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Evelyn Brody, *Chicago-Kent College of Law*

Chicago-Kent College of Law
ILLINOIS INSTITUTE OF TECHNOLOGY

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The States' Growing Use of a Quid-Pro-Quo Rationale For The Charity Property Tax Exemption

by Evelyn Brody

Evelyn Brody is a professor of law at Chicago-Kent College of Law, an associate scholar with the Urban Institute's Center on Nonprofits and Philanthropy, and the reporter for the American Law Institute's project on Principles of the Law of Nonprofit Organizations. She is the editor of Property-Tax Exemption for Charities: Mapping the Battlefield (Urban Institute Press 2002), the following parts of which appeared in State Tax Notes: Janne Gallagher, "The Legal Structure of Property-Tax Exemption," State Tax Notes, May 5, 2003, p. 451; Dick Netzer, "The Role of the Property Tax in Local Government Finance," State Tax Notes, June 23, 2003, p. 1053; Joan M. Youngman, "The Politics of the Property Tax Debate," State Tax Notes, July 14, 2003, p. 107; and Edward A. Zelinsky, "Property Tax Reform as Preservation," State Tax Notes, June 30, 2003, p. 1145. Much gratitude to State Tax Today's daily reporting of court decisions and legislation for making it relatively painless to stay current in a multijurisdiction area of tax law.

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Introduction

In general, state property tax exemption for nonprofits is more accurately an exemption for "charities" as that term is used in the common-law sense — and thus extends to such entities as churches and nonprofit schools, arts and cultural institutions, hospitals, and social service agencies.[1] As a threshold matter, being classified as a charity under IRC section 501(c)(3) does not automatically entitle the entity to property tax exemption. Although some state statutes and common-law tests are less developed than the federal income tax regime, others detail specific types of exempt ownership and use. Some state high courts have construed property tax exemption for charities as requiring the satisfaction of a multifactor test that requires the charity to reduce the burdens of government, operate free from profit motive, and donate a portion of its services. Receiving government funding, competing with for-profit businesses, or even charging market-based fees might have legal significance.

In most states, the charity must both *own* the property (having a charitable tenant rarely qualifies the owner for exemption) and *use* the property for an exempt activity. In some states, charities forfeit property tax exemption by using the property, even in part, for an unrelated business or for investment, while in other states the exemption is apportioned. Charities exempt from property taxes are not usually exempt from user fees and other charges. Separately, charities in some localities face demands to enter into voluntary agreements to make payments in lieu of taxes (PILOTs).

Property tax exemptions for charities cost local governments roughly $8 billion to $13 billion a year.[2] Local administration raises complexities that differ from a charity's experience with an income tax (or sales tax) regime. Depending on the economic environment and other factors, charities might expect the host municipality to bring challenges to the exemption itself, to seek to tax property in part, or to press for PILOTs.

Despite the frequency with which property tax exemption for charities makes the front pages,[3] the data, while sparse, suggest that exemptions granted to nonprofit organizations constitute a small fraction of total exemptions — the largest category of exempt property belongs to governments. Moreover, municipal demands for PILOTs occur only sporadically, and even when PILOT programs exist, they raise comparatively little revenue. How to explain this gap between perception and reality?

If all politics is local, no tax system is more local than the property tax. Property tax exemptions are enacted at the state level, often in the state constitution. Because

[1] *See* Evelyn Brody (editor), *Property-Tax Exemption for Charities: Mapping the Battlefield* (Urban Institute Press 2002). Parts of this introduction are drawn from the introduction to that volume.

[2] *See* Joseph J. Cordes, Marie Gantz, and Thomas Pollak, "What Is the Property-Tax Exemption Worth?" in Brody (ed.), *supra* note 1, pp. 81-112, at 89.

[3] For recent press coverage, see the news stories noted below. *See generally* Harvy Lipman, "The Value of a Tax Break" and "Cities Take Many Approaches to Valuing Tax-Exempt Property," in *The Chronicle of Philanthropy*, Nov. 23, 2006. That feature includes a chart captioned "How Much the Nation's Biggest Cities Lose Because Charities Are Exempt From Property Taxes," along with tables of the 10 most valuable properties owned by nonprofits in each of those 23 cities: Baltimore; Boston; Charlotte, N.C.; Columbus, S.C.; Dallas; Denver; El Paso, Texas; Fort Worth, Texas; Houston; Jacksonville, Fla.; Los Angeles; Memphis, Tenn.; Nashville, Tenn.; New York; Philadelphia; Phoenix; Portland, Ore.; San Diego; San Francisco; San Jose, Calif.; Seattle; Tucson, Ariz.; and Washington, D.C.

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property tax units are local (municipal, county, or special districts, such as school districts), the burden of exemption is distributed unevenly throughout the state. Property ownership by charities tends to cluster in center cities; the same municipalities that host a disproportionately high share of nonprofit property often suffer a disproportionately high demand for public expenditures. In recent years, as population migrates to the suburbs, nonprofits and the burden of exemption follow.

Thus, averages mask the widely varying impact of exemptions on particular communities and of taxes or PILOTs on particular nonprofits. Moreover, the benefits of a particular charity's activities might be enjoyed more broadly than the narrowly bounded municipality that bears the cost of the exemption. Finally, as charities engage in a wider range of activities — including some very commercial ones — public support for exemption crumbles. Much to the nonprofit sector's consternation, tax exemption has come to be viewed as a subsidy granted by government rather than as an inherent entitlement of the organizational form.

Recently, lawsuits and legislation (enacted or proposed) asserting tighter definitions for exemption reflect a growing divergence of federal and state policies and a growing acceptance by the states of a quid pro quo rationale for granting exemption.[4] Most visibly, as states become increasingly concerned about the health needs of the uninsured, legislatures, if not courts, are tempted to to equate charity care with charity as a condition of property tax exemption for nonprofit hospitals. Another significant pressure point is elderly housing. Even a proliferation of churches can rankle.[5] States that prefer a more systemic reform of the property tax treatment of charities might need to obtain a state constitutional amendment.[6] So far, though, charities have succeeded in fighting fundamental change.[7] In addition to the developments described below, consider the following rumblings:

- In October 2002 the supervisors of Fairfax County, Va., approved a moratorium on any new nonprofit tax exemption, citing the need to preserve resources in the face of likely budget cuts. A year earlier, the World Wildlife Federation had won a spectacular $300,000 annual exemption for its new headquarters.[8] In November 2002, voters approved a referendum to transfer approval of new exemptions from the legislature to local authorities. Fairfax County nonprofits worry that the legislation would embolden local communities to demand PILOTs.[9]
- In December 2002 a Cleveland research body proposed as "alternatives for balancing the valuable services contributed by tax-exempt organizations and the revenue needs of local governments" a variety of changes, including: requiring local jurisdiction consent before a tax-exempt entity can buy taxable property; phasing in tax exemption on newly acquired property; phasing out exemption after a specific period; limiting acreage eligible for exemption; adopting a dollar cap on exempt property; and including an allowance in state intergovernment aid to jurisdictions with a large amount of exempt property.[10]
- In 2006 *The New York Times* found that "Connecticut municipalities have become more aggressive in the last several years in trying to collect property taxes from tax-exempt organizations, as cities and towns face shortfalls in their budgets, rising costs, and decreasing aid from the state. After Bridgeport tried to tax a homeless shelter in 2003, the issue landed in the General Assembly, where legislators passed a law exempting nonprofit groups from property taxes if they receive only as much rent, profit or income from their properties as is reasonably needed to carry out their mission."[11]

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[4]*See* Pennsylvania's "Institutions of Purely Public Charities Act," Act 199755, 10 P.S. section 371 et seq., , the legislative intent for which included the following declaration:

> It is the intent of this act to encourage financially secure institutions of purely public charity to enter into voluntary agreements or maintain existing or continuing agreements for the purpose of defraying some of the cost of various local government services. Payments made under such agreements shall be deemed to be in compliance with any fiduciary obligation pertaining to such institutions of purely public charity, its officers or directors.

10 P.S. section 372(a)(7). *See generally* Carolyn Marshall, "As Colleges Grow, a City Is Asking, 'Who Will Pay?'" *The New York Times*, Jan. 19, 2007, p. A14 (relating to a public college, the University of California (at Santa Cruz), exempt under the state constitution). *Cf. City of Marina v. Board of Trustees of the California State University*, 138 P.3d 692, 704 and 706 (Cal. 2006) ("While there does exist a general rule to the effect that 'property owned by the State is exempt from taxation (Cal. Const., art. XIII, [section] 3, subd. (a)), no rule precludes a public entity from sharing with another the cost of improvements benefiting both. Furthermore, while education may be CSU's core function, to avoid or mitigate the environmental effects of its projects is also one of CSU's functions." Accordingly, "a payment by the Trustees for the purpose of mitigating CSUMB's environmental effects would not constitute an unlawful gift of public funds").

[5]*See* Lianne Hart, "Churches Putting Town Out of Business," *The Los Angeles Times*, July 31, 2006, p. A13 (subtitled: "Stafford, Texas, has 51 tax-exempt religious institutions and wants no more: 'Somebody's got to pay for police, fire and schools'").

[6]*See* proposals in Richard D. Pomp, "The Collision Between Nonprofits and Cities Over the Property Tax: Possible Solutions," in Brody (ed.), *supra* note 1, at 383-91.

[7]*See* David Salamone, "Property-Tax Exemption for Charities: The Minnesota Experience," in Brody (ed.), *supra* note 1, at 353-59.

[8]Lisa Rein, "Fairfax Closes Door on Nonprofit Tax Breaks," *The Washington Post*, Oct. 8, 2002, p. B3.

[9]Jacqueline L. Salmon, "As Nonprofit Tax Breaks Vanish, Unease Appears; New Local Authority to Levy Fees Might Imperil Projects," *The Washington Post*, March 16, 2003, p. C1.

[10]Richard G. Sheridan, David A. Ellis, and Richard Marountas, *The Impact of Demographic, Technological, and Federal Policy Changes on Ohio's State and Local Tax Structure* (Federation for Community Planning [now the Center for Community Solutions]: Report 8, December 2002), *available at* http://www.communitysolutions.com/images/upload/resources/TAXINGISSUES8.pdf.

[11]Jane Gordon, "Playing Tough With the Tax-Exempt," *The New York Times*, May 7, 2006, sec. 14CN, p. 1.

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- On February 20, 2007, the town of Mt. Pleasant, N.Y., lost its bid for U.S. Supreme Court certiorari of a decision by the high court of New York rejecting the town's attempt to use its zoning and land use controls to preserve and stabilize the municipal tax base. The New York Court of Appeals had held that ''keeping property in taxpaying hands is not a legitimate purpose of zoning.'' *Town of Mt. Pleasant v. Legion of Christ Inc.*, 850 N.E.2d 1147, 1150 (N.Y. 2006), *cert. denied*, 127 S.Ct. 1332 (2007).

The discussion that follows begins with a brief consideration of the constitutional issues generally underlying property tax exemption for charities.[12] I then examine the definition of charity by looking at the various required factors adopted by state legislatures and courts. The focus of this article is on recent judicial decisions; the many decisions from state supreme courts demonstrate the importance of property tax exemption to the states. The article concludes by looking at alternative means that municipal governments employ to obtain revenue from nonprofits, notably user fees and PILOTs.

I. Constitutional Limitations

A. Equal Protection, Contracts Clause, Commerce Clause, and First Amendment

The U.S. Constitution has few limits on the freedom of states to establish exemptions. As applied today, the equal protection clause, the contracts clause, the commerce clause, and the First Amendment generally permit states to enact tax schemes that offer exemptions to charities (including churches), as long as the classifications are neutrally designed and administered.

As for churches, the U.S. Supreme Court rejected a challenge under the First Amendment's establishment clause to property tax exemption for churches when the exemption is part of a neutrally written statute covering a wide range of nonprofits. *Walz v. Tax Commission*, 397 U.S. 664 (1970). By contrast, the North Carolina Supreme Court struck down a statute that granted property tax exemption for homes for the aged, sick, or infirm only if those homes were operated by religious or Masonic entities. *In the Matter of the Appeal of Springmoor, Inc.*, 498 S.E.2d 177, 180 (N. Car. 1998). The court concluded, ''Religiously affiliated homes are singled out for a tax benefit denied to others that are similarly capable of carrying out the secular objectives which the State may wish to encourage.'' *Id.* at 183. A three-judge dissent believed that *Walz* supports exemption because the homes at issue were exempted as part of a much broader statute that includes secular institutions, and suggested that to the extent secular homes have a valid complaint, it would be under the equal protection and due process clauses (an argument not raised). Most explicitly religious property tax exemptions relate to parsonages, and several (but a diminishing number) of states offer targeted sales tax exemptions related to Bibles.[13]

In one apparently anomalous case, a federal court applied the equal protection clause to strike down Wisconsin's grant of tax exemption to organizations that discriminate on the basis of race, because ''a tax exemption constitutes affirmative, significant state action in an equal protection context where racial discrimination fostered by the State is claimed.'' *Pitts v. Department of Revenue*, 333 F. Supp. 662, 668 (E.D. Wis. 1971). By contrast, in *Bob Jones University v. United States*, 461 U.S. 574 (1983), the Supreme Court held, as a matter of statutory interpretation rather than constitutional law, that Congress did not intend the definition of charity in section 501(c)(3) to include educational organizations engaged in racial discrimination.[14]

In an unusual circumstance, in September 2003 a federal district court held that Northwestern University was entitled to a trial on its claim of ''vindictive action equal protection'' based on its charge that the city of Evanston, Ill., unconstitutionally created a historic preservation district drawn around the university in retaliation for the university's refusal to make PILOTs. *Northwestern University v. City of Evanston*, 2002 U.S. Dist. LEXIS 17104, *25 (N.D. Ill. Sept. 11, 2002).[15] The court

[12]This article does not address state personal property, sales, or income taxes. Nor does it get into the details of exemption for churches. Government-owned property is also beyond the scope of this article.

