely be a cost-minimization decision in the absence of a profit motive.

*When the establishment of the Federal Buildings Fund was being considered, GSA anticipated there would be "more efficient and economical use of space if agencies had to budget and pay for it." General Accounting Office, *Costs and Budgetary Impact*, *op. cit.*, p. 3.

all state/local taxes (not just real property taxes) in their location decision, other factors play a much larger role. These factors include access to the consuming public and the work force, space availability, and proximity to other agencies.[22]

Second, the U.S. government's location decision must, by law, be heavily influenced by the Presidential policy guidelines. Thus, the GSA has recently issued regulations, pursuant to Executive Order No. 12072 of August 1978, which require that federal agencies give primary consideration to locating their activities in central business areas. Special priority is to be directed to distressed downtown areas.

2. *The exemption gives the 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 prices of real property, cet. par., the tax exempt status of the federal establishment allows it to offer a higher price for a given parcel of property than can its nonexempt competitor. In addition to this competitive disadvantage, the private taxpayer may find that the land he does own will decline in value from what it otherwise would have as more of the tax jurisdiction's land goes to tax exempt uses. This apparent paradox can arise if, as a result of the erosion of the real property tax base within municipal boundaries, effective tax rates are increased in order to maintain the flow of public services. These increased taxes, when capitalized, will reduce the remaining property's value. This occurs because the portion of the property tax levied on land, which is in fixed supply, cannot be shifted forward in the form of higher land prices. Thus, the burden of this increase in the property tax falls on the landholder.

The likelihood of this occurring will vary among local jurisdictions according to their ability to use nonproperty taxes or their willingness to reduce the scope and quality of public services in order to hold down tax burdens. Thus, individual and commercial residents of a municipality that must rely heaviliy on the real property tax (as most do) and which, for various locational and institutional reasons, attracts a great deal of tax exempt activities (federal plus private), are most likely to experience this land value distortion.[23]

ACIR's empirical evidence on the significance of this land value distortion hypothesis is mixed. As is shown in *Table 7*, when the median value of owner-occupied homes is used as a proxy for the land value changes, there is some support for this hypothesis in the random sample of 40 cities. As the data indicate, there is a negative and statistically significant relationship between the value of federal tax exempt property and home values. However, the table also shows that there is no such significant relationship for the 45 largest cities. What this suggests, in conjunction with the smaller city finding, is that there may be some threshold factor at play here—i.e., that large cities, although having a large absolute dollar tax loss due to the federal tax exemption, are not as heavily impacted in relative dollar terms as are smaller jurisdictions and thus do not reach a level at which the federal exemption becomes significant.

Another reason the evidence is mixed is that the *Table 7* data also show that, for both sets of city samples, the relationship between the amount of nontaxable federal property and per capita real property tax burdens is not statistically significant—a finding that cannot be cited as support for the depressed land value argument. Whether there are other reasons for the federal government's relationship to depressed land prices is conjectural, although one might expect such a phenomenon if the federal property were providing a "negative service" such as a penitentiary or an influx of commuters who were failing to "pay their way" for the costs they create.[24] For now, it is best to recognize that the land value distortion probably is significant for some cities, but that the phenomenon may be offset by other factors, such as the ability to use nonproperty tax revenues or the agglomeration economy that may be created around the federal property itself.

3. *The exemption may increase central city-metropolitan fiscal disparities.* This argument is predicated on acceptance of the land value effects discussed immediately above. Moreover, for this phenomenon to occur, two events, both plausible, came about. The first is full compliance with the GSA regulations to implement Executive Order No. 12072, requiring federal agencies to locate in city areas whenever possible. If GSA has the will to en-

force its regulations, such locational effects may occur.[25] The second is a reduction in the amount of federally leased real property, leading to a larger amount of federally owned facilities in central areas per E.O. 12072. In fact, one of the main proposals of a recent Senate bill was to establish a long-run goal to place no more than 20% of federal workers in leased buildings. The bill, S. 2080, and its companion House bill, H.R. 6075, died in a conference committee of the lame-duck 96th Congress in December 1980. Taken together, these events could provide the very kind of effect needed to flip those same statistical relationships in *Table 7* to significance for the large as well as the smaller city. Moreover, there is ample evidence to indicate that the other side of this disparities equation—suburban growth and rising assessed property values relative to the metropolitan core—is already occurring.

Does this mean that current federal policy is inconsistent, in that its very attempt to revitalize the cities can, if it works, tend to depress land prices? Yes, this is quite possible. The one simple way to minimize this inconsistency would be to eliminate the property tax base erosion effect with payments in lieu of taxes—a program which may become quite important to some cities should such an extreme proposal as the above-mentioned section of S. 2080 be enacted.*

Revenue Productivity: Strengthening Fiscal Federalism

The case for a financially strong local government sector as a necessary ingredient for maintaining a viable system of fiscal federalism has been discussed adequately elsewhere. Arguments for maintaining some local fiscal autonomy do not derive from an inherent bias against higher levels of governments, but are based simply on the recognition that there is a framework for designing a system whereby public sector functions are allocated among the federal, state, and local units. Although there inevitably will be an overlapping and sharing of some functions by two (or all three) levels of government, ACIR research shows that some public functions should not only be viewed as predominantly local, but that such functions can best be implemented at that level. These activities include routine police control and investigation, traffic control, fire protection, street and sidewalk maintenance, refuse collection, water and sewer mains, recreation centers, small libraries, elementary and secondary education, zoning, sanitation, and public housing management.

This long list is overwhelmingly financed by the property tax, a levy which accounted for 80% of local taxes in 1978.* Moreover, it is reasonable to assert that, acting in their best interests, state and, especially, federal government officials are better off if they leave as much as possible of the financing—and the management that inevitably follows that financing control—of these *peculiarly local* functions to the local officials.

Clearly, one way to accomplish this is to help local governments maintain their own sources of revenues. But that task is becoming increasingly difficult as muncipalities face rate and levy limits (largely imposed by the states) on their property tax raising capacities, and tax revolts continue to come in forms ranging from continued erosion of the residential property tax base through homeowner preferences to local voter rejection of school bond issues. *Table 18* indicates the extent of the resulting centralization of government financing from a state-local perspective. In the past ten years alone, the *relative* dependency of local government on higher level of governments (not including the state takeover of once local functions) has increased by more than one-third.

* No comment is intended at this time on other provisions of S.2080—just a strong indication that a payments in lieu of taxes program is a reasonable corollary to it.

* ACIR, *Significant Features of Fiscal Federalism, 1978–79*, M–115, Washington, DC, U.S. Government Printing Office, 1979, Table 28. Local nonproperty taxes are, however, increasing in importance, especially for cities. In 1977 local nonproperty taxes accounted for $14.5 billion, or 19.4%, of local tax revenue. Local sales taxes provided 7.2%; local income taxes, 5.0%; and all other nonproperty taxes—such as license fees and selective sales and gross receipts taxes on utilities, motor fuel, alcohol, and tobacco—7.2%. While these percentages are low relative to the property tax, their importance is increasing. The relative contribution of local nonproperty tax revenues to total local tax revenues was 15.4% in 1971–72 and 13.4% in 1966–67. For a discussion see Steven David Gold, *Property Tax Relief*, Lexington, MA, D.C. Heath and Co., 1979, Chapter 10.

Table 18

STATE-LOCAL INTERGOVERNMENTAL REVENUE, BY AMOUNT AND IN RELATION TO GENERAL REVENUE FROM OWN SOURCES, FOR LEVEL AND TYPE OF GOVERNMENT, SELECTED YEARS, 1955–79

	State Intergovernmental Revenue from—		Local Government Intergovernmental Revenue From—											
			Federal Government (direct)				State Governments[1]				All Governments—Federal, State and Interlocal			
Fiscal Year	Federal Government	Local Governments	All Local Governments[2]	Municipalities	Counties	School Districts	All Local Governments[2]	Municipalities	Counties	School Districts	All Local Governments[2,3]	Municipalities	Counties	School Districts
	Intergovernmental Revenue (in millions of dollars)													
1955	$ 2,762	$ 226	$ 368	$ 121	$ 31	$ 169	$ 5,987	$ 1,236	$ 1,767	$ 2,720	$ 6,355	$ 1,439	$ 1,837	$ 3,031
1960[4]	6,382	363	592	256	45	225	9,522	1,868	2,245	4,850	10,114	2,321	2,385	5,278
1965[4]	9,874	447	1,155	557	98	331	14,010	2,745	3,325	6,865	15,165	3,534	3,495	7,460
1970[4]	19,252	995	2,605	1,337	234	535	26,920	6,173	7,000	12,895	29,525	7,906	7,290	14,436
1971[4]	22,754	1,054	3,391	1,861	302	700	31,081	7,401	8,145	14,730	34,473	9,697	8,490	16,299
1972	26,791	1,191	4,551	2,538	405	749	35,143	8,434	9,252	16,471	39,694	11,528	9,956	17,653
1973	31,353	1,339	7,903	4,370	1,075	790	39,963	9,694	10,262	17,995	47,866	14,697	11,736	19,291
1974	31,632	1,538	10,199	5,458	2,331	829	44,553	10,464	10,890	21,720	54,752	16,624	13,666	23,112
1975	36,148	1,680	10,906	5,844	2,385	871	51,068	13,052	11,842	24,209	61,974	19,648	14,755	26,066
1976	42,013	2,704	13,576	7,442	2,911	894	56,169	13,772	13,156	27,181	69,746	22,234	16,677	29,160
1977	45,938	2,737	16,637	8,880	3,741	934	60,311	14,236	14,315	29,660	76,948	24,139	18,787	31,887
1978	50,200	3,262	19,393	10,234	4,824	1,229	64,661	14,492	15,389	33,631	84,054	25,833	20,878	34,858
1979[4]	53,500	3,700	19,640	10,080	5,010	1,285	70,750	15,160	18,240	36,500	90,390	26,480	24,120	37,000
	Intergovernmental Revenue as a Percentage of General Revenue from Own Sources													
1955	28.9	1.7	2.5	1.9	1.1	4.3	40.6	19.4	59.9	69.0	43.1	22.5	62.2	76.9
1960[4]	31.0	1.8	2.6	2.8	1.0	3.2	41.6	20.1	52.2	69.3	44.1	25.0	55.5	75.4
1965[4]	32.3	1.5	3.6	4.5	1.6	3.1	43.3	22.2	53.7	64.8	46.9	28.6	56.5	70.5
1970[4]	33.5	1.7	5.1	7.1	2.3	3.1	52.4	33.0	67.4	75.1	57.5	42.2	70.2	84.1
1971[4]	37.1	1.7	5.9	8.9	2.6	3.7	54.1	35.4	69.0	77.4	60.0	46.4	72.0	85.6
1972	37.9	1.7	7.1	10.8	3.0	3.6	54.5	35.9	68.1	79.3	61.6	49.1	73.3	84.9
1973	39.0	1.7	11.2	17.0	7.1	3.5	56.7	37.7	67.9	80.2	67.9	57.2	77.7	86.0
1974	35.5	1.7	13.3	19.8	14.2	3.4	58.1	38.0	66.2	88.6	71.3	60.4	83.1	94.3
1975	37.3	1.7	12.9	19.3	13.1	3.2	60.5	43.2	65.3	90.3	73.5	65.0	81.3	97.2
1976	39.1	2.5	14.6	22.5	14.4	3.0	60.3	41.6	64.9	91.5	74.8	67.2	82.3	98.1
1977	37.9	2.3	16.3	24.2	16.5	3.0	59.1	38.7	63.2	94.4	75.4	65.7	82.9	101.5
1978	37.0	2.4	17.5	25.8	19.2	3.7	58.4	36.5	61.1	97.0	75.9	65.1	82.9	103.7
1979[4]	36.8	2.5	17.0	24.0	19.4	3.7	61.1	36.1	70.6	105.5	78.0	63.1	93.3	107.0

[1] Includes indirect federal aid passed through the states. In 1979 such aid was estimated to be approximately $16 billion.

[2] Includes townships and special districts.

[3] Duplicative intergovernmental transfers are excluded.

[4] Partially estimated.

SOURCE: ACIR, *Significant Features of Fiscal Federalism*, A-123, Table 108, p. 165.

The states have fared much better, increasing their relative dependence by less than half that percentage.

If local governments could simply shore up their own-source fiscal position by using nonproperty tax revenues, this growth in intergovernmental dependency would not be so great. But with a very few exceptions, they cannot do so. As a rule, localities must stay with the property tax if they are to maintain fiscal autonomy. As was discussed above, their "open" economy character requires that local governments must rely heavily on the real property tax base—the base which, for all practical purposes, is physically immovable, and thus the only readily accessible one.

One implication of this fiscal arrangement, which is beyond the control of the local government, is that efforts need to be made by all governmental levels to maintain the strength of the property tax as the mainstay of the local revenue system. Although it would be quite incorrect to claim that the enactment of a tax equivalency payments in lieu of taxes program is going to "save" the property tax, it will have some importance in the aggregate—as it will, if fully implemented at the subnational level, increase local property tax collections by 5% to 6%. For some communities the contribution to revenues will clearly be above that mark; for hundreds of others, of course, there will be no gain. Overall, however, a PILOT will strengthen the local property tax.

Finally, it should be noted that, to the extent a PILOT does strengthen the local property tax, it will contribute to the community's ability to secure bond financing, as taxable assessed value is an important factor for determining a municipality's credit rating.

Fiscal Accountability

An underlying principle of the payments in lieu of taxes program is that, by acquiring land, buildings, and structures and facilities, the federal government has tacitly assumed a responsibility borne by private property owners, and thus it should make payments in lieu of taxes on much the same basis that owners of private property pay real estate taxes. This concept is not only consistent with the foregoing justifications; it has the additional merit of adding to the fiscal accountability characteristics of the intergovernmental system. As an accountability device, the PILOT would provide not only a means of disclosing to the taxpaying public what its tax burden is (or would be) in the absence of a tax exemption; it would eliminate, at no political threat to the viability of the U.S. government, a federally mandated state-local to federal subsidy. Moreover, because this subsidy is hidden—i.e., it does not receive the periodic budget review given other types of direct subsidies or expenditures—it violates principles of sound public administration.

Does the fact that the federal government, as a "taxpaying" institution, fails to have a collective vote on setting local tax rates and expenditure priorities similarly imply that state/local government will not be held accountable for its use of payments in lieu of taxes receipts? Such a situation might well exist in some cases. For example, if the bulk of federal workers were nonresident commuters, the federal government might argue that they are not represented adequately in local legislative councils. The same, of course, can be said of nonresident owners and factor suppliers of local business firms. However, in reality, when the government—even as an institutional entity quite apart from its employees and consumers of its services—accepts the responsibilities of a property owner, it also becomes the recipient of various well-established political and legal avenues through which to make its institutional views known. Moreover, if a local government is shown to be unaccountable in its use of public money, the federal government still has a unique final political resource: it can refuse to make the payments in lieu of taxes and avoid any of the penalities which, if it were a private taxpayer, would certainly be levied.

ALTERNATIVE FORMS OF A PAYMENTS IN LIEU OF TAXES SYSTEM

The full tax equivalency method is not the only approach to consider in determining the payments in lieu of taxes base. Rather, there are two broad types of alternatives. First, tax equivalency could be modified from a "full" to a "partial" approach. This latter path would be adopted if the full tax equivalency base were

eroded for various reasons of fiscal and adminstrative expediency. The second alternative is to reject tax equivalency altogether and adopt an entirely new form of payments base computation by focusing on approaches, such as actual cost reimbursement for the state and local public services received or the net benefits created by the federal government. The remainder of this chapter addresses each of these issues.

Partial Tax Equivalency

THRESHOLD

When the Canadian federal government initiated its tax equivalency payments in lieu of taxes in 1951, the program included an eligibility threshold so that payments were limited to municipalities where the value of federal property exceeded 4% of the combined value of taxable and federal property.[26] At that time, 4% was thought to be the average ratio of federal property value to total (private plus federal) value. This eligibility threshold was lowered to 2% when the Payments in Lieu of Taxes Act was amended in 1955, and removed altogether in 1957.

Presumably, the purpose of such a threshold is either to minimize the cost of the payments in lieu of taxes to the federal government or to eliminate a certain set of small PILOT recipients for administrative ease. A threshold would accomplish both of these objectives. An immediate major problem arises, however, because there is no *a priori* way to determine the "proper" threshold level. Should it be set at some aggregate average figure as in Canada's initial program? If so, the U.S. amount would also be about 5.2%. But why not 2.6% or 10.4%? Surely these could be "justified" on grounds of fiscal and/or administrative expediency.

In addition to the arbitrary nature of the threshold approach, it also has serious equity and administrative defects. The equity violation is straightforward: if communities "*A*" and "*B*" each have $*X* thousand of assessed value of federal real property, but for "*A*" that amount happens to just exceed the threshold, whereas for "*B*" the amount falls just below it, then "*A*" receives a payments in lieu of taxes based on its entire federal property but "*B*" is totally excluded. In public finance jargon, a "notch" problem has been created, and the principle of horizontal equity—"equal treatment of equals"—is violated.

