STANFORD
GRADUATE SCHOOL OF BUSINESS
STANFORD SOCIAL INNOVATION *review*

An Accidental Good

How savvy social entrepreneurs seized on a tax loophole to raise billions of corporate dollars for affordable housing

By Doug Guthrie

Stanford Social Innovation Review
Fall 2004

Copyright © 2004 by Leland Stanford Jr. University
All Rights Reserved

DO NOT COPY

STANFORD
GRADUATE SCHOOL OF BUSINESS
Stanford Social Innovation Review
518 Memorial Way, Stanford, CA 94305-5015
Ph: 650-725-5399. Fax: 650-723-0516
Email: info@ssireview.com, **www.ssireview.com**

AN acc

How savvy
social entrepreneurs
seized on a tax loophole to
raise billions of corporate dollars for affordable housing

idental good

MANY NONPROFIT EXECutives spend a good chunk of their time trying to talk corporate executives into giving them money. And companies big and small often respond generously. But social entrepreneurs should also consider a less well-known technique for generating new revenues: lobbying for changes in government tax policy. Such changes can yield an enormous outpouring of new resources for the social sector.

A case in point is the Low-Income Housing Tax Credit (LIHTC), passed by Congress in 1986. The LIHTC generates nearly $400 million annually for the development of affordable housing, an amount that far surpasses the level of gifts from Fortune 500 companies to any one cause. Corporations have become extremely adept at lobbying for tax changes that are advantageous to them. Coalitions of nonprofit organizations, too, could take a more aggressive approach to changing the system in ways that better reflect their needs.

The LIHTC was approved as part of the 1986 Tax Reform Act, a major overhaul of the federal tax code. The LIHTC was a minor element in the act, but one that would have major implications for the development of low-income housing while producing a windfall for corporations. Although the LIHTC is often cited as an instance of bipartisan cooperation that led to an effective system of privatizing a public good, this account reflects collective amnesia on the part of lawmakers. The reality is that the LIHTC became much more than it was ever intended to be in the public and private sectors alike.

Congress passed the LIHTC as part of an effort to close a loophole that had become very lucrative for wealthy individuals. But savvy social entrepreneurs seized on this opening to help corporations gain a double tax break while generating hundreds of millions of dollars for affordable home construction. With beneficiaries on both ends of the political spectrum, powerful lobbies quickly formed to protect the LIHTC. By the late '80s, this political mistake would become one of the key engines of urban revitalization in the United States, giving rise to a whole new industry of community developers and related financiers. It also became one of the most significant vehicles for corporate welfare, guaranteeing it an entrenched place in the federal tax code.

The roots of this sweeping change reach back to the 1970s, when many U.S. cities were suffering the long-term consequences of decaying housing

by DOUG GUTHRIE

PHOTOGRAPH BY GARY RHIJNSBURGER/MASTERFILE

Congress passed the Low-Income Housing Tax Credit as part of an effort to close a loophole that had become VERY LUCRATIVE FOR WEALTHY INDIVIDUALS.

projects, a situation aggravated by municipal budget crises and a stagnant economy. In 1980, Ronald Reagan became president and began a major reform of the welfare state, ushering in a new era of privatization. His Tax Reform Act of 1981 heralded a period of dramatic cutbacks that affected many programs including the Section 8 New Construction Program, which funded low-income housing.

Though U.S. Department of Housing and Urban Development (HUD) budgets had actually been in decline in the late '70s, many in Congress blamed the Reagan administration for this shift. As Sen. John Kerry (D-Mass.) put it in 1986: "The crisis we feel today has been brought about in part as a result of the Reagan administration's rejection of the federal government's historic role in stimulating the production of multifamily housing directly through federal spending programs. Since 1981, budget authority for housing has declined by 60 percent."

The first real attempt to shift the burden of low-income housing development to the private sector came with the "passive loss" provision in the 1981 tax bill. The passive loss system created incentives for wealthy individuals to invest in housing for the poor. The concept was modeled on a mainstay of U.S. corporate tax law: Companies have the opportunity to write off taxes against the depreciating value of their property. In the 1981 tax bill, this idea was applied to individuals, who could receive write-offs against depreciation of low-income properties in which they invested. While it seemed like a positive development in the move toward privatization, by the mid-1980s a host of problems had developed.