[13]As for sales tax exemptions, the unique and preferential treatment that some states provide to ''religious'' literature is at risk as content-based discrimination that cannot be saved by a compelling state interest. *See Texas Monthly, Inc. v. Bullock*, 489 U.S. 1 (1989) (plurality opinion) (striking down sales tax exemption for religious literature but not nonreligious texts); *accord Finlator v. Powers*, 902 F.2d 1158 (4th Cir. 1990) (North Carolina); *Thayer v. South Carolina Tax Commission*, 413 S.E.2d 810 (So. Car. 1992); *Haller v. Department of Revenue*, 728 A.2d 351 (Penn.), *cert. denied sub nom. Pennsylvania Dep't of Revenue v. Newman*, 528 U.S. 929 (1999); *Budlong v. Graham*, 414 F. Supp. 2d 1222 (N.D. Ga. 2006). *Compare Arkansas Writers' Project, Inc. v. Ragland*, 481 U.S. 221 (1987) (striking down a state law exempting religious, professional, trade, and sports journals from taxation, but subjecting general interest magazines to a sales tax); *cf. Ahlburn v. Clark*, 728 A.2d 449 (R.I. 1999) (striking down, on free press grounds, tax exemption for sale of ''any canonized scriptures''). Exemptions for sales of religious publications and Bibles remain on the books in Florida and Louisiana, while the Tennessee legislature repealed its exemption.

[14]*Compare Generation Ministries, Inc. and Family Fitness Factory v. Hamburg Township*, MTT Docket No. 28225 (Mich. Tax Tribunal, July 18, 2003), in which the court denied exemption to a health club operated by a religious society because, among other grounds, it discriminated on the basis of religion. The tax tribunal relied on the Michigan Supreme Court decision in *Michigan United Conservation Clubs v. Lansing Township*, 378 N.W.2d 737 (Mich. 1985), that the charity must ''benefit the general public without restriction,'' but it does not discuss why such a ruling does not also jeopardize exemption of the petitioners' summer camp.

[15]Northwestern University obtained its charter from the Illinois legislature in the 19th century. Its charter exemption provides: ''All property, of whatever kind or description, belonging to or owned by said corporation, shall be for ever free from taxation for any and all purposes.'' The legislature later enacted a statute limiting exemptions to property owned by and *used for* exempt purposes. The Illinois Supreme Court held that

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rejected the city's argument ''that any animus it may have toward Northwestern University is not in fact illegitimate'': ''The City suggests it is perfectly rational to harbor animus for an institution which fails to pay for the provision of City services and which threatens to encroach on existing residential neighborhoods. While the City's frustration with the University is understandable, animus against an entity which is merely exercising a right under its charter to be free from property taxation simply cannot be described as legitimate.'' However, the court granted Evanston's motion for summary judgment on Northwestern's claims based on equal protection, substantive due process, procedural due process, and the First Amendment. Following settlement negotiations mediated by Abner Mikva (a former congressman, federal judge, and White House adviser), 14 properties were excluded from the district.

Similar classifications are upheld under state constitutions. In the rare litigated case, courts have rejected challenges to the property tax exemption of single-sex private schools. A Pennsylvania court held that the Hill School, all male at the time, qualified before its admission of girls as an ''institution of purely public charity'' under state law because there is no statutory prohibition against single-gender educational institutions. *Pottstown School District v. The Hill School*, 786 A.2d 312 (Pa. Commw. 2001). The Massachusetts Supreme Judicial Court in 1982 never even reached the merits in dismissing a charge by local assessors that Smith College should be denied exemption because the women's college engaged in sex discrimination in violation of the Equal Rights Amendment to the Massachusetts Constitution. *Trustees of Smith College v. Board of Assessors of Whately*, 434 N.E.2d 182 (Mass. 1982). The court held that the assessors lack the statutory authority to raise such a constitutional challenge and suggested in dicta that such a challenge would have to be made by the attorney general or, possibly, the commissioner of revenue.

this amendment authorized requiring Northwestern to pay tax on properties it leased out, on the grounds that the phrase ''property for schools and religious and charitable purposes'' in the constitution (as then in effect) must have meant property adapted to and intended to be used directly for education. The U.S. Supreme Court disagreed: ''The purposes of the school and the school are not identical. The purpose of a college or university is to give youth an education. The money which comes from the sale or rent of land dedicated to that object aids this purpose. Land so held and leased is held for school purposes, in the fullest and clearest sense.'' *University v. People*, 99 U.S. (9 Otto) 309, 324 (1878). A century later, however, the Cook County collector assessed a tax on the leasehold interests of Northwestern's *tenants*, a maneuver upheld by the Illinois Supreme Court. *Nabisco, Inc. v. Korzen*, 369 N.E.2d 829 (Ill. 1977), *appeal dismissed for want of a substantial federal question*, 435 U.S. 1005 (1978). Following passage of a nonbinding referendum in the university's hometown of Evanston asserting that Northwestern does not pay its ''fair share'' for city services, Evanston considered imposing a $10-per-employee tax on organizations having more than 1,000 workers — affecting only Northwestern and two tax-exempt hospitals.

For some charities, the spillover effect of exemption can extend beyond the state borders, to the consternation of the state hosting the exempt properties.[16] As a matter of statutory interpretation, the Vermont Supreme Court rejected the argument of a town that argued ''that implicit in the definition of public use is a requirement that the people served must be primarily citizens of Vermont and the Town because the Legislature would have no reason to make property exempt to benefit residents of other states.'' *Institute of Professional Practice, Inc. v. Town of Berlin*, 811 A.2d 1238 (Vt. 2002) (holding exempt a building used for the administration of a charity operating out-of-state group homes, foster homes, and assisted living programs for those with developmental and other disabilities). As a federal constitutional matter, in 1997 the U.S. Supreme Court struck down a Maine statute that exempted only nonprofit camps that primarily serve Maine residents. *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564 (1997). The Court accepted the argument that charitable activity is entitled to protection of the commerce clause, which prohibits states from discriminating in interstate commerce. Distinguishing direct government grants from tax exemption, though, the Court suggested that it likely would uphold an outright subsidy targeted either to Maine residents or to camps serving residents. However, four justices, who could not conceive of charities as businesses, strenuously objected to the application of the commerce clause.[17]

B. Judicial vs. Legislative Powers

An important aspect of constitutional law flows from property tax exemptions granted in or authorized by state constitutions and the degree of vigilance with which the courts guard their authority over the constitution.

[16] *See, e.g., Yale Club of Chicago v. Department of Revenue*, 574 N.E.2d 31, 37 (Ill. App. 1991):

> The [Yale Club of Chicago] argues that it ''is organized and operated to benefit the public by the influence of education'' and that it accomplishes this public benefit by ''identifying and evaluating applicants to Yale, stimulating interest in Yale among alumni and the public at large, and maintaining a Yale presence in Chicago.'' An organization designed to benefit Yale exclusively does not appear to dispense its benefits to an indefinite number of people or all those who need and apply for it. The State of Illinois and its taxpayers receive no apparent relief from any economic burden by the YCC's activities. Accordingly, we find it hyperbolic to claim as a ''charitable purpose'' the benefits reserved exclusively to Yale alumni and students.

[17] Moreover, adopting a subsidy approach but rejecting a constitutional distinction between tax exemption and direct grants, the dissenters would also have permitted Maine to target tax exemption to charities whose services lessen the burdens of state government. Scholars are currently debating whether a constitutional distinction between tax subsidies and direct subsidies can be sustained. We recently could have had an answer to this question, except that the Supreme Court avoided reaching the merits by ruling that the plaintiffs lacked standing. See *DaimlerChrysler Corp. v. Cuno*, 126 S. Ct. 1854 (2006). The existence of churches makes applying a subsidy approach to tax exemption a particularly delicate constitutional issue.

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Compare in their construction of similar state constitutional language the more deferential attitude of the Pennsylvania Supreme Court to the legislature with the absolutist approach of the Illinois Supreme Court.

Pennsylvania's constitution provides: "The General Assembly may by law exempt from taxation: . . . (v) Institutions of purely public charity, but in the case of any real property tax exemptions only that portion of real property of such institution which is actually and regularly used for the purposes of the institution."[18] In 1985 the Pennsylvania Supreme Court promulgated a five-part test requiring that an entity claiming classification as a purely public charity under the Pennsylvania Constitution must prove that it

(a) advances a charitable purpose;

(b) donates or renders gratuitously a substantial portion of its services;

(c) benefits a substantial and indefinite class of persons who are legitimate subjects of charity;

(d) relieves the government of some of its burden; and

(e) operates entirely free from private profit motive.

Hospital Utilization Project v. Commonwealth of Pennsylvania, 487 A.2d 1306 (Pa. 1985) (this has become known as the HUP test).

In 1997 the Pennsylvania legislature passed Act 55, The Institutions of Purely Public Charity Act, to

> eliminate inconsistent application of eligibility standards for charitable tax exemptions, reduce confusion and confrontation among traditionally tax-exempt institutions and political subdivisions and ensure that charitable and public funds are not unnecessarily diverted from the public good to litigate eligibility for tax-exempt status by providing standards to be applied uniformly in all proceedings throughout the commonwealth for determining eligibility for exemptions from state and local taxation which are consistent with the traditional legislative and judicial applications of the constitutional term.[19]

The Pennsylvania statute is built around the five-prong HUP test. However, in the view of David Glancey, "While the legislature used the 5-prong standards enunciated initially in the *Hospital Utilization Project* case, it greatly expanded those standards well beyond what any appellate court had ever decided."[20] Indeed, he observes that both before and after the enactment of Act 55, Pennsylvania courts differed on the definition of purely public charity. Lower courts tended to construe the test strictly, while the Pennsylvania Supreme Court accepted an expanded definition. See *City of Washington v. Board of Assessment Appeals*, 704 A.2d 120 (Pa. 1997) (upholding the exemption of Washington and Jefferson College); *Unionville-Chadds Ford School District v. Chester County Board of Assessment Appeals*, 714 A.2 397 (Pa. 1998) (upholding the exemption of Longwood Gardens).

Even though the Pennsylvania Supreme Court is the final arbiter of Pennsylvania's constitution, a challenge to the constitutionality of the legislative scheme created by Act 55 has not materialized. Instead, the Pennsylvania Supreme Court has twice sidestepped the issue, first in 2000 when it reversed the commonwealth court's decision in *Community Options, Inc. v. Board of Property Assessment*, 764 A.2d 645 (Pa. Commw. 2000),[21] and again in 2007, when it reversed the commonwealth court's decision in *Alliance Home of Carlisle Pa. v. Board of Assessment Appeals*, 2007 Pa. LEXIS 844 (Pa. April 17, 2007). *Alliance Home* upheld exemption for an independent living apartment facility in a licensed continuing care retirement community that also included a skilled nursing facility and an assisted living facility.[22] More important than the specific holding is the Pennsylvania Supreme Court's observations about the problems that would be raised by a conflict between the state constitution and the statute:

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[18]Pa. Const. Art. VIII, section 2(a)(v).

[19]10 P.S. section 372(b).

[20]David B. Glancey, "PILOTs: Philadelphia and Pennsylvania," in Brody (ed.), *supra* note 1, at 211-32.

[21]The intermediate court had held that an entity seeking exemption must first establish that it qualifies as a purely public charity under the state constitution — and thus under *HUP* — before it is measured by the statutory standards of Act 55. The property owner was a home for the mentally retarded that received nearly all of its funding from government contracts. The trial court had held that the home was not tax-exempt under pre-Act 55 standards but became exempt after the effective date of Act 55 because it met the requirements of that legislation, which defined in detail the "relieving the burdens of government" standard. On appeal, the commonwealth court agreed that the home was not exempt under pre-Act 55 (constitutional) standards; therefore, for post-Act 55 years, the court need not reach the question whether the home satisfied Act 55's liberalizing standards. The Pennsylvania Supreme Court, however, concluded that the "Appellant relieves the government of some of its burden, satisfying the fourth prong of the *Hospital Utilization Project* test, and therefore qualifies under the Pennsylvania Constitution as a 'purely public charity.'" Since the taxing authorities conceded the home's exemption under the new statute, exemption followed. *Community Options, Inc. v. Board of Property Assessment*, 813 A.2d 680 (Pa. 2002).