Finally, although there will be some administrative benefits to the federal government from a threshold (if it were set high enough, of course, no payment would be made), as such "strings" start to be attached, compliance costs increase for the local government—enough so, perhaps, to actually deny the payments in lieu of taxes to communities which theoretically should qualify. This conclusion follows from the research quoted earlier in this report—that the reason federal grant payments often do not reach many smaller cities for which they are intended is the complexity in applying for them.[27] Interestingly, however, it should be noted that the small cities with inadequate "grantsmanship" would not, as a class, be the biggest losers under a threshold approach. As the data in *Table 7*—on the relationship between federal property value and owner-occupied home values—suggest, the ratio of federal real property values to total value may be lower for large cities than for all cities. The fact is, that, without a jurisdiction-by-jurisdiction analysis for all local governments in the U.S., one is unable to tell who will be the largest losers under a threshold approach—a fact, of course, that serves to further emphasize the arbitrary nature of such a proposal.

If, after considering these arguments, "practical" considerations still dictate some sort of plan to minimize the cost of the payments in lieu of taxes to the federal government, while at the same time recognizing the principle that some payments in lieu of taxes should be made, then the solution would seem to be simply to fund the program at some amount less than 100% of the $3.65 billion and reduce the payments to all governments accordingly. If, however, the rationale is to reduce U.S. compliance costs by eliminating a large grouping of potential PILOT recipients, the threshold is an appropriate tool.

A CEILING

Many large federal installations are situated in sparsely populated areas with little privately owned taxable property and limited needs for

government services. Accordingly, the question arises as to whether in such cases some ceiling should be included in a payments in lieu of taxes program as an "antiwindfall" provision.[28]

The idea has some merit, as it is probably just as wise politically to avoid creating an extreme class of winners as it would be to create a class of losers. Again, however, one is faced with the arbitrary nature of any ceiling: quantitatively where does a windfall begin to occur? In addition, this approach implicitly assumes a static fiscal relationship between the local and federal governments. Is a windfall scenario really so likely and threatening as it seems initially? If a federal agency is so very large relative to its surrounding area, then it seems that one solution—which is equally as plausible as letting the windfall occur—would be for officials of that agency, even if they are from Washington rather than residents of the local area, to "lobby" just as any business has to do in a similar situation to reduce the rate applied to the base. This solution would avoid the threat of a windfall and, just as important, would avoid creating the attendant equity and efficiency distortions of an arbitrarily determined ceiling.

A CUTOFF DATE

In the only previous comprehensive study of a broad-based payments in lieu of taxes program, the Bureau of the Budget (1951) submitted a plan to the Truman Administration that would have made ineligible for inclusion in the payments in lieu of taxes base any property acquired or constructed prior to January 1, 1946—i.e., wartime (WW II) properties.[29] The argument for a cutoff date reflected the presumption that adjustments for the exempt status of older federal properties have been made through the process of tax capitalization. To make payments on account of federal properties acquired before some reasonably recent date would bestow windfalls on many present owners of taxable property who purchased their properties at prices that already reflected local tax readjustments necessitated by federal removal of other properties from the tax roll.[30]

The argument is an elegant one and is based on the same principles discussed above in regard to efficiency, albeit with a somewhat different policy twist. What it does not address, however, are the other arguments for PILOT applied to all properties. Indeed, a cutoff date would reject most of the equity concerns noted above, as well as undercut the attempt to strengthen the local tax base. In addition, the idea of a cutoff date raises a fundamental type of "home rule" issue. If one accepts the argument that all inequities are capitalized over time, does that mean that any tax "reform" is, therefore, inequitable because it always bestows some windfall? Probably so. Thus, this argument is very much embodied in the "old tax is a good tax" principle. Nevertheless, the concern is sufficiently narrow, and the current inequities sufficiently large, to reject the cutoff argument as a policy guideline.

Alternative Tax Bases

This report has consistently focused on the tax equivalency form of a payments in lieu of taxes program, a decision which, as will become clear, was made on conceptual as well as on practical and methodological grounds. Obviously, the form of the PILOT base has direct implications for the cost of the program: designating a particular PILOT base measurement approach as the most appropriate one for computing a payment also determines the level of the payment. Accordingly, a review and valuation of alternative ways to measure the payments in lieu of taxes base is appropriate. Four such alternatives are examined below.

COST-OF-SERVICES[31]

The narrowest prescription for determining the level of payments in lieu of taxes is the cost-of-services approach. In its strictest formulation, this approach would require the federal government to compensate the local jurisdiction for the actual costs of all services provided directly to the federal properties (e.g., fire and police protection and sanitation). Accordingly, the approach requires the local jurisdiction to estimate the cost of such services. There are, however, three limitations to this approach. The first is directly concerned with the estimation requirements; the second and third are of a conceptual nature.

First, the costs should represent only incremental, or marginal, costs incurred in provid-

ing services to the federal government. That is, the federal government should only compensate the state or local government for costs incurred above and beyond the total costs of providing the services to residents. To the extent that goods provided by the local government exhibit the characteristics of "pure" public goods—goods consumed jointly or collectively—it is difficult to distinguish the federal from the nonfederal component of demand, i.e., the free rider problem. Theoretically, if all goods were "pure" public goods, the marginal cost of extending any service to the federal government would be zero.

A conceptual problem, related to the first, is how to evaluate the cost of services provided directly by the local government. The marginal cost should, by definition, be the difference between total expenditures on a particular service when it is extended to the federal government and when the federal share is excluded from the amount supplied. For two reasons, it should not be the average cost multiplied by the level of service provided to the federal government. First, average cost data include fixed costs which are spread evenly over all units produced. If the additional output going to the federal government does not require additional capacity, the change in total cost is not related to the existing fixed costs but rather is limited to increases in variable costs. On the other hand, if the additional output for the local government requires additional capacity—a very significant cost element for some jurisdictions*—the total cost of such additional capacity should be included and not spread over all previously produced units. Second, as the quantity of a certain public good supplied increases (with the addition of services to the federal government), the average cost of production may fall, rise, or remain unchanged depending on the cost conditions associated with the current level of production.

A third criticism of this approach is that it provides an inherently myopic view of the fiscal impact of the federal presence: it ignores such crucial factors as other tax revenues foregone because of the federal presence or the increase in local spending that results from Congressional mandating of state/local expenditures (requiring certain service levels or service quality without providing funding).

*Unpublished remarks on PILOT by Portsmouth, VA, Mayor Richard J. Davis, Senate Rules Committee, Virginia General Assembly, January 17, 1979. Mayor Davis notes that the most expensive of all the cost of services to the local community due to Norfolk Naval Shipyard is the "construction of highways to accommodate morning and evening peak traffic loads."

ADJUSTING FOR FEDERAL OWN-SERVICES

In any political debate regarding the choice of a PILOT base, one point is likely to be raised against full tax equivalency: that some federal agencies provide state and local government-type services for their own personnel and property and thus do not place as large a fiscal impact on state/local services as do private individuals or institutions. The strongest case for this argument is illustrated by the military facility with has its own police, fire, judiciary, sanitation, and on-base transportation services. A corollary to this is that education—the most significant direct service not provided by the federal facility—does receive some federal assistance under the education impact grants administered by the Department of Education.

This argument has merit. But at the same time, it has enough flaws to warrant its rejection as a policy guide:

- The most fundamental flaw is that there is no guideline for determining whether, for example, a military police force or a member of the Federal Protective Service (an in-house security force for civil buildings) is supplementing or supplanting similar state/local services. Clearly, both of these elements exist. When there is a disturbance in a shipyard, the military police or even the FBI may be called in. However, whenever there is a disturbance outside the base, or, as is generally true, inside or outside any federal civil operation, the state or local police are required. Where is the supplementing-supplanting line drawn?
- Even if there is some supplanting of local services, many private taxpayers (usually commercial) provide the same sort of services for their personnel and properties. Rather than rely on federal or local police, they hire store police or private security agencies. The clearest case to "prove" supplanting would occur if the

local government refused to service federal facilities, thus forcing the U.S. to supply those services to itself. Certainly, if such a situation were to arise (even if by mutual agreement of the U.S. and state or local government), then a payments in lieu of taxes discount might be warranted. However, it is important to note also that private businesses in many cities must supply their own trash collection or even infrastructure improvement services (e.g., curbing, sewer hookups).

- The argument ignores the practical fact that property tax receipts finance much more than direct services. If the property tax were designed to cover only direct service costs which accrue to a given property owner, the entire tax base would be narrowed substantially for the PILOT as well as for private taxpayers.
- The very real and practical methodological and conceptual problems with cost-of-service measurement are yet to be solved. Yet this discounting approach presumes that it can be done.

NET BENEFITS (BENEFIT-COST)

So far, much has been said in this report about the economic costs that the federal presence creates for a community. It is also quite true, however, that acquisition and use of property by the federal government can confer significant economic benefits on the jurisdiction in which the federal facility is located. These benefits are real and can accrue directly in the form of higher community incomes and indirectly through local multiplier effects that generate second and third-round increases in local economic activity. In fact, there is some evidence that the federal government's activity may be associated with smaller spending leakages, and, therefore, larger local multipliers, than various types of private sector activity.[32] That these benefits are clearly recognized by local officials is attested to by the inevitable protests that accompany a proposed defense plant closing or relocation of a civil agency. Indeed, it is probably fair to observe that those officials who complain most loudly about the costs of the tax exempt federal establishment are also the most likely to wage a strong lobby effort to keep the federal installation—even though conversion to private uses might have more beneficial economic effects in the long run.

In the context of determining a payments in lieu of taxes base, this benefit issue is used as a justification for providing a payment at an amount less than full tax equivalency. The argument herein is that, because the federal presence creates benefits, some downward adjustment needs to be made in the "full tax" approach. This approach usually takes one of three variants:

- *Local vs. Nonlocal Burden*. On the general presumption that local tax costs of property devoted to activities that are of a predominantly national interest (e.g., defense bases, national or regional office operations) should be borne largely by federal taxpayers, and that local tax costs of activities that are chiefly of local interest and benefit (e.g., post offices, weather stations, and land offices) should be borne by the community, it is deemed necessary to have a class-by-class review of which properties should be excluded from a payments in lieu of taxes base. In essence, this argument is an extension of the usual criteria a state or city legislative body may consider in determining which private institutions qualify for local tax exemption. The dividing line between what is and what is not in the tax (payments in lieu of taxes) base focuses on the practical questions of "who pays for the subsidy" vs. "who benefits from it."
- *Benefits and Costs*. The second argument for discounting the PILOT for benefits is based on a net benefit-cost effect of the federal presence on the local community. Thus, while this viewpoint accepts the unreimbursed cost arguments presented above, it also recognizes that the federal government, by its presence, indirectly creates community growth and, thus, indirectly adds sales and income tax revenues to those that would exist without the government's presence. It does not and cannot compare these revenues with those generated by private economic activities.

- *Extraordinary Burden.* The third variant of the benefits argument declares that as a general rule the federal property owner more than "pays its own way"—although there might be special cases of the existence of an "extraordinary burden" if the U.S. government crosses some sort of federal-to-total-property threshold. Just what constitutes this threshold is unspecified, but, as discussed in *Chapter 2*, the presumption is that it is up to the federal government to make that determination. Thus, as a practical matter, the threshold is likely to be a function of the level of payment the government is in the mood to make. As with any threshold arrangement, there are no *a priori* guidelines. Thus, of the three variants listed here, the "extraordinary burden" argument is already the least defensible conceptually.

Although each of these benefits adjustments will narrow the PILOT base relative to what it would be under full tax equivalency, the degree of tax base narrowing will vary with different perceptions regarding the appropriate classes of federal property. Thus, the application of the nonlocal burden test would keep military facilities in the payments in lieu of taxes base, whereas, for at least some jurisdictions whose economy is dominated by the base, the benefit-cost theory might argue for exclusion. Unlike these two scenarios, however, the design of a base according to some notion of an "extraordinary burden" would begin with the presumption that all federal property be excluded from the PILOT base, and only then would the payments in lieu of taxes base be determined according to some notion of proper specific inclusions for making an in lieu of tax payment.

Which of these variants justifies a discounting or downward adjustment from the tax equivalency approach proposed here? For a number of reasons, none is persuasive:

A benefits adjustment violates the guiding principle that, by acquiring real property (recall that public domain land is excluded from the payments in lieu of taxes base), the federal government has tacitly assumed the responsibility borne by the private property owner. Accordingly, unless there are special home-rule (local) reasons for preferential treatment of U.S. government properties, they should be treated as if they were fully taxable. Application of any of these benefits tests to a Boeing plant in Seattle (would Seattle exist as it does without Boeing?), or the financial industry in New York, or tourism in Miami Beach, or the grain elevators in Seneca County, Ohio—the list could go on and on—would, quite correctly, be viewed as the ultimate in political expediency. Yet that is just what is being proposed here for the federal government.

In addition, for many cities that are heavily impacted by the federal presence, the benefit-cost adjustment rationale falls apart when taken to its logical extreme. It can be plausibly argued, for example, that if the seat of the U.S. government had not been located to meet George Washington's wishes to have it near Mount Vernon, the place we now know as Washington, DC, might still be a swamp. At the very least, without the federal goverment, there might not be a large city at that spot on the Potomac. Moreover, without Washington, there would be no Maryland or Virginia suburbs: this whole federal complex would be located elsewhere. Thus, the argument goes, the benefit side of the federal presence is so enormous to Washington that it is folly to even suggest that the beneficent government establishment should now pay local taxes (though it probably would under the nonlocal burden variant). Before one argues that this extreme viewpoint is simply an absurd extension of an historical accident and not a modern fiscal concern, it is important to note that this very kind of argument is currently being used as one reason the new Kings Bay, GA, and Kitsap County, WA, Navy Trident Bases, and the developing Fort Stewart Army Base in Georgia should not be subject to in lieu real property tax payments—despite the enormous current and future public service and infrastructure maintenance costs being heaped on the host counties and nearby towns and cities.

Of course, not all federal facilities can be said to have "created" their local communities. What, then, about the quite observable fact that when the federal government plans to relocate or shut down a large facility, local officials may strenuously object? Was the coalition of the members of Congress from New Jersey, Penn-

sylvania, Delaware, and New York acting unwisely in the fall of 1979 when it succeeded in getting the Pentagon to reverse a decision to shut down the recruiting-training operations at Fort Dix, NJ? No, at least not in the short run. To argue that it is wrong to include a benefits test in the determination of a payments in lieu of taxes base is not to deny that a military base or a federal civil agency office creates local economic benefits. The two points are simply not related.

In the longer run, however, it is probable that such public protestations may be unwise. The fact is, the local economy might be better off if the federal establishment were to yield to private business activity. For example, when Brookley Air Force Base in Mobile, AL, closed in 1969 with the loss of 13,600 civilian jobs, public protests were described as "bitter" and "acute." Now, a decade later, state and local officials see themselves "a lot better off" as a result of conversion.[33] A similar experience can be cited in the case of the Brooklyn Navy Yard, closed in 1966 and now leased by New York City to a nonprofit development concern which, in turn, has leased space in the yard for ship repair, shipbuilding, and a variety of manufacturing activities. In fact, according to a study by the Pentagon's Office of Economic Adjustment (OEA), which helps communities search for new industry, of 77 military bases that were closed between 1961 and 1977, 72 had been put to use for industry, education, aviation, commerce, recreation, or a combination of these. The former bases are now the sites of 47 industrial parks, seven four-year colleges, and 26 postsecondary-vocational institutes.[34] The view that many communities tend to benefit over the long run from military base closings was corroborated by John Lynch, Assistant Director, Office of Economic Adjustment, Department of Defense, in testimony before the Commission on the review of the Federal Impact Aid Program. According to Mr. Lynch, "Most communities are . . . far better off with that base converted to civilian use with a stable civilian taxpayer than they were in its previous period of military occupancy."[35]

Finally, there are serious methodological problems in each of the proposed benefits adjustments, particularly with respect to the net benefits (benefits-minus-costs) issue. As a research undertaking, the estimation of benefits and costs is a complex and speculative enterprise. Procedures for judging relatively small developments, i.e., those that do not alter the structure of an area's economic base, such as a federal water project, have acquired some general acceptance. But comparable methods have not been used in analyzing the kinds of intergovernmental relationships involved here.[36] Not only are the analytical problems involved in measuring costs and benefits unresolved; the total impact of the federal presence would depend on a host of special characteristics unique to each community—e.g., size, nature of the economic base, and the public service flows between the city and its surrounding rural or suburban areas. In short, if it is to be meaningful, a net benefit test would, at the very least, require separate case studies for each jurisdiction with federal properties within its borders.[37]

Fixed Formula Approach

The fourth method examined here for determining the base of payments in lieu of taxes is the fixed fee or formula approach, whereby the payment would be made according to a flat payment per federal employee, or, perhaps as a fixed percentage of state and local own-source revenue or expenditure. Payment on a flat fee basis not only has the great virtue of administrative simplicity, but also it scores the highest of all the PILOT base options on a Congressional control criterion.[38] However, when evaluated against all other criteria for judging a PILOT, the formula approach has the most serious shortcomings of all the alternatives being examined.

