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State Tax Exemptions of Non-Profit Organizations

Carroll H. Sierk*

MARK SCHOENFELD'S NOT-TOO-BROAD TOPIC seems to contrast sharply with mine. When I first accepted this subject I asked Howard Oleck for some guidance. He suggested that I start with Chapter XXX in his book¹ where I would surely find that, "Mark Schoenfeld and I have already done a great deal of the work for you." So, thinking I had it made, I looked at Chapter XXX in the book and discovered that it is a four and one-half page very general outline of the topic which begins by saying:

An almost limitless variety of taxes is imposed by an almost limitless number of taxing jurisdictions—fifty states plus their myriad subdivisions. To complicate matters, constantly statutes are enacted, amended, or repealed, and court decisions frequently construe these statutes in unexpected ways. A book such as this cannot pretend to completeness in such a field. Because of this complexity, reference should be made to a currently-supplemented loose-leaf service, such as Prentice-Hall's *State and Local Taxes*, for up-to-date information concerning the tax laws of the state or states involved in a given problem.²

I fear that the quotation is all too accurate. It would be impossible, futile, perhaps even foolish, to attempt to cover this entire subject area in a short speech or a short article. One way of narrowing the subject and making it manageable would be to concentrate on one jurisdiction. However, I understand that that is not what is expected or desired here. A general review of the overall national situation is expected. For those especially interested in one particular state there are many publications available. The national tax publishers, Prentice-Hall and Commerce Clearing House, put out state and local tax materials for each and every state. Many states have important local publications such as those produced by The Institute of Continuing Legal Education (in Michigan) and The Institute for Continuing Legal Education in Ohio.

Of the several different types of taxes which need to be discussed, perhaps the real property tax is the most important. The real property tax exemption area currently seems to be where most of the action is, most of the legislative activity and most of the significant litigation. Of lesser importance is the personal property tax. Developments in the per-

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¹ Oleck, *Non-Profit Corporations, Organizations and Associations*, (2d ed. Prentice-Hall, 1965).

² *Id.* at 433.

sonal property tax area tend to follow those in the real property tax area. With regard to sales and use taxes, we have two separate exemption areas. The first is that of sales totally exempt because made to charitable organizations. The second is that of sales exempt because made by non-profit organizations. Sometimes organizations which make exempt sales cannot purchase with an exemption and vice versa. The matter of income tax exemptions under the various state income tax laws must also be considered. So must inheritance and estate tax exemptions. With regard to corporate franchise taxes we note that commonly non-profit organizations do not have to pay such taxes, at least not the same ones that business corporations have to pay. In a miscellaneous category we find that commonly there are special state tax provisions dealing with motor vehicles owned by non-profit charitable organizations and that non-profit charitable organizations may be exempted from the requirements of workmen's compensation laws. Perhaps unemployment compensation taxes belong in this same miscellaneous category.

Real Property Taxes

Real property taxation, and exemption therefrom, seems to be about as old as history. In the ancient world some rather complex real property tax systems could be found, systems with different types of property being taxed at different rates depending on the types of crops raised on the property. Ecclesiastical and military properties seem to have been tax exempt from an extremely ancient time.³ One historian reports that the "economic equilibrium of the state was endangered" by the fact that the tax exempt temples owned fifteen percent of the cultivable land and vast amounts of slaves and other personal property during the reign of Ramses III about 1200 B.C.⁴ The problem of tax exempt properties and their effect on the economy is obviously not a new one.

In addition to military and ecclesiastical exemptions, tax exemptions to further specific economic policies (immigration, attraction of new industries, etc.) have been with us in the United States since early colonial times.⁵ However, tax exemptions in the 19th century United States were probably neither too numerous nor too significant because of relatively low property tax rates and a limited amount of charitable activity due to the agricultural economy prevailing in most of the country.⁶ Then after the turn of the century the number of property tax exemptions began to increase, with some acceleration during the depression, producing during

³ Breasted, *A History of Egypt*, at 413 and 479 (Bantam Books 1964 ed.).

⁴ *Id.* at 413.

⁵ Stimson, *The Exemption of Property From Taxation In The United States*, 18 *Minn. L. Rev.* 411 at 416-418 (1934).

⁶ Reitze, *Real Property Tax Exemptions in Ohio—Fiscal Absurdity*, 18 *W. Res. L. Rev.* 64 at 65-66 (1966).

the last thirty or forty years the problem we now have of probably too many property tax exemptions. As early as 1934⁷ the argument was made, most emphatically, that all tax exemptions should be done away with, that there simply should not be any such thing. It was even argued that the exemption of government property from taxation should be done away with because this would cause governmental units to be more efficient. It was argued that publicizing the inefficient use of land by governmental units would be a good thing in itself.

