



Evaluating Payments in Lieu of Tax in Light of Nonprofit Directors' Fiduciary Duties

Payments in lieu of tax – or PILOTs – have proven a creative and successful approach to balancing the tax-exempt status of nonprofit entities with the need to finance rising costs of municipal services that benefit nonprofit and for-profit entities alike. By making voluntary payments in lieu of tax, nonprofits can further assist struggling communities and foster strong partnerships with local government, while at the same time preserving their historic tax exempt status.

There is, however, a natural tension between agreeing to PILOTs – which are typically voluntary – and nonprofit directors' fiduciary duty to at all times act in the best interests of the nonprofit entity. This paper explores that tension and provides guidance for nonprofit directors to evaluate PILOTs in a manner that is consistent with their fiduciary duties.

I. The Ascension of PILOT Programs

In Massachusetts, PILOTs arose as a consequence of the state's longstanding property tax exemption for most nonprofit organizations.¹ The policy justification for the historical practice of exempting nonprofits is that they provide public services – including educational, healthcare, and charitable services – the costs of which would otherwise be borne by government. But those exemptions can place a strain on municipal resources, particularly in Massachusetts where property taxes provide the vast majority of revenue for local governments. Reliance on property taxes, coupled with the high concentration of nonprofit entities in the state – particularly in and around Boston – have caused local governments to seek alternative ways to raise revenue from nonprofit entities.²

PILOT arrangements have proven largely successful in achieving that goal. In Boston, for example, the city seeks PILOTs from any tax-exempt entity holding real estate assessed at \$15 million or more. The amount of the requested PILOT in Boston is equal to 25% of what the tax-exempt entity would pay in real estate taxes were it fully taxable. Boston will also credit a nonprofit up to 50% of the requested payment for community benefits that directly benefit the city and its residents. Although PILOTs remain strictly voluntary in Boston, the program has achieved considerable participation and success.

¹ See, e.g., G.L. c. 59, § 5 cl. Third (exempting real estate owned and used by a charitable organization), cl. Eleventh (exempting houses of worship).

² Apart from the proliferation of PILOT programs, recent proposals in the Massachusetts Legislature have included a bill that would have required a four-year "phase in" of the exemption when taxable real estate is purchased by a nonprofit, and a bill that would have given municipalities a right of first refusal on property being sold by a nonprofit.





In the 2016 Fiscal Year, 32 nonprofits participated in Boston's PILOT program, resulting in more than \$32 million in revenue for the city.³

Beyond Boston, a number of other municipalities across New England – including Cambridge, Brookline, Watertown, Worcester, Northampton, and Providence, Rhode Island – have utilized PILOTs to generate additional revenue from nonprofit institutions. A key feature of nearly all PILOT programs is that the payments remain voluntary. That means nonprofit directors are faced with a choice: agree to a requested PILOT, agree to pay some lesser amount, or decline to make any payment at all. A challenge for many nonprofit directors is how to weigh those options in light of their fiduciary duties.

II. The Fiduciary Duty of Directors to Act in the Best Interests of the Nonprofit Organization

As with directors of a public company, directors of a nonprofit organization owe fiduciary duties of care and loyalty to the nonprofit. Those duties require that directors of a nonprofit at all times act in good faith, in the best interests of the nonprofit organization, and that they not act out of self-interest to the detriment of the nonprofit.⁴ Massachusetts courts have even suggested that heightened duties of care and loyalty govern the conduct of directors of nonprofit organizations as compared with their for-profit counterparts.⁵

Included among nonprofit directors' fiduciary duties is the obligation to use the charitable funds with which they have been entrusted to further the organization's charitable mission. Donors and benefactors have an expectation that the funds they provide to a charity or other nonprofit organization will be put to a particular use, and not diverted to other purposes (no matter how worthy those other purposes may be). More importantly, Massachusetts law strictly regulates the use of charitable funds and requires that they be applied to their intended purpose.

³ See City of Boston, Fiscal Year 2016 Payment in Lieu of Tax (PILOT) Program Results, https://www.boston.gov/sites/default/files/fy16_pilot_results_for_web.pdf (last visited Mar. 6, 2017).

⁴ In Massachusetts these duties are codified by statute. The statutory duties require that:

A director, officer or incorporator of a corporation shall perform his duties as such . . . in good faith and in a manner he reasonably believes to be in the best interests of the corporation, and with such care as an ordinarily prudent person in a like position with respect to a similar corporation organized under this chapter would use under similar circumstances.