Consider the fixed payment per federal worker first. To begin with, there is no *a priori* link between the size of the federal work force and the value of property on and in which these employees do their work. Two obvious reasons for this are the leasehold vs. ownership dichotomy and the fact that the production function (the labor and property mix) will vary widely according to the location and use of the federal property. Thus, in cases such as office building operations, which dominate the federal activity in many of the country's large cities, there does appear to be a significant direct relationship between federal property value and the number of federal employees. This employee-property relationship falls apart

when one looks for the same link in areas that have other than just office type operations. (*Table 7*, characteristic number 9.)

Not only does the idea of determining the payment according to a fixed percentage of state/local revenue or expenditure also fail on empirical grounds (as was shown in *Table 7* above, there is no significant relationship between real property value and fiscal indicators); it would also distort the public decision-making process. For example, if the base of the fixed percentage approach were total local government expenditure, the federal payment would have the effect of reducing the relative prices of public goods and services, thereby generating increases in the size of the public sector. Alternatively, when the base of a fixed-percentage approach is local own-source revenue, relative prices are not changed; but the formula now leads to some perverse results.[39] If the federal government were to expand its holdings of tax exempt property, thereby further eroding the local property tax base and revenues, this approach would suggest a reduction of the payment in lieu of taxes—just the opposite of the desired effect.

Thus, while the simplicity of a fixed fee or formula approach is attractive, its other weaknesses are critical. The approach makes no recognition of the reasons a payment in lieu of taxes can be justified and, in addition, would create a whole new set of distortions in intergovernmental fiscal relationships.

FOOTNOTES

[1]Total indirect plus direct U.S. tax expenditure aid to state and local governmens was approximately $18.4 billion in FY 1980. These expenditures are largely in the form of the federal tax exempt status of state and local securities ($5.9 billion) and the deductibility of state and local taxes against the federal income tax ($12.5 billion). Note, however, that this $18.4 billion represents the revenue loss to the federal Treasury; the money does not accrue to the state or local government. Much goes directly to individuals and business taxpayers—the entire $12.5 billion of the federal tax offset. Federal government tax expenditure estimates are produced in Congressional Budget Office, *Five-Year Projections and Alternative Budgetary Strategies for Fiscal Years 1980–84: Supplemental Report on Tax Expenditures*, Washington, DC, Congressional Budget Office, 1979, 55 pp.

[2]ACIR staff computations, "Federal Grants-In-Aid In Relation To State and Local Receipts From Own Sources, Total Federal Outlays, and Gross National Product, 1955–81," unpublished study, June 1980.

[3]This generally accepted division is used by Peggy L. Cuciti, in *City Need and the Responsiveness of Federal Grants Programs* (Committee Print), a report to the Subcommittee on the City of the Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, 95th Congress, 2nd Sess., Washington, DC, U.S. Government Printing Office, 1978, 81 pages. The definitions used by Cuciti are essentially the same as those adopted here.

[4]*Ibid.*, pp. 64-65, 72.

[5]*Ibid.*, pp. 71–72.

[6]U.S. Department of the Treasury, *Fiscal Impact of the Economic Stimulus Package on 48 Large Urban Governments*, Washington, DC, U.S. Government Printing Office, 1977.

[7]The first formula is currently used in 20 states and considers five factors: population, relative per-capita income (inversely), urbanized population, tax effort, and state personal income tax collections. The alternative formula considers population, tax effort, and relative per-capita income (inversely), urbanized population, tax effort, and state personal income tax collections. The alternative formula considers population, tax effort, and relative per-capita income and is used by 30 states. Also see Cuciti, *City Need, op. cit.*, pp. 55–59 and, generally, Office of Revenue Sharing, U.S. Department of the Treasury, *State and Local Data Elements, 7 and 8*, Washington, DC, 1977, *et. seq.*

[8]The programming and processing of the raw data were done by Robert M. Stein of Rice University, Houston, TX, and the U.S. Advisory Commission on Intergovernmental Relations.

[9]ACIR, *The Adequacy of Federal Compensation to Local Governments for Tax Exempt Land*, A-68, Washington, DC, U.S. Government Printing Office, July 1978, p. 117ff.

[10] Currently 21 states and the District of Columbia assess tax exempt property located within their borders.

[11]See remarks by Nonna Noto on the "Local Taxation of Business," at a conference sponsored by the American University School of Law and the Multistate Tax Commission, Washington, DC, October 1979, in *The American University Law Review*, Washington, DC, Winter 1980, p. 305.

[12]Section 322 of the *Economy Act of June 20, 1972*, as amended; Section 15, Title II of the *Economy Act of March 3, 1933* (40 USC 278a), as amended.

[13]Note that not all of this rented area is designated as the same usage category as the area measured by BOMA. Thus, the downtown estimates are probably overstated.

[14]Conversations with USPS realty management personnel.

[15]United States Postal Service, *Realty Acquisition and Management*, RE-1, TL-1, 7-1-75, at 6–203, "Tax Provisions."

[16]U.S. General Accounting Office, *Costs and Budgetary Impact of the General Services Administration's Purchase Contract Program*, LCD–80–7, Washington, DC, U.S. Government Printing Office, 1979, p. 2.

[17]*Ibid.*, p. 6.

[18]USPS, *Realty Handbook*, at 6–203.2, emphasis added.

[19]U.S. General Accounting Office, *Costs and Budgetary Impact, op. cit.*

[20]For a comprehensive review of procurement practices

prior to 1972, see the six-volume *Report of the Commission on Government Procurement*, Washington, DC, U.S. Government Printing Office, 1972. A recent review of the procurement issue is provided by the U.S. General Accounting Office, *Legislative Recommendations of the Commission on Government Procurement: 5 Years Later*, Washington, DC, U.S. Government Printing Office, July 1978, 26 pages.

[21]For example, see the discussion in Marion Clawson, *Suburban Land Conversion in the United States*, Baltimore, MD, The Johns Hopkins University Press, 1971, pp. 355–59.

[22]For a review of the literature, see Robert D. Ebel, "Research and Policy Developments: Major Types of State and Local Taxes," in John E. Petersen, Catherine Lavigne Spain, and Martharose F. Laffey, eds., *State and Local Government: Finance and Financial Management*, Chicago, IL, Municipal Finance Officers Association, 1978, pp. 1–21.

[23]John M. Quigley and Roger W. Schmenner, "Property Tax Exemption and Public Policy," *Public Policy*, Summer 1975, pp. 295–297.

[24]For a discussion of this suburban fiscal exploitation, see Kenneth V. Green, William B. Neenan, and Claudia D. Scott, *Fiscal Interactions in a Metropolitan Area*, Lexington, MA, Lexington Books, 1974.

[25]The order required that agencies not only remain in cities, but, when feasible, move back in from the suburbs. In the two years since the order was issued, more than 230 offices were moved back into central business areas by the General Services Administration. However, there are pressures for a change in policy. For a discussion, see: John Goodale, "Putting Federal Offices Downtown—The Suburbs Are Yelling 'Foul'," *National Journal*, November 15, 1980, pp. 1935–37.

[26]Lewis H. Greensword, "Grants In Lieu of Taxes on Federal Property," *Proceedings of the 41st Conference of Assessment Administration*, Washington, DC, September 1975. Mr. Greensword is Chief, Municipal Grants Division, Canadian Department of Finance.

[27]See *Chapter 3*. Robert M. Stein, "Federal Categorical Aid Equalization and the Application Process," a paper presented at the Annual Meeting of the American Society for Public Administration," Baltimore, MD, April 1-4, 1979.

[28]An "antiwindfall" provision was proposed in the Bureau of the Budget's *Executive Communication No. 722 Regarding Payments in Lieu of Taxes*, Washington, DC, August 16, 1951. This communication provided the explanatory statement for the proposed 1951 payments in lieu of taxes legislation.

[29]*Ibid.*, p. 8.

[30]*Ibid.*

[31]This section relies heavily upon Michael E. Bell, "Alternative Treatment of Government-Owned Tax Exempt Properties In Urban Areas," *Proceedings of the 70th Annual Meetings of the National Tax Association-Tax Institute of America*, Louisville, KY, 1977, pp. 174–182.

[32]First Hawaiian Bank, *The Impact of Exports on Income in Hawaii*, Honolulu, HI, First Hawaiian, 1972.

[33]John Herbers, "Cities Find Conversion of Old Military Bases a Boon to Economics," *The New York times*, p. A–1, April 26, 1979.

[34]Office of Economic Adjustment, *Summary of Completed Military Base Economic Adjustment Projects*, 1961-1979, Washington, DC, The Pentagon, 1979, 26 pages. A similar view that, over time, communities benefit from military base closings is presented in David A. Mackinnon, "Military Base Closures: Long Range Economic Effects and the Implications for Industrial Development," *AIDC Journal*, American Industrial Development Council, Inc., July 1978, pp. 7–41.

[35]John Lynch testimony of May 28, 1980, to the Commission on "The Review of the Federal Impact Aid Program." Letter to ACIR from Judith Jacobsen, June 1980.

[36]For a contrary view which is not accepted here, see Henry J. Raimondo, "Compensation for Tax Exempt Property in Theory and Practice, *Land Economics*, February 1980, pp. 33–42.

[37]This conclusion is also presented in a Wisconsin State study, *Payments in Lieu of Taxes on State Owned Lands*, report of the University of Wisconsin Public Lands Impact Study Committee, Madison, WI, February 1967.

[38]U.S. General Accounting Office, *Alternatives for Achieving Greater Equities in Federal Land Payment Programs*, *op. cit.*, p. 39.

[39]Michael E. Bell, "Alternative Treatments," *op. cit.*, p. 181.

Quantitative Aspects: the Base and Yield of a PILOT

Information on the magnitude of the current value of federal tax exempt real property and the cost and geographic distribution of a compensatory PILOT program is essential in order to make sound policy judgments regarding the enactment of a federal PILOT. Accordingly, a major focus on this study was on providing those estimates. The method of making the estimates and the results are summarized in this chapter. A detailed description of the methodology is provided in *Volume 2*.

This chapter is divided into three parts. The first summarizes briefly the nature of the historical cost records regarding the federal government's real property holdings and the methods employed in this study to derive estimates of the current value of those properties. The second part presents the PILOT base and payment numbers under varying assumptions regarding the scope of the PILOT and its military vs. civilian and urban vs. nonurban divisions. This is followed by details on the geographic impacts of the PILOT as defined in *Chapter 3*.

Finally, the third part of this chapter presents alternative strategies for the replacement of all or a portion of the 57 existing payment programs discussed in *Chapter 2* and listed in *Tables 1* and *2* of this volume. As is clear from a reading of this Commission's formal recommendation for authorization of a uniform PILOT based on real property tax equivalency, this replacement approach was a key element in the Commission's deliberations.

ESTIMATING THE CURRENT VALUE OF FEDERAL REAL PROPERTY (1978)

Aggregate Data

A detailed description of the state of the art regarding the federal government's knowledge of its own real property value is provided in *Volume 2*. The major methodological points reported there are:

- Except for some data on buildings and structures and facilities (and land for the Department of the Army) collected by the various branches of the military, there is no attempt by the U.S. government to maintain current estimates of the value of its real property holdings.
- The U.S. inventory of its real property is limited to information on the cost of acquisition of each federally owned building, structure and facility, and parcel of land (GSA officials, who are in charge of this inventory and who must rely on the accuracy of the reports provided to them by all other government agencies, indicate that some federal properties are probably not listed in the inventory). However, for many of the buildings and facilities and structures entries, the cost data are associated with a "from" and "to" date. Thus, a piece of real property may have the following cost information:

	From	*To*
Cost: $100,000	1950	1952

  Such data are published annually by GSA and by each branch of the military. At the time this ACIR analysis was made, the most recent data were in the 1977–78 GSA inventory.
- The procedure for estimating the current value of federal real property was to use the GSA listing, which includes both civilian and military properties, as a basis for updating the cost figure for each individual property entry by a growth multiplier. This multiplier was developed from construction cost indexes as well as from established techniques for adjusting for depreciation. Because the multipliers to be used will increase as one goes back in time, current value estimates of federal property were computed using both "from" and "to" dates. Thus, in the example of the hypothetical property above, the property has the following range of values in 1978:

	Cost	*Multiplier*		*Current Value (1978)*
"From"	$100,000 ×	1.98	=	$198,000
"To"	100,000 ×	1.77	=	177,000

  As *Volume 2* details, although this is the basic approach, the actual procedure was a good deal more complicated because of problems regarding the treatment of depreciation of buildings and structures and facilities and the range of the "from" and "to" dates.
- This same process was repeated, using the GSA inventory for civilian properties only and then adding the values independently estimated from Army, Navy, and Air Force data. This was done in order to provide a "check" or comparison for both the GSA and GSA-plus-military data. Although the Army was the only branch for which an estimate of current land values could be obtained, the data in *Table 20* indicate that each of these two approaches gives comparable results, the GSA-plus-military data being the larger of the two estimates. However, because the GSA inventory was more comprehensive and easier to manipulate, nearly all of the PILOT base and payment numbers used in this chapter are based on only the GSA inventory.

PRESENTATION OF THE NATIONAL PILOT BASE TOTALS

The national estimates of the PILOT base are presented in *Tables 19* and *20*. Two types of basic data are presented and are referred to as "Regular Phase" (e.g., Phase I, Phase II, etc.) and "Phase A" (e.g., Phase I–A, Phase II–A, etc.). The only difference stems from the fact that the GSA real property inventory frequently lists parcels by acquisition cost on both a "from" date—the year the property was initially acquired—and a "to" date or the last year the property was acquired (in the case of land) and/or improved (in the case of buildings). The

other real property category—structures and facilities—is treated as having only a "to" date.

Rather than choosing between the "from" and the "to" date for application of our real property multipliers, multipliers were applied to both years:

> *Regular Phase Data*: provide estimates of current plant value of federal property, assuming the "from" date is always used—i.e., for both land and buildings.
>
> *Phase A Data*: provide estimates of current plant value of federal property, assuming the "from" date is still used for land and the "to" date is used for buildings. As a result, as *Table 19* shows, regular phase estimates are always larger than "A" phase estimates.

It should be recognized that the "A" phase uses the "from" date for land. Again, the only difference between "Regular" and "A" phase data is that the "to" date was applied in estimating the value of buildings. There are three reasons for using a "from" date for land throughout. First, the procedure used here assumes that the bulk of any parcel of federal land is acquired at the first date of acquisition. Additions of land to the individual parcels are assumed to be so small, relative to the total land holdings, that to use the "to" date would seriously understate current land values. Second, whereas a review of the GSA inventory shows that most buildings have a "from" and "to" date, most land has only the initial (from) date. This observation, thus, supports the assumption noted just above. And, third, a manual review of the GSA inventory for land indicates that when land has a "to" date, it is usually (a) for 1978, and (b) so listed by the Army and Air Force in what is believed to be an arbitrary entry. Thus, using a "to" date for land would, in effect, mean entering a parcel at its cost acquired in, say, 1920 as if that same 1920 dollar cost existed in 1978.

As shown in *Table 19*, the total value of all federally owned real property in the U.S. is $279 billion (Phase I), using the "from" dates for buildings, and $209 billion if the later, or "to" dates, are used (Phase I–A).

For purposes of this study, however, the most pertinent data are in Phases II through V, which limit the scope of the PILOT base to various components of the "nonopen space" properties as defined in *Chapter 3* (e.g., military vs. civilian, urban vs. nonurban). In addition, there is a clear preference for the use of "Regular Phase" rather than "Phase A" data. This preference is founded on at least two grounds:

1. Using regular phase data implies that most of a building was constructed in the first year or two of its life during the "from" and current (1978) years, and that the "to" date largely reflects structural improvements (not repair, which is not reflected in these values) and/or less than major additions to the building. This is a more plausible assumption than that which the Phase "A" data requires—*viz*, that although the building was begun in a given year, the major part of its construction was delayed, sometimes for quite a long period of time.
2. The ACIR methodology used to estimate all phases of these numbers (*Volume 2*) tends to be conservative—especially when compared with the procedures employed by the military. Accordingly, using the higher "regular" phase numbers will minimize the likelihood of underestimating the current value of federal property.

Using the regular phase estimates, *Table 19* shows that, for 1978, given the PILOT base as defined in *Chapter 3*:*

- The total value of federal property holdings in the U.S. was $210 billion.
- Of that total, 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 the civilian holdings.
- The larger part of the total value of federal property is held outside the central county area, largely because of the loca-

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*Excluding certain categories of federal real property, which primarily reflected "open space"-type uses.