A 1963 governmental report,⁸ in a chapter entitled "The Limits of Property Tax Philanthropy," refers to "the erosion of the property tax base that has occurred over the past half century or more and continues to occur." This report hints that the time may have come for the erosion to cease and some land restoration to take place. A similar concern with erosion of the federal income tax base preceded the recent enactment of the federal Tax Reform Act of 1969.⁹ Many of the arguments recently put forth for increasing the federal income tax base apply with even greater force to the area of local property taxes.

Recent developments and trends are a bit hard to appraise. We do not find all the courts, all the legislative bodies, and all the administrative agencies in all the states moving in the same direction at the same time. However, my impression is that generally the trend is in the direction of limiting or removing tax exemptions. The Prentice-Hall, STATE AND LOCAL TAXES Report Bulletin for April 29, 1969, begins with the headline, "Chipping Away Tax Exemptions For Non-Profit Organizations." In that particular report are reviewed a number of cases suggesting that state courts and administrative authorities are becoming very critical of the basic underlying assumption that tax exemptions should be granted to non-profit organizations. Many of the recent cases deal with homes for the aged. The opinions generally seem to agree that taking care of poor old people is a worthy cause, that it is a matter which should be of concern to the government, and that a charitable organization which provides for poor old people is serving a governmental purpose entitled to tax exemption. However, in many of these cases the particular home involved was held not tax exempt because the old people being taken care of were not really poor. It was frequently found that what the home was doing in fact was operating an apartment house

⁷ Stimson, *supra* n. 5.

⁸ Advisory Commission on Intergovernmental Relations, *The Role of the States in Strengthening the Property Tax*, Vol. I, Ch. 8.

⁹ See, for example, the series in 80 and 81 Harv. L. Rev.: Bittker, A "Comprehensive Tax Base" As a Goal of Income Tax Reform, 80 Harv. L. Rev. 925 (1967); Musgrave, In Defense of an Income Concept, 81 Harv. L. Rev. 44 (1967); Pechman, Comprehensive Income Taxation: A Comment, 81 Harv. L. Rev. 66 (1967); Galvin, More on Boris Bittker and the Comprehensive Tax Base: The Practicalities of Tax Reform and the ABA's CSTR, 81 Harv. L. Rev. 1016 (1968); Bittker, Comprehensive Income Taxation: A Response, 81 Harv. L. Rev. 1032 (1968).

and trying to gain tax exemption benefits at the same time that they were competing with, and operating on substantially the same basis as, commercial apartment houses. Many such cases involved rentals of \$200, \$300 or more per month for an apartment. In many instances the senior citizen could get into the apartment house only by paying a substantial fee upon entrance. In some cases a \$5,000 or \$10,000 "founder's fee" or deposit was required. Calling this charity generally disturbed the courts. It was all too clear in many cases that the organization involved was claiming charitable exemptions to help support its activity of providing housing for wealthy, or at least middle class, elderly citizens who could well afford to house themselves without having to go to any special tax exempt homes. In most of these cases the actual charity involved was nominal; in others there simply was none.¹⁰

It has been said that the federal Tax Reform Act may produce so many changes as to make it necessary to have another institute on the subject of non-profit organizations next year. Quite apart from what the Congress has done in the federal tax area, the Supreme Court of the United States may provide us with a truly significant change in the law relating to tax exemptions for real property, a change so significant and so far reaching in its implications and impact as to require another institute next year. For the past few years writers and speakers have been saying, "Exemption of church buildings does not violate the free exercise of religion clause of the First Amendment of the United States Constitution," citing *Murray v. Comptroller*.¹¹ The high court's recent decision to review the *Walz* case,¹² which the New York court decided on the authority of the *Murray* case, suggests that it is going to take a second look at the religious property exemption issue. If the *Walz* case is reversed, a substantial volume of problems will follow. If the churches lose tax exemptions completely, it will change the whole pattern in this area. It would give added thrust toward questioning the tax exemptions of all charitable organizations.

I felt that I could see a trend toward judicial disposition to limit or remove tax exemptions in Georgia a few years ago, in such cases as

¹⁰ Recent cases of this type include: *United Presbyterian Ass'n. v. Board of County Commissioners*, 448 P. 2d 967 (Col. Sup. Ct. 1968); *Hilltop Village, Inc. v. Kerrville Independent School District*, 426 S.W. 2d 943 (Tex. Sup. Ct. 1968); *Methodist Old Peoples Home v. Korzen*, 233 N.E. 2d 537 (Ill. Sup. Ct. 1968); *In the Matter of Dienstberg Foundation, Inc.* (Ohio B.T.A., 1968).