G.L. c. 180, § 6C.

⁵ *Boston Athletic Ass'n v. Int'l Marathons, Inc.*, 392 Mass. 356, 366 & n.12 (1984) (referencing the "heightened scrutiny of the management of nonprofit corporations" and observing that "[t]hose entrusted with the management of funds dedicated to charitable purposes and donated out of a sense of social or moral responsibility owe an especially high degree of accountability to the individual donors as well as to the community").





Primary authority to enforce nonprofit directors' fiduciary duties in Massachusetts rests with the Attorney General.⁶ Other stakeholders, however, also retain authority to police nonprofit directors' compliance with their fiduciary duties. For example, the organization itself – or a fiduciary acting on its behalf (such as a bankruptcy trustee) – likely has the authority to sue directors for breach of fiduciary duties.⁷ And in certain circumstances even donors may have standing to enforce particular conditions they have placed on a charitable gift.⁸

Actions for breach of fiduciary duty for the mismanagement of charitable assets are not subject to any statute of limitations in Massachusetts, and can result in personal liability for directors of a nonprofit organization.

III. Evaluating PILOTs in Light of Directors' Fiduciary Duties

Decisions by nonprofit directors about voluntary participation in a PILOT program, as with all decisions regarding use of the nonprofit organization's assets, implicate the directors' fiduciary duties. In many cases there will be good reasons for the nonprofit to participate in a PILOT program, and such participation may be fully consistent with its directors' fiduciary duties. But as even Boston's PILOT Task Force acknowledged, "increasing an institution's PILOT commitment may have unintended consequences – an institution may have to scale back community commitments and/or reduce staff to meet the expected PILOT level."⁹ Thus, as PILOTs rise in popularity and expand to meet the growing needs of local governments, circumstances could arise where a decision to apply charitable funds to a voluntary PILOT rather than a nonprofit's charitable mission would run afoul of the fiduciary duties of directors. Although compliance with fiduciary duties is rarely susceptible to bright line rules, the following principles can help guide nonprofit directors tasked with deciding whether to participate voluntarily in a PILOT program.

⁶ See G.L. c. 12, § 8 ("The attorney general shall enforce the due application of funds given or appropriated to public charities within the commonwealth and prevent breaches of trust in the administration thereof.").

⁷ See *In re Boston Regional Medical Center, Inc.*, 328 F. Supp. 2d 130 (D. Mass. 2004) (holding that committee of unsecured creditors acting on behalf of bankruptcy estate had authority to bring claims for breach of fiduciary duty against trustees of bankrupt nonprofit entity).

⁸ See, e.g., *Trustees of Andover Theological Seminary v. Visitors of Theological Inst. in Phillips Academy in Andover*, 253 Mass. 256 (1925).

⁹ Mayor's PILOT Task Force, Final Report & Recommendations at 12 (Dec. 2010), available at http://documents.boston.gov/images_documents/PILOT_%20Task%20Force%20Final%20Report_WEB%20_tcm3-21904.pdf (last visited Mar. 6, 2017).





Participation in a PILOT program is likely to be consistent with nonprofit directors' fiduciary duties where:

- It has the potential to maintain or increase the nonprofit's standing and goodwill in the community, which can both raise the profile of its good work and attract potential donors.
- It has the potential to maintain or strengthen the nonprofit organization's relationships with local government, particularly where the nonprofit partners or works closely with government entities in delivering services.
- The local services supported by funds raised through the PILOT program are closely aligned with the nonprofit's own mission.
- Participation in a PILOT program mitigates a material risk that, absent such participation, a change in law could threaten the nonprofit's tax exempt status.

Serious tension with directors' fiduciary duties could arise, however, from participation in a PILOT program where:

- A director seeks to curry personal favor with government officials by agreeing to a PILOT, rather than seeking legitimate benefits for the nonprofit entity.
- The PILOT program fails to distinguish among nonprofits based on size or ability to pay.
- Directors agree to a PILOT based on improper coercion exerted by local government officials (e.g., threats that permits or other unrelated government benefits will not be forthcoming absent payment).
- The PILOT request fails to take into account the community benefits that the nonprofit organization already provides.
- Agreeing to a PILOT at the requested amount would materially limit the nonprofit organization's ability to further its charitable mission.

By keeping these principles in mind, nonprofit directors can help ensure that any decision to commit their organization's resources to a PILOT is consistent with their fiduciary duties to the organization.





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