Table 19

ESTIMATES OF 1978 REPLACEMENT VALUE OF FEDERALLY OWNED REAL PROPERTY, BY ALTERNATIVE REAL PROPERTY BASES (PHASES)
(in thousands of dollars)

Phase	Description	Valuations			
		Land	Buildings	Structures and Facilities	Total
Phase I	All federally owned real property in U.S.	$63,655,300	$148,365,157	$66,733,567	$278,754,024
Phase IA	All federally owned real property in U.S., to date	63,655,300	78,629,838	66,733,567	209,018,705
Phase II	Federally owned real property in U.S., excluding certain usage categories for "open space" lands	20,023,886	148,365,157	41,793,604	210,182,647
Phase IIA	Federally owned real property in U.S., excluding certain usage categories for "open space" lands, to date	20,023,886	78,629,838	41,793,604	140,447,328
Phase III	Federally owned real property in U.S., excluding certain usage categories, for civil functions only	11,202,781	45,634,153	23,208,439	80,045,373
Phase IIIA	Federally owned real property in U.S., excluding certain usage categories, for civil functions, to date	11,202,781	30,330,927	23,208,439	64,742,147
Phase IV	Federally owned real property in U.S. urban counties, excluding certain usage categories, for civil functions only	6,054,487	24,339,756	3,044,693	33,438,936
Phase IVA	Federally owned real property in U.S. urban counties, excluding certain usage categories, for civil functions only, to date	6,054,487	18,049,862	3,044,693	27,149,042
Phase V	Federally owned real property in U.S. nonurban counties, excluding certain usage categories, for civil functions only	5,148,294	21,294,397	20,163,746	46,606,437
Phase VA	Federally owned real property in U.S. nonurban counties, excluding certain usage categories, for civil functions only, to date	5,148,294	21,294,397	20,163,746	46,606,437

SOURCE: ACIR staff computations.

Table 20

REPLACEMENT VALUE ESTIMATES FOR MILITARY REAL PROPERTY OWNED BY THE FEDERAL GOVERNMENT, 1978 (in thousands of dollars)

Division	Description	Buildings	Structures and Facilities	Subtotal	Land	Total with Land
Group I	Military real property owned by the federal government in U.S., with certain usage categories excluded					
Air Force		$ 34,502	$ 25,652	$ 60,154	N.A.	N.A.
Army		43,968,535	46,154,609	90,123,143	$3,260,511	$93,383,655
Navy		N.A.	N.A.	55,265,140	N.A.	N.A .
Total		44,003,037	46,180,261	145,448,438		
Group II	Military real property owned by the federal government in U.S. urban counties, with certain usage categories excluded					
Air Force		19,828	13,163	32,991	N.A.	N.A.
Army		20,358,204	3,675,554	24,033,758	1,413,656	25,447,415
Navy		N.A.	N.A.	31,767,568	N.A.	N.A.
Total		20,378,032	3,688,717	55,834,318		
Group III	Military real property owned by the federal government in U.S. nonurban counties, with certain usage categories excluded					
Air Force		14,673	12,489	27,163	N.A.	N.A.
Army		23,610,331	42,479,054	66,089,385	1,846,854	67,936,239
Navy		N.A.	N.A.	23,497,572	N.A.	N.A.
Total		23,625,004	42,491,543	89,614,120		

N.A. = Not Available.
SOURCE: ACIR staff computations.

tion of structures and facilities and their respective spatial demands and various functions.

The results of combining estimates based on the GSA inventory for property in civilian uses with estimates based on data supplied by the Air Force, Army, and Navy are presented in *Table 20*. The findings are not fully comparable with the numbers in *Table 19*, as the Navy and Air Force did not have sufficient information (presumably independently of GSA) to give land value estimates. Subject to this important shortcoming, however, *Table 20* shows:

- The Army is the largest owner of real property (buildings and structures), accounting for 62% of the total. These data are presented in the Group I division.
- Group II and III data provide central urban county and nonurban county breakdowns. Not surprisingly, due to the land-intensive nature of military bases and other defense properties, the bulk (62%) of military holdings are "nonurban."
- Within central urban counties the values of military properties are also a bit more evenly distributed, as the Army's holdings account for only 44% of the real property in this division. However, the disparity between Army and all other military real property values increases to 74% in nonurban areas.

The higher nonurban incidence of military real properties, combined with the relative importance of military to total federal property values in the U.S., serves to highlight an important feature for policy discussions of the characteristics of a PILOT: that any attempt to exclude "defense" from the PILOT base will not only significantly erode the base; it also will be a decidedly antismall city and antirural decision.

Table 21 presents the computational "check" of the two sets of data referred to earlier. For example, the sum of Phase III and Group I shows the civilian PILOT base plus the military PILOT base. The total equals $228.7 billion even without the Navy and Air Force land value data. This figure is higher than the separately estimated Phase II data, a fact that can be explained by the large upward bias in the military estimation procedures. See *Volume 2*.

Detailed Data

As part of the analysis for this study, estimates were made for several sets of data. The following tables were derived for all five regular data sets (45 tables):

GSA Table Reference
(See *Volume 2*.)

- * 6 Federally owned (FO) real property by state
- * 7 FO real property by agency and bureau
- 11 FO land by agency and predominant usage class (e.g., storage, park, historic site, grazing, etc.)
- 12 FO land by state and predominant usage
- * 13 FO buildings by agency and predominant usage
- * 14 FO buildings by state and predominant usage
- 15 FO structures and facilities by agency and predominant usage
- 16 FO structures and facilities by state and predominent usage
- * 23 FO real property in the U.S. by state and agency and bureau.

Print outs for *Phase A* estimates were also made of those tables indicated by an asterisk (*) to the left of the table reference number (25 tables).

Table 21

ESTIMATED VALUE ESTIMATES FOR CIVIL AND MILITARY REAL PROPERTY

Division	Current Value (in thousands)
Phase III and Group I	$228,754,323
Phase IIIA and Group I	213,451,097
Phase IV and Group II	90,685,911
Phase IVA and Group II	84,396,017
Phase V and Group III	138,067,412
Phase VA and Group III	129,054,080

Because cost constraints prohibited the reproduction of all 70 tables, this report provides the above detailed information for regular Phase II data only—i.e., for the current value of all federally owned real property in the U.S., excluding those "open space" categories listed in *Chapter 3*. Presented in their entirety in *Volume 2*, these data are the focus of the remainder of this chapter, as they provide the estimates most relevant for policy deliberation pertaining to the Commission's recommendation for a comprehensive federal payment in lieu of tax system for real property. These findings pertaining to the current value of federal real property (1978) are presented in a series of charts and tables:

Chart 3 shows the value of real property owned by various civil agencies as a percent of total federal civil property in the U.S. As is evident from the chart, the largest single holding can be attributed to one of the most recently organized federal departments, the Department of Energy. The next largest amount is attributed to GSA, an agency which "owns" many of the buildings that are actually *used* by other agencies. Thus, if one is talking about the "control" of federally owned real property in an actual use sense, many of the other agencies in the chart would see increases in their percentage allocations and GSA would show a large decrease.

Chart 4 shows the value of real property owned by various military branches as a percent of total defense property in the U.S. These findings are quite straightforward and indicate that the Army controls the single largest amount of the defense property owned in this country. Beyond making this observation, it is difficult to draw many other policy conclusions regarding the relative "control" of property among the military branches. This is because the data in *Chart 4* (as well as those in *Chart 3*) do not reflect the value of property leased from the private sector or technically owned by GSA. Again, regarding the distinction between GSA-owned and used buildings, it is noteworthy that the Pentagon building in Arlington, VA, is owned not by the Department of Defense, but by GSA.

Table 22 and *Chart 5* present information on the state-by-state distribution of the federal government's real property holdings. These state data are arranged by region in the charts. Note even when national park areas, grasslands, and other open space-type lands are excluded, in terms of absolute value measures the southeast and the far west regions together account for half of the federal government's real property value.

Chart 6 is one of the most interesting of these presentations, as it indicates the relative impact of federal real property holdings by states and regions. By relating the data in *Table 22* to the total value of federal plus assessed private taxable property, the chart provides an interesting perspective on the degree of real property tax base erosion created by the federal presence. By region, the major impacts are clearly in the southeast and in most areas west of the Mississippi River.

The state-by-state comparisons are equally interesting. Not surprisingly, the District of Columbia, which serves as the Nation's Capital, is shown to be the most heavily impacted area. With federal real estate comprising about 5% of the total federal plus private taxable values for the U.S. as a whole, the federal proportion in DC is over one-third. DC government officials have long pointed to this feature as a major contributor to that city-state's fiscal problems. Also evident from *Table 22* is the impact on many of the plains and western states (including Hawaii) of the military presence and the buildings and structures and facilities that serve those U.S.-owned land areas which have been excluded from these estimates. Those interested in the values of federal property by particular usage categories for individual states (e.g., office buildings, military, institutional, housing, storage, industrial, and research and development) should refer to *Volume 2* for further detail.

PILOT YIELD

Before presenting the estimates made for the yield of a PILOT based on property tax equivalency, it must be recognized that these payment amounts, which are simply computed as the product of the federal property value base times an effective property tax rate, have an upward bias. There are two practical reasons for this phenomenon. First, even if Congress were to grant its consent to a PILOT, it is quite plausible that, at least initially, some local govern-

Table 22

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

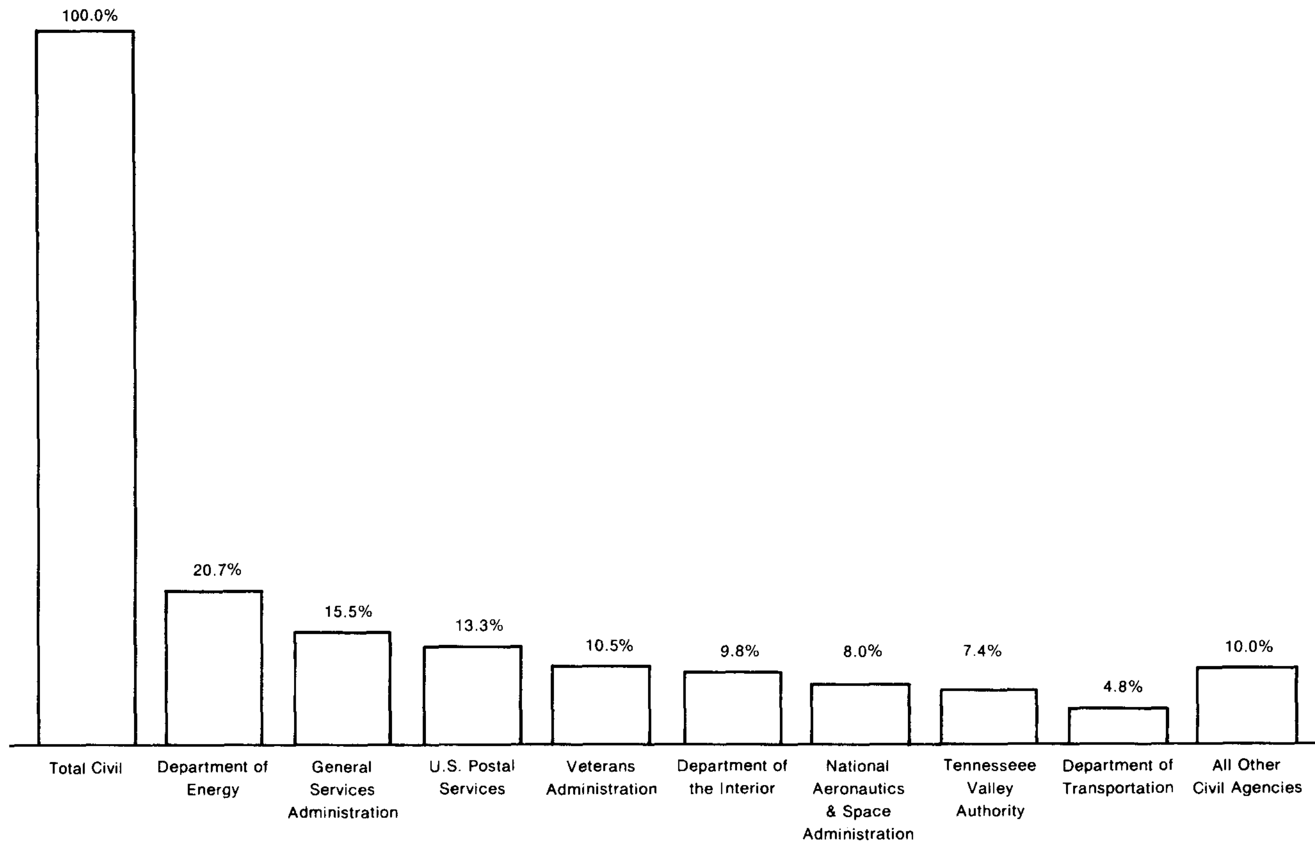
State	Number of Installa-tions	Number of Buildings	Value in Thousands of dollars			
			Land	Buildings	Structures and Facilities	Total
Alabama	350	7,232	$ 261,564	$ 2,522,265	$2,248,427	$ 5,032,256
Alaska	1,052	7,793	403,905	3,912,568	1,296,096	5,612,569
Arizona	358	11,053	135,248	2,432,069	1,121,871	3,689,188
Arkansas	298	4,534	133,374	673,716	666,183	1,473,273
California	1,504	59,686	3,450,564	18,516,400	3,417,166	25,384,130
Colorado	445	7,086	328,151	3,057,883	769,488	4,155,522
Connecticut	204	2,129	139,911	1,116,906	79,139	1,335,956
Delaware	85	1,148	31,286	447,134	71,516	549,936
District of Columbia	153	1,923	996,983	6,351,949	208,592	7,557,524
Florida	753	14,838	808,404	5,427,955	1,453,351	7,689,710
Georgia	475	12,741	1,056,522	3,553,717	906,101	5,516,340
Hawaii	279	14,610	426,645	3,797,645	752,196	4,976,486
Idaho	307	4,195	73,828	909,105	513,700	1,496,633
Illinois	681	7,151	716,968	5,342,579	471,790	6,531,337
Indiana	353	5,566	275,984	1,708,013	340,547	2,324,544
Iowa	289	1,642	110,802	625,368	98,171	834,341
Kansas	308	7,749	267,625	3,000,297	600,678	3,868,600
Kentucky	316	6,847	253,921	2,131,678	1,123,299	3,508,898
Louisiana	351	4,880	264,673	1,996,541	321,846	2,583,060
Maine	290	3,196	69,087	880,869	274,589	1,224,545
Maryland	347	11,691	503,271	6,628,344	728,290	7,859,905
Massachusetts	444	5,315	446,673	2,695,877	259,615	3,402,165
Michigan	659	6,308	181,661	1,582,748	231,345	1,995,754
Minnesota	374	3,014	77,201	747,080	109,392	933,673
Mississippi	275	5,543	137,897	1,370,179	575,275	2,083,351

Missouri	644	6,142	259,689	2,580,849	419,751	3,260,289
Montana	596	6,144	90,909	751,200	1,327,973	2,170,082
Nebraska	308	2,499	112,668	1,081,693	234,610	1,428,971
Nevada	223	4,780	55,864	678,756	488,790	1,223,410
New Hampshire	94	814	24.071	209,254	67,814	301,139
New Jersey	377	7,466	431,705	3,429,698	511,375	4,372,778
New Mexico	314	11,710	244,382	3,057,901	517,907	3,820,190
New York	1,037	9,322	1,318,165	6,709,314	553,987	8,581,466
North Carolina	453	15,348	199,991	2,649,503	538,666	3,388,160
North Dakota	617	4,696	18,357	887,510	999,327	1,905,194
Ohio	613	5,597	433,982	4,427,330	705,577	5,566,889
Oklahoma	374	7,253	120,613	2,533,217	425,939	3,079,769
Oregon	714	4,470	235,933	540,381	2,239,886	3,016,200
Pennsylvania	719	6,312	515,922	3,506,273	583,053	4,605,248
Rhode Island	94	2,644	86,077	728,027	178,785	992,889
South Carolina	253	9,970	651,598	3,231,940	820,239	4,703,777
South Dakota	397	2,990	24,736	766,722	621,508	1,412,966
Tennessee	436	5,902	845,838	3,711,080	3,303,898	7,860,816
Texas	1,178	26,344	823,050	9,519,931	1,396,515	11,739,496
Utah	282	4,759	56,382	1,444,932	462,536	1,963,850
Vermont	106	334	17,197	105,188	11,512	133,897
Virginia	537	17,617	813,079	8,125,512	1,676,688	10,615,279
Washington	846	16,706	875,898	4,222,146	4,513,080	9,611,124
West Virginia	249	1,213	82,549	403,326	92,372	578,247
Wisconsin	385	4,404	87,751	1,096,706	139,567	1,326,024
Wyoming	305	3,188	43,332	537,883	323,586	904,801
U.S. Total	23,101	406,494	20,023,886	148,365,157	41,793,604	210,182,647

SOURCE: ACIR staff computations.