Other examples of recent cases restricting, denying, or limiting tax exemptions to non-profit organizations include:

In the Matter of Workman (Ohio B.T.A., 1969); *Most Worshipful Prince Hall Grand Lodge v. City of Fort Worth*, 435 S.W. 2d 274 (Tex. Civ. App., 1968); *In the Matter of Ohio Women's Christian Temperance Union* (Ohio B.T.A., 1968); *American Concrete Institute v. Michigan State Tax Commission*, 12 Mich. App. 595, 163 N.W. 2d 508 (1968).

¹¹ 241 Md. 383, 216 A. 2d 897, *cert. denied*, 385 U.S. 816 (1966).

¹² *Frederick Walz v. Tax Commission of the City of New York*, 24 N.Y. 2d 30, 246 N.E. 2d 517 (1969), *cert. granted* 395 U.S. 956 (1969).

Camp v. Fulton County Medical Society,¹³ *Presbyterian Center v. Henson*,¹⁴ and *Historic House Museum Corp. v. Camp*.¹⁵ In the *Fulton County Medical Society* case the Supreme Court of Georgia took a position, which it has continued to follow, of strictly construing statutory and constitutional provisions dealing with property tax exemptions. The strict position simply amounts to saying that if the tax exemption is not clearly provided for, no tax exemption will be allowed no matter how worthy the organization claiming the exemption. The Fulton County Medical Society was claiming exemption for its building where Society meetings were held, a library was maintained, and research (by members of the society and others) was carried on. The Georgia court was not too charitable to the Medical Society, saying that the building was being used primarily for the benefit of the medical fraternity rather than society at large, thus was not used strictly for public charity and was not entitled to tax exemption. I don't believe the *Fulton County Medical Society* case shocked very many people. I doubt that it was viewed in 1964 as indicating a change in judicial attitudes toward the exemption of property from taxation. However the *Presbyterian Center* case, decided in 1966, did cause some concern. In that case the Georgia Supreme Court noted that religious institutions are not necessarily considered charities for all purposes and held a church office and headquarters building not exempt from *ad valorem* taxation. A similar result was reached in the *Historic House Museum Corp.* case: simply maintaining a property because of its historic interest is not charity. These two cases caused tax assessors throughout the State of Georgia to take a second look at some properties which had generally been assumed to be tax exempt. One such property was a fine old Southern home owned by the Garden Club of Macon. Certainly the property was a thing of beauty and of some civic value. However, in view of the *Presbyterian Center* and *Historic House* cases, the property could hardly be said to be operated as a purely public charity, and there was no specific statute exempting garden club real property. Complicating the situation was the fact that no statute of limitations prevented taxes being assessed for many, many years back. Settlement, largely on the tax collector's terms, seemed called for. Probably the garden club ladies were unhappy not only with the local tax assessor but also with their attorneys who had failed to anticipate any such problem. Perhaps this suggests a general rule to be applied in this area: proceed with caution.

Others have suggested that we should encourage our clients to go to the limit of the law, to push to the extreme limit to get all of the benefits of operating in the form of a non-profit organization. It has been sug-

¹³ 219 Ga. 602, 135 S.E. 2d 277 (1964).

¹⁴ 221 Ga. 750, 146 S.E. 2d 903 (1966).

¹⁵ 223 Ga. 510, 156 S.E. 2d 361 (1967). See Sierk, *State and Local Taxation*, 19 Mercer L. Rev. 182 at 187 (1967).

gested that encouraging abuses of the non-profit form will ultimately be good for society in that it will cause a crack-down on such abuses. I believe an attorney's duty to his client prevents this. I think it unwise and improper to advise a client to operate in a non-profit form with the hope of putting something over on the public or getting a doubtful benefit. I feel that it is necessary to recognize the doubtful area and the risk involved and to keep the client aware of the risk.

