

## CHARITABLE ORGANIZATIONS' PROPERTY TAX EXEMPTION

The following memorandum is the result of a request from the Advisory Commission on Intergovernmental Relations for past bills that have amended or have attempted to amend North Dakota Century Code (NDCC) Section 57-02-08(8). Before reviewing those bills, this memorandum provides information compiled by the interim Taxation Committee during the 1997-98 interim. During that interim, House Concurrent Resolution No. 3052 directed a study of the tax exemption for charitable organizations. The Taxation Committee was assigned this study.

### CHARITABLE ORGANIZATIONS' PROPERTY TAX EXEMPTION

#### Background

#### Constitutional and Statutory Provisions

The Constitution of North Dakota provides in Article X, Section 5, that ". . . property used exclusively for schools, religious, cemetery, charitable or other public purposes shall be exempt from taxation."

North Dakota Century Code Section 57-02-08(8) provides an exemption for:

All buildings belonging to institutions of public charity, including public hospitals and nursing homes licensed pursuant to section 23-16-01 under the control of religious or charitable institutions, used wholly or in part for public charity, together with the land actually occupied by such institutions not leased or otherwise used with a view to profit . . . .

Most property tax exemptions provided by the Legislative Assembly do not apply to land. The Constitution of North Dakota, Article X, Section 5, provides that "The legislative assembly may by law exempt any or all classes of **personal property** from taxation and within the meaning of this section, fixtures, buildings and improvements of every character, whatsoever, upon land shall be deemed personal property. . . ." (emphasis supplied). This constitutional authority of the Legislative Assembly does not include providing an exemption for land upon which buildings are located. However, the same section of the constitution provides that the "property" used exclusively for charitable purposes shall be exempt from taxation. Because this provision is not limited to personal property, it appears both real and personal property of charities is intended to be exempted by the constitutional provision.

#### Unity of Ownership and Use

The statutory requirement that buildings and land, to be exempt, must be property "belonging to"

institutions of public charity requires that the property must be owned by the institution of public charity to be eligible for the exemption and ownership by an individual renders property ineligible for the charitable property tax exemption. Vacant lots owned by institutions of public charity are not exempt because they are not "actually occupied" by the charitable institution.

In *Riverview Place, Inc. v. Cass County*, 448 N.W.2d 635 (N.D. 1989), the Supreme Court of North Dakota said:

[T]he determination of whether an institution falls within the exemption is, essentially, a two-step process in which it must be determined "whether the organization claiming the exemption is in fact a charitable one, and whether the property on which the exemption is claimed is being devoted to charitable purposes." . . . ownership of the property in question by an institution of public charity does not, by that fact alone, exempt the property from taxation . . . it is the **use** made of the property . . . which determines whether the property is exempt from taxation. [emphasis in text] The property's use must be devoted to charitable purposes and it must actually be used in carrying out the charitable purposes of the organization claiming the exemption.

#### Use With a View to Profit

In *Riverview Place*, the Supreme Court of North Dakota said:

. . . When a charitable organization charges a fee for its services and operates at a small net profit which is reinvested back into the organization's charitable operations, those facts do not automatically disqualify the entity's property from an exemption on the basis that it was operated "with a view to profit," as the concept of charity encompasses "something more than mere almsgiving" and therefore a "benevolent association is not required to use only red ink in keeping its books and ledgers."

The following conclusions have been reached in application of the exemption by the Attorney General and the Tax Commissioner:

1. Only the amount of land that is reasonably required for a site for the buildings and improvements used for charitable purposes is eligible for the exemption. Excess land used to pasture cattle is "used with a view to profit."
2. The meaning commonly given to "not used with a view to profit" is that no individual stockholder or investor will receive any kind of profit or gain or dividend from the operation of

the charity. It does not mean that the charity cannot make some type of charge for certain services.

3. Occasional rental of property owned by a public charity and rented for nonexempt purposes does not destroy the tax-exempt status of the property.
4. If a charitable organization leases a building to another charitable organization at rent substantially below market rental rates so as to constitute financial assistance to the lessee charitable organization, then a charitable use by the lessor can be established.
5. A used clothing store operated by a public charity is not exempt because it is used for profit rather than the charitable uses of the charitable institution.

### **State Limits on Charitable Property Tax Exemptions**

Property tax exemptions originated at a time when churches conducted most educational and charitable activities. Because these activities were operated by churches and relieved government of the cost of performing some services or obligations, there was little controversy when property tax exemptions were written into states' constitutions and laws. As other organizations began to offer these services, exemptions were extended to these new activities. However, modern operation of charitable organizations has changed so that they sometimes compete with businesses run on a for-profit basis. A 1990 United States Government Accounting Office report prepared for the House Select Committee on Aging noted these changes and observed that nonprofit hospital goals most often relate to increasing the share of patients within market areas, mirroring the goals of investor-owned institutions. Several observers have suggested that granting and retaining charitable exemptions in the modern political environment have more to do with political clout than benefits to the public and government. The changing nature of charitable organization operation is one of the factors that led assessment officials to more closely scrutinize application of exemptions. Another factor leading to increased scrutiny of claims for exemptions is the proliferation in tax-exempt real property and resulting tax burden shifted to other taxpayers, who voice growing displeasure with property tax levels.