Chart 3

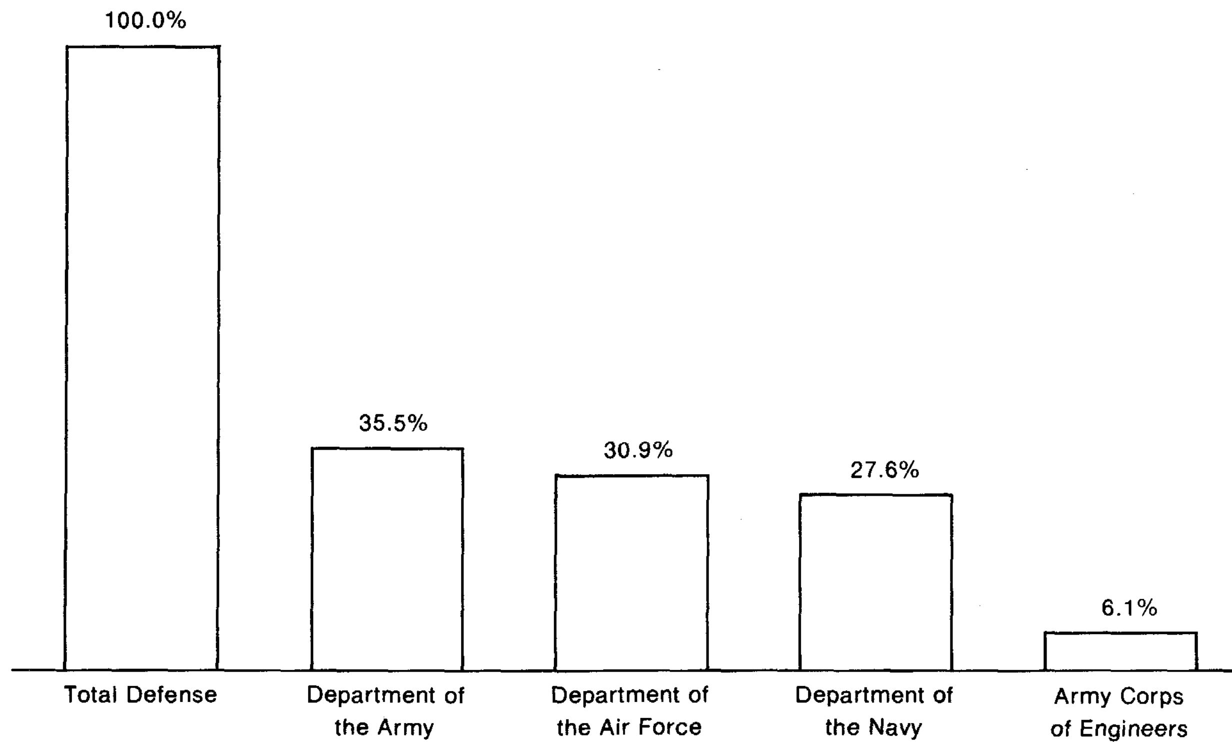
VALUE OF REAL PROPERTY OWNED BY VARIOUS CIVIL AGENCIES AS A PERCENT OF TOTAL FEDERAL CIVIL PROPERTY IN THE UNITED STATES, 1978



SOURCE: Volume 2.

Chart 4

VALUE OF REAL PROPERTY OWNED BY VARIOUS MILITARY BRANCHES AS A PERCENT OF TOTAL DEFENSE PROPERTY IN THE UNITED STATES, 1978



SOURCE: Volume 2.

Chart 5

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: Volume 2.

Chart 6

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%
Nebraska	30.8	4.6%
North Dakota	13.5	14.1%
South Dakota	15.6	9.0%
SOUTHEAST	945.1	5.8%
Alabama	51.9	9.7%
Arkansas	33.1	4.4%
Florida	190.8	4.0%
Georgia	79.4	6.9%
Kentucky	45.9	7.6%
Louisiana	55.0	4.7%
Mississippi	30.7	6.8%
North Carolina	81.2	4.2%
South Carolina	59.2	7.9%
Tennessee	76.4	10.3%
Virginia	215.2	4.9%
West Virginia	26.3	2.2%
SOUTHWEST	435.4	5.1%
Arizona	61.9	6.0%
New Mexico	24.6	1.6%
Oklahoma	52.5	5.9%
Texas	296.4	4.0%
ROCKY MOUNTAIN	160.2	6.7%
Colorado	62.1	6.7%
Idaho	22.2	6.7%
Montana	22.1	9.8%
Utah	29.1	6.7%
Wyoming	24.7	3.7%
FAR WEST	776.4	6.4%
California	553.0	4.6%
Nevada	21.1	5.8%
Oregon	57.4	5.3%
Washington	89.9	10.7%
Alaska	20.9	26.9%
Hawaii	34.1	14.6%

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

ments will not assess the federal properties. Currently, only 21 states and the District of Columbia require assessment of federal real property; thus, it is reasonable to expect that some localities in the other 29 states will not have adequate staff resources to join the PILOT program immediately.

Second, and more important, is that these payment estimates have not been subjected to the inevitable pressures for downward adjustment that would occur if the federal properties were in the "taxable" arena. Thus, local estimates of the assessed value of federal property may be overstated for several reasons, ranging from the nature of the assessment and billing cycle (relatively few jurisdictions have annual cycles) and the accuracy of assessments (appeals could be expected) to the politics of the local property tax rate policy.*

In addition to these practical problems in estimating the payment amounts for the PILOT base, the choice of the correct effective tax rate will influence the overall (though not relative) levels of the PILOT to be paid to various jurisdictions. Because it was impossible for purposes of this report to determine the effective rate for each of the several thousand local real property taxing jurisdictions, it was necessary to consider several national and state average rates. The following effective rates were considered:

1. A rate of 1.74%, which would yield approximately $3.65 billion when applied to the Phase II base. This rate was determined by estimating, on a state-by-state basis (including the District of Columbia), the tax equivalent PILOT as determined by the product of the total federal assessed value in that state and either the FHA effective rate for 1977 or, where available, the higher effective classified property tax rate. (*Table 23*.)

2. A 1978 FHA first-quarter-only effective rate of 1.56, which will yield a total of $3.3 billion.

3. The Census Bureau's figure of 1.8%—the median rate estimated for all federal property in the U.S. The yield would then be $3.8 billion.*

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*Regarding this latter point, if all exempt property were fully taxed, the overall effective property tax rate would presumably fall, particularly in jurisdictions heavily impacted by federal properties.

*The *1977 U.S. Census of Governments* computed the 1976 median effective property tax rate for each of the cities of 50,000 population or more for which a sufficient sample of measurable sales was available, a total of 492 local areas. The data showed a 1.8% effective rate for the group of "all types of realty." The data were not grouped by state or region; the median was derived from a national sample. The median rate was slightly higher in cities with less than 100,000 population, 1.9%, while cities over that population mark showed a lower median rate of 1.6%. See *1977 Census of Governments*, Vol. 2, pp. 25–28.

If these median rates are applied to the ACIR estimates of the value of federal real property, another estimate for federal PILOT liability can be derived for the U.S. as a whole and for the groups of urban counties and nonurban counties used in the ACIR data sets. The logic behind using different effective tax rates for each of the county data sets would be the assumption that nonurban counties would not include taxing jurisdictions with more than 50,000 or 100,000 population. Conversely, it would be assumed that most of the 315 central urban counties, which include all or major portions of each SMSAs central city, if not major portions of the SMSA itself, would represent those jurisdictions with populations larger than 100,000. To be sure, there would be some urban counties that would include cities within the 50,000–100,000 range, and would thereby be classified improperly, and understate PILOT estimates. However, when dealing with estimated valuations of this magnitude, the basic trends that are illustrated are important and it can probably be safely assumed that the "overstated" estimate rates and PILOTs from the nonurban counties would compensate.

The estimates that result from these comparisons are as follows:

Basic Data Set	Estimated Value of Federal Property	Effective Tax Rates	Estimated Federal PILOT Liability
	(dollar amounts in thousands)		
Phase II	$210,182,647	1.8%	$3,783,288
Phase III and Group I	228,754,323	1.8	4,117,579
Phase IV and Group II (urban counties)	90,685,911	1.6	1,450,975
Phase IV and Group III (nonurban counties)	138,067 ,412	1.9	2,623,281

The total PILOT liability yielded from the variable effective tax rates is only slightly smaller, $4,074,255 thousand, or a difference of $43,322 thousand from what was computed using a 1.8% overall effective tax rate. This difference is attributable to the approximate 40% central urban county/60% nonurban county mix of the federal property.

Table 23

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.

The amount of the PILOT using each of these alternatives is set forth in columns 1–3 of *Table 24*. As the table shows, the payment is computed for each of the alternative types of PILOT bases (Phase I through V–A and the military estimates)—although the focus of this discussion is on Phase II. Column 4 of the table presents the estimate assuming a 2.0% rate as a likely upper limit.

Three comments on methodology should be made regarding the ACIR judgment that the "best" rate for policy purposes is 1.74%:

1. As noted, the rate was essentially derived from the state totals presented in *Table 23*. Clearly, since the property tax is overwhelmingly a local levy (local governments account for 96.6% of the $67.6 billion in total property tax collections in 1978),[1] preparing state-by-state estimates of a tax equivalent PILOT is a risky business. Nonetheless, because of raw data constraints (there is no compendium of the effective rates of all local governments), the statewide rate data, which is a population-weighted average, is the most reliable disaggregation available short of a survey of all U.S. local property tax jurisdictions.

2. The basic source of the *Table 23* rates are the data compiled by the U.S. Department of Housing and Urban Development on average effective property tax rates for existing single-family homes with FHA-insured mortgages. Alternatively, another set of state effective property tax estimates can be obtained by using U.S. Census data by multiplying nominal tax rates by state times state assessment sales ratios. Both the FHA and Census numbers have, characteristically, some sampling errors built into them. Upon detailed examination of the nature of each of these data sets (FHA and Census), it was decided that the FHA data would be most useful for purposes here.

The use of FHA data to estimate a PILOT requires two assumptions. Not only are the effective rates on single family homes assumed to be representative of all real property in the state, including residential and commercial; in addition, the value of federal property is assumed to be distributed across the state's local property taxing jurisdictions in the same proportion as all the other property. The latter assumption permits the use of the same relative proportions of effective property tax rates throughout a state—no minor assumption.

Table 24

ESTIMATED PILOT PAYMENTS FOR EACH PHASE AND GROUP, BY VARYING NATIONAL EFFECTIVE TAX RATES (in thousands of dollars)

Phase and Group	FHA (1.56)	Census (1.8)	ACIR (1.74)	2.0
Phase I	$4,348,562.8	$5,017,572.4	$4,850,320.0	$5,575,080.5
Phase IA	3,260,691.8	3,762,336.7	3,636,925.5	4,180,374.1
Phase II	3,278,849.3	3,783,287.6	3,657,178.5	4,203,652.9
Phase IIA	2,190,978.3	2,528,051.9	2,443,783.5	2,808,946.6
Phase III	1,248,707.8	1,440,816.7	1,392,789.5	1,600,907.5
Phase IIIA	1,009,977.5	1,165,358.6	1,126,513.4	1,294,842.9
Phase IV	521,647.4	601,900.8	581,837.5	668,778.7
Phase IVA	423,525.1	488,682.8	472,393.3	542,980.8
Phase V	727,060.4	838,915.9	810,952.0	932,128.7
Phase VA	586,452.4	676,675.9	654,120.0	751,862.1
Group I*	2,319,859.0	2,676,761.0	2,587,535.7	2,974,179.0
Group II*	893,052.0	1,030,445.0	996,097.4	1,144,939.0
Group III*	1,426,791.0	1,646,297.0	1,591,421.0	1,829,219.0

* Totals include Army land.

SOURCE: *Tables 19* and *20*.

However, because of the prohibitive cost of reproducing and printing county-by-county PILOT data and the GSA's uncertain method of providing substate data on the cost of federal property, this assumption was accepted and its shortcomings simply acknowledged here.

Nevertheless, for at least two reasons, the assertion that the FHA rates are representative of those that would be applied to federal property for PILOT purposes is reasonable and workable. First, for those states using a uniform (nonclassified) property tax system, the law requires that the same nominal rate that is applied to FHA houses also be applied to commercial property—the type of "property" this report assumes federal holdings to be. The only problem here is that some homeowners in some states are the beneficiaries of two important tax relief devices which are unavailable to owners of commercial property—circuit breakers (in 30 states plus the District of Columbia in 1978–79)[2] and/or homestead exemptions (37 states and DC in 1979)—and have the practical effect of reducing effective tax rates on residential properties.[3] Thus, other things being equal, the use of FHA rates probably understates the cost of a PILOT in some states. The complete extent of this understatement is, however, not large. In 1977, total circuit breaker and homestead benefits were approximately $950 million and $880 million respectively, each less than 1.5% of total residential real property taxes collected for that year.[4]

Second, possible errors leading to an understatement of the effective rates to be applied to federal real property in the nine states plus DC, with a classified property tax in 1978, were minimized by obtaining (via direct correspondence) statewide estimates of the effective tax rates applied to commercial properties in four of the classifying states (Alabama, Arizona, Minnesota, and West Virginia). These classified effective rates were used in computing the numbers in *Table 23*.

3. Finally, it should be noted that in order to use FHA data for all but the four states that were able to supply data on their classified property tax, it was necessary to use 1977 rather than 1978 rates. The 1978 figures were simply not yet available. These 1977 rates (and, in some cases 1974 or 1975 rates—see *Table 23*, footnotes 4 and 5) were then applied to the 1978 federal tax base data; thus *Table 23* reads "1978." This use of rates for years prior to 1978 lends an upward bias to the PILOT estimates as U.S. property tax rates have been falling, not only between 1977 and 1978, but also throughout the second half of the 1970s.

PILOT AS A REPLACEMENT FOR CURRENT AD HOC PROGRAMS

The discussion in *Chapter 2* detailed a number of ad hoc federal payment programs that Congress has established over the years in order to compensate state and local governments for the fiscal effects of federal activities operating within their borders. However, because these programs are of an ad hoc nature, they can only be characterized from a national perspective as a patchwork of uncoordinated programs. Accordingly, one of the benefits to be derived from the enactment of a comprehensive PILOT, from a Congressional workload as well as economic policy view, would be the use of the uniform PILOT as an opportunity for rationalizing the entire federal payment program—that is, to enact the tax equivalency PILOT which would replace several of the existing ad hoc programs.

Three such replacement strategies should be considered. The first would be to eliminate all existing state and local receipts-revenue sharing and ad hoc in lieu of tax payments made throughout the U.S. in favor of the full tax equivalency PILOT applied to all federal real property.* This would mean eliminating the $2.04 billion of payments listed in *Tables 1* and *2* of *Chapter 2*—i.e., those payments and sharing programs that are targeted to "open-space lands" and, where applicable, "non-

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*The state *and* local recipient guideline is an important one if state/local sleight-of-hand is to be avoided here. Under the provisions of the *Payment in Lieu of Taxes Act of 1976*, the 1976 PILOT is reduced by any revenue from the public lands that is actually received by the unit of *local* government during the preceding fiscal year under nine existing land revenue-sharing payment plans. Since these provisions refer only to *local* government recipients, some states have been able to "double dip" by transferring the existing payment from their localities to the state, thereby eliminating the practical effect of the replacement provisions.

open" (urban and nonurban) properties alike.* This strategy is consistent in principle with that recommended by the Public Land Law Review Commission and the same as that recommended by the U.S. General Accounting Office.[5] According to *Table 24*, the gross cost of a full tax equivalency PILOT applied to all U.S. real properties would be approximately $4.85 billion if an average U.S. effective rate of 1.74% were employed. Thus, by elminating the $2.04 billion in current payments, the net cost to the U.S. Treasury from adopting this first replacement strategy would be $2.81 billion.

A second replacement strategy would be to replace only those current payment programs that are designed as compensation for real property taxes foregone. Under this strategy, the following types of programs would not be replaced or eliminated: those relating to Department of Interior land sales, excise tax sharing from federal sales of sport fishing equipment and from firearms and archery equipment and supplies; the annual "federal government payment" to the District of Columbia; and growth impact grants such as those made for those State of Washington counties experiencing increased infrastructure costs resulting from the buildups of the Trident submarine bases ($11 million).** The extra cost of not including these non*property* tax-related programs is small, relative to total net costs; however, the principle to be maintained by not replacing nonproperty-based payments is an important one, *viz*, a recognition that the real property base is not the only source of erosion of the state/local revenue system (see *Chapter 2* discussion).