Obviously there are some factors moving contrary to the general trend of limiting tax exemptions. It has been suggested that we may "solve" our current urban housing problems via the tax exemption-tax incentive route.¹⁶ This method has the virtue of providing an automatic subsidy to the activity being encouraged without the necessity of setting up a new administrative agency to dispense the benefits. It has the vice of hiding the cost of the subsidy from the public. The legislatures in many states have added several proposed specific tax exemptions in 1969.¹⁷ And, there were some cases in some states manifesting a tendency to liberal treatment of tax exemptions.¹⁸ One such case which I find interesting in its implications is the *Christward Ministry* case¹⁹ in California dealing with a nature worshipping group whose members felt most strongly that they absolutely had to be surrounded by trees and natural beauty in order to worship properly. The California tax administrators were quite willing to exempt the church building and the grounds immediately surrounding the house of worship, but not all of the vast acreage which the group had in order to be away from the world of commercial buildings. It was felt to be just too much property to all be entirely tax exempt. The California Court of Appeals disagreed. It said that since the members of the church believed that all the property was needed for the proper conduct of their religion, all the property was being used for purposes of worship and all the property was tax exempt. I hate to think what might happen if all members of all faiths were to decide that natural surroundings, away from the mod-

¹⁶ Stewart, To Save Our Cities, 55 A.B.A.J. 157 (Feb. 1969). But see, Stone, Tax Incentives as a Solution to Urban Problems, 10 Wm. & Mary L. Rev., 647 (Spring 1969), for another point of view.

¹⁷ Examples are: Hawaii, S. B. 541 exempting off-campus housing owned by colleges and used by college personnel, Oregon S. B. 508 exempting non-profit corporation realty used as a home for elderly persons, New York S.B. 5220 providing a special exemption of aged or ill clergymen, and Arkansas H.B. 262 exempting non-commercial property of Public Housing Authorities and Urban Renewal Agencies.

¹⁸ Recent cases of this type include: State Board of Tax Commissioners v. Warner Press, Inc., 248 N.E. 2d 405 (App. Ct. of Ind., 1969); State Board of Tax Commissioners v. Fort Wayne Sport Club, Inc., 248 N.E. 2d 372 (App. Ct. of Ind. 1969); Board of Assessors v. Pioneer Valley Academy, Inc., 246 N.E. 2d 792 (Sup. Jud. Ct. of Mass., 1969); Board of Assessors v. Knoll-Wood Cemetery, 246 N.E. 2d 660 (Sup. Jud. Ct. of Mass., 1969); Young Israel of Far Rockaway v. City of New York, 297 N.Y.S. 2d 671 (N.Y. Sup. Ct. 1969); Bowers v. Akron City Hospital, 16 Ohio St. 2d 94, 243 N.E. 2d 95 (1968).

¹⁹ *Christward Ministry v. County of San Diego*, 76 Cal. Rptr. 854 (App. 1969).

ern world, were necessary to proper worship and all churches felt obligated to expand their land holdings in order to provide a proper atmosphere for worship. That thought has a rather horrifying potential in the crowded world in which we live today. Sacred lands could become the sacred cows of our society.

In some states there is no provision for partial tax exemption of property which is being used partly for tax exempt purposes and partly for commercial or other non-exempt purposes.²⁰ In such states a unit of property is either entirely tax exempt or entirely taxable. In other states a method of allocation is provided so that the portion of a property which is used for tax exempt purposes is not taxed while the portion used for other purposes is taxed. The Supreme Court of Wisconsin interpreted a statute of the latter type recently in *Alonzo Cudworth Post No. 23 v. City of Milwaukee*.²¹ The Court was perhaps too generous to the post in finding most of the property allocable to tax exempt patriotic meeting purposes leaving only the area directly used for a purely social club-room taxable. However, I believe allocation statutes, like the Wisconsin statute, to be desirable even though it may tempt the courts to be too generous in allocating property values to tax exempt purposes.

In *Camping and Education Foundation v. State*²² the Minnesota Supreme Court dealt with a group which had been operating a day camp on a purely commercial basis for many years before deciding to operate the non-profit way—perhaps after consulting an attorney who had read Professor Oleck's book.²³ The Court found that they were not really operating the camp for general charitable purposes at all but were simply using the form of a non-profit organization to conduct the same business they were operating before and did not let them get away with it.

The Superior Court of Pennsylvania recently denied Albright College tax exemption for the house it provided its president emeritus.²⁴ The reason for the Court's decision was that the property was not, in its view, being used for college purposes. The Court indicated that in Pennsylvania college property is tax exempt only when necessary for college purposes.

Before being modified by the decision in *Carmelite Sisters, St. Rita's Home v. Board of Review*²⁵ the case of *Crestview of Ohio, Inc. v. Donahue*²⁶ was clearly in line with the general "strict" trend. In *Crestview* there was a community operated by a non-profit corporation, affiliated with the Methodist Flower Hospital of Toledo, consisting of a 170 unit

²⁰ See 84 C.J.S. *Taxation* § 282 at 557.

²¹ 165 N.W. 2d 397 (1969).

²² 164 N.W. 2d 369 (1969).

²³ Oleck, *op. cit. supra* n. 1.