### **Taxation Committee Considerations**

Assessment officials expressed concerns about the charitable organizations exemption. One difficulty is determining whether property qualifies and another difficulty is dealing with public concerns about possible unfair advantages exempt property provides in competing with taxable property. Assessment officials described the statutory exemption as requiring a great deal of legal interpretation, which can result in differences in administration within and

across jurisdictions. Another growing problem is how to approach assessment for hospitals, YMCAs, and other organizations providing an expanded range of services in recent years. These expanded activities generate complaints from private businesses about unfair competition being fostered by a property tax exemption. Assessment issues can become extremely complicated when a property is used for charitable purposes and nonexempt activities. This requires a partial assessment against the property, which becomes difficult when there is mixed usage of certain areas.

A representative of the North Dakota Healthcare Association said nonprofit entities are required by Internal Revenue Code standards to not use earnings or donations to benefit private shareholders or others similarly situated; to not pay compensation to directors, officers, and employees based solely upon financial performance of the organization; and to use any excess revenues to further the organization's nonprofit purposes or fund other nonprofit organizations. The association representative suggested that adding criteria to define charitable activities can become extremely complex and lead to an unworkable, narrow test that becomes an accounting exercise and does not adequately address the range of activities engaged in by nonprofit organizations.

The committee considered a bill draft patterned after 1997 Pennsylvania law which established specific criteria to determine what constitutes charitable use of property for property tax exemption purposes. The Pennsylvania law established five detailed criteria to determine what qualifies as a purely public charity:

1. The institution must advance a charitable purpose. This criterion is satisfied if the institution is organized and operated primarily to fulfill any of six listed purposes.
2. The institution must operate entirely free from private profit motive. Without regard to whether the institution's revenues exceed expenses, this criterion is satisfied if four listed criteria are met.
3. The institution must provide a community service by donating or rendering gratuitously a substantial portion of its services. This criterion is satisfied if the institution benefits the community by meeting one of seven detailed standards.
4. The institution must benefit a substantial and indefinite class of persons who are legitimate subjects of charity. "Legitimate subjects of charity" is defined as individuals unable to provide themselves with what the institution provides for them. The bill specifically disqualifies any organization not recognized as exempt under Section 501(c)(3) of the Internal Revenue Code and certain institutions otherwise qualified under Section 501(c)(3) of the Internal Revenue Code.

5. The institution must relieve the government of some of its burden. This criterion is satisfied if the institution meets any one of six criteria.

Committee members said it would be useful to establish a workable standard for assessors to fairly distinguish charitable activities from those that should not be eligible for property tax exemptions. Committee members were critical of the approach in the Pennsylvania law as being too complicated and placing too much emphasis on tracking revenues and expenses. Committee members said the Pennsylvania law was obviously directed toward hospitals and does not adequately address other charitable organizations.

The committee considered a bill draft that limited the property tax exemption for property of hospitals to those areas of a building essential to providing inpatient services. Committee members said hospital activities have changed substantially in recent years, hospitals now have enormous budgets, and health care customers are now paying for services that did not exist several years ago like sports medicine, women's health centers, screening services, and other efforts. These activities were described as intended to expand operations and the client base for the hospitals and as encroaching in areas that should be left to private enterprise. Committee members did not support the bill draft approach because of concern about its effect on small town medical facilities and the difficulty assessment officials would have to determine which portions of a facility would be exempt as being essential for inpatient services.

### **Recommended Legislation**

The interim Taxation Committee recommended House Bill No. 1051 to allow imposition of special assessments by cities against exempt property of charitable organizations. The bill allowed a city to establish a special assessment district composed only of property of charitable organizations. The bill allowed imposition of special assessments by the governing body of a city for the proportionate share of

costs of police and fire protection and infrastructure expenditures paid from the budget of the city. The bill limited the amounts that may be levied against subject properties based on comparison of the value of those properties to the value of taxable property in the city. Committee members said the bill would provide local flexibility in determining whether and at what level special assessments would be imposed. The bill gave cities an option to require charitable organizations to pay for the value of certain city services in the same manner they pay special assessments for property improvements under existing law because the services contribute to the value of the property. House Bill No. 1051 failed to pass in the House.

### **OTHER LEGISLATIVE ACTION**

In the last 20 years, two other bills have been introduced that have attempted to change NDCC Section 57-02-08(8). Both of these bills were introduced in 1997--House Bill No. 1460 and House Bill No. 1289. Both failed to pass in the House.

House Bill No. 1460 would have changed the test to determine if a building is exempt from property taxation on charitable grounds to if the building belongs to "an organization organized and operated exclusively for charitable purposes, but any portion of that building is not exempt if it is not used exclusively for charitable purposes." In addition, the bill provided that "[a]n organization is not organized and operated exclusively for charitable purposes if it . . . pays wages . . . exceeding seventy-five thousand dollars to any person employed in this state during the taxable year."

House Bill No. 1289 would have required a charitable exemption to be specifically approved by the governing body of the city, if the property is located within city limits, or by the governing body of the county in which the property is located, if not within city limits. The bill would have grandfathered existing exemptions so that city or county approval was not required to continue the exemption.