The third replacement strategy (essentially that recommended by the ACIR) would be to enact a comprehensive property tax equivalency PILOT on only "nonopen space" properties—that is, on the tax base detailed in *Chapter 3*. This approach would mean taking a "hands-off" policy with respect to those payment programs already in place for the open-space (lands) programs enumerated in *Tables 1* and *2* of *Chapter 2*. Thus, current payment programs targeted to properties identified by the following usage categories would be maintained (i.e., would not be included in a tax-equivalency PILOT base): grasslands, grazing, forest and wildlife, reclamation and irrigation, mineral leasing, and national parks. Any nonproperty-related PILOTs, including (but not prospectively limited to) existing excise tax and land sales receipts-sharing programs, and the federal payment to the District of Columbia, would also be maintained. Thus, under this third strategy, the following programs are replaced with a tax equivalency PILOT:

Programs to be Eliminated	1978 Amount ($000)
Oregon and California Grant Lands	$ 106,045
Boulder Canyon Project	500
Colorado River Dam Fund	600
Columbia Basin Project	11
Trinity River Project	11
Federal Impact Aid (for education)	805,000
HUD Public Housing Authority	33,306
HUD Payments on Foreclosures	18,500
St. Lawrence Seaway Act	7
Veterans Administration Foreclosures	6,876
TVA Mitigation Payments	6,589
Atomic Energy Commission	8,500
Norris City, TN, Payments (TVA)	—
Total Replacement Savings	$ 985,945

NOTE: Data are for 1978. Total replacement savings in 1979 equaled $989,428 (including Norris City funding, which commenced in that year).

Using this strategy, the net cost of the PILOT is approximately $2.67 billion (1978).

Clearly, if any one of these replacement strategies is adopted, there will be some jurisdictions which, on balance, lose federal dollars. A few jurisdictions may find that the amount of

*Because of their nontax (or in lieu of tax) nature, the annual federal payment to the District of Columbia, in-kind payments of an administrative nature, loan guarantees and the like are not considered proper candidates for replacement under any of these three strategies.

**Included in this "open space" category as a nonreplacement item is $116 million in Community Energy Impact Funds (CEIF) made available in response to offshore energy facility impacts. These CEIF payments are considered in the nonreplacement category because their legislative intent was to provide for an in lieu property tax payment, a rationale that is accepted here but which seems rather questionable —particularly since $110 million of this is in the form of a loan guarantee.

education impact aid they receive—the single largest program to be replaced—is greater than its PILOT entitlement.

However, the vast majority of states and localities will be net gainers under any replacement, for two reasons. *First*, many of the current PILOTs being replaced are flat sums subject to negotiation. The PILOT proposed here, however, would exhibit the same general magnitude of revenue elasticity as the real property tax. *Second*, and obviously most important, is the simple arithmetic, which shows that in the aggregate the PILOT will add federal dollars to state/local treasuries.

FOOTNOTES

[1] Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism, 1978–79 Edition*, M–115, Washington, DC, U.S. Government Printing Office, 1979, Tables 28, 33, pp. 44–45, 52–53.

[2] ACIR, *Significant Features, 1978–79*, *op. cit.*, p. 63.

[3] For complete discussion of these issues, see Steven David Gold, *Property Tax Relief*, Lexington, MA, D.C. Heath and Co., 1979, Table 4–1, p. 83. Gold argues that such homeowner preferences are a backdoor-form of classification.

[4] *Ibid.*, pp. 13 and 21, and *Significant Features, 1978-79*, *op. cit.*, pp. 45 and 52.

[5] *One Third of the Nation's Land*, *op. cit.*, Chapter 14. The commission also recommends a public benefits discount of at least 10% but not more than 40%. Also, U.S. General Accounting Office, *Alternatives For Achieving Greater Equities*, *op. cit.*

Witness Statements

On June 19, 1980, the Advisory Commission on Intergovernmental Relations held a public hearing on payments in lieu of taxes. The names and formal statements of the witnesses who testified follows.

D.H. Clark, Assistant Director, Federal-Provincial Relations Division, Department of Finance, Government of Canada.

Charles M. Stephenson, formerly Chief, Government Research Division, Tennessee Valley Authority.

Robert W. Rafuse, Jr., Deputy Assistant Secretary for State and Local Finance, U.S. Department of the Treasury.

Kenneth W. Hunter, Senior Associate Director, Program Analysis Division, U.S. General Accounting Office.

Richard J. Davis, Mayor of Portsmouth, VA.

Jerry K. Emrich, County Attorney for Arlington County, VA.

STATEMENT OF

D.H. Clark,

ASSISTANT DIRECTOR, FEDERAL-PROVINCIAL RELATIONS DIVISION, DEPARTMENT OF FINANCE, GOVERNMENT OF CANADA

I have been asked to provide the Commission with a description of the Canadian system of grants in lieu of property taxes. It is an honour and privilege for me to be asked to do this. The remarks which I make are personal and should not be attributed to the Government of Canada.

The property tax in Canada fulfills a function closely similar to that of the property tax in the United States. That is to say it is the mainstay of local government, and is the prime source of financing municipal and school services—along with grants from provincial governments.

The property tax is presently the fourth largest tax levied by governments of all levels in Canada, exceeded only by the personal income tax, corporation income tax, and general sales tax. In 1980 it will yield close to $10 billion, in an economy that is about one-tenth as large as that of the United States. Of this amount, over 98% will go to local government and less than 2% to provinces. The provinces control the property tax and have established a very strong system. As one example of this, there are almost no special property tax concessions for private industry in the whole country.

The property tax accounts for approximately 75% of total local government revenues from own sources. While I refer to the property tax in the singular, this is actually a family of taxes which are all related to real property. Approximately 85% of total property tax revenue in Canada comes from the well-known real property tax, an annual levy on owners of real property. The balance comes mainly from the business occupancy tax, which is a tax levied on the occupant of property used for business purposes. The latter tax accounts for approximately one-eighth of total property tax revenues, and appears to be a rather unique Canadian contribution to the property tax family. We also have local improvement taxes and a number of miscellaneous, small, property taxes but no personal property tax.

The largest property owner in Canada is the federal government. However, the federal government's holdings appear to be somewhat less, in relative terms, than those of the United States government because the public domain in Canada belongs to the provinces rather than the national government, and because our defence properties, while important, are obviously of less significance than those of the United States.

Property belonging to the Government of Canada, and to provincial goverments as well, is exempt from taxation by virtue of a specific and very clearly worded provision of the Canadian Constitution, which states that "No lands or property belonging to Canada or any province shall be liable to taxation." However, the government of Canada began making payments in lieu of property taxes in 1950, with the present legislation having last been amended in 1957. To my knowledge, it was the first jurisdiction in North America to do so. However, we were preceded by the United Kingdom in 1874 and, possibly, by other countries as well.

I would like to describe how the federal grant system works and then make some comments about the rationale which underlies these payments. I will focus on grants in lieu of the real property tax as this is much the most important property tax in Canada. In so doing, I will make some references to legislation that is presently before the Parliament of Canada, known as Bill C-4—the "Municipal Grants Act, 1980" which, if approved, will enlarge and update the program.

The Canadian system is based upon the concept of full tax equivalency. That is to say, while the payments are grants, they are intended to be the same in amount as if they were actual tax payments. Equivalency is achieved by two simple steps. First, federal property is to be valued as if it were taxable property. Second, the rate of tax to be applied to the value of federal property to calculate a grant, is to be the rate of tax that would be applicable to federal property if it were taxable property. There are a few exceptions to these simple concepts but they will be effectively removed by Bill C-4.

The properties in respect of which grants are

paid are defined in the Municipal Grants Act. In other words, the government has not provided that it would pay grants in respect of any property that would be taxable if it were privately owned. The properties in respect of which grants are now paid include office buildings, post offices, defence properties of all kinds in urban areas, defence housing accommodation and land in rural areas, research laboratories, airports, penitentiaries, experimental farms, warehouses, marine properties, training schools, veterans' hospitals, customs stations, police detachments, and vacant land. Some of the properties on which grants are paid—such as hospitals and schools—are normally tax exempt when owned by someone other than the federal government.

Bill C-4 will bring a number of categories of property into the grant system for the first time. This will include national parks, defence buildings in rural areas that are now excluded, the Parliament Buildings, museums, libraries, art galleries, concert halls, conservation projects, and reclaimed lands.

As a result of these changes, grants will be paid on all federal real property holdings other than structures, Indian reserves, and urban park lands. This is a very short list of exclusions. However, the exclusion of structures removes from the grant system such items as docks, piers, breakwaters, jetties, storage tanks, canal locks, and aircraft runways and is a significant limitation because many of these items are taxed in some jurisdictions.

Some of the properties are to be brought into the grant system gradually, by a phase-in process, which I would strongly recommend to other jurisdictions that are interested in introducing a system of grants in lieu of taxes. In the case of Bill C-4 the government is using a four-year phase-in for major new inclusions in the grant system, such as national parks.

The total cost of the matured grant system at the end of the four-year phase-in period, in terms of 1980 dollars, will be approximately $175 million. Payments are made to more than half of Canada's 4,200 municipalities. These numbers refer to the properties of government departments. A further amount of at least $110 million is presently paid by federal corporations, or Crown corporations, as we call them. In addition, there is in place a system of federal grants in lieu of real property taxes on diplomatic and consular properties of foreign governments. As a consequence, Bill C-4 will result in a comprehensive system of grants in lieu of taxes which will be approaching $300 million a year.

Responsibility for administering grants on departmental properties was recently transferred to the Department of Public Works from the Department of Finance. Public Works is responsible for managing much of Canada's real property holdings. The grant program is presently administered by a staff of 29, of whom 16 are professional real property assessors. Their task is to examine the values of federal property placed by local assessors, with a view to establishing that it has been valued "as if it were taxable property," as required by the federal act. This is the key element of the administrative process.

It sometimes happens that there are differences of opinion concerning the value of property that is subject to grant. Where this occurs, discussions take place between federal and local assessors with a view to resolving the differences. Usually differences can be resolved, but where this cannot be done, the federal government reserves the right to establish its own values. Some of the properties which have to be valued are, of course, very complex and it may be impossible to find comparable taxable properties to be used as a guideline for arriving at value. In such instances, it is necessary to ascertain the average level of assessment for taxable property of a comparable category. I can assure you that the valuation problems, while difficult, are manageable.

It is fair to say that the federal program of grants in lieu of taxes has enjoyed considerable success over the 30 years that it has been in operation. Few programs have lasted as long and it appears to be a permanent element of intergovernmental relationships in Canada. Nine of the ten provinces have followed the federal example and pay grants in lieu of taxes on their own properties. In 1980, for the first time, the grants paid by the provinces collectively will exceed those paid by the federal government. The increase in provincial grants is largely attributable to a spectacular expansion of the grant system by the Province of Quebec through legislation enacted in Decem-

ber 1979. This legislation removes virtually all restrictions on Quebec's grant system, and therefore goes beyond what the federal government will do even with the recently proposed enlargement.

The bill, which is now before the Parliament of Canada, indicates the broad degree of support in Canada for a system of grants in lieu of taxes. The bill received second reading in the House of Commons on May 20, and 15 members of Parliament, from all three parties, represented in the House, participated in the debate. There was no criticism of the principle of having the government pay grants in lieu of taxes. However, a number of speakers expressed regret that the measure could not go even further so as to remove remaining restrictions on the grant program. These restrictions relate to the nonpayment of grants on structures and urban park lands, the exclusion of business occupancy taxes from the grant system, the lack of an appeals procedure, and the nonpayment of interest where grants are paid after tax due dates.

Before turning to the rationale behind our grant system, I would like to note two related aspects of the program. First, the payments are unconditional. That is to say there are no conditions imposed on the grant-receiving bodies. Second, the payments apply to the City of Ottawa, which is the national capital, and provide the only important, regular means of federal financial support for that city. This greatly simplifies relations between the national government and the national capital and is clearly in sharp contrast to my understanding of the situation which prevails in Washington, D C At the federal end, our grant to Ottawa is administered, in a typical year, by the equivalent of about two person-years, and I would think that there is a similar involvement on the part of the city—including the assessment staff who, in this case, are employees of the Province of Ontario.

This method of support for the City of Ottawa not only has the virtue of simplicity but also of certainty. By certainty, I mean that the City of Ottawa usually knows, within a margin of less than 1%, what its federal grant will be, and it knows this at the beginning of its fiscal year as soon as it has struck its tax rate. This has proved to be a good arrangement for the federal government as well, because the amount of payments is determined automatically by a formula. While the grant can go up sharply in any given year if city council makes a sharp increase in its tax rate, this can only be done if private citizens are subject to the same rate of tax increase.

This brings me to the rationale for the grant system. In a fundamental sense, the rationale for paying grants is that federal property in Canada receives very valuable services from local government. Hence, in a broad sense, it is the benefits-received principle. It is not the ability to pay principle which, in my view, cannot appropriately be applied to governments. The principle of benefits received would be less important if federal property were uniformly distributed about the country but, of course, this is not the case.

While benefits received is the basic rationale for a system of grants in lieu of taxes, it cannot be applied to properties on an individual basis. Theoretically, this might be possible; but a program based upon this concept would be difficult to administer, a source of endless controversy, and would lack public credibility. As a consequence, we are forced to the conclusion that benefits received can apply only in an aggregate sense. For individual properties, we must fall back upon the principle that a government should put itself in the position of an owner of private property. This principle has gained an extraordinary degree of acceptance within Canada. This principle emphatically rejects the notion that a federal government, or anyone else, warrants tax exemption on the grounds that it brings particular benefits to a municipality when it locates there. I, personally, find such a notion repugnant because, if you think about it, it clearly implies that a millionaire should be exempt from property tax on his residence.

The principle that government should put itself in the position of a private taxpayer can be applied in full—to all properties and all types of property tax—or, as the federal government has done, to a wide range of properties, and to most types of property tax.

Finally, there are two other important rationales for a system of grants in lieu of taxes. First, a system of grants in lieu of taxes embraces the concept of neutrality between the public and private sectors of the economy, and inhibits

undue expansion of property ownership by the public sector by raising the cost of ownership so that it is comparable to private sector cost. It also achieves neutrality within the public sector in respect of the choice between owning and leasing real property.

Second, a system of grants in lieu of taxes will strengthen a valuable national asset, which is the property tax institution. We all know that one tax exemption begets another, and leads to a vicious cycle of tax base erosion. A system of grants in lieu of taxes is a strong and high profile step in the opposite direction. A strengthened property tax will, of course, strengthen an even more available institution, that of local government itself.

STATEMENT OF Charles M. Stephenson,

FORMERLY CHIEF, GOVERNMENT RESEARCH STAFF, TENNESSEE VALLEY AUTHORITY

I appreciate the opportunity to appear before you today.

Introduction

I think that the ACIR staff has done a superb job in preparing the report under discussion at this hearing. It is comprehensive; it analyzes the present problems clearly; and it sets out the pros and cons of possible alternatives with careful consideration. Now you have the task of formulating the Commission's policy position, and deciding upon official recommendations for action.

Whatever weight you might give to my views and opinions in this regard must depend, I believe, on your assessment of my qualifications for reaching my own judgments and recommendations. Hence, with your indulgence, I shall briefly review my professional background and experience which form the basis for rather strongly held opinions, to be expressed later.

Background

I was trained in public finance and taxation at the University of Kentucky graduate school under the distinguished Professor, James W. Martin.

I joined the fledgling Tennessee Valley Authority in 1934, and immediately started work on research concerning the growing tax loss problems and state-local governmental relationships faced by that agency as reservoir lands and electric utility properties were being acquired and removed from the tax base. I participated in drafting the amendment of Section 13 of the *TVA Act*, which was passed in 1940 and established a new basis for TVA payments in lieu of taxes on its power properties and operations. I then supervised the administration of TVA payments from fiscal year 1941 to 1975, when I retired from the position of Chief of the Government Research Staff in TVA.

Either as a TVA representative or, since 1975, as a sometime consultant to ACIR, I have had a part in every significant study of the problem of federal tax immunity and payments on federal property since World War II, excepting only the GAO report of 1979. These have included the Hoover Commission studies; the Bureau of the Budget study of the early 1950s; the Kestnbaum Commission reports of the middle 1950s; the Public Land Law Review Commission report of 1970; the 1978 ACIR report (A–68) relating to open-space lands; and the present study of nonopen space federal real properties. (These several reports are more particularly identified and summarized in the ACIR staff study under consideration here.)

Moreover, I have carefully read every one of the reports just referred to; and I daresay that I am as familiar with the extant literature on this subject as any person around. The reason for this specialization is that it has literally been part of my lifework as a professional in government service. Thus I speak from long observation and experience both as a researcher and as a TVA administrator.