[22]*But see* the commonwealth court's denial of exemption in *WRC North Fork Heights Inc. v. Bd. of Assessment Appeals*, 2007 Pa. Commw. LEXIS 65 (Pa Commw. 2007), involving a low-income retirement home federally subsidized under HUD section 202. WRC invoked a Pennsylvania statute declaring that "any charitable organization providing residential housing services in which the charitable nonprofit organization receives subsidies for at least 95 per centum of the residential housing units from a low-income Federal housing program shall remain a 'purely public charity' and tax exempt provided that any surplus from such assistance or subsidy is monitored by the appropriate governmental agency and used solely to advance common charitable purposes within the charitable organization." The court, however, applied the *HUP* factors independent of this statute, concluding:

> WRC's vague testimony that it assists residents in accessing help with medical, social, emotional and spiritual needs, with no attempt to quantify the costs incurred by WRC, could not meet the specific requirements regarding donations stated in [the Charity] Act. In terms of the *HUP*

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> If the Act 55 presumption and test would lead to a holding that a taxpayer qualified as ''an institution of purely public charity,'' where the HUP test would not, fundamental and foundational questions could arise concerning whether: (1) the HUP test, which was adopted in the absence of legislation addressing the constitutional term, occupied the constitutional field concerning the exemption, or instead left room for the General Assembly to address the matter; (2) the legislative scheme as adopted comported with the constitutional command and displaced the HUP test; and/or (3) if HUP were deemed authoritative and comprehensive, whether the legislative findings and scheme set forth in Act 55 gave reason to reconsider the contours of the test thus distilled from judicial experience with individual cases.[23]

Commentator Joseph Bright said of the pattern of decisions in Pennsylvania, ''The commonwealth court has intimated that if Act 1997-55 and *HUP* conflict, *HUP* governs. It is evident from [the] *Alliance Home* opinion that the supreme court not only does not necessarily agree, but that the court believes the provisions of Act 1997-55 should be given greater weight.''[24]

By contrast, consider a 2004 ruling by the Illinois Supreme Court in *Eden Retirement Center, Inc. v. Department of Revenue*, 821 N.E.2d 240 (Ill. 2004). The Illinois Constitution permits the legislature to exempt certain types of property from taxation: ''The General Assembly by law may exempt from taxation only the property of the State, units of local government and school districts and property used exclusively for agricultural and horticultural societies, and for school, religious, cemetery and charitable purposes.''[25] For our purposes, the question is the meaning of the term ''charitable purposes'' in the constitution. Two years before this constitution was adopted, the Illinois Supreme Court adopted its own multipart test for charitable exemption under the constitution then in effect. *Methodist Old Peoples Home v. Korzen*, 39 Ill. 2d 149 (1968), required that: (1) the benefits extend to an indefinite number of persons for their general welfare or in some way reduce the burdens on government; (2) the organization has no capital, capital stock, or shareholders, and does not profit from the enterprise; (3) funds derive mainly from private and public charity and are held in trust for the objects and purposes expressed in the organization's charter; (4) charity is dispensed to all who need and apply for it; (5) no obstacles are placed in the way of those seeking the benefits; and (6) the exclusive (in other words, primary) use of the property is for charitable purposes.

In 1984 the Illinois legislature enacted a detailed property tax statute that granted exemption to, among other categories:

> Old people's homes, facilities for persons with a developmental disability, and not-for-profit organizations providing services or facilities related to the goals of educational, social and physical development, if, upon making application for the exemption, the applicant provides affirmative evidence that the home or facility or organization is an exempt organization under paragraph (3) of Section 501(c) of the Internal Revenue Code or its successor, and either: (i) the bylaws of the home or facility or not-for-profit organization provide for a waiver or reduction, based on an individual's ability to pay, of any entrance fee, assignment of assets, or fee for services, or (ii) the home or facility is qualified, built or financed under Section 202 of the National Housing Act of 1959, as amended.[26]

In *Eden Retirement Home*, the lower courts concluded that the home qualified for the charitable-use property tax exemption based solely on its exemption from federal income taxes and its bylaw provision allowing for the

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analysis, the record lacks evidence that WRC donates or renders gratuitously a ''substantial portion'' of its services.

As to the fourth prong of the *HUP* test, the Court is convinced that WRC's facility is not like that in *Four Freedoms House*, where rents lower than market rate were charged and the entity did not rely on government subsidies to make up the difference.

Id. at *20 (footnote omitted). The dissenting judge pointed out that the specific statute is all that should be required, especially in light of a post-*HUP* Pennsylvania Supreme Court decision with identical facts (although under a different version of the statute), and that *Community Options, Inc.* involved a different type of facility. Moreover, the judge observed that WRC ''can only draw so much in the way of federal subsidies to make up the budgetary shortfall created by inadequate rents; there is no evidence that WRC can simply get more federal funds to pay taxes'' — almost $35,000 in 2004.

Compare two cases decided the same day by the Pennsylvania Commonwealth Court: *Menno Haven Inc. v. Franklin County Bd. of Assessment*, 2006 Pa. Commw. LEXIS 744 (Pa. Commw. 2007) (holding that a skilled nursing facility was not exempt from property tax because the facility did not donate or render gratuitously a substantial portion of its services and did not benefit a substantial and indefinite class of persons), and *Lock Haven Univ. Found. v. Clinton County Bd. of Assessment Appeals*, 2007 Pa. Commw. LEXIS 102 (Pa. Commw. 2007) (upholding exemption for a student housing complex owned by a foundation that is ''the authoritative body to approve and coordinate all fundraising activities carried out on behalf of Lock Haven University'').

[23]2007 Pa. LEXIS 844, *50 (footnotes deleted). Deleted footnote 9 begins: ''Of course, this Court is not obliged to defer to the legislative judgment concerning the proper interpretation of constitutional terms.''

[24]Joseph C. Bright, ''State Supreme Court Overturns Ruling on Charitable Exemptions,'' *State Tax Notes*, Apr. 30, 2007, p. 320. Bright concluded, ''It seems obvious that the state supreme court will not leap to the conclusion that Act 1997-55 is

(Footnote continued in next column.)

unconstitutional because it appears to conflict with *HUP* or any of the cases that preceded or followed it. Rather, the court has laid the groundwork for the conclusion that judicial holdings should be harmonized with Act 1997-55. The General Assembly passed the act almost unanimously after several years of intensive discussion and negotiation among interested parties. The court won't let that effort go to waste.''

[25]Ill. Const. 1970, Art. IX, section 6.

[26]35 ILCS 200/15-65.

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reduction or waiver of charges based on residents' inability to pay. The Illinois Supreme Court reversed:

> The appellate court's analysis is erroneous. The *Methodist Old Peoples Home* criteria are not mere non-statutory ''hurdles'' intended to apply only to the pre-1984 version of the charitable-use property tax exemption statute. Rather, this court articulated the criteria in *Methodist Old Peoples Home* to resolve the constitutional issue of charitable use. The legislature could not declare that property, which satisfied a statutory requirement, was *ipso facto* property used exclusively for a tax-exempt purpose specified in section 6 of article IX of the Illinois Constitution. It is for the courts, and not for the legislature, to determine whether property in a particular case is used for a constitutionally specified purpose.[27]

The Illinois Supreme Court does not explain why only the courts, and not the legislature, may put a gloss on the term ''charitable purposes.''

II. The Definition of Charity

Caveat: Because of the indistinct boundaries of the various factors examined by the courts for demonstrating charity, many of the cases that follow could be assigned to more than one of the categories.

A. Charitable vs. Private or Other Nonprofit Purposes

States sometimes exempt benevolent organizations, but the nonprofit tax exemption is essentially a charity exemption. Although state laws vary in their terminology and details, they have several features in common. In general, exempt property must be owned and operated by a nonprofit religious, educational, charitable, or (as explicitly stated in some states) healthcare institution, exclusively for exempt purposes. Federal section 501(c)(3) status, while often necessary, is not always sufficient. According to Janne Gallagher of the Council on Foundations, ''Since state constitutions exempt 'charities' or 'public charities' or 'institutions of purely public charity,' defining what is meant by charity has been a key issue in the development of state tax-exemption law.''[28] (See also Part I, above.)

In some cases, the question is whether the charity serves a sufficiently charitable class:

- *Kasey Building Association v. Township of Davison*, MTT Docket No. 274470 (Mich. Tax Tribunal, May 20, 2003) (ruling that a corporation established to hold and manage property for a Knights of Columbus hall is not a tax-exempt charitable organization, but rather is a fraternal organization).
- *Wing's Neck Conservation Foundation Inc. v. Board of Assessors of the Town of Bourne* (Mass. App. Tax Bd., July 8, 2003) (ruling that a conservation society is not eligible for an exemption because the property is accessible only to residents of the area and not to the general public: ''Only Wings Neck landowners who belong to the Wings Neck Trust Association, a group of landowners who pay an annual assessment to the Trust for use of Trust lands, are permitted access onto the Trust lands that are clearly marked 'Private Property'''), *aff'd without opinion* 810 N.E.2d 863 (Mass. App. 2004).
- *Country Bible Church v. County of Grant*, 2003 Minn. Tax LEXIS 19 (Minn. Tax Ct. 2003) (upholding exemption for a Christian youth center, including the contested areas: ''We believe that the Destiny Center's prayer room and weight room are devoted to and reasonably necessary to the Church's purpose in attracting and providing a Christian message to others'').

Other cases find too much insider financial benefit — what is known to federal tax practitioners as private inurement:

- *Parson's Inn, Inc. v. Mahaska County Bd.*, 720 N.W.2d 193 (Iowa App. 2006) (family use represented substantial majority of use of inn).
- *St. Joseph's House v. Chester County Bd. of Assessment Appeals*, 872 A.2d 281 (Pa. Commw. Ct. 2005) (upholding denial of exemption based on trial court's finding that founders ''have full and unfettered discretion to collect and distribute the donations received by'' the charity, and that they also ''use donated goods, services, and money for the support of themselves and their fifteen adopted children'').
- *Lyons v. City of Philadelphia Board of Revision of Taxes*, 2003 Pa. Commw. LEXIS 508 (Pa. Commw. Ct. 2003) (denying exemption to property titled in the reverend of a church, rejecting his claim that the church was the equitable owner and holding that even if it were, the institution qualified as a purely public charity).

B. State Multifactor Tests: Ascertaining Charitable Purpose

As suggested in Part I, above, state statutes or supreme courts sometimes adopt multifactor tests for the charity property tax exemption. These tests require not only that the charity be organized as such but also that it operate in specific ways that could be stricter than the federal 501(c)(3) requirements.

The ambiguities and generalities used in these sometimes overlapping factors to define charity mean that resort to court is still required, with differing consequences across the states.[29] The Minnesota Supreme Court's recent description of such an approach implicitly concedes the slipperiness of these ''tests'':

> A worthwhile objective alone does not justify classification as an institution of purely public charity. In *North Star [Research Institute v. County of Hennepin*, 236 N.W.2d 754 (Minn. 1975)], this court established a six-factor test to help determine whether an organization is an institution of purely public charity for the purposes of real property tax exemption.

[27] 821 N.E.2d at 250 (citations omitted).

[28] Janne Gallagher, ''The Legal Structure of Property-Tax Exemption,'' in Brody (ed.), *supra* note 1, pp. 3-22, at 10.

[29] A few states allow municipal veto by placing some types of charities in local option exemption categories.

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> Not every *North Star* factor needs to be met to determine that an organization is a purely public charity. Therefore, when applying the *North Star* factors, we are mindful that the ''purpose of the exemption is to foster and facilitate delivery of charitable services.'' The tax court must decide each case on its own facts.

Croixdale Inc. v. County of Washington, 726 N.W.2d 483 (Minn. 2007) (citations omitted). The concurring justice criticized his court's multifactor test: ''I see a significant risk that the mechanical application of that test could deny the exemption to a charity that our Constitution intended to benefit. I understand the desirability of having a multi-factor test that can give practical meaning to the broad constitutional concept of an institution of 'purely public charity.' But I question whether the *North Star* factors do so. In fact, I believe that at least one of those factors actually contradicts the constitutional concept.''[30] He further commented:

> I find that the organization for which the factors were developed in *North Star* — an organization that performed applied research on the opportunities for economic development for the benefit of private enterprises — is not the type of organization that is traditionally thought of as charitable. In *North Star* we identified traditional charitable undertakings as ''care for the sick, the aged, and the infirm; education of young people; hospital care for the poor; facilities to promote moral and educational welfare of youth; [and] institutions for religious education.'' . . . Obviously, Croixdale's care for the aged by providing assisted living services is an activity that has traditionally been viewed as a charitable undertaking. And the facts surrounding Croixdale's development and implementation of its assisted living services program demonstrate that it deserves to be classified as a traditional charity.[31]

He added, ''In fact, *North Star* observes that '[t]he tendency of our decisions has been to sustain exemption where these traditionally ''charitable'' objectives are being furthered, so long as no individual profits from ownership of the ''charity'' are realized and so long as the undertaking is not a subterfuge by which the needs of a select and favored few are accommodated.' 306 Minn. at 6, 236 N.W.2d at 757.''[32] See further discussion of *Croixdale* below.