²⁴ *In re Albright College*, 249 A. 2d 833 (Super. Ct. of Penn., 1968).

²⁵ 18 Ohio St. 2d 41, 247 N.E. 2d 477 (1969).

²⁶ 14 Ohio St. 2d 121, 236 N.E. 2d 668 (1968).

apartment for people over 65 years of age, the residence of the director, an undeveloped meadow and small golf course for the use of the residents, and a hospital and nursing care center. Residents of the apartment units were required to pay a fee for food and a guaranteed life care plan was part of the contract for every resident. The court held that the community was not tax exempt because none of the land was being used exclusively for charitable purposes. However, in the *St. Rita's Home* case the court ruled that all services connected with the care of the aged and infirm in such a home are for charitable purposes and modified its *Crestview* decision except as to the undeveloped meadow, the small golf course and the residence of the executive director. Interestingly, the *St. Rita's Home* case was not a property tax case but one involving liability for contributions to the state unemployment compensation fund. In finding that the home was not an "employer," (hence not liable for contributions to the fund) the court concluded that it was rendering services exclusively for charitable purposes. Having determined that all services connected with the care of the aged and infirm in a home which (unlike a commercial apartment house) provides such medical and other services, are for charitable purposes within the meaning of the unemployment compensation statute, the Court evidently felt compelled by considerations of consistency to modify several property tax decisions including *Crestview*.

Sales and Use Taxes

Unlike property taxes, sales and use taxes as we now know them are of relatively recent origin, dating back only to the 1920s. While there may well be a trend in the direction of sales tax uniformity, nothing approaching uniformity in exemptions seems to have been achieved as of now. A glance at the Prentice-Hall STATE AND LOCAL TAX SERVICE Chart (§ 92,953.2) indicates that generally at the present time 28 states exempt sales to non-profit organizations while 19 states tax such sales. The notes to the chart indicate that these general rules are subject to numerous specific exceptions. It is difficult to get uniformity wherever we allow the several states to continue to act like sovereign states. It seems we cannot even get uniformity in the matter of determining the time of day.²⁷

A few years ago Babson in an article on tax exemptions concluded:²⁸

Definite efforts are being made by the tax administrators in many states either to reduce greatly the areas of exemption or to eliminate them altogether in favor of a reduction in the rate of taxation. It would appear, therefore, that unless the imponderable arguments of

²⁷ Michigan was on standard time in the summer of 1969.

²⁸ Analysis of Sales and Use Tax Exemptions, 9 Vand. L. Rev. 294, 308-315 (1956).

political consideration take over, the virtual elimination of exemptions in this area may win out in the race with uniformity.

It seems to me that the trend throughout the country in recent years has been to raise sales tax rates rather than reduce them. Perhaps the imponderable arguments of political consideration have taken over. It should be pointed out that materials dealing with sales tax exemptions rarely deal solely with charitable organization exemptions or exemptions for non-profit organizations. There are many other types of sales tax exemptions—exemptions of specific type of products such as food and prescription drugs, exemptions of products purchased for resale, etc. In one of the very few recent cases dealing with sales tax exemptions of non-profit organizations the Ohio Board of Tax Appeals held in favor of tax exempt sales to an organization which provided chaplaincy services, work for the socially handicapped in an industrial department, family and children services, and a village for the aged where ability to pay was not a condition of residency.²⁹

Income Taxes

Unfortunately state income taxes, both corporate and personal, are not uniform. This lack of uniformity has proven itself such a burden that many multistate business operators have demanded that the federal government do something to compel uniformity.³⁰ While few state income tax statutes are nearly exact copies of the federal code, nearly all of them are influenced by it. Surely federal income tax reform should inspire state tax reform. The trend is illustrated by a 1969 California statute³¹ providing for the income taxation of the unrelated business income of religious institutions. It should be noted in passing that qualification for federal income tax exemption under Section 501(c) (3) of the 1954 Internal Revenue Code does not guarantee exemption from state taxes.

Conclusion

In conclusion I would like to repeat my view that this is not a time for taking chances or pushing the law to its limits or encouraging clients to do so. In my opinion it is a time for extreme caution, for urging clients to move with care. Certainly it is a time when it is wise to protect oneself by informing clients of the risks involved, now and in the future, in using the non-profit form merely for the purpose of achieving tax exemptions.

²⁹ Lutheran Social Services of Miami Valley v. Porterfield, Ohio B.T.A. #70708 (1969).

³⁰ Recent developments on this matter, including new proposed federal legislation, are reported on in Prentice-Hall *State & Local Taxes* Report Bulletin No. 11 (September 16, 1969) at ¶ 11.1.

³¹ S.B. 1127.