For one thing, many affluent people were avoiding taxes entirely by investing in cheap, declining property. More significantly, the passive loss provision was actually contributing to urban blight. Because the write-offs hinged on depreciating value, investors let inner-city properties deteriorate as much as possible. The *Congressional Record* is replete with acknowledgments from across the political spectrum of the problems with this early experiment in privatization. Sen. Bob Packwood (R-Ore.), then chairman of the Senate Finance Committee, raised the issue when he introduced the Tax Reform Act of 1986.

"What very wealthy individuals would do is invest in properties, usually real estate but not always, that generated paper losses," Packwood said. "They would offset the paper losses against their regular income. This would reduce their regular income, their taxable income, down to zero. They paid no taxes. Everyone in this chamber has gone home and had this question put to them – these are people making fifteen or sixteen thousand dollars a year. 'Senator, I don't mind paying my fair share, but why don't they pay something?' … Every year, the story is printed in the papers – and I paraphrase – 844 Americans last year made over $1 million and paid no taxes. That, justifiably, galls the average taxpayer who is making $15,000 a year and paying $1,000 in taxes. This bill closes those loopholes."

In 1986, the Low-Income Housing Tax Credit replaced the passive loss provision. The LIHTC was meant to give the same wealthy beneficiaries of passive losses incentives to continue investing in low-income housing, while removing the impetus for allowing their properties to decline. Under the LIHTC, the tax credits would go to corporations, so the actual developers/owners of the properties had no reason to let them fall apart. Since they would receive no tax benefits if a building's value declined, the owners had every reason to keep them up so they could be sold at a profit in the future.

No Double-Dipping

Congress clearly acknowledged at the time that creating the LIHTC required closing the passive loss loophole; there was widespread agreement that investors should not get a "double-dip" with both passive losses and tax credits, which are dollar-for-dollar write-offs against tax liability.

"Perhaps no aspect of the current tax system is as unseemly as the incentives that encourage otherwise rational people to invest in order to lose money," said Sen. George Mitchell (D-Maine) during a debate over the passive loss provision. "This is particularly the case with real estate, where overly generous depreciation and improper accounting rules encourage the formation of limited partnerships designed to produce large tax losses for investors. Nowhere is this truer than investment in low-income housing, an area where Congress has by design encouraged wealthy people to invest for the tax losses that are generated. I support the changes in tax reform that will make the system of real estate depreciation less generous and restrict losses from tax shelter activities."

It is crucial to note that the LIHTC was intended for individuals. In the entire record of the 99th Congress, there is no mention of corporations as intended beneficiaries of the tax cred-

DOUG GUTHRIE *is associate professor of sociology and management at New York University. His primary areas of research are organizational theory and the impact of corporations on the social sector. He has written extensively on the impact of foreign companies in China, including "Dragon in a Three-Piece Suit: The Emergence of Capitalism in China" (Princeton, NJ: Princeton University Press, 1999) and "Social Connections in China: Institutions, Culture, and the Changing Nature of Guanxi" (Cambridge, England: Cambridge University Press, 2002). Guthrie has also taught at Stanford, Columbia, and Emory. He can be reached at doug.guthrie@nyu.edu.*

In Cleveland, a Transformation

In 1992, construction workers began building 50 new single-family homes in the African-American neighborhood of Mt. Pleasant in Cleveland. The dwellings marked the first time low-income housing tax credits were used in Mt. Pleasant, located next door to the affluent Shaker Heights area.

Instead of concentrating the subsidized homes in one part of Mt. Pleasant, developers spread them out over roughly 40 blocks, building on vacant lots between existing homes, a technique known as "infill" construction. The results soon began to transform Mt. Pleasant.

A strip mall was built in 1995. Drug stores began to pop up. Home prices began to rise. Residents took more pride in the area. The local city councilwoman began holding contests for best lawn and most beautifully decorated balcony.

"As soon as we started building, you saw grass getting cut, flowers going in, paint going up," recalled India Pierce Lee, senior program director for the Cleveland/Northeast Ohio Local Initiatives Support Corp., a nonprofit that supplies financing, training, and technical assistance to local community groups. "When people see something going on, they want to be part of it if it's positive."

Families could lease the three-bedroom, one-and-a-half-bathroom houses for $350 a month, with an option to buy after 15 years. The lion's share of the new homes, Lee said, were targeted for parts of Mt. Pleasant that were the most deteriorated, but community developers deliberately avoided clustering the dwellings together.

