STATE OF CALIFORNIA

880.0128.005

STATE BOARD OF EQUALIZATION
450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082
916-323-3186 • FAX 916-323-3387
www.boe.ca.gov

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May 30, 2013

Re: Revenue and Taxation Code Section 214 – Ownership Requirment
Assignment No.: 13-052

Dear Mr. :

This is in response to your inquiry as to whether a nonqualifying owner of real property can meet the ownership requirement of Revenue and Taxation Code section 214,[1] the property tax welfare exemption, by creating and using a "synthetic lease"[2]. As hereinafter explained, the answer is no. Constitutional and statutory provisions pertaining to exemption of real properties from property taxation under the welfare exemption require, among other things, fee ownership of property by a qualifying religious, hospital, or charitable community chest, fund, foundation, trust, limited liability company or corporation; and recordation of the owner's interest in the real property on the lien date in the office of the recorder of the county in which the real property is located. Property owned by a nonqualifying owner cannot meet these and other ownership and use requirements for the welfare exemption.

Facts

In your letter, you state the following:

> One of my exempt clients, a hospital, created a for[-]profit subsidiary to purchase a medical office building. The title, being held in the name of the for[-]profit company, precludes the hospital from receiving the property tax [welfare] exemption. At the time of purchase the hospital used very little of the space. By the end of this year it will be the sole tenant.
>
> It appears that the use of a synthetic lease can provide the mechanism to achieve exempt status. To that end we have followed annotation 220.0354 in constructing the enclosed lease. We have followed the language of the lease as discussed.
>
> We would appreciate a review and the opinion of the Board of Equalization as to the true tax owner of the property.

[1] All further statutory references are to the Revenue and Taxation Code, unless otherwise specified.
[2] We understand "synthetic lease" as you use the term to be a financing structure whereby a company reports an asset as a lease for financial accounting purposes, but as owned for income tax purposes.

Law & Analysis

The welfare exemption follows from article XIII, section 4, subdivision (b) of the California Constitution which states:

> The Legislature may exempt from property taxation in whole or in part: [¶ … ¶]
>
> Property used exclusively for religious, hospital, or charitable purposes and owned or held in trust by corporations or other entities (1) that are organized and operating for those purposes, (2) that are nonprofit, and (3) no part of whose net earnings inures to the benefit of any private shareholder or individual.

Thereafter, the Legislature enacted section 214 et seq. to implement the Constitutional provision. Section 214, subdivision (a) provides for exemption for property used as specified and owned and operated by community chests, funds, foundations, limited liability companies, or corporations organized and operated for specified purposes, if all the requirements of section 214 and related sections are met.

You cite Property Tax Annotation No. 220.0354, which states, in relevant part:

> **Leases.** A financing lease is a type of purchase agreement whereby the seller (vendor) accepts periodic payments for the purchase price while retaining title to the property for security purposes. Possession of the property transfers to the lessee without full legal title until payment of the purchase price or on a predetermined date. The true owner of the property subject to a financing lease is considered to be the lessee, even though legal title to the property remains in the lessor for purposes of security, if at the time of entering into the agreement: (1) the parties have a fixed intention to buy and sell; and (2) the entire obligation to pay arises, payments being on a deferred basis; or (3) the lessee is under an economic compulsion to exercise the purchase option.

It appears that you cite this Annotation for the proposition that your client, a Hospital, should be considered the owner of the property even though it is a lessee of the property. We first note that this annotation pertains to change in ownership under Proposition 13, governed by California Constitution article XIