



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	2/25/02	Bill No:	AB 2844
Tax:	Property	Author:	Simitian
Board Position:		Related Bills:	

BILL SUMMARY

This bill would allow real property leased for agricultural purposes to private parties and owned by a nonprofit land conservation organization in San Mateo County, as specified, to be eligible for the welfare exemption.

ANALYSIS

Current Law

Revenue and Taxation Code Section 214 provides for a “welfare exemption” under which property is exempt from property taxation if it is used exclusively for religious, hospital, scientific, or charitable purposes, and it is owned and operated by funds, foundations, or corporations meeting numerous statutory requirements.

Revenue and Taxation Code Section 214.02 specifies that the welfare exemption also applies to properties in their “natural states.” These are properties that are used exclusively for the preservation of native plants or animals, biotic communities, geological or geographical formations of scientific or educational interest, or open-space lands used solely for recreation and for the enjoyment of scenic beauty, provided the properties are open to the general public, subject only to reasonable restrictions. To qualify, the property must be owned and operated by a scientific or charitable organization with a primary interest of preserving those natural areas and meeting all the requirements of Section 214.

Under current law, any portion of property owned or held in trust by a nonprofit organization otherwise eligible for the welfare exemption and leased to persons who privately use the property for non-charitable purposes is not eligible for exemption. Specific to this bill, that portion of property leased to persons or companies for their private agricultural purposes is not eligible for the welfare exemption and, therefore, is subject to property taxation.

Proposed Law

This bill would add Section 214.03 to the Revenue and Taxation Code to extend the welfare exemption to property held in trust by a nonprofit land conservation organization but leased to private persons for agricultural purposes subject to San Mateo County Board of Supervisor approval.

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The leased portion of the property would be eligible to receive the welfare exemption if:

- The lessee that leases the property uses it exclusively for agricultural purposes.
- The nonprofit organization uses the proceeds from the lease payments exclusively for “natural resource management” and “agricultural infrastructure improvements”.

"Natural resources management" is defined to include erosion control, stream bank stabilization, native plant restoration, exotic species control, and wildlife habitat improvement and mitigation.

"Agricultural infrastructure improvements" is defined to mean the construction, repair, and maintenance of agricultural fences, farm roads, nonpermanent farm structures and hazardous materials removal that is related to prior agricultural activities.

This bill would also require that the land conservation organization annually provide the assessor of San Mateo County records of income from the lease and records that indicate projects that were funded by revenues from the lease and a finding that lease revenues were expended exclusively for natural resource management and agricultural infrastructure improvements.

In General

Welfare Exemption. Under Section 4(b) of Article XIII of the California Constitution, the Legislature has the authority to exempt property (1) used exclusively for religious, hospital, or charitable purposes, and (2) owned or held in trust by nonprofit organizations operating for those purposes. This exemption from property taxation, popularly known as the *welfare exemption*, was first adopted by voters as a Constitutional Amendment on November 7, 1944. With this amendment, California became the last of 48 states in the country to provide such an exemption from property taxes. The ballot language in favor of the amendment stated:

These nonprofit organizations assist the people by providing important health, citizenship and welfare services. They are financed in whole or in part by your contributions either directly or through a Community Chest. It is good public policy to encourage such private agencies by exemption rather than to continue to penalize and discourage them by heavy taxation.

When the Legislature enacted Section 214 of the Revenue and Taxation Code to implement the Constitutional provision in 1945, a fourth purpose, *scientific*, was added to the three mentioned in the Constitution. Section 214 parallels and expands upon the Constitutional provision by exempting property used exclusively for the stated purposes (religious, hospital, scientific, or charitable), owned by qualifying nonprofit organizations if certain requirements are met. An organization's *primary* purpose must be either religious, hospital, scientific, or charitable. Whether its operations are for one of these purposes is determined by its activities. A qualifying organization's property may be exempted fully or partially from property taxes, depending on how much of the property

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is used for qualifying purposes and activities. Section 214 is the primary welfare exemption statute in a statutory scheme that consists of more than 20 additional provisions. Over the years, the scope of the welfare exemption has been expanded by both legislation and numerous judicial decisions.

Owned and Operated Requirement. Section 214 requires that, to be eligible for the welfare exemption, both the owner and the user of a property must meet specific requirements. The first step in determining welfare exemption eligibility is to determine if the organization itself qualifies. In brief, an organization must meet the following requirements:

- It must be organized and operated for exempt purposes;
- It must not be organized or operated for profit;
- The owner organization must have an IRC §501(c)(3) or Revenue and Taxation Code 23701d letter of exemption;
- The user organization may also qualify with an IRC §501(c)(4) or Revenue and Taxation Code §23701f or §23701w letter;
- Organization's earnings must not benefit any private shareholder or individual;
- Articles of Incorporation must contain an acceptable statement of irrevocable dedication of the property to exempt purposes;
- Articles must contain an acceptable Dissolution Clause; and
- The property owner must be the owner of record on the lien date.

With respect to this bill, where there are multiple owners (the nonprofit land conservation organization) and operators (the lessee), property is not eligible for exemption unless the **owner and operator** meet the specific requirements of Section 214. An operator is a user of the property on a regular basis, with or without a lease agreement. Typically, the owner and operator are one and the same and the filing of one claim for exemption will suffice. However, it is not necessary that the owner and the operator of the property be the same legal entity. If property is owned by one exempt organization and operated by another exempt organization, each must qualify and file a claim for exemption. In this case, the operator is not an exempt organization. Where property is leased from an exempt owner to a non-exempt lessee, the welfare exemption is not available on that leased portion of the property. However, the remaining portion of the property may be eligible for exemption if it's used exclusively by the qualifying organization.

Specific Requirements for Use of Property. The Constitution and statutes impose a number of requirements that must be met before property can become eligible for exemption. Nonprofit organizations claiming exemption for their properties must satisfy various organizational requirements and must meet additional requirements that govern the uses of their property. With respect to the use of the property:

- The property must be used exclusively for exempt purposes.

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- The property must be used for the actual operation of an exempt activity.¹
- The property is not to be used to benefit any person through distribution of profits, compensation or the more advantageous pursuit of his or her business or profession.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the author. According to the author's office, this bill, in its introductory form, does not reflect the author's ultimate intent. Further, but unknown amendments are anticipated.
2. **Presumably, in fixing the terms of a lease or rental agreement, property tax expenses are either passed through to the lessee by recouping the expense in the lease payments charged or the agreement specifies that property taxes will be accounted for separately.** If property taxes can be fully recouped via the lease payments charged, then it seems that an argument can be made that this bill, in its current form, ultimately benefits the private lessee rather than the nonprofit organization. Other sections of law reflect the general notion that lease payments will reflect a property tax component. These sections specify that when property is owned by a private individual or company and leased to an organization for a use that qualifies the property for a property tax exemption (library, museum, schools, churches), the property owner must pass on any property tax savings to the lessee via the lease payment calculation. See Revenue and Taxation Code Sections 202.2 and 206.2.
3. **Does this bill create a competitive advantage for the lessees?** If the lease payments charged are lower because the property is not subject to property tax, would other persons who lease or own agricultural properties which are subject to property tax claim that this bill creates a competitive disadvantage?
4. **Additionally, this bill requires that lease proceeds be used for certain purposes which can be viewed as primarily benefiting the lessees in their business pursuits.** For instance, lease proceeds are to be used for "agricultural infrastructure improvements," which includes the construction, repair, and maintenance of agricultural fences, farm roads, nonpermanent farm structures and hazardous materials removal from prior agricultural activities. These improvements generally seem to benefit the lessees of the property as well as the nonprofit land conservation organization. Even if the proceeds are used to only benefit the nonprofit land conservation organization, the courts have previously held that it is not sufficient that the income from property is used to further the exempt purposes; the property itself must be so held or used.

¹ The exemption is limited to the amount of property reasonably necessary for the accomplishment of the exempt purpose. Portions of the property in excess of that reasonably necessary for the purposes of the organization do not meet the requirements for property tax exemption and are subject to taxation.

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5. **This bill would set a precedent for allowing the welfare exemption on property leased and used for nonexempt purposes.** Other non-profit organizations also lease or rent some of their properties in a manner that causes those portions to be ineligible for the welfare exemption. Similarly situated organizations may also seek exceptions. Additionally, other organizations that lease or rent their properties may also use the lease proceeds to further their specific causes.
6. **This bill only applies to property located in San Mateo County.** This bill includes an uncodified statement that provides that the Legislature finds and declares that a special law is necessary because the unique land use patterns and land use issues in the County of San Mateo provide a unique opportunity to implement and refine possible solutions for the preservation of open space throughout the state.

COST ESTIMATE

The Board would incur some minor absorbable costs in informing and advising County Assessors, the public, and staff of the change in law.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

The requirements of this bill would apply to property owned by the Peninsula Open Space Trust that is located in San Mateo County. According to the San Mateo County Assessor’s Office, the total assessed value of land owned by the Peninsula Open Space Trust is approximately \$52 million. Currently, exempt portions of the land total approximately \$19 million, leaving the taxable value at approximately \$33 million. Also, according to the assessor, they estimate that approximately 80 percent of the taxable portion, or \$26.4 million, consists of agricultural land currently being leased. Therefore, the current annual revenue impact from exempting the property from the basic one percent tax rate is \$264,000 (\$26.4 million x .01). This does not take into consideration any recent or future purchases of land.

Revenue Summary

The annual revenue impact at the basic one percent property tax rate from exempting the real property owned by Peninsula Open Space Trust that would qualify under this proposal is a revenue loss of \$264,000.

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