"We consciously made sure it was not concentrated," she said. "To rebuild a neighborhood you have to diversify. You're not going to rebuild a neighborhood off poor [people] alone. … If you put all the low-income units in one place, it looks like a low-income neighborhood."

Success bred success. When local banks realized that tax credit-financed housing was making Mt. Pleasant more stable, they became more comfortable about making construction loans there, adding to the stock of new homes. The 50-unit Mt. Pleasant Homes I project gave way to a second 50-unit project. Tax credits combined with historic rehabilitation credits helped finance the conversion of a onetime girl's school, Notre Dame Academy, into 73 apartments for seniors. Since the 1986 advent of the Low-Income Housing Tax Credit program, said Lee, more than 2,000 units have been built in Cleveland.

"Tax credits make sense if it's strategic and it's well-planned with the community and it's integrative," she said. "That's what makes it effective."

its. Indeed, the entire debate over whether to eliminate passive losses centered on how to move rich people away from investments that rely on depreciation to those that would use the tax credit. At the time, the consensus among people in the community-development industry was that the legislation would not help them much.

Given Congress' decision to get rid of the passive loss provision and replace it with the LIHTC, how did corporations come to benefit from a double-dip tax break? The answer lies partly in the vision of a few community-development entrepreneurs in Cleveland, New York, Boston, and Chicago. They spotted something in the legislation that Congress had not, and created a system that provided an astounding set of resources for social change.

At the time, a number of players were actively seeking opportunities to inject resources into low-income housing development. They immediately began scrutinizing the LIHTC. But raising money by convincing individuals to buy tax credits proved very difficult, and initially it looked like the LIHTC would go nowhere.

For one thing, many investors were angry with Congress for changing the rules after they had sunk money into passive loss projects. Some financial institutions tried to raise capital by offering individual investors shares in mutual funds that owned baskets of properties, but these early experiments failed.

In early 1987, however, a group of people involved in community development in Cleveland realized that corporations were much better suited for investing in the LIHTC than individuals for a variety of reasons.

Corporate tax liability, they knew, is much greater than individual liability, so the potential pool of cash that could be channeled into low-income housing was much greater. More

The LIHTC Survives a Washington Struggle

EARLY LAST YEAR, THE LIHTC INDUSTRY WAS IN an uproar in the wake of President Bush's proposal to eliminate taxes on corporate dividends.

Affordable housing advocates worried that the White House plan, part of a $674 billion tax cut package, would weaken incentives for corporations to buy low-income housing tax credits. The result, they argued, would be a sharp drop in the number of new homes built for the poor.

Led by state housing agencies and nonprofit housing groups, tax credit supporters launched a sophisticated nationwide lobbying campaign aimed at persuading the president and Congress to preserve the LIHTC.

Proponents called newspapers, wrote op-ed articles, and informed members of Congress about affordable housing in their districts that had been financed through the LIHTC. They also commissioned a study by Ernst & Young, a global auditing and business-services firm that concluded that the number of LIHTC-financed units would plunge by 40,000 a year if the dividend tax cut passed.

The Bush administration argued that the exclusion was needed because corporate profits were unfairly being taxed twice: Corporations paid taxes on income, and then their stockholders paid taxes on dividends that were distributed to them out of the remaining profits.

The administration proposed that no further taxes be imposed on corporate income that had already been fully taxed, and insisted that its plan would not harm the tax credit industry. But LIHTC supporters worried that companies would have less incentive to purchase tax credits, which offset taxes dollar for dollar and can often be bought at a hefty discount. If stockholders stood to gain more from the dividend exclusion, companies would be less likely to invest in tax credits, housing advocates said.

"I think it would have severely curtailed the corporate tax market for the LIHTC," said Buzz Roberts, senior vice president for policy and program development at the Local Initiatives Support Corp., a New York-based agency that helps revitalize low-income communities.

Ultimately, the LIHTC industry prevailed. With many lawmakers arguing that Bush's proposed tax reductions were too big, Congress slashed the tax cut package to $350 billion and the president signed it into law in May 2003. A compromise reduced, but did not eliminate, dividend taxes.

But some tax credit advocates think the White House may take another run at getting rid of taxes on dividends.

"Assuming Bush is reelected," said one, "it would not surprise a lot of people to see them come back with another [plan]."

importantly, although Congress had eliminated passive losses for individuals, the shelters still existed for corporations. That meant companies could double-dip by buying tax credits and writing off passive losses against future depreciation of low-income property.