C. Relevance of Government Financing and Donations

As described in Part I, some states explicitly require that a charity must relieve the burdens of government, either in all cases or as one factor. However, the activities of the charity need not necessarily be congruent with services currently provided by government. *Christian Fellowship and Renewal Center v. Town of Limington*, 896 A.2d 287 (Me. 2006), is a 4-3 decision in which the Maine Supreme Judicial Court granted exemption for facilities that are provided to houses of worship or other religious societies at a low rate. (The dissent emphasized the ambiguous record that could support either a recreational or charitable (or religious) use.) The majority stated:

> The charitable exemption was created in an age when government provided few services and religious institutions and charities provided many services that government neither provided nor subsidized. Then and now, organizations need not displace government programs in order to serve the common good and qualify for the charitable exemption by providing charitable services to defined groups or to the public at large. One legislative study indicated that the original purposes of the charitable exemption were to promote not only providing services in lieu of government services, but also ''providing a service in which the state has a genuine interest.''[33]

A requirement to lessen the burdens of government raises particular difficulties for charities that rely on government funding: How can the charity be reducing government's burden when government is footing the bill? Compare *Community Options, Inc.* (Pennsylvania) with *Eden Retirement Center, Inc.* (Illinois), discussed in Part I.B, above. Courts ruling in favor of exemption emphasize the beneficial services provided by the charity. See, for example:

- *Southern Jersey Family Medical Center v. City of Pleasantville*, 798 A.2d 120 (N.J. App. Div. 2003), *aff'd without opinion*, 821 A.2d 1147 (N.J. 2003) (ruling that a nonprofit hospital serving low-income patients does not lose property tax exemption because it received substantial government funding and few voluntary contributions).[34] The tax court, having found that the government contributed 85 percent of Southern Jersey's revenues, concluded that the government was not being relieved of its burden. In reversing denial of exemption, the appellate court explained:

  > The Tax Court judge recognized that there is ''no dispute [Southern Jersey] provides medical services to patients in need of care, regardless of their ability to pay.'' . . . Southern Jersey's facility . . . is conveniently located for Pleasantville residents, many of whom are poor and unable to pay market rates for health-care services. Should Pleasantville residents be unable to afford the services offered by profit-making health-care facilities in the area, their only alternative to Southern Jersey

[30] *Id.* at 491 (Hanson, J., concurring).
[31] *Id.*
[32] *Id.* at 493.
[33] 896 A.2d at 295 (citations omitted).
[34] *Compare Disabilities Resource Center/Atlantic and Cape May, Inc. v. City of Somers Point*, 851 A.2d 792 (N.J. App. Div. 2004) (upholding application of the separate ''feeble-minded'' exemption for a group home for the mentally retarded, all of the funding of which comes from the state).

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> would be to receive care at hospital emergency rooms, located in noncontiguous municipalities. Thus, . . . Southern Jersey provides vital services which are unique to the area where the property is located.

As a separate matter, the court observed that "government aid, which is generally not provided to a for-profit commercial enterprise, may support a taxpayer's position that it is exclusively engaged in charitable services." The Appellate Division added that the statute "is silent with regard to the need for a charity to receive donations to maintain its charitable status. Simply because the taxpayer does not engage in significant fund-raising does not lessen the importance of the services it provides to the community."

- *Fairbanks North Star Borough v. Dena' Nena' Henash a/k/a Tanana Chiefs Conference, Inc.*, 88 P.3d 124 (Alaska 2004) (upholding exemption of an organization that provides health, social, and economic services to Alaska natives and villages, despite the borough assessor's factual finding "that TCC is fully, or more than fully, remunerated for its services by federal and state government funding, medical insurance payments, and its investment and rental income"). The Alaska Supreme Court explained, "Our constitution and statutes do not mention lessening of a governmental burden as a factor in charitable-purpose analysis, nor do our cases." The court observed, "It may also be significant that some cases in which receipt of government funding rendered property ineligible, federal grant money was used to construct low-income housing and subsidize rent." By contrast, "many of the cases upholding exemptions despite government funding involved corporations that provided services to their beneficiaries."[35]

As mentioned in Part I, above, and in Part II.D, immediately below, state multifactor tests commonly require some unquantified element of "gift" both in the entity's sources of support and in its service to clientele. The Alaska Supreme Court decision in *Fairbanks North Star Borough* observed, "In some jurisdictions that have adopted multi-factor tests that consider source of funding, courts have not distinguished between government funding and donations. We find this . . . group of cases to be more persuasive."

In an unusual explanation of how a requirement for donative subsidy might be counterproductive, the Minnesota Supreme Court declared in a case involving an assisted living center:

> The tax court's failure to consider whether Croixdale's services were below "cost" penalizes Croixdale for becoming more professional and fiscally responsible. If, to be exempt, a charity must be fiscally irresponsible, not use best management practices, and depend on operating donations to constantly bridge the shortfall in its cash needs, then most exempt charities will not survive because they cannot realistically depend on perpetual operating contributions. The whole purpose of the charitable exemption, to encourage and support the societal contributions of true charities, would be defeated by requiring that they be casually managed. More specifically, a charity that improves its infrastructure and establishes break-even budgets will be one that can stabilize and maximize the care that it can provide to the residents in need. These enhancements should be seen as being supportive of, not contradictory to, the charitable mission.

Croixdale Inc. v. County of Washington, 726 N.W.2d 483, 489 (Minn. 2007). (In Croixdale, however, as described in Part II.E.2, below, the court held that the center failed to meet its burden of proof.) See also discussion of the concurring opinion, in Part II.D, immediately below.

D. Profit Motive: Fee-Charging and Competition With For-Profits

Often a state multifactor test prohibits the charity from operating the property for profit. Special focus falls on charities that charge clients a fee for their services. See, for example:

- *Adult Home at Erie Station Inc. v. Assessor of City of Middletown*, 828 N.Y.S.2d 459, 461 (N.Y. Sup. App. Div. 2007) (granting exemption to a retirement home where "90% of its residents are unable to afford the regular room rates charged in comparable facilities, and the petitioner has incurred deficits which are made up by contributions, subsidies, and debt forgiveness from its parent corporation and affiliates"). The court ruled:

> The fact that a percentage of the petitioner's residents are able to pay the regular room rates or a portion thereof with private funds does not alter the petitioner's essentially charitable nature. Revenues derived from private income are not applied to anyone's profit, but are applied toward the petitioner's charitable purposes. A "commercial patina" alone is not enough to defeat tax-exempt status, especially when such income is merely incidental or auxiliary to the main exempt purpose and does not realize a profit but is used to cover the petitioner's costs.[36]

"Moreover," the court continued, "it is undisputed that no pecuniary profit, apart from reasonable compensation, inures to the benefit of any officers, members, or employees, nor is the petitioner simply used as a guise for profit-making operations."

- *Hazelden Springbrook Inc. v. Yamhill County Assessor*, *2004 STT 134-18* (Or. Tax Ct. 2004) (denying exemption to a residential substance-abuse treatment facility that limits its services to "addicted professionals" and the cost of which is paid "through insurance and personal resources").

[35] *Id.* at 133-34 (footnotes omitted) (citing to *Southern Jersey*, immediately above).

[36] *Id.* (citations omitted).

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- *Bethesda Healthcare, Inc. v. Wilkins*, 806 N.E.2d 142 (Ohio 2004) (affirming denial of property tax exemptions to a portion of a nonprofit-owned health center that granted fee waivers only to a minuscule percentage of patrons).
- *Riverside Medical Center v. Department of Revenue*, 795 N.E.2d 361 (Ill. App. 2003) (denying exemption to nonprofit clinics whose "charity care appears to be a use secondary to the primary function of providing health care to paying customers"). According to the court, "Ninety-seven percent of Riverside's revenues for 1998 came from patient billings: The clinics also had income from rental space. Only 0.05% came from donations."
- *Matter of the University for the Study of Human Goodness and Creative Group Work*, 582 S.E.2d 645 (N.C. App. 2003) (ruling that a restaurant used by a nonprofit organization to teach life skills is not considered educational property for tax exemption purposes).
- *Arts Club of Chicago v. Department of Revenue*, 777 N.E.2d 700 (Ill. App. 2002) (holding that an avant-garde and modern art club that "regularly gives the general public the opportunity to view its permanent collection and temporary exhibits as well as the opportunity to attend various artistic programs and events which it hosts" is a public charity).

The concurring opinion in *Croixdale Inc. v. County of Washington*, 726 N.W.2d 483, 489 (Minn. 2007) (described in Part II.C, above, and in Part II.E.2, below) had another take on the significance of charging fees:

> The added qualification in *North Star* — that the organization is not a "subterfuge by which the needs of a select and favored few are accommodated" . . . is particularly important where, as here, the persons being served are charged a fee for services, because their ability to pay may make them a "select and favored few." Further, this qualification is important where, as here, similar services are provided by for-profit businesses and the question is whether the organization is more akin to a commercial enterprise than to a charity.

However, the concurrence objected to the majority's application of one of the *North Star* factors that "would require the court to make subjective judgments about how much profit is permissible, as being consistent with the charitable mission, and how much is not permissible because it is too great. The Constitution does not provide any objective standards by which to make that judgment and neither does *North Star*."

The existence of for-profit competitors is generally not enough to render property taxable, although courts do consider competition a factor in the analysis described above. See, for example:

- *Regional Economic Community Action Program, Inc. v. Bernaski*, Index No. 4122-2004 (N.Y. Supr. Ct. 2005) ("As the Court views the record, the Petitioner is asking that the Court order a tax exemption for its activities which are actually in competition with private industry. . . . The RECAP apartments are indistinguishable from a commercial apartment complex. . . . [T]he operation of a housing complex, for the 'poor,' does not, *per se*, qualify the property as an exempt charitable use. . . . [¶] The crucial test is that the apartments are run in the same manner as 'for profit' landlords").
- *International Society of Arboriculture v. Department of Revenue*, 2005 STT 159-8 (Ill. ALJ, Dept. Rev. 2005) (ruling that arboriculture society's property is not exempt because the society serves only its members and is operated with a view to profit. "Were I to recommend granting a property tax exemption to ISoA, it would gain an incredible monetary advantage over any other business that promotes and educates persons interested in gardening and other horticultural activities and has to pay its fair share of property tax").

The 1997 Pennsylvania statute described in Part I, above, contains a unique provision that declares, in part, "It is the policy of this act that institutions of purely public charity shall not use their tax-exempt status to compete unfairly with small business."[37] The operative subsection provides, "An institution of purely public charity may not fund, capitalize, guarantee the indebtedness of, lease obligations of or subsidize a commercial business that is unrelated to the institution's charitable purpose as stated in the institution's charter or governing legal documents."[38] A subsection captioned "Remedies" begins: "The Department of State shall establish a system of mandatory arbitration for the purpose of receiving all complaints from aggrieved small businesses relating to an institution of purely public charity's alleged violation of this section." Surprisingly little litigation has ensued under this provision — and small business will not be encouraged by the results of that litigation. In *Selfspot, Inc. v. The Butler County Family YMCA*, 818 A.2d 587 (Pa. Commw. 2003), a for-profit health club was unable to stop a nearby YMCA's "plans to build a new, 35,000-square-foot, full-service fitness center . . . which will feature a state-of-the-art health club and will operate as a tax-exempt charity."[39]

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[37]Pennsylvania Act 1997-55, 10 P.S. section 378(a). This and the next two paragraphs are drawn from Evelyn Brody, "Business Activities of Nonprofit Organizations: Legal Boundary Problems," in *Nonprofits and Business*: *A New World of Innovation and Adaptation* (C. Eugene Steuerle and Joseph J. Cordes, eds.) (forthcoming Urban Institute Press).

[38]*Id.* at section 378(b). Existing commercial activities (unless expanded) are grandfathered, and exceptions are provided to a charity for "commercial business . . . intended only for the use of its employees, staff, alumni, faculty, members, students, clients, volunteers, patients or residents"; "commercial business [that] results in sales to the general public that are incidental or periodic rather than permanent and ongoing"; and "investment in publicly traded stocks and bonds; real estate, whether directly or indirectly." Compare the federal tax exceptions to the unrelated business income tax for activities not regularly carried on, investments, and facilities provided for the convenience of members, students, patients, officers, and employees. See Internal Revenue Code sections 511(a)(1), 512(b), 513(a)(2).

[39]The commonwealth court overruled *Dynamic Sports Fitness Corp. of America, Inc. v. Community YMCA of Eastern Delaware County, Ridley Area YMCA Branch*, 768 A.2d 375 (Pa. Commw. 2001), "to the limited extent that it held that 'promotion of

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Executive compensation is attracting greater attention, at both the federal and state levels. The Pennsylvania Commonwealth Court denied exemption to a nonprofit physicians' clinic (federally exempt as an organization described under section 501(c)(3)) that did not pay dividends to shareholders. *Guthrie Clinic, Ltd. v. Sullivan County Board of Assessment Appeals*, 898 A.2d 1194 (Pa. Commw. 2006). The court ruled that because the clinic compensated physician employees on the basis of ''productivity,'' it did not prove that it operated free from profit motive.[40] But compare a suit brought under Tennessee law by a group of for-profit health club owners against the YMCA of Middle Tennessee. The Tennessee statute requires that ''directors and officers shall serve without compensation beyond reasonable compensation.'' An appeals court rejected the plaintiff's claim that the compensation paid to the Y's chief executive is ''clearly excessive'' when ''the record indicates that the YMCA has a $60 million operating budget, it has hundred[s] of programs, which serve over 160,000 people, [and it] has approximately 2,900 employees and 3,100 volunteers.'' *Club Systems of Tennessee, Inc. v. YMCA of Middle Tennessee*, 2005 Tenn. App. LEXIS 793 (Tenn. App. 2005).