When I first began the study of federal tax immunity and payments on federal properties

some 45 years ago, the matter was analogous to a cloud on the horizon no bigger than a man's hand. But then came World War II. And when we in TVA prepared and submitted to the Congress in 1944 a report on Section 13 of the *TVA Act* and payments thereunder during the first four years of operations following passage of the 1940 amendment, federal property ownership and activities had been greatly expanded (and were still growing rapidly), and tax loss problems had intensified. This wartime change was reflected in TVA then; and postwar developments have been even more significant throughout the federal government.

Sometime in the 1950s, recognizing that the TVA system of payments no longer fitted the new circumstances that had developed since the payment statute was revised in 1940, I prepared a brief analysis of the situation, including possible approaches towards improvement, and proposed that a careful study of the matter be undertaken by TVA. My modest proposal was blocked by higher level administrators and lawyers in TVA. Later on, as actors changed in the TVA hierarchy and the climate appeared more hopeful of success, I renewed my suggestion from time to time but it was always turned down. (I should point out there that the TVA Board never had an opportunity to consider and decide on this matter. Under TVA procedures—as is common in government circles—such proposal had to be submitted upwards through administrative channels after internal staff coordination, and the cutoff could operate anywhere along the line.)

I think that this experience within TVA is typical of federal departments and agencies. Responsible high-level officials generally prefer to cope with existing problems as best they can, rather than opt for change and fly to possible ills they know not of. Thus it is hard for a government agency to anticipate developing problems and try to forestall them if it might require statutory changes. The don't-rock-the-boat syndrome is very compelling, and positive action usually occurs only in response to overwhelming pressures from outside. Incidentally, I think that lawyers in the government service wield an overly strong influence in this regard—and I make this comment despite the fact that I have many lawyer friends, and even a lawyer daughter. (We argue good naturedly about the lawyer's proper role.) Too often, in my view, the lawyer in government *makes* rather than advises on policy.

The Basis for Policy Formulation

If I have learned anything of value from my long experience of working in the vineyards of government, it is that the validity of theoretical underpinning is crucial to the soundness of any public policy and governmental action. Faulty rationale and an illogical conceptual framework can only lead to questionable policy and unsatisfactory operating results in the long run. While conditions can change and new thinking may eventually point the way towards policy revision, each step of policy formulation and action along the route should be predicated upon the soundest possible base apparent at the particular time.

The mere greasing of squeaky wheels is not, in my view, a proper basis for governmental policy. Yet, the recent proliferation of ad hoc payments by various departments and agencies is a manifestation of just that expedient approach to the problem of federal tax immunity.

In one case that has come to my attention, a federal agency has entered into an agreement with a state whereby the state has promised to return its payment in lieu of taxes—legally due under present statutory provisions—in exchange for a larger payment, equivalent to real taxes on a private enterprise, to be channeled through a third-party operations contractor acting on behalf of the federal entity. Such offbeat arrangements are likely to increase as state and local officials come to realize the strength of their bargaining position in the face of federal agency efforts to secure desired benefits from the states and localities. State and local control over certain types of regulatory authority and many public services gives them a strong hand in such negotiations—and they are learning to use this newfound clout.

The Choice of Policy

I come now to the heart of the problem now faced by this Commission; namely, the choice of policy for determining recommendations for action. Once the policy questions are decided, the approriate recommendations will follow almost as a matter of course.

What are the real policy alternatives for the "tax" treatment of federal owned nonopen space properties? The staff report has explored these various possibilities in ample detail. Suffice it to say now that, broadly speaking, the issue boils down to a choice between two alternatives: either change to a general system of tax equivalency for federal properties, or continue with the hodgepodge of payments represented by the status quo.

The detailed arguments for and against each of these alternatives have been clearly set out in the staff report and need not be repeated here. But, in my opinion, this decision cannot be founded upon purely objective criteria. The final choice must rest, in a sense, upon a value judgment which is essentially political in character. Which policy is the simplest, the most equitable, and also feasible of administration? (I note here that "simplest" is not the same as simplistic, which, in my thinking, is closer to half-baked.)

From the standpoint of simplicity and understandability, tax equivalency has the great advantage of being closest to the general system of *ad valorem* taxation—one of the oldest types of taxes, and still the greatest revenue producer for the state and local governments in the U.S. (I do not advocate outright abrogation of the principle of federal property tax immunity—mainly for political reasons.) Given that the revenue loss problem under consideration has its roots in the immunity of federal property from state and local taxation; then it seems to me that the obvious remedy is for the federal government to make payments on its property equivalent in amount to what the actual taxes might otherwise be except for the legal doctrine of intergovernmental tax immunity.

In terms of equal treatment of like properties similarly situated, tax equivalency is the only approach which seems to fill the bill in the context of the ubiquitous general property tax. An in lieu payment system based upon other methods of determination inevitably leads to erratic results hard to justify on grounds of equitable treatment, whether from the property standpoint or that of the recipient units of government.

It should be remembered that both the Public Land Law Review Commission (PLLRC) report of 1970 and the recent GAO report recommended the tax equivalency approach for payments on federal property. While it is true that these studies were concerned primarily with the treatment of federally owned open-space lands, the arguments they advanced in support of such policy are even more compelling, I believe, when applied to urban-type properties.

I note also that the PLLRC equivocated somewhat in taking its stand, in contrast to GAO's more forthright position; but I ascribe the former Commission's hesitancy to the political temper of the times in conjunction with its concern for the problem of administrative feasibility. However, conditions have changed over the last ten years, and state-local property tax administration has greatly improved—as shown by ACIR's own studies. Therefore, the GAO indicated no qualms over the matter of administrative feasibility of a system of tax equivalency payments for federal properties—and I share their confidence on this score.

Looking now at the findings and conclusions of the ACIR report before us, I agree fully that ". . . the appropriate federal policy response [to the unsatisfactory *status quo*] would be to authorize either direct local taxation of federally owned and used real property or enact a uniform system of payments in lieu of taxes based on full tax equivalency." (Draft Report, p. 41.)

Time For Action

Mr. Chairman, I feel that the time has come for definitive action on this long festering problem of intergovernmental relations. The matter has been thoroughly studied. One might say that it has almost been studied to death. There is no need for more analysis or gathering of additional information. What is called for now is for those in responsible positions in government, including this Commission, the executive Administration, and the Congress, to screw up their political courage and say, in effect, "This is the way to go."

The risk of bureaucratic procrastination is perhaps illustrated by the case of the National Forest revenue sharing payments. After long years of complaint by county officials, the Forest Service finally arranged in 1975 for a study of the problem by ACIR. (Later the study was

broadened to cover all open-space lands held by the federal government.) But by 1976 the pressures by the National Association of Counties and others on the Congress had become overwhelming; and the *Payments in Lieu of Taxes Act of 1976* (P.L. 94–565), establishing a new system of payments for nearly all federal open-space lands, was passed before ACIR could finish its study. Consequently, the previous hodgepodge of revenue sharing payments was made even more complex by over-layering with a new system of per acre payments, modified by offsetting credits, minimums, and maximums. It is little wonder that the GAO last year found the combined system to be virtually impossible of accurate and equitable administration.

Conclusion

In conclusion, I believe the time has finally come for action on the problem of tax immunity of federal urban-type properties. The matter has been amply researched; adequate information has been assembled; alternative policies have been fully analyzed; and now the hard policy decision must be made. Do we or don't we opt for a sensible and broad coverage system of tax *equivalency* payments in place of the confused, hit-or-miss conglomeration of payments and exemptions now prevailing? I strongly urge the desirability of order and consistency. I hope you will agree with that view, and that you will recommend appropriate legislative action to achieve it.

STATEMENT OF

Robert W. Rafuse, Jr.

DEPUTY ASSISTANT SECRETARY FOR STATE AND LOCAL FINANCE, U.S. DEPARTMENT OF THE TREASURY

This ACIR study is the most thorough and comprehensive treatment of the immunity of federal real property from state and local taxation that has yet been performed. Its attempt to present a balanced view is impressive, and it breaks new ground, particularly with respect to the inventory of federal real property and in its attempt to develop ways of evaluating federal property. I compliment the authors on an excellent effort.

Considerations of both equity and efficiency argue for the undesirability of the federal immunity, given the predominant role of the real property tax in local government finance. These considerations argue for the taxability of all real property, including federal, state, and all types of private property. They are the same considerations that argue for the inclusion of all types of consumption expenditures in the base of a sales tax, and for a true "accretion" concept as the base of an income tax.

However, equity and efficiency considerations are persuasive arguments only in the abstract. In the instant case, they would be conclusive only in an ideal world, one in which, for example, all real property—regardless of ownership—were subject to taxation on an equivalent basis, and other flows of funds, exemptions, and immunities were not major features of our intergovernmental fiscal system. Unfortunately, we do not live in an ideal world.

The world of 1980 is one characterized by myriad deviations from the ideal:

- an extraordinarily complex set of exemptions from taxation of numerous types of real property; exemptions that vary significantly from state to state and locality to locality within states;
- many forms of state and local immunities from federal taxation;
- deductibility from federal income taxes of a number of types of private tax payments to state and local governments;
- the exceptional variety of federal grant-in-aid payments to state and local governments for purposes ranging from the sublime to the trivial; and
- a complex of 57 ad hoc federal programs that pay as much as $2 billion in one form or another of compensation to state and local governments for the immunity of federal property from taxation.

In such a world, concepts of equity and effi-

ciency can offer important guidance on the directions of desirable change. But they cannot be presumed to dominate all other considerations. Decisions on the desirability of a payment in lieu of taxes system or termination of the immunity of federal property cannot be reached independently of the overall current state of the intergovernmental fiscal system in the United States.

The equity argument, for example, suggests that the federal government should be contributing to the payment of the costs of local and state government on a par with the contributions of the private sector, as measured by the market value of real property owned—to the extent that real property is the only or predominant measure of an appropriate contribution. Can anyone doubt, however, that the federal government's contribution of unrestricted funds to the support of state and local governments under the revenue sharing program alone ($6.85 billion per year) exceeds its potential liability for property taxes (estimated in the Commission's study at $3.7 billion per year)?

The overall magnitude of the contribution cannot obscure the fact that revenue sharing is paid only to general-purpose governments, and that other discrepancies between the locations of property values and allocation of revenue sharing no doubt exist. The point may be made in the most practical possible terms, however, by asking whether state and local governments, as a group, would swap $3.7 billion in revenue sharing payments for termination of the federal tax immunity and the panoply of ad hoc compensation programs.

The hard reality is that we do not know how the distribution of federal real property values compares with the allocation of revenue-sharing payments, or how either compares with the overall incidence of federal grant-in-aid payments to state and local governments, to say nothing of the incidence of other tax immunities, exemptions, and deductions. How, then, can we be sure that, from the perspective of some global equity concept, the adoption of a single system of in lieu payments or termination of the tax immunity of federal property would produce a more equitable distribution of federal payments to state and local governments?

On an even more practical note, one might even ask how—in an age when policy is never made out of the sight of the computer printout—the Congress could be expected to approve either of the report's policy options on the immunity issue in the absence of anything approximating estimates of the distribution of the gains and losses from whatever package of policy changes might be proposed.

Even if the desirability of a PILOT were to be conceded, such a program could prove exceedingly difficult and costly to administer. The magnitude of the problem of evaluating federal property is staggering. Even with the contribution the ACIR's study makes to developing current value estimates, major inequities are likely to result to the potential detriment of the federal taxpayer. In fact, it may be on administrative grounds that the recommendation for a PILOT is most vulnerable, at least from the federal government's point of view.

- To the extent that a property tax is based on the value of the property, which reflects the capitalization of an implicit or explicit stream of earnings, the property's use and, therefore, its value is reflected in its market price in the private sector. As a public facility, its current market value or price reflects its potential use in the private sector, but generally not in the public sector. Appropriate assessment, either by the federal government or by local assessors, would generally not be impossible, but enough cases of problems would remain to plague the assessors.
- While much progress has been made, many states and localities still have a long way to go in developing practical and acceptable methods of evaluating their own structures and land, much less those of the federal government. State oversight of local property tax administration is not yet adequate, despite major advances in recent decades. The result could be extensive litigation and appeals, based on major differentials in evaluation from locality to locality, and from state to state.
- The potential bureaucratic and adjudication problems arising from local assessment of federal real property must be

viewed as both complex and substantial, and almost surely not worth the trouble, given the marginal dollar increase in federal payments that might result.

In conclusion, I am opposed to a federal PILOT program and termination of immunity on the basis of the above conceptual, budgetary, and administrative grounds. While the ACIR study is a major contribution to the discussion of the matter, it does not conclusively resolve many major issues and problems.

I have no problem with the recommendation for improving the federal inventory of real property regarding current value, consistent reporting requirements among agencies, and improved recordkeeping, if the additional cost would be reasonable. However, if the primary rationale for changes in existing procedures is the establishment of PILOT, these changes may not be necessary. The General Services Administration already has extensive detailed information on federal real property, though it is imperfect in the many respects noted in the report. The ACIR findings do not necessarily require the recommended changes unless, or until, a PILOT program is enacted. To the extent that the ACIR's recommendations will contribute to improved policy decisions regarding the uses of federal real property, however, changes in GSA practices are almost surely in order.

The report notes that "no state provides for a comprehensive approach to the immunity issue." Is this not an ideal candidate for state pioneering of an innovation in intergovernmental fiscal relations? I would urge the Commission to focus its recommendations in this area on state policy—to recommend that at least one state adopt a comprehensive policy of the sort comprehended in the draft recommendations for the federal government. Many of the practical, administrative issues could be thoroughly explored in a state effort, and the lessons learned could be invaluable in the design of an appropriate federal policy should the time for the idea ever arrive.

In this connection, I am perplexed by the draft recommendation that the Congress "authorize" a system of federal in lieu payments or taxation of federal property, but that "each state *examine* its own real property tax immunity and *consider* authorizing a program . . . ." This strikes me as a cart-before-the-horse situation. I do not understand why the states should not be called upon to undertake the initial innovating and the federal government to do the examining and considering, based on the results of the state experience, in the spirit of that process of innovation that is such a venerable tradition in our federal system.

STATEMENT OF

Kenneth W. Hunter

SENIOR ASSOCIATE DIRECTOR, PROGRAM ANALYSIS DIVISION, U.S. GENERAL ACCOUNTING OFFICE

I am pleased to appear before you today to discuss our work on land payment programs. I will summarize the information presented in our report "Alternatives for Achieving Greater Equities in Federal Land Payment Programs" (PAD-79-64 dated September 25, 1979) and then comment briefly on your Commission's study.

Results of Existing Land Payment Programs

A variety of land payment programs have evolved over the years to compensate states and counties for the tax exemption of federal land within their jurisdiction. We reviewed the operations and results of 11 programs that cover about 760 million acres and made $610 million in payments in fiscal year 1978. Our field studies were conducted in eight western states where about 80% of the payments were made.

We examined the combined results of these 11 programs in order to assess the reasonableness of their compensation. Ten of the programs are designed to share the federal receipts from timber sales, mineral leases, and grazing

fees. Public Law 94-565, the 11th and newest of these programs, was enacted to compensate counties from appropriated funds that were considered to be inadequately compensated under existing receipt-sharing programs. To minimize overcompensation, however, the act's payment formula provides that maximum acreage payments will be reduced by selected receipt-sharing payments that are received by the local governments under the other ten federal programs. Thus these 11 programs are now interrelated through the P.L. 94-565 program.

We found many inequities and inconsistencies in the operations and results of these 11 programs.

- First, although the basic aim in enacting these programs was to compensate states and counties for lost tax revenues and the economic burdens of tax exempt federal land, as the programs have been designed and implemented they pay states and counties a percentage of the annual federal receipts generated by the land rather than equivalent taxes that would have been paid if the land were privately owned. For six states and their counties, for which we were able to make a comparison, we estimated that in 1978 they received $213 million in federal land payments which was $187 million, or about 87% more than they would have received on a tax equivalency basis.
- Second, since each program has its own percentage for receipt-sharing, ranging from 5% to 90%, and there are variations in land productivity, some local governments received large payments while others received little or no payment. For example, under the mineral royalty program, states and counties can receive both federal payments and taxes. The federal government rebates 50% of the total mineral royalty revenues to the state (Alaska receives 90%) where the public lands generating the revenue are located. Notwithstanding these royalty payments, the leaseholders often pay the same states severance and county property taxes on their oil and mining operations, the same as they would pay if the operations were on private lands. This was the case in most of the states covered by our review. Thus, while states and county governments in these states lost nothing in oil and mineral taxes from leaseholders, they also received 50% of federal mineral royalty receipts and at least a minimum payment under P.L. 94-565.
- Third, the states can influence the size of the payments to their counties under P.L. 94-565 by the way they distribute the receipts they receive under the other programs. The P.L. 94-565 payments are reduced by only the receipts passed through directly to the counties; if they are passed to an independent school district or used by the state to provide services to the counties, they need not be deducted. There is no consistency among states in the proportion of payments which are passed directly to counties and are therefore deducted in computing P.L. 94-565 payments. In the eight states we reviewed, for example, the amount of receipt-sharing payments passed through to counties varied from 3% in Nevada, New Mexico, and Utah to 75% in Oregon.
- Fourth, administrative problems in dealing with 11 programs and several thousand political entities have also added to the inequities and inconsistencies. The particular problems include inaccurate state reports on receipt distribution, inaccurate acreage data from federal agencies, initial uncertainty about the deduction of payments to independent school districts, and difficulty in making corrections for erroneous payments in prior years.

In view of these problems with the existing programs, we analyzed alternative approaches. I have attached to my statement a table from our recent report which outlines the criteria we used, the options we evaluated, and the results of our analysis.

Based on our findings regarding the existing programs and the analysis of alternatives, we have recommended that the Congress use tax equivalency as a basis for these land payments. We also recommended the elimination of the permanent authority to automatically use the federal receipts generated by these programs,

EVALUATING FEDERAL LAND PAYMENT OPTIONS

Criteria / Options	Tax Equivalency	Fee Per Acre	Receipt-Sharing	Receipt-Sharing Plus Fee Per Acre	Fee for Service	Fiscal Impact of Federal Ownership	Imposed Expenditures	Comparable Tax Burden
1. Legislative Requirements								
a. Plan related to program intent?	Yes	No	No	Somewhat	Somewhat	Yes	Yes	Yes
b. Congressional intent clear?	Moderately difficult	Very easy	Yes	Needs careful wording	Needs careful wording	Very difficult	Very difficult	Very difficult
2. Uniformity								
a. Payments determined uniformly?	Yes	Depends upon payment schedule	No	Depends upon payment plan	Yes	Yes	Yes	Yes
b. Consistent principles and procedures?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
3. Congressional Control								
a. Budgetary control maintained?	Depends upon implementation	Yes	No	Receipt, sharing, no; fee, yes	Depends upon implementation	Probably not	Probably not	Probably
b. Manipulation of payments possible?	Depends upon implementation	No	No	No	Depends upon implementation	Probably not	Probably not	Probably not
4. Federal Administrative Requirements								
a. Data available on time?	Yes	Yes	Yes	Yes	Probably	No	No	Perhaps
b. Audit authority identified?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
c. Economical and easy to administer?	Probably costly	Very easy and economical to administer	Yes	Yes	Probably costly	No	No	No
5. Recipient's Administrative Requirements								
a. Advance payment estimates provided?	Very likely	Yes	No	No	Yes	No	No	No
b. Payments timely?	Yes	Yes	No	Receipt, sharing, no; fee, yes	Yes	Yes	Yes	Yes
c. Payments stable?	Depends upon stability of taxes	Yes	No	No	Depends upon services provided	Probably	Probably	Probably

SOURCE: U.S. General Accounting Office, *Alternatives for Achieving Greater Equities in Federal Land Payment Programs,* PAD–79–64/, Washington, DC, U.S. General Accounting Office, p. 48, Table 10.

the setting of expiration dates for each program, and the setting of distribution totals through periodic appropriations action. We recognize that it would be very difficult for the states and counties if these payments were eliminated all at once; therefore, we recommended a phasing out of the programs over several years.

In reaching our conclusions, we gave emphasis to the need for standards for measuring a program's effectiveness and equity. Therefore, we were particularly concerned with the relationship between the program's intent and the payment method. Our views on these relationships are presented in the following table.

If the program rationale is,	*then the payment method should be*
The tax immunity of federal lands	Tax equivalency
A business partnership between federal government and states and local governments	Receipt sharing
To reimburse local governments for the added costs incurred	Fee for services
To offset fiscal impact	An estimate of fiscal impact or imposed costs
A compromise to meet a payment obligation by a simple administrative method	Fee per acre

Since tax immunity is the expressed Congressional rationale given the greatest weight for the programs we examined, tax equivalency is our preferred payment method.

We are pleased that the Department of the Interior concurs with our findings. In addition, as a result of our report they have taken action to correct underpayments totaling $12.6 million and to recover overpayments of $1.1 million.

ACIR Staff Studies

The ACIR has conducted two studies—one of "open space" federal land which addresses the same type of range, mineral, and timber land we reviewed and a current study of "nonopen space" federal real property which addresses the land and structures owned by the federal government and used by it for such purposes as offices, bases, hospitals, airports, roads, bridges and tunnels, railroads, and more.

Your staff study on "open space" federal land concludes that the payment methods should continue as is—in short, that these lands not be put on a tax equivalency basis. We came to the opposite conclusion.

Your staff study on "nonopen space" real property concludes that tax equivalency is the preferred basis for all such property. Since we have not made a detailed study of these programs, we are not in a position to comment except in very general terms. Nor are we able to use the analysis we made of open-space land to automatically conclude that tax equivalency should be used for all classes of real property. In fact we may very well reach different conclusions for some classes. There are several factors that we would want to consider further:

- First, the open space federal land is being used or could be used for the same commercial purposes as the adjacent privately owned land—grazing, timber, and mineral extraction. Since the uses or potential uses are the same, the basis for determining tax equivalency is clear. However, the nonopen space real property includes a number of classes of property used for a wide range of purposes; and for many of these there are no similar commercial properties such as military bases.
- Second, the federal government's relationships with states and local governments are different from those of a private owner of property. For example, it has taxing powers, it provides for the common defense, and it maintains the post offices and post roads. While the Commission's staff study recognizes these factors, we would likely give them greater weight.
- Third, the degree to which any class of federal real property is an asset and contribution to a local government or is a liability and burden varies among classes, from one time to another, and among different parts of the country. The concern over military base closings and the relocation of agency operations is an indication of some value to communities.

- Fourth, the Commission's staff study suggests consideration of the concept that local authorities should have the "right" to tax federally owned real property. The effect of this approach would be to create another entitlement, or mandatory program over which the Congress would have no financial control. In short, the states or local entitles would set federal expenditures by their taxing. We believe it is the Congress that should determine whether such payments are warranted and at what financial level. We prefer that the program rationale and the method of payment be stated explicitly in authorizing legislation and that the amounts to be paid be subject to positive action by the appropriations committees of the Congress.

Although we may differ on the approach to be taken on the various land programs, we do agree with the general message of the Commission's staff studies that substantial changes are needed in the "patchwork" of existing policies and programs. We share your concern and will support efforts to rationalize and streamline the programs and the necessary intergovernmental relationships. However, I believe this will be a difficult undertaking.

STATEMENT OF
RICHARD J. DAVIS
MAYOR OF PORTSMOUTH, VA

My name is Richard J. Davis, and I am the Mayor of Portsmouth, VA. I am here today to speak on behalf of Portsmouth and many other local governments on the subject of the federal government's responsibility for land ownership.

We are delighted that the study on the subject of payments in lieu of taxes has been completed. The federal government has extensive land holdings throughout the nation. While the concentration of this ownership varies widely, in some communities the federal government may be the dominant landholder. With few exceptions, however, no tax equivalency payments are made to the communities in which this land is located. In many cases, including ours, this creates a severe hardship on the host community.

For background information, I want to acquaint you with some facts about Portsmouth, and how they relate to this subject.

Portsmouth is an older, seaport city settled in 1752 and incorporated in 1858. The city has been associated with the shipbuilding and ship repairing industry and with other maritime activities since its earliest days. The Norfolk Naval Shipyard, oldest in the nation, was established on the outskirts of Portsmouth in 1767, just 15 years after the city was settled.

Through the years, Portsmouth has grown both in population and, as a result of several annexations, in land area. Today the city contains 30 square miles of land and about 100,000 people. Future growth in the area is not possible, because Portsmouth is surrounded on all sides by water or by other incorporated municipalities.

I quote these statistics only to point out to you that Portsmouth is a compact, densely developed community. There are only 1,300 acres of undeveloped land remaining, and most of that is land which has already been committed to housing or industrial development or redevelopment. The remaining vacant land consists mainly of small scattered individual lots. Thus, not only is growth in land area barred, but growth within the existing city limits is severely limited.

Portsmouth is a typical core city with all the attendant problems associated with such cities nationwide.

These problems include a restricted tax base and a relatively poor population. The 1970 census shows Portsmouth to have a larger percentage of persons living in poverty, fewer high school graduates, more elderly, and so on. This is not to say that we have stood idly by and helplessly watched these developments. We have undertaken an ambitious program of renewal, housing conservation, and industrial diversification designed to insure that Portsmouth remains a viable, forward looking com-

munity. Without going into detail, I will just point out that most of our community development funds have gone toward rebuilding two of the most blighted communities in the city, primarily for their residents. We have attracted private developers to build middle to upper income housing on our downtown waterfront to reverse the migration of middle and upper income residents to neighboring suburban communities. All of these efforts, combined with the vigorous pursuit of industry to help expand our tax base, will help ease the financial burden we face.

I have already made reference to the fact that Portsmouth's land area is quite small, compared to the other tidewater localities. Exacerbating this difficulty is the high percentage of land held by tax exempt entities, particularly the federal government.

Portsmouth's corporate limits include 29,141 acres (45.5 square miles) of land and water, of which 19,181 acres (30 sq. miles) are land area. Total Navy land holdings are 1,840 acres, comprising the naval shipyard, Craney Island fuel depot, naval hospital, and New Gosport and Stanley Court housing. The Coast Guard base is an additional 187 acres. The total 2,027 acres is 11% of the city's land area.

In addition to these holdings is the Craney Island landfill, operated by the Army Corps of Engineers to store dredge material collected from the area's shipping channels. The total site, including water, is 6,900 acres, of which about 2,560 is fill area. The city has worked extensively in recent years to secure title to the landfill when the Army finished its work there. The land gained by the city would be used to further help its industrial diversification program aimed at increasing the tax base, jobs, and public services.

Eleven percent of any community's corporate area is a significant holding, particularly in a city like Portsmouth where land is at a premium. Even more significant, however, is the location of this land. With the exception of the 70 acres comprising the two Navy housing projects, all of the government holdings are on waterfront land, constituting 65% of the city's prime industrial property. This land is among the most valuable in the entire city, especially considering the port and port-related activities which contribute so heavily to Portsmouth's economy, and the attempts by the city to expand its tax base. It is when one examines the *value* of tax exempt property in Portsmouth, however, that the real impact of the federal presence becomes apparent. Total value of all land and improvements in Portsmouth is $2.3 billion. Nearly $1.3 billion, or 54.7% of this, is tax exempt or tax immune. More than 80% of the tax exempt or tax immune property is owned by the federal government. The ratio of tax exempt and immune property is comparable to that of Washington, DC, where the federal presence is, of course, better known.

Federal impact aid to the City of Portsmouth has totaled as follows for the preceding four years:

1976—$760,190
1977—$1,057,359
1978—$1,043,381
1979—$946,512
1980—$1,217,000 (estimated)

As you can see, the payments, although needed and very much appreciated, do not equal the estimated tax revenues we would receive if federal property were taxed.

The City of Portsmouth has, for the past several years, initiated and supported national recognition of federally impacted communities and the problems resulting from the loss of revenue. Your report more than adequately outlines the problems, and we are grateful to all who made it possible.

The federal payment to Washington for fiscal year 1979, as authorized by P. L. 93–198, was $317 million, or 25% of all sources of revenue. Portsmouth, with a higher percentage value of federally owned property, received for 1978–79 an estimated $1,043,381 in impact funds for its school system. This amounts to 1.6% of Portsmouth's general fund. If Portsmouth were allowed to tax federally owned property at the $1.24 per hundred dollars of valuation that applies to nonexempt property, approximately $13,800,000 would be received by the city each year.

The Washington case is not the only precedent which can be cited in favor of a national payment in lieu program. Following the passage of P.L. 94–565—which provides for payment in lieu of taxes to local jurisdictions which contain National Park Service, National Forest, and Bureau of Land Management lands,

and an amendment to this law which adds inactive military lands and certain parks to the payment in lieu program—we have urged legislation to partially compensate local governments for the tax immunity which is suffered by them. In addition, *The Refuge Revenue Sharing Act of 1978* (P. L. 95–469), makes similar payments for certain wildlife refuge areas.

If payments are justifiable in rural areas and in Washington, DC, they are also justifiable in our nation's cities, which, for the most part, have proportionally greater problems and fewer resources to deal with those problems.

I want to emphasize at this point that we in Portsmouth are not critical of the military presence in our city. We realize there are many benefits which we enjoy because of their presence. Cooperation between city and Navy has been exemplary in many instances. We would be the poorer were they not located in Tidewater and in Portsmouth.

Even some of the positive impacts are mitigated, however, by the tax-free nature of federal installations. For example, many millions of dollars worth of retail sales take place at the shipyard every year, denying Portsmouth the revenues from business licenses and sales taxes that would be generated if these facilities were fully integrated into the local economy.

Since national defense benefits all Americans, we feel that a reasonable payment in lieu program is not unfair. After all, the city provides water to the shipyard and hospital for which it is, of course, paid, although at a reduced rate. We have a mutual aid agreement with the shipyard and hospital fire departments. Police, particularly traffic-related services, are necessary for the commuters. Possibly most expensive of all is construction of highways to accommodate morning and evening peak traffic loads.

Given the situation as I have described it in Portsmouth, and given the fact that in Virginia the real estate tax is our basic source of revenue, this is why we have so strongly supported a national payment in lieu of taxes program for federally owned property within jurisdictions containing such property.

It is our feeling that your study has been a vital step in this direction, and has laid a strong foundation for assistance to cities with federal property. We urge that the recommendations contained therein be reviewed and adopted, so that an equitable payments in lieu program can be developed as soon as possible. We believe that the precedent is there to do so.

STATEMENT OF
JERRY K. EMRICH

COUNTY ATTORNEY, ARLINGTON COUNTY, VA

The proposal of payments in lieu of taxes for federal real property is a logical next step in the 43-year progression of judicial and legislative relaxation of federal government immunity from state and local taxes. The beginning of the immunity was the 1819 decision of the United States Supreme Court in the case of *McCullough vs. Maryland*. The purpose of creating the immunity at that time was to prevent undue interference with the federal government by state and local governments; however, the Court observed that nondiscriminatory taxes were acceptable.

McCullough established the principle of immunity, and it would appear that the issue should be addressed on the basis of that principle. If the principle is not valid today, immunity with regard to nondiscriminatory taxation should be abolished in the interests of federalism.

After the *McCullough* decision, the immunity doctrine was applied and extended by the federal courts in a very mechanical way for about 120 years, with the result that states could not tax federal employees, sales taxes could not be imposed on those selling to the federal government, and state income tax could not be levied on rents received from property leased to the United States. The courts in these cases lost sight of the purpose of *McCullough* which was the prevention of undue interference, not the prevention of any economic burden.

Beginning in 1937, the Supreme Court began reversing its position, and ruled in a series of

cases that state and local taxes could be imposed on the gross receipts of contractors dealing with the federal government, the salaries of federal employees, and even the use of federal government property by private parties.

In one of the most recent cases, the Supreme Court held that a local government could tax the possessory interest of federal employees in federally owned housing in which the employees were living for the convenience of the government. The Court recognized that these taxes were passed on to the federal government and increased the total cost of government, but it found such a result nothing more than "the normal incident of the organization within the same territory of two governments, each possessing the taxing power."

All of the state and local taxes which have been paid as a result of these court decisions have, no doubt, added billions of dollars a year to the federal budget. These changes in the immunity rules have occurred as a result of reviewing the original principle of implied federal immunity and determining that it was no longer an appropriate principle. Significantly, the Court rejected the principle without consideration of the need of a particular state or local government. The changes occurred as a result of recognition by the Supreme Court of the proper intergovernmental relationships in a system of federalism.

Congress has also acted to eliminate Congressionally created tax immunity. In 1953, it abolished the previously created immunity of the AEC, because it recognized the appropriate position of the federal government in our system of federalism.

There remains an element of implied immunity, which is the immunity from taxes imposed directly on the federal government. It is possible that the Supreme Court, in the right case, will also abolish this immunity, since such action would be a natural extension of what had occurred during the prior 43 years.

Local taxes on real property are taxes that would be imposed directly on the federal government, and therefore would be prohibited under current judicial decisions absent Congressional action. There would appear to be no substantial reason why Congress should not act. Real property taxes in almost every state, if not all, require uniformity of assessment among members of each class of property. In addition to state provisions, it would be simple enough for Congress to include uniformity provisions in its legislation. The requirement of uniformity would act as a deterrent to unequal assessment of federal property. While there would be problems in determining the value of certain federal property, the problems would be of the same type as those which have been faced by assessors for many years with regard to specialized private property.

The federal courts would be the appropriate forum in which the federal government could challenge the validity of assessments. It is not likely that there would be a flood of this type of litigation, because experience has indicated that specialized property assessments are not often litigated. This is probably the result of many factors, not the least of which is the cost of litigation for both the assessing authority and the property owner.

Congressional recognition and adoption of the judicial trend in federal tax immunity as it applies to real property is entirely appropriate at this time.

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