"That's the beauty of what we did, because if I'm an individual and I buy credits, I only can take the credits," said Joe Hagan, a former Ohio housing official who is now president of the nonprofit National Equity Fund, which has raised $4 billion from tax credit sales since 1987. "I can't take the losses. And [early innovators] were thinking that the market for this was individuals. And then when the corporations started taking it, they had this added other benefit, of taking these losses. Because as a corporation you're able to take the passive losses associated with the development."

By itself, the LIHTC offered no more than an even tradeoff with paying taxes to the government, and corporations had little incentive to participate. But when passive losses were added, the deals were irresistible. Hagan estimated that many of the early packages he put together yielded an additional 15 percent return for corporations in unpaid taxes over the next decade. Rather than simply pay taxes, corporations could take their tax liability, "invest" it in low-income housing, and generate significant extra income.

Rise of the Syndicators

The deals work like this: The Internal Revenue Service allocates tax credits to the states at a rate of $1.80 per person in the state population. State housing agencies then distribute the credits to developers based on a point system that reflects the priorities of state government. Syndicators like the National Equity Fund sell the credits to corporations, often at a discount, and developers use the resulting capital to erect low-income housing units. (Discounts, used to entice buyers in a competitive market, often amount to 20 percent of the credits' face value. Thus a corporation could buy $1,000,000 worth of credits for only $800,000.) The credits usually fund between 30 percent and 70 percent of a property's development costs, with the rest of the capital coming from other sources including bank loans, government housing bonds, and private money.

A nonprofit syndicator, the Ohio Capital Corporation for Housing, brokered an early tax credit sale in 1987, with Exxon, Bank One, and Standard Oil buying in. Out of this innovation sprang an industry. The Enterprise Foundation, the Local Initiatives Support Corporation (LISC), and Fannie Mae arranged similar deals.

But corporations weren't the only beneficiaries. As the double-dips multiplied, resources began flowing heavily to com-

munity-development corporations, relatively new organizations set up to improve the inner cities. By the time the tax credit was up for renewal in 1989 (Congress had attached a sunset clause), the emerging LIHTC industry had significant momentum, and powerful interest groups – from corporations to nonprofit developers to the members of Congress who represented them – arose to protect it.

As federal lawmakers realized that the LIHTC was being used in ways for which it was not originally intended, they seemed eager to claim that this model of innovation was what they had in mind all along. For example, as Sen. John Heinz (R-Pa.) described one of the early projects to sell credits to corporations, he seemed to go out of his way to state that current practices matched Congress' original intent:

"This project [in Pittsburgh] utilizes provisions of the 1986 Tax Reform Act, and it is precisely the kind of low-income housing initiative the Congress contemplated in enacting these tax provisions," said Heinz. "At a time when federal housing funds are particularly limited, and our nation faces a continuing erosion of its low-income housing stock, it is important for corporations to step up and use the tools Congress has provided."

The LIHTC soon acquired strong bipartisan support in Con-

A Helping Hand for Trinity Towers

A few years ago, things were grim for the low-income tenants of the Trinity Towers Apartments in Washington, D.C.

Construction work on a subway station across the street had unleashed a rat infestation. Drug dealers and vagrants hung out at a run-down convenience store on the ground floor. And some tenants knew far more than they wanted to about their next-door neighbors, thanks to poorly insulated walls.

But all that changed after a for-profit Maryland development company purchased the 122-unit complex in 2001. The firm, Community Partners, launched a $5.6 million overhaul of Trinity Towers using a combination of low-income housing and historic rehabilitation tax credits, bonds from the D.C. Housing Finance Agency, and D.C. Department of Housing and Community Development funds.

By the time the renovation was complete, a large community meeting room had replaced the convenience market. Carpeting covered the hallways. Fresh paint and new black tile flooring graced the lobby, along with better security. A first-floor laundry room was put in for the benefit of disabled and elderly tenants.

The living units had been upgraded as well. Inside each one was a new kitchen with glasstop stoves, dishwashers, built-in microwave ovens, and refrigerators with ice makers. The bathrooms had been redone with new fixtures and sliding-glass shower doors.

"It was just amazing," tenant Carol Burnett told the *Washington Post*. "When you looked around, you couldn't even imagine what it looked like before." She was delighted to find that her new two-bedroom apartment had a balcony.