In 2001, YMCAs in Wisconsin obtained the protection of an explicit statutory exemption. The state appellate court, in *Lake Country Racquet and Athletic Club Inc. v. Morgan*, 710 N.W.2d 701 (Wis. App. 2006), upheld the new statute against constitutional challenge. In February 2007 the Colorado Board of Assessment Appeals ruled that two YMCA of the Rockies camps were recreational, not religious, allowing exemption only for the small portion of the land occupied by the chapel. ''The decision, which could be far-reaching because more than 6,000 properties in the state have religious exemptions, will likely be reviewed by a Colorado court.''[41]

As a separate matter, Joan Youngman cautioned, ''Controversial positions on social, economic, and cultural issues will inevitably attract hostile attention to any public subsidy or tax preference benefiting the positions' proponents.''[42]

health' is necessarily intertwined with the charitable mission of a YMCA, such that a complaining small business cannot state a claim under Section 8 by challenging a YMCA's provision of new or expanded commercial health-club type facilities.'' *Id.* at 593-94.

[40]This decision was criticized in Joseph C. Bright, ''Court Denies Tax-Exempt Status to Medical Group,'' *State Tax Notes*, June 12, 2006, p. 832 (''However, the applicable statute proscribes compensation based on the financial performance of the institution — not based on the performance of employees. 10 P.S. section 375(c)''). ''Indeed,'' the author concluded, ''it would be counterproductive to prohibit any such measurement of useful work.''

[41]Jennifer Carr and Cara Griffith, ''The Muddled World of Colorado's Religious Use Property Tax- Exemption,'' *The Exempt Organization Tax Review*, Apr. 2007, p. 79.

[42]Joan M. Youngman, ''The Politics of the Property-Tax Debate,'' in Brody (ed.), *supra* note 1, pp. 23-46, at 33.

E. Specific Categories: Hospitals, Housing and Skilled Nursing Facilities, Day Care

1. Hospitals

Although health clubs remain a focus of municipal challenge, hospitals attract even more attention. Given their visibility in the community — both in terms of property ownership and economic power as employers — hospitals sometimes find that even an explicit statutory mention does not ensure their exemption.[43] At the federal level, policymakers recently held a hearing on the rationale for exemption, notably for healthcare organizations.[44] At the state level perhaps more than at the federal level, the special claims of nonprofit hospitals can fade in the sunshine of data showing their resemblance to the operations of for-profit hospitals, particularly in the level of charity care and billing practices for uninsured patients.[45]

The Illinois hospital sector has been shaken by the September 29, 2006, administrative ruling of the Illinois Department of Revenue that Provena Covenant Medical Center, a nonprofit hospital in Urbana, should lose its $1 million a year exemption because it spent less than 1 percent of revenue on charity care.[46] (The hospital is appealing in court.) This ruling came on the heels of an unnerving legislative proposal by Illinois Attorney General Lisa Madigan that property tax exemption for a hospital should be conditioned on spending at least 8

[43]Notably, Texas imposes special community service requirements on nonprofit healthcare. Gallagher explained, ''Strictly speaking, the Texas community-care requirements, which can be found in chapter 61 of the Texas Health and Safety Code, are a condition of hospital licensure, not property-tax exemption. However, Pennsylvania authorities used them as a model when drafting the community-service provisions of Act 55, the 1997 statute addressing property-tax exemption for institutions of purely public charity.'' Gallagher, *supra* note 28, at 20 n.4.

[44]See the testimony presented at the April 20, 2005, House Committee on Ways and Means hearing, ''Overview of the Tax-Exempt Sector,'' available through links at http://waysandmeans.house.gov/hearings.asp?formmode=detail&hearing=400.

[45] But see Mark Schlesinger and Bradford H. Gray, ''Nonprofit Organizations and Health Care: Some Paradoxes of Persistent Scrutiny,'' in Walter F. Powell and Richard Steinberg (editors), *The Non-Profit Sector*: *A Research Handbook* (2d ed.) (Yale University Press 2006) (presenting a nuanced analysis of over 200 empirical studies comparing performance of for-profit and nonprofit hospitals, nursing homes, and managed-care organizations). See also Jill Horwitz, ''Does Nonprofit Ownership Matter?'' 24 *Yale J. on Reg*. 139 (2007) (rejecting arguments that nonprofit hospitals should either lose their tax-exempt status or adhere to new, strict, and specific requirements to provide free services for the poor, by showing that nonprofit hospitals act in the public interest by providing services that are unlikely to be offered by the other types of hospitals). For links to current developments relating to the hospital exemption, at both the federal and state level, see the Web site of the American Hospital Association, at www.aha.org/aha/key_issues/bcp/index.html.

[46]*See* Jennifer Carr and Cara Griffith, ''The Fight Over Tax-Exempt Hospitals in Illinois,'' *State Tax Notes*, Nov. 13, 2006, p. 457.

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percent of operating costs on charity care.[47] The attorney general's proposal was quickly tabled but is scheduled to return in some form. Then, in February 2007, the DOR revoked the exemptions of Carle Hospital and Richland Memorial Hospital. Note that in the case of the latter, the town had no objection to exemption.[48]

By contrast, the Michigan Supreme Court found that no particular monetary level of charity care is required by the state statute. *Wexford Medical Group v. City of Cadillac*, 713 N.W.2d 734 (Mich. 2006). In that case, the amount of pure charity care in one year was $2,400 (out of a budget of $10 million). The court described the difficulty of determining what forgone revenue to count as charity care, concluding, ''Clearly, courts are unequipped to handle these and many other unanswered questions. Simply put, these are matters for the legislature.''

University of Illinois law professor John D. Colombo observed, ''Even in those states that have not 'officially' returned to a charity care focus for exemption, the current trend is having an effect. For example, a number of states have enacted reporting requirements that force exempt healthcare entities to disclose their charity care efforts, and healthcare associations in several states, including Missouri, New Jersey and Massachusetts, have begun issuing charity care guidelines for members in attempts to stave off more drastic governmental intervention.''[49] Compare the similar debate at the federal level, where the requirement for exemption is not charity care per se, but rather community benefit.

An Illinois appeals court in *Community Health Care, Inc. v. Department of Revenue*, 859 N.E.2d 1196 (Ill. App. 2006), denied exemption for a healthcare corporation's primary care clinic because of the corporation's failure to show that it was a charitable organization and that it used the clinic exclusively for charitable purposes. The court found:

> CHC's ''charitable purpose'' is to provide discounted or free medical service to a medically underserved community. By its own admission it uses the property for that purpose only 27% of the time. The remaining 73% of the time, CHC uses the property as a not-for-profit medical clinic. Further, CHC's evidence as to the level of charitable operations at this facility is speculative. CHC relied on ''organization-wide financial data to extrapolate the patient and payor mix'' at the Rock Island facility. In fact, CHC states that it ''had little concrete data to support its conclusion other than reliance on its previous years of historical data and knowledge'' at other facilities.

See also Part III.A, below, discussing apportioning between taxable and exempt use.

2. Housing (low-income, retirement, and special needs) and skilled nursing

Long-term housing gives rise to frequent litigation, particularly retirement housing offered at market rates.[50] (See also Part II.D, above, discussing profit-motive and competition.) According to Gallagher, ''Seeing the clear contrast between, for example, elderly people who live in their own homes and pay taxes, and those who live in property owned by a charitable institution that does not, many courts have held housing providers to a particularly strict standard of proof.''[51] Decisions relating to retirement, assisted living, and low-income housing facilities vary depending on differences in state law:[52]

- *Alliance Home of Carlisle Pa. v. Board of Assessment Appeals*, 2007 Pa. LEXIS 844 (Pa. April 17, 2007), discussed in Part I.B, above. Applying the statute's ''parcel review'' to the independent living apartments in the continuing care retirement community (CCRC), the court noted, ''Although the language employed in the statute is not identical to the constitutional text — i.e., where the constitutional text speaks of 'used for the purposes of the institution,' the statute speaks of 'being used to advance the charitable purpose' — it would appear that any definitional difference is minor and, if anything, would serve to narrow the exemption, which the General Assembly is free to do.'' The court then ruled, ''Considering the unique nature of the institution at issue (i.e., a CCRC operated as a charitable institution), we have no doubt that the independent living facility is indeed actually and regularly used for the purposes of the institution.''[53]

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[47]Madigan press release, Jan. 23, 2006, available at www.illinoisattorneygeneral.gov/pressroom/2006_01/20060123.html. For information, including primary sources and analysis, on this proposal and other Illinois developments, go to the Web site of the Illinois Hospital Association, at www.ihatoday.org/issues/payment/charity/agproposals.html.

[48]*See* Mike Colias, ''Exemptions Denied for 2 More Illinois Hospitals,'' *Crain's Chicago Business*, Feb. 28, 2007 (''Unlike in the Champaign County cases, in which tax officials recommended Provena and Carle be denied exemptions, local tax officials had granted Richland's exemption. (The state has the final say on exemption requests.)'').

[49]John D. Colombo, ''The Failure of Community Benefit,'' 15 *Health Matrix* 29 (2005).

[50]Separately, parsonage exemptions have proved controversial. *See also* Jennifer Carr and Cara Griffith, ''A Look at Alaska's Religious Education Housing Tax Exemption,'' *State Tax Notes*, July 3, 2006, p. 63, reporting that on June 12, 2006, ''the American Civil Liberties Union of Alaska and two Anchorage residents, Keith Coonrod and Ray Metcalfe, filed suit against the state of Alaska over a new law that provides a property tax exemption for housing owned by a religious organization and used to house teachers and other employees (religious teacher exemption).'' *See generally* Diana B. Henriques, ''In God's Name: As Religious Programs Expand, Disputes Rise Over Tax Breaks,'' *The New York Times*, Oct. 10, 2006, p. A1 (describing various residential properties run by religious bodies).

[51]Gallagher, *supra* note 28, at 5-6.

[52]*See generally* David A. Brennen, ''The Commerciality Doctrine as Applied to the Charitable Tax Exemption for Homes for the Aged — State and Local Perspective,'' __ *Fordham Law Review* __ (forthcoming 2007).

[53]The court explained:

> Appellant's status as a CCRC has been recognized and licensed and, as such, it is subject to the restrictions and regulations placed upon such communities by the CCPRDA. Although the independent living facility, if it

(Footnote continued on next page.)

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- *Croixdale Inc. v. County of Washington*, 726 N.W.2d 483 (Minn. 2007) (denying exemption to assisted living facility because the taxpayer failed to prove how it allocated costs between an admittedly nonexempt living facility and the assisted-living facility, and inviting reapplication for future years). Note that 90 percent of the residents are low-income persons, 28 percent of whom receive government assistance either under the center's elderly waiver program or an alternative care program. *Id*. at 494.
- *Appeal of Town of Wolfeboro*, 879 A.2d 1137 (N.H. 2005) (denying exemption for a housing unit rented to the elderly at market rates when, without more, the owner ''happens to operate under the corporate umbrella of a charitable organization'').
- *Eden Retirement Center, Inc. v. Department of Revenue*, 821 N.E.2d 240 (Ill. 2004) (holding that a nonprofit home for the aged was not exempt as a charitable use because its services were not available to an indefinite number of persons and its fees created a substantial obstacle to those seeking charitable services). (See discussion in Part I.B, above.)
- *Maplewood Community, Inc. v. Craig*, 607 S.E.2d 379 (W. Va. 2004) (denying exemption for two assisted living facilities for the elderly; the facility's services are generally limited to those who are able to pay). The court observed (footnote omitted):

> Appellants are essentially seeking a policy decision from this Court that entails the determination that a limited economic subset of this state's senior citizenry are exempt from property taxation based on their specific type of residential arrangements. That issue, however, is not a judicial decision but a determination that must be made by the Legislature, either through expanded regulations or through a separate legislative enactment that specifically addresses whether not-for-profit corporations, such as Appellants, that provide alternative residential arrangements for this state's senior citizens are entitled to exemption from ad valorem property taxation.