More than 1.6 million apartment units have been constructed nationwide with the help of the Low-Income Housing Tax Credit since its 1986 inception, according to the National Council of State Housing Agencies (NCSHA). But while about 125,000 units are produced each year for poor and elderly tenants, the NCSHA said that even more – 150,000 – leave the low-income inventory due to rent increases, deterioration, or abandonment.

Community Partners chief executive Bradley Jeffries told the *Post* the key to a successful low-income housing project is to make it look like it's not really low-income housing. That wasn't too hard with Trinity Towers, a 1928 complex that was placed on the National Register of Historic Places in 2001. With the help of preservation consultants, Jeffries' firm tracked down early photos of the building so its look could be restored. The firm even bought bricks from Australia because they most closely matched the originals.

The hardest part was relocating tenants during the restoration. Faced with a housing shortage in the Washington, D.C. region, Community Partners moved the tenants to another apartment complex it owns in Suitland, Md. But Jeffries isn't quite finished improving Trinity Towers. A playground in the courtyard is being built, and word has gotten out about the improved living conditions. Today, more than 100 people are on a waiting list for the building.

Businesses Doing Good – Given the Right Tax Breaks

Federal Empowerment Zones:

Value: $6 billion in federal tax breaks in 2002, according to the U.S. Department of Housing and Urban Development.

Incentives for businesses located in the empowerment zones include up to $3,000 in credits for every newly hired or existing employee who lives in the zone, and up to $2,400 for each employee hired from groups with traditionally high unemployment rates. Businesses also are entitled to lower-cost loans to finance property and equipment purchases, and tax deductions up to $35,000 for depreciable property such as equipment and machinery.

State Enterprise Zones:

Many states have designated certain urban areas for economic revitalization. In Philadelphia, for instance, American Street, Hunting Park West, the Port of Philadelphia, and West Parkside are designated as state enterprise zones.

Value: From 1983-1999, 323 businesses started or expanded in Philadelphia zones, with a total public investment of $136 million. Total business investment was $417 million. More than 7,600 new jobs were created and nearly 33,000 jobs were retained.

Incentives for businesses located in these areas include low-interest loans, state tax credits of up to 20 percent of invested funds, utility discounts, lower city property taxes, and workforce training programs.

Energy Conservation:

Many states provide tax credits to businesses for using alternative energy sources. The state of Hawaii, for instance, encourages businesses to conserve energy by providing tax credits for wind and solar energy.

Value: Thirty-five percent or $250,000, whichever is less, of invested capital for solar units installed in hotels, and commercial and industrial facilities. Businesses using wind energy can take up to 20 percent or $250,000, whichever is less.

Difficult-to-Hire Populations:

The federal Work Opportunity Tax Credit (WOTC) provides a tax credit for employers who hire members of certain targeted low-income groups, including former welfare recipients, veterans, ex-felons, food stamp recipients, summer youth employees, and Supplemental Security Income (SSI) recipients.

Value: Employers take a tax credit of up to 40 percent of the first $6,000 (up to $2,400) in wages paid during the first 12 months for each new hire.

Disability Access:

Small businesses may take an annual tax credit for making their businesses accessible to the disabled. Credits are available for expenses on sign language interpreters, reading equipment for the visually impaired, and removal of barriers in buildings.

Value: Tax deduction of up to $5,000 per year.

(Sources: HUD, City of Philadelphia, Enterprise Honolulu, U.S. Department of Labor)

gress. Conservatives who had been pushing for the double tax break for wealthy individuals found they had unwittingly appeased a much wealthier and more powerful constituency – the corporate community. At this point, the debate over passive losses quickly fell away, as Republicans realized they had gotten even more than they initially asked for in their desire to reinstate the passive loss provision. Congressional Democrats realized that in an era of declining budgets for HUD, the tax credits, which had uncorked a growing flood of resources into urban housing projects, were perhaps the best they could hope for.

Subsequent changes in the industry and in the legislation came quickly. The LIHTC became a catalyst that allowed community-development organizations like the LISC and the Enterprise Foundation to situate themselves at the center of local development deals, giving them an institutional power they never before had. In 1987, both of these organizations founded new subsidiaries – the National Equity Fund and the Enterprise Social Investment Corporation, respectively – which syndicated tax credits and managed the resulting funds. In addition, with new funding sources flowing into the industry, LISC and the Enterprise Foundation began to work with banks as well as corporations in structuring deals.

For corporations, the financial benefits attached to buying the credits made participation in the LIHTC program a relatively simple calculus. But large banks began to get involved in inner-city development as well. Since 1977, banks had been under pressure to direct their business to the inner cities in which they operated as a way to combat redlining. However, they could also receive federal Community Reinvestment Act (CRA) credits by engaging in philanthropic activity in the core cities. Most banks preferred to work through CRA channels, as the conventional wisdom of the banking industry was still that lending in inner-city areas was a high-risk proposition.

Banks Come Around

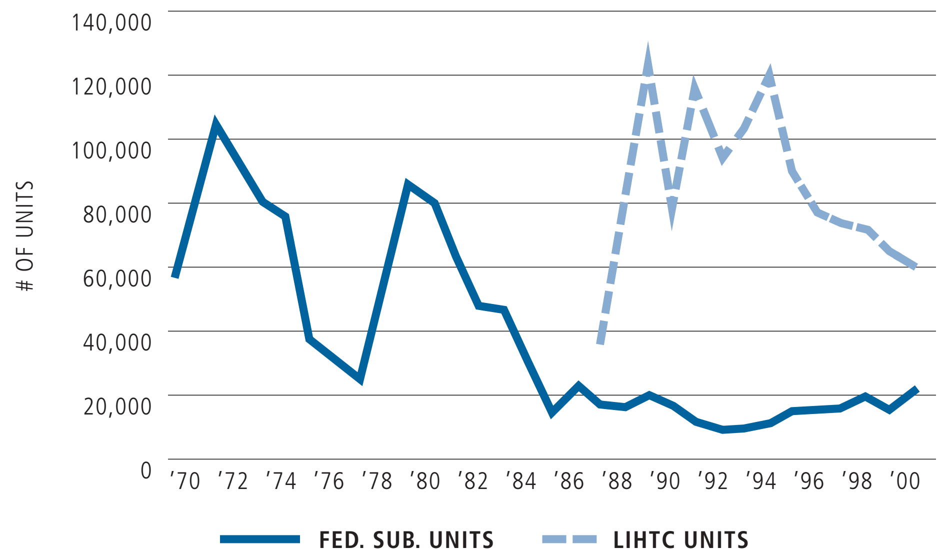
However, with corporate equity investment reducing the amount of construction loans required to complete a project, banks soon came around to lending in the inner city. The new funds available through tax credits often reduced the amount needed for financing by about 30 percent, so that it now made financial sense for banks to lend in areas they had steered clear of in the past.

"In the early years [of the LIHTC], banks and large corporations were uncomfortable with [investing in the inner city],"

explained Kim Nauer, former executive director of the Center for an Urban Future, a New York City think tank. "They were afraid of the inner city, and it just seemed like a foreign world to them. But in the last dozen years or so, two things have happened. First, these banks got comfortable in these areas and began to realize that there is a profit to be made in these areas. And if they built them up – in other words, if they used the money they had to spend effectively – the profits could be even greater. Second, around this time these intermediaries like LISC and Enterprise started to emerge. This was absolutely crucial. These intermediaries were able to work with the banks. This is the fabric that holds it all together. … When corporations started to invest, and these intermediaries emerged to help them figure out how to spend their money on a local level, and then the banks got involved, this dynamic changed everything."

(Figure 1)

Federally Subsidized and LIHTC Multifamily Housing Units, 1970-2000



With the LIHTC, Congress had found a mechanism to privatize low-income housing development. Figure 1 illuminates this shift: By 1986, federally funded multifamily units dropped below 20,000 for the first time in the history of HUD; by 1988, nearly all low-income multifamily units were being funded by the LIHTC.

This shift marked a fundamental moment of institutional change, and not only because it represented a transformation of the funding and development of a public good. Government resources in the form of tax credits leveraged other resources, allowing actors in this newly emerging field to create a common pool of funds and a common set of goals. But "privatization" does not really define this process, because it implies a transfer of public expenditures to private hands. Instead, this process represents a basic transformation of fund generation and governance for housing policy.

More importantly, this was one of the early experiments in the trend toward removing the federal government from housing development and management. The LIHTC has become the primary driver behind the flow of resources into inner-city housing construction, accounting for more than $5 billion in corporate investments.

The history of the LIHTC is a story not only of the unintended consequences of government action, but also of the role of social entrepreneurship in the context of public policy. Government creates opportunities, and social entrepreneurs use them to forge new models of action. In 1986, the tax credit was little more than an attempt to deal with the political bombshell that tax shelters for wealthy individuals had become. But it had unanticipated applications, fundamentally changing the flow of resources in community development and constituting it as a new organizational field. Social entrepreneurs seized on this opening to produce a new model of resource allocation in support of a much-needed public good.