- *Sioux Center Community Hospital Health Center*, 720 N.W.2d 192 (Iowa App. 2006) (no automatic exemption for assisted living facility operated by a charitable hospital).
- *Jewish Geriatric Services Inc. v. Board of Assessors of Longmeadow*, 807 N.E.2d 194 (Mass. App. 2004) (''While the Supreme Judicial Court has not set a bright line test for determining whether an organization serves 'a sufficiently large or indefinite class,' the evidence supports the board's conclusion that Ruth's House . . . serves only a financially independent segment of our population, defeating its claim that it serves a charitable purpose.'' Separately, ''[t]hat some of the residents of Ruth's House would be physically unable to live independently is irrelevant to the taxpayers' contention that the government would have to care for them if there were no Ruth's House'').
- *Lamad Ministries, Inc. v. Dougherty County Board of Tax Assessors*, 602 S.E.2d 845 (Ga. App. 2004), and *Board of Tax Assessors of Ware County v. Baptist Village, Inc.*, 605 S.E.2d 436 (Ga. App. 2004) (exemptions granted under a specific statute for nonprofit homes for the aged). In *Lamad Ministries*, the appeals court declared that the ''clear and unambiguous purpose'' of the statute ''was to encourage the building and operation of homes for the aged by offering ad valorem tax exemption to nongovernmental tax exempt nonprofit Georgia corporations, because there is a growing aging population and a need for housing for them; therefore, the scheme and purpose of the Act was to encourage, and not to discourage, the creation of homes for the aged.'' In *Baptist Village*, the appeals court rejected the argument that the independent-living units (located on a property that also included assisted-living and nursing-care facilities) were held for investment purposes, which under the statute would have resulted in taxability.
- *Wittenberg Lutheran Village Endowment Corporation v. Lake County Property Tax Assessment Board of Appeals*, 782 N.E.2d 483 (Indiana Tax Court, Jan 24, 2003) (holding that a retirement community established by 160 northern Indiana Lutheran congregations was entitled to exemption as a charity).
- *The Fanny J. Crosby Memorial Inc. v. City of Bridgeport*, 811 A.2d 1277 (Conn. 2002) (affirming holding that housing for the elderly is not a charitable purpose, based on Conn. Gen. Stat. section 12-81(7), which expressly excludes low- and moderate-income housing from being a charitable purpose). Note that while Bridgeport has treated the property as exempt since 1927, in 1996 the use of the facility shifted almost entirely to a residential substance-abuse program and providing shelter to the homeless.[54]

were viewed in isolation or as a separate institution, might not on its own qualify as a purely public charity, its role in the comprehensive care scheme provided by appellant is consistent with, is tied to, and advances appellant's charitable purpose. The independent living facility is not a public restaurant, movie theater, golf course or some other unrelated business entity existing solely as a revenue stream to finance a different and charitable endeavor. Instead, as Judge Leavitt emphasized in dissent below, the independent living units offer entry into a community which promises to provide for the future needs of the elderly and infirm, needs that may change over time to include assisted living and skilled nursing care. In the CCPRDA, the General Assembly recognized that such ''continuing-care communities have become an important and necessary alternative for the long-term residential, social and health maintenance needs for many of the Commonwealth's elderly citizens.'' 40 P.S. section 3202.

[54]*Cf. Matter of Community Action Agency Inc. v. Board of Equalization of Nez Perce County*, 57 P.3d 793 (Idaho 2002) (upholding a one-year revocation of exemption for low-income housing provider):

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In 2004 the Wisconsin Legislature enacted SB 512 (signed into law as Act 195) to restore tax-exempt status to nonprofit housing for low-income persons, thus overruling *Columbus Park Housing v. City of Kenosha*, 671 N.W.2d 633 (Wis. 2003).

Compare housing for a special-needs population other than the elderly able to pay market rates. In *Community Access Unlimited Inc. v. City of Elizabeth*, 21 N.J. Tax 604, 2003 N.J. Tax LEXIS 20 (2003), the tax court found that housing is secondary to the charity's main purpose of giving individuals incapable of functioning on their own an opportunity to live as close to a normal life as possible; that rehabilitating the mentally disabled is an important and legitimate government concern; and that the charity depends on charitable contributions. Specifically, because of substantial capital campaigns (including the donation of two of the subject properties for consideration of less than $100), ''CAU is able to reduce the government's burden by providing mentally disabled members with rehabilitative services and housing at a lower cost per individual than the government.''

Separately, as mentioned in Part I.A, above, exemption might be available for clergy housing (parsonages). But see *First Presbyterian Church of Chattanooga v. Tennessee Board of Equalization*, 127 S.W.3d 742 (Tenn. App. 2003), denying exemption to a house bequeathed to a church to be used for the temporary housing and convenience of the church's missionaries, and so used. The court cited a case seeking exemption for a minister's parsonage, *Blackwood Brothers Evangelistic Association v. State Board of Equalization*, 614 S.W.2d 364 (Tenn. App. 1980), which held, ''Parsonages, per se, are not given exemption under the statute; only those pieces of property that are used purely and exclusively for religious, charitable, scientific or educational purposes are exempt.''

For an adverse ruling against a skilled nursing facility, see the 2007 Pennsylvania Commonwealth Court decision in *Menno Haven*, discussed in footnote 22, above. The court found two factors particularly significant under the HUP test: Menno Haven has a low population of Medicaid recipient residents (between 25 percent and 28 percent) and Menno Haven receives a large amount of fees, including a ''hefty'' entrance fee, from the residents.

This case comes as close to the borderline in weighing factors as any that have come to this Court. It is difficult to ignore the fact that the Board granted the exemption before and after the year in question. There are apparently no facts to distinguish the years in which an exemption has been granted and the year when it was denied. Under these circumstances it is difficult to apply the principle that tax exemptions are strictly construed against the taxpayer. [¶] . . . [T]he board must determine, on a yearly basis, whether an organization is exempt from property tax. The Board was justified in re-examining those properties that were previously granted a property tax exemption. It was also justified in revisiting the issue and again granting the exemption. Quasi estoppel does not apply in the present case.

3. Day care

Depending on the vagaries in a state's property tax scheme, a nonprofit day-care facility might have to rely on the education category of exemption. Some states distinguish custodial day care from educational day care and deny exemption to the former category. Compare the following:

- *Under the Rainbow Child Care Center Inc. v. County of Goodhue*, 2007 Minn. Tax LEXIS 3 (Minn. Tax Ct. 2007) (upholding exemption): ''While the legislature has not taken to directly providing child care services pursuant to these objectives, it has enacted a comprehensive legislative framework in developing, expanding, and improving access and availability of child care services statewide.''
- *In the Matter of the Appeal of Chapel Hill Day Care Center, Inc.*, 551 S.E.2d 172 (N.C. App. 2001) (upholding denial of exemption to a child-care facility not ''wholly and exclusively used for educational purposes,'' as required by statute, beginning when the day care center was spun off from a church; distinguishing *Springmoor, Inc.* (N.C. 1998), discussed in Part I.A, above).
- *Matter of Totsland Preschool Inc.*, 636 S.E.2d 292, 297 (N.C. App. 2006) (holding that a nonprofit day care center for the children of low-income individuals was exempt despite government subsidies; the center was provided for the community's benefit without expectation of pecuniary profit or reward). (Compare with *Chapel Hill Day Care Center* (above).) The court added:

  > In addition to daycare services, Totsland provides a number of other services to the community at large, free of charge. The organization provides job training to youth, along with an after school program for children up to age twelve. Totsland also offers educational programs for parents, and works to educate them on various issues and on resources available in the community. Totsland serves as a referral source for parents so that they can learn what services are available to them. While Totsland relies heavily on government funding, and would not be able to continue to operate absent the government funding, it also relies on donations of equipment from other area nonprofit organizations, and on the services of volunteers.

- *Milwaukee Regional Medical Center Inc. v. City of Wauwatosa*, 720 N.W.2d 161 (Wisc. App. 2006), *petition for review granted*, 724 N.W.2d 202 (Wisc. 2006) (holding that a medical center's day-care facility located on land leased for $1 a year from the county to build a day-care facility was not exempt from property tax because the center was the beneficial owner of the facility and it was not ''substantially and primarily devoted to educational purposes'').

On separate grounds, a nonprofit employer might be able to obtain exemption for facilities providing day care to its own employees. In *St. Joseph's Hospital of Marshfield Inc. v. City of Marshfield, 2004 STT 175-28* (Wis. App. 2004), the court held that a hospital's child-care facility was

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reasonably necessary to the efficient operation of the hospital to the extent operated for employees and is thereby partially exempt from property tax. See also South Carolina Revenue Ruling 05-18 (2005), described in Part III.B, below; *In the Matter of the Moses H. Cone Memorial Hospital*, 439 S.E.2d 778 (N.C. App. 1994).

III. Exempt Ownership and Use

Exemption is generally not available for property leased (but not owned) by a charity, nor is it available for (most) investment property.

A. Used in Part for Exempt Purposes

For property used only in part for an exempt purpose, some states deny exemption altogether, some states ignore de minimis unrelated use, and, most commonly, some states apportion tax for property used in part in an unrelated business. In this last situation, exemption might be allocated on the basis of time (for example, days used) or space (for example, square feet). Gallagher reported:

> California has adopted a sophisticated statutory formula to apportion tax exemption for property that falls within the state's "welfare" exemption — that is, property used for religious, hospital, scientific, or charitable purposes (Cal. Rev. & Tax Code, [section] 214). For purposes of the formula, a use is unrelated to the property's exempt purpose only if it produces unrelated business taxable income, as defined in section 512 of the Internal Revenue Code. If the organization uses a reasonably ascertainable portion of the property to produce the unrelated income, the tax obligation for that piece will be apportioned based on the amount of income it derives from taxable versus exempt activities at that location. If the exempt activity does not produce income, the tax will be apportioned based on the amount of time devoted to taxable versus exempt activities at that location. If there is no ascertainable portion of the property used to produce the taxable income, the assessor applies the same formula to the entire property (Cal. Rev. & Tax Code, [section] 214.05).[55]

The Girl Scouts-Great Trail Council in Ohio breathed a sigh of relief when the Ohio Supreme Court held that the council's use of a small portion of an office building as a store selling scouting merchandise did not subject it to property taxes. *Girl Scouts-Great Trail Council v. Levin*, 862 N.E.2d 493 (Ohio 2007). The Ohio statute grants exemption for charity-owned property "used exclusively . . . in furtherance of or incidental to its charitable, educational, or public purposes and not with the view to profit." The supreme court ruled, "In the instant case, the store operated by the Girl Scouts exists to accommodate the Girl Scouts, the prices charged are intended to cover its costs of operation, and the merchandise is not marketed to compete with commercial, for-profit enterprises." Having previously ruled that "exclusively" means "primarily," the court concluded "that the primary use of the property is to fulfill the charitable function served by the Girl Scouts." Finally, the court declared, "The amount of profit that an institution realizes is not a determinative factor for whether an institution has used its property with a view to profit."

State tax authorities are slowly awakening to the increasing sophistication to which nonprofit organizations are putting their property. For example, the South Carolina Department of Revenue recently issued guidance on a variety of properties commonly owned by nonprofit hospitals, applying as the test whether the property is "devoted to, and necessary for, the functional operation of the hospital."[56] While the examples in this ruling are conditioned on the facts and circumstances, generally, property tax exemption is not available in South Carolina to a shopping center (received as a gift); a medical office building (except for offices occupied by doctors who are employees); a child-care center for the convenience of employees; and a parking facility (but only to the extent used by or for unrelated businesses, including non-employee doctors).

The New Jersey courts expressed skepticism — if not incredulity — over an argument for an "evolving definition" of the term "hospital purposes." Several different uses of the property were at issue in *Hunterdon Medical Center v. Readington Township*, 22 N.J. Tax 302, 2005 N.J. Tax LEXIS 11 (N.J. Tax Ct. 2005), *aff'd* 2007 N.J. Super. LEXIS 88 (N.J. App. Div. 2007), which arose under a statutory exemption for facilities used for "hospital purposes." Strictly construing the statutory exemption, the tax court formulated a three-part analytical framework that considers: "the nature and extent of the integration between the hospital and the subject facility"; "the extent to which the activity conducted in the facility is under the control or supervision of the hospital medical staff"; and "whether the facility serves primarily hospital patients or primarily members of the general public." The appellate body approved of this approach: "The components of the analytical framework contain rational, objective criteria, with a built-in flexibility that enables a fair balancing of the interests of the hospital and the municipality." Applying this framework, exemption was allowed only for the portion of the hospital's building used exclusively for rehabilitation. Exemption was denied for the portions occupied by the pediatric practice run jointly with physicians, because the practice shared profits with the physicians; it primarily served members of the public, not hospital patients; and it directly competed with nearby private physician practices. Exemption was also denied for the portion occupied by the Wellness Center. The tax court explained that the evolving definition of hospital purposes urged by the property owner "possibly could include a supermarket owned and operated by a hospital and selling only food products approved by its dietitian or nutritionist . . . or a hospital-owned massage

[55] *See* Gallagher, *supra* note 28.

[56] S.C. Revenue Ruling 05-18, Dec. 13, 2005, available at www.sctax.org/NR/rdonlyres/52FC5E2A-82A8-4153-9806-CFB6DC1025F4/0/RR0518.pdf.

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parlor providing services only to those working at high levels of stress.'' Such an approach ''improperly conflates the concept of hospital purpose with any service or activity which has a health benefit.''

The requirement of ''use'' means that taxes continue to be owed while a charity holds property for future development, with litigation sometimes occurring over ''whether the drawing up of plans or the application for permits constitutes the formal commencement of the construction process.''[57] The use requirement can result in excess property — such as that held by a summer camp or church — not being exempt. Some statutes set forth specific acreage or value limitations. *Student Loan Fund of Idaho, Inc. v. Payette County*, 69 P.3d 104 (Idaho 2003), affirmed a decision to deny property tax exemption to the Student Loan Fund of Idaho, whose 60-acre property was not used exclusively for its charitable purposes (note that the taxpayer did not raise the issue of apportioning exempt use).

B. Property Leased to Another

If two charities co-own and occupy property for each of their exempt activities, the property would presumably be exempt.[58] Nevertheless, property leased by one charity to another charity for use in the tenant's exempt purpose is, in the absence of a statute to the contrary, usually taxable. Gallagher explains that in such a case, some states ''simply disregard situations in which one charity permits another to occupy a small percentage of its space, treating such uses as incidental. As the trend toward apportioning space between taxable and nontaxable uses has grown, however, courts and legislatures have been forced to fashion equitable solutions. A common one is to permit exemption only when the lease arrangements are at or below cost.''[59]

Matter of Application of KSU Foundation, *2005 STT 128-11* (Kan. App. 2005), held that a foundation formed to support Kansas State University was not entitled to a property tax exemption on a building that it acquired at the university's request to lease at cost for the university's printing operations: ''Under this lease arrangement, we conclude the Foundation's only use of the property is a financial one.'' By contrast, under a statute allowing exemption for property leased by one charity to another, *Miracit Development Corp. v. Zaino*, 2005 Ohio 1021 (Ohio App. 2005), the court recognized the exemption of a nonprofit day-care center that furthers the ''objective of revitalizing an economically depressed neighborhood . . . and assisting the economically disadvantaged residents of that neighborhood.''

South Carolina H 4426, signed into law as Act 360 on June 9, 2006, exempts the portion of property leased by one entity exempt as a nonprofit corporation funded by federal or state loans or as a religious, charitable, eleemosynary, educational, or literary organization to a similar property tax-exempt organization.[60] More broadly, as approved by a 2006 referendum, Georgia law now provides that ''real estate or buildings which are owned by a charitable institution that is exempt from taxation under Section 501(c)(3) of the federal Internal Revenue Code and used by such charitable institution for the charitable purposes of such charitable institution may be used for the purpose of securing income so long as such income is used exclusively for the operation of that charitable institution.''[61]

As for a charity whose purpose is to provide rental housing to individuals, compare two conflicting 2006 decisions from Michigan appeals courts. In opposing interpretations of whether the charity occupied the property, an autism home was held exempt while a low-income housing facility was denied exemption.[62] The Michigan Supreme Court ordered oral arguments in the case of the denial, specifically asking the parties to address the conflict with the other decision.[63] Such a narrow view of the ''occupied by'' requirement is not as preposterous as it might seem. Ten years ago, in examining the availability of property tax exemption for an assisted living facility, Christine Solt and Marion

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[57]Gallagher, *supra* note 28, at 9. Some state statutes explicitly provide for exemption when the property is not rented out during the development period, sometimes imposing time limits on such ''landbanking.''

[58]Gallagher cautioned, ''The requirement that distinctions be made between ownership and use has caused some nonprofits to lose exemption when corporate restructurings have placed ownership of the property in one corporation and the charitable activity in another. . . . Exemption loss also can occur when property is owned by a real estate partnership that includes profit-motivated investors.'' *Id.* at 9.

[59]*Id.* at 8.

[60]*See also* Arizona SB 1481, *2006 STT 134-5* (July 13, 2006), signed into law as Chapter 392, which generally provides a property tax exemption: for property owned by a nonprofit religious or charitable organization and leased to a nonprofit educational organization for educational instruction in any grade or program through grade 12; and for residential rental property bond-financed and eligible for the low-income housing tax credit.

[61]O.C.G.A. section 48-5-41(d)(2), as added by Ga. L. 2006, p. 376, section 1/HB 848 (eff. Jan. 1, 2007).

[62]*Compare Pheasant Ring v. Waterford Township*, 726 N.W.2d 741 (Mich. App. 2006) (''Although Pheasant Ring does not use the property for its own offices, the property is occupied by tenants of Pheasant Ring in furtherance of its charitable purpose. This Court, in determining whether a charitable organization 'occupied' a subject property, for purposes of qualification for a tax exemption, has determined that '[t]he proper test is whether the entire property was used in a manner consistent with the purposes of the owning institution'''), *with Liberty Hill Housing Corp. v. City of Livonia,* 2006 Mich. App. LEXIS 1651 (unpublished), *rev. considered*, 726 N.W.2d 732 (Mich. 2007).

[63]The Michigan Supreme Court's order reads: ''On order of the Court, the application for leave to appeal the May 16, 2006 judgment of the Court of Appeals is considered. We direct the Clerk to schedule oral argument on whether to grant the application or take other peremptory action. MCR 7.302(G)(1). At oral argument, the parties shall address whether *Pheasant Ring v. Waterford Township* . . . was correctly decided. They may file supplemental briefs within 28 days of the date of this order, but they should avoid submitting a mere restatement of the arguments made in their application papers.''

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Fremont-Smith observed that state laws' focus on the actual use of a facility can lead to a different answer than under federal tax law:

> Having examined the necessary fees and community benefits for obtaining a property tax exemption, it is clear that merely providing housing to the elderly will destroy a facility's quest for tax exempt status. It is the provision of care to the elderly, not housing, which secures [assisted living facilities] their property tax exemptions. In contrast, providing housing to the elderly would be a tax exempt purpose under section 501(c)(3). . . . If a facility merely provides housing, local assessors or the state tax courts are likely to find that the elderly individual leasing the apartment, rather than the charity, occupies the space, thereby requiring taxation of the property.[64]

C. Ancillary Property: Parking Lots and Student Housing

Ancillary-use property might or might not be exempt, depending on the circumstances and on the state. Parking lots and employee or student housing are a frequent subject of litigation. The Pennsylvania Supreme Court recently reversed a 1959 precedent on parking lots necessary for worship. In *Wesley United Methodist Church v. Dauphin County Bd. of Assessment Appeals*, 889 A.2d 1180 (Pa. 2005), the court found, ''In this day and age, parking lots may be a necessity for a church, rather than just a convenience. People and churches have both moved away from towns, and many people are no longer living within walking distance of their church. To attend, they are required to drive and park a vehicle. With no available parking, church-goers may be forced to seek religious expression elsewhere, causing a decrease in membership and impeding the ability of the church to exist.''

D. Open Space

Tax-exemption for land set aside for conservation is a hot topic under both federal and state tax policy. For our purposes, consider the concern expressed by a bill introduced in New Jersey, whose legislative findings include the following statement:

> The Legislature further finds and declares that while the dedication of privately-owned open space to public use and enjoyment is a significant governmental interest, there needs to be a balance between the tax incentives granted to encourage that dedication and the burden placed on municipalities that lose that tax revenue; and that no municipality, without its prior consent, shall be required to grant a tax exemption under this act if the land area of the real property for which the exemption would be granted, when combined with the land area already owned in fee simple for recreation and conservation purposes in the municipality by the State, a local government unit, or a qualifying tax exempt nonprofit organization, would exceed 30% of the total land area of the municipality.[65]

IV. Taxes vs. User Fees and Special Assessments

The law makes a distinction between taxes (from which exemption is available) and user fees and special assessments (from which charities are generally not exempt).[66] Of long-standing practice, municipalities commonly charge user fees for specific services or impose special assessments that relate to improvements that benefit specific property. However, these charges cannot recoup the general portion of the forgone tax, notably the amount paid for public schools.

Gallagher explains that although a ''tax is classically defined as an 'enforced contribution to provide for the support of government' (*United States v. LaFranca*, 282 U.S. 568, 572 (1931))'' a ''true user fee is not imposed as a tax, is not enforced as a tax, and is generally based on the amount of goods or services received. Moreover, the usual penalty for failure to pay a user fee is denial of access to the desired good or service.''[67]

Accordingly, the Georgia Supreme Court in *McLeod v. Columbia County*, 599 S.E.2d 152 (Ga. 2004), ruled that because ''a charge is generally not a tax if its object and purpose is to provide compensation for services rendered,'' a storm drainage assessment based proportionately on the size of developed runoff surface is a fee, not a tax. Citing *McLeod*, an Illinois appeals court upheld a storm water service charge imposed on a church. The court in *Church of Peace v. City of Rock Island*, 828 N.E.2d 1282 (Ill. App. 2005), declared, ''Clearly, if any of the plaintiffs chose to not avail themselves of the storm water drainage system provided by the City, it could do so and avoid paying the assessment. While it might be cost prohibitive for each plaintiff to construct its own storm water run-off containment system, each would certainly be able to calculate the cost of doing so versus the cost of paying for the use of the City's system. Voluntary participation involves nothing more than weighing the competing costs of participation.''

Gallagher illustrated the dynamics of special assessments:

> Nonprofits are generally not exempt from special assessments. Moreover, even if nonprofits are exempt, they may be subject to intense pressure to make voluntary payments if they own property

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[64]Christine G. Solt and Marion R. Fremont-Smith, ''An Argument for Charitable Status and Property Tax Exemptions for Nonprofit Assisted Living Facilities,'' 2 *State & Local Tax Lawyer* 65, 80 (1997) (footnotes omitted).

[65]A3056 (see identical bill S33), available at http://www.njleg.state.nj.us/2006/Bills/A3500/3065_I1.PDF.

[66]Compare other levies; *see, for example, Episcopal Church Home and Infirmary v. Revenue Cabinet*, Order No. K- 18922 (Ky. Bd. Tax App., April 7, 2003) (ruling that even though an infirmary is exempt under the state constitution from property tax as an institution of purely public charity, it is not exempt from the Healthcare Provider Tax; the appellate body noted, though, that ''it is beyond the Board's authority to consider constitutional attacks on a statute as written by the legislature'').

[67]Gallagher, *supra* note 28, at 17.

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within the special district. For example, the state legislation that authorized the city of Baltimore to create the Charles Village district exempted nonprofits from assessments to the extent they were exempt from ordinary property taxes. However, the operating plan for the district was premised on nonprofits' making voluntary payments to support the district's work, and district supporters put considerable pressure on area nonprofits to make contributions. Ultimately, both Johns Hopkins University and a local hospital agreed to contribute to the effort.[68]

Contrast these user fees and special assessments with municipal service fees to be imposed on otherwise exempt nonprofits to reflect their share of police and fire protection, street maintenance and repair, and sanitation services. Gallagher noted, "Over the course of the decade, at least seven states — Kansas, Iowa, Maine, Massachusetts, New Hampshire, Oregon, and Wisconsin — have rejected these proposals, but efforts continue."[69] She views these purported fees as a partial repeal of the property tax exemption, not only because the fee is generally based on the value of the property, but also because "the legislative proposal states that the 'fees' will be assessed only against exempt property, with other property owners continuing to support the same services through their tax payments. In addition, the fees would be enforced through liens on property in the same manner as property taxes."[70]

Youngman adds that municipalities increasingly turned to user fees and special assessments — imposed on taxable as well as exempt users — after the enactment of several tax-limitation measures adopted in the 1970s. Notably, "a California court held that business-improvement district assessments fall outside the limitations of Proposition 218, which requires taxpayer approval of any new or increased taxes or assessments (*Howard Jarvis Taxpayers Association v. City of San Diego*, 84 Cal. Rptr. 2d 804 (Cal. Ct. App. 1999))."[71] "The unpredictable and contradictory results" of challenges to the plethora of fees, Youngman observed, "only emphasize how uncertain the distinction between taxes and fees can be. For example, the Massachusetts Supreme Judicial Court found a Boston fee for fire protection to be an unconstitutional tax (*Emerson College v. City of Boston*, 462 N.E.2d 1098 (Mass. 1984)), while the West Virginia Supreme Court found a fire and flood protection fee not to be a tax (*City of Huntington v. Bacon*, 473 S.E.2d 743 (W. Va. 1996)), and the Montana attorney general found fire protection fees to constitute a benefit assessment (*Opinions of the Montana Attorney General* 46: 7 (1995))."[72]

More recently, in 2004, the Baltimore City Council, as part of a $30 million package of increased telephone, energy, and real estate taxes, adopted a 6 percent energy tax on nonprofits (compared with a 2 percent tax on energy for residents and manufacturers, and an 8 percent energy tax already imposed on businesses).[73] "Baltimore tried to add an energy tax on nonprofit organizations four years ago but agreed to forgo it when some groups agreed to collectively pay $20 million between then and the summer of 2005."[74] In May 2003, North Carolina legislators sought to link an increase in the vehicle registration fee (to be used for mass transit) to a requirement that tax-exempt Duke University pay for city services it uses.[75]

V. PILOTs[76]

For some nonprofit organizations, lying between the shelter of property tax exemption and the exposure of fully taxable status is the shadowy realm of PILOTs. These payments do not automatically favor either the municipality or the nonprofit organization. And except in the rare case when a statute or global agreement regularizes the arrangement, PILOTs are not necessarily consistent among nonprofit organizations in the jurisdiction. Rather, PILOTs represent a compromise between the parties using what leverage they have available and negotiating in light of the hazards of litigation.[77] As in any negotiation, either party could be making the concession. In some cases, PILOTs represent an erosion of statutory tax exemption; in other cases, they forestall the imposition of tax, and so are synonymous with giveaways. In the battles fought in this realm, it is sometimes difficult to agree even on rhetoric: Charity partisans characterize PILOTs as extortion, while municipality supporters call them contributions.[78]

Consider the relationship between the city and suburbs of Cleveland and University Hospitals and the Cleveland Clinic, as described by one recent press report: "The [$1.5 billion] value of the hospitals' vast holdings hit such heights only in the last decade, at the very time many school districts and municipalities found themselves tapped out. The untaxed holdings suddenly have

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[68]*Id.* at 18.
[69]*Id.*
[70]*Id.* at 19.
[71]Youngman, *supra* note 42, at 26.
[72]*Id.* at 25-26.