The LIHTC was a tipping point of sorts, bringing corporations and commercial banks into community development in an unprecedented way. Today, the LIHTC is backed by a robust community-development industry that has radically transformed the way that low-income housing is funded and built in urban areas throughout the country.

Of course, we need to be cautious about using the LIHTC as a model for public policy. First, the tax credits represent a massive windfall for corporations. As the welfare state shrinks, it is one thing to think about tax credits as a way to directly allocate resources to a given area (rather than allowing an inefficient government bureaucracy to spend tax dollars in a given area).

But is it necessary or wise to give such a large subsidy to corporations? Under the current system, corporations receive both tax credits and passive loss write-offs that Congress has placed out of bounds for individuals. The LIHTC also is one of many

A handful of community-development entrepreneurs spotted something in the legislation that Congress had not, and created a system that provided an astounding

SET OF RESOURCES FOR SOCIAL CHANGE.

mechanisms that have allowed corporations to become more and more de-linked from the welfare state. By the middle of the 20th century, corporate and individual income taxes each represented about 9 percent of gross domestic product. While individual income taxes still represent about 9 percent of GDP today, corporate income taxes have fallen steadily to about 1 percent.

Linking the development of a public good to the logic of the market has costs as well. For example, developers of LIHTC properties have incentives to keep them at the high end of the "low-income" category – defined as up to 60 percent of local median income – so they can extract the highest rents possible. Sixty percent of median income is certainly low income, but it is a position that is occupied by the working poor. If the LIHTC replaces all federally funded new construction, then who will build housing for the truly poor? Indeed, when I posed such a question to a city official in Atlanta, he simply shrugged and said: "Good question. We do worry about what this is doing to the truly poor."

How the Tax Code Can Help Nonprofits

Nevertheless, there are lessons to be learned from the LIHTC as policy template.

An outbreak of social innovation in the context of shifting federal policies undercuts the notion that social entrepreneurship and government are natural enemies. Congress may not have understood exactly what it was doing at the time, but community developers like Joe Hagan and Jim Rouse of the Enterprise Foundation did. It was through their canny scrutinizing of the institutional opportunities that resources began to flow in a way that they hadn't before. And the LIHTC wasn't a simple case of privatization. Local governments, nonprofit community builders, corporations, and commercial banks came together, each with their own sets of interests, in partnerships that have transformed some cities in the last decade and a half.

Moreover, these partnerships have empowered local nonprofit and community groups in a way that was not possible before. They have not only brought about a more direct flow of resources for community groups, but have put the nonprofits at the table with corporate and financial institutions. These mechanisms are part of a new era of corporate social investment. Though corporations are less moved by the "responsibility" element in the much-touted concept of "corporate social responsibility," they *are* moved by incentives that add up on the accounting side of things. And if they can achieve positive balance sheets while helping to develop a public good, so much the better.

As far as I know, low-income housing is the only area in which nonprofits pursue corporate dollars through "double-dipping." However, there are other models that might be used to similar ends. Corporate philanthropic donations could be employed across a variety of social sectors. Take, for example, the channeling of corporate resources into underfunded public schools. Advertising opportunities or other types of public relations payoff often drive corporate donations. But suppose a nonprofit organization approached a corporation with another form of "payoff": tax breaks. The company would bankroll construction of a new school facility – say a gym, cafeteria, or computer lab. Then it would lease the facility to the school for a low rent through an intermediary organization and take annual write-offs against the depreciation of the asset. As with the LIHTC, the deals could be structured so there is a finite period for the passive loss benefits. And the facility eventually would be donated to the school, giving the corporation an additional write-off for the charitable donation.

This would require a longer time horizon than most corporate foundations are used to. But, if structured the right way, the deals could be financially attractive to corporations – at least more attractive than a simple charitable donation. In order to make a system like this work, a group of nonprofit organizations would have to step up and play the intermediary roles that organizations like the National Equity Fund, the Local Initiatives Support Corporation, and the Enterprise Foundation play with respect to low-income housing. But if the history of the LIHTC teaches us anything, it is that a little innovation can help guide the flow of significant resources to the development of public goods. □

Research for this paper was funded through a grant from the Ford Foundation, with additional support provided by the Social Science Research Council. I would like to thank Philippe Darbouze and Ellen Chan for research support.