[73]Laura Vozzella, "Higher City Taxes Causing High Anxiety," *The Baltimore Sun*, June 23, 2004, p. A1.
[74]Jamie Smith Hopkins, "Nonprofit Growth Creates Quandary," *The Baltimore Sun*, June 21, 2004, p. A1.
[75]C.D. Kirkpatrick, "Leaders: Raise Fee to Boost Transit: State Lawmakers Want to Tie Increase to Duke Payments," *[Durham] Herald-Sun*, May 22, 2003, p. B1.
[76]Portions of this part are drawn from Evelyn Brody, "Nonprofit Organizations, Payments in Lieu of Taxes ('PILOTs')," *in Encyclopedia of Taxation and Tax Policy* (Joseph J. Cordes, Robert Ebel and Jane Gravelle, eds.) (2d. ed., Urban Institute Press 2005).
[77]*See* the public choice analysis in David Sjoquist, "A Public-Choice Approach to Explaining Exemptions and PILOTs," in Brody, *supra* note 1, at 361-67.
[78]*See generally* Pamela Leland, "PILOTs: The Large City Experience," in Brody, *supra* note 1, at 193-210; Youngman, *supra* note 42; and Glancey, *supra* note 20; *compare* Gallagher, *supra* note 28, at 14-16.

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governments drooling, wondering how to change the rules and get extra cash from the hospitals. As suddenly, the hospitals want more holdings exempted from taxes.''[79]

Gallagher describes the combined carrot-and-stick approach of municipalities in soliciting PILOTs:

> Some governments appeal to charities' sense of fairness, arguing that since nonprofits benefit from taxpayer-funded services, such as fire and police protection, it is only fair that they pay a share of those costs. Other governments accompany their requests with thinly veiled threats that noncompliance may trigger a challenge to the organization's property tax exemption or make it more difficult to obtain a building permit or a zoning waiver. Some subtlety is required, however. A New York court ruled that a city could not deny a special-use permit solely because an applicant was exempt from property tax and refused to agree to make a payment in lieu of taxes (*Pacer Inc. v. City of Middletown*, 635 N.Y.S.2d 704 (App. Div. 1995)).[80]

Note that in Pennsylvania, the 1997 statutory regime allows the prong that requires ''relief of the burden of government'' to be satisfied in any of six ways, one of which is that the charity has a ''voluntary agreement'' to make PILOTs.[81]

The systematic use of PILOTs can be traced to Boston's 1925 pioneering agreement with Harvard and the Massachusetts Institute of Technology,[82] and is expressed most recently in Providence, R.I.'s 2003 arrangement with four local universities and Pittsburgh's 2005 deal:

- On January 5, 2006, a coalition of nonprofit organizations known as the Pittsburgh Public Service Fund, after extensive negotiation with the mayor and city council, ''voluntarily'' transferred $4.57 million to the city of Pittsburgh. This was the first of three promised annual payments, totaling $13.2 million, to help ameliorate the ailing city budget. The fund released the names of the 102 contributing organizations but not the amounts they contributed. One press report observed critically, ''Some of the organizations that chose not to contribute to the cash-strapped city constitute a Who's Who of prominent charities in Pittsburgh.''[83] Eventually, even the amounts given by each participating charity leaked out.[84]
- In June 2003 Providence reached an agreement under which four area colleges would make PILOTs totaling $50 million during the next 20 years.[85] Brown University is the best-known institution, but in the next four years, the Rhode Island School of Design will make the highest payments because of the amount of currently taxable property it is acquiring.[86]
- In November 2002, prompted by a five-year loss of more than $60 million of taxable properties from the tax rolls, the Worcester, Mass., City Council began to consider asking for PILOTs from its larger nonprofit institutions.[87] In February 2002 the council had unanimously approved a proposal to have the city administration try to negotiate with local colleges and hospitals for a moratorium on exemption on newly acquired properties.[88]
- In September 2002 Harvard University agreed to pay Watertown, Mass., a record-setting $3.8 million a year in PILOTs on the Arsenal, a 30-acre former munitions factory that the university had acquired in 2001. Then-President Lawrence Summers declared a ''new Harvard principle'' of generous payments for newly acquired, previously taxed property. Payments will continue until 2054, regardless of how Harvard uses the property. The town manager cites as the turning point in negotiations the introduction of a bill in the state legislature to impose tax on properties that account for more than 2.5 percent of a community's tax base.[89]

For an introduction to the issues, a summary of recent events, and a recommended strategy for nonprofits, see

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[79]Joan Mazzolini, ''Clinic and UH Worth a Lot, but Taxed a Little,'' *[Cleveland] Plain Dealer*, Apr. 9, 2006, p. A1.

[80]Gallagher, *supra* note 28, at 15.

[81]10 P.S. section 375(f)(6).

[82]*See* Gallagher, *supra* note 28, at 15-16. For the modern version of the agreement, see Assessing Department, City of Boston, ''Payment in Lieu of Taxes Program: Guidelines for Tax-Exempt Institutions'' (1997).

[83]Jeremy Boren, ''Some Nonprofits Do Not Chip In,'' *Pittsburgh Tribune Review*, Jan. 6, 2006. For the list of contributing organizations, see ''City Gets First Payment From Nonprofit Coalition,'' *[Pittsburgh] Post-Gazette*, Jan. 5, 2006.

[84]*See* Rich Lord, ''City Asking Nonprofits for Consistent Contributions; Organizations' Contributions Varied Widely,'' *[Pittsburgh] Post-Gazette*, Feb. 20, 2007. *See also* Rich Lord, ''City Backs Formula for Taxing of Nonprofit Organizations; Nonprofits' Group Opposes Guidelines for What It Views as Gifts to the City,'' *[Pittsburgh] Post-Gazette*, Feb. 21, 2007 (reporting that for 2005, ''according to documents obtained by the Pittsburgh Post-Gazette, donations ranged from $10 by the Pittsburgh Ballet Theater to $1.5 million by the University of Pittsburgh Medical Center'').

(Footnote continued in next column.)

[85]Scott MacKay, ''Colleges to Pay Millions to City,'' *Providence Journal-Bulletin*, June 6, 2003, p. A1.

[86]As reported in *id.*, the agreement provides for two types of payments: ''annual cash payments, which are based roughly on the size of each institution's budget''; and ''payments instead of property taxes for 15 years on taxable properties [the colleges] buy in Providence.'' Specifically, ''the institutions will pay 100 percent of the assessed rate for the first five years they own a property. That will drop to 66 percent for the next five years and 33 percent for the next five. After 15 years, the properties will become fully tax-exempt.''

[87]Nick Kotsopoulos, ''Nonprofits Are Targets for Revenue: Some in City Hope PILOT Will Fly,'' *[Worcester] Sunday Telegram*, Nov. 24, 2002, p. B1.

[88]Michael Cohen, ''Free Ride: Some Cities Get Millions From Colleges, Non-Profit Hospitals, and Other Institutions, Worcester Doesn't Get a Dime,'' *Worcester Magazine*, Mar. 7, 2002.

[89]Anthony Flint, ''Harvard, Watertown Set Deal for Lost Taxes,'' *The Boston Globe*, Sept. 25, 2002, p. A1.

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"Tool Kit: Facing Challenges to Property Tax Exemptions," produced by the National Council of Nonprofit Associations (2003).[90]

As in cases challenging exemption, municipalities seeking PILOTs usually focus on hospitals, institutions of higher education, nursing homes, and retirement homes.[91] After all, the charities that look most attractive to local governments are those that have income (excluding, in general, only donations) and often operate in competition with for-profit businesses, and those whose income comes primarily from patrons (or third parties like private health insurers and Medicare) outside the taxing jurisdiction. Accordingly, taxing the nonprofit can be viewed as a proxy for taxing the nonresident payers. Under the same theory, municipalities could extend this policy to museums and performing arts organizations — and even to break-even social service nonprofits, thus adding taxes to the costs passed on to government funders (state and federal). (That theory might provide a nonconstitutional explanation of why municipalities have not sought to tax churches, which rely primarily on donations, and whose benefits are primarily local, although news stories are starting to report PILOTs made by churches as well as church-affiliated retirement homes.) Under this commerciality view, the property tax becomes almost an income tax.

Finally, we find a growing trend by center-city nonprofit property owners — notably universities — to pour funds into local community development, a form of services in lieu of taxes. For universities located in undesirable neighborhoods, this represents a reversal of their traditional siege mentality and reflects, no doubt, some self-interest in the competition for students.

Critics of PILOTs and services in lieu of taxes contend that public finance should not rely on voluntary, negotiated agreements carried out without sunshine and without the opportunity of the public (and charities) to monitor. Occurring haphazardly, and, at times, opportunistically, PILOTs highlight why an ideal tax system is visible, systematic, and evenhanded. Indeed, Pam Leland found that even in cities where some PILOTs are made, some city officials or other charities are unaware of them.[92] Most generally, no uniform percentage-of-tax formula applies. PILOTs seem to be most acceptable to nonprofits when they apply only to new construction or to taxable property being taken off the rolls, and are time-limited.

As a separate issue, charities often produce positive externalities that spill over municipal boundaries, arguing for a state-level solution. As a model of such an intergovernment system, Connecticut makes PILOTs to municipalities hosting private hospitals and colleges.[93] However, while the state payments smooth town-gown relations, the Connecticut program still depends on annual legislative appropriation.[94] Notably, the statute allows the state to pay up to 77 percent of the property taxes the nonprofit hospitals and colleges would otherwise pay, but the current appropriated rate is 64 percent.[95] Connecticut's scheme has been copied only (and not to the same degree) by neighboring Rhode Island. A similar proposal introduced in Maryland in January 2003 was not enacted, but the policy advantages of such an approach continue to attract interest around the country.

Conclusion

Nonprofits and their advisers have been uneasily watching renewed congressional and IRS interest in the standards for federal tax exemption for charities. Less visible is the significant level of activity regarding the charity property tax exemption. State exemption requirements generally reflect more of a quid-pro-quo rationale than does the federal exemption. Many of the cases revolve around four basic issues: demonstrating charitable as distinct from private or other nonprofit purpose; satisfying multi-factor tests adopted by state supreme courts under state constitutions; the relevance of government financing and donations; and the relevance of fee-charging and competition with for-profits. The many recent decisions from state supreme courts — particularly involving hospitals, housing and skilled nursing facilities, and day care — demonstrate the importance of property tax exemption. The solution to many disputes between property-owning charities and the municipalities they inhabit is often more likely to be "political" than legal, such as the agreement to make payments in lieu of taxes.

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[90]Available at www.ncna.org/_uploads/documents/live//Property_tax_tool_kit.pdf.

[91]This paragraph is derived from Evelyn Brody, "Legal Theories of Tax Exemption: A Sovereignty Perspective," in Brody, *supra* note 1.

[92]*See* Leland, *supra* note 78, at 200-02.

[93]*See* description of the development of this program in Nicholas R. Carbone & Evelyn Brody, "PILOTs: Hartford and Connecticut," in Brody, *supra* note 1, at 233-52. Connecticut H.B. 6311, a bill to extent this program for property owned by nonprofit human services organizations, "failed joint favorable deadline" on March 23, 2007.

[94]Moreover, the state payments do not forestall municipal demands for private PILOTs, particularly in New Haven. *See, e.g,* "Finally, a Go for Cancer Center," *Hartford Courant*, Mar. 24, 2006, p. A10 (editorial) (praising deal between Yale-New Haven Hospital and the city to allow construction of a $430 million cancer center, "New Haven's biggest-ever economic development project"). Among other things, "the hospital will fund neighborhood development projects, hire 100 residents each year from the Hill and adjacent neighborhoods, pay the salaries of two city health workers, give $100,000 a year to the Mayor's Youth Initiative, and hire a consultant to work on parking problems on the hospital campus and surrounding areas. The hospital will also make substantial payments in lieu of taxes to the city and will support a secret ballot election overseen by the National Labor Relations Board."

[95]*See* Thomas B. Scheffey, "New London's Novel Plan To Tax Colleges," *Connecticut Law Tribune*, Feb. 20, 2006, p. 5. Note that Yale University and four other large nonprofits, under a PILOT arrangement with New Haven, pay $250 annually for each employee and dormitory or hospital bed. "New Haven's deal with Yale and others, plus the state payment, total $42 million a year, which is 10 percent of that city's operating budget." Rich Lord, "Pittsburgh's Pleading for Nonprofit Money Called 'Unique,'" *[Pittsburgh] Post-Gazette*, Feb. 26, 2007.

(Footnote continued in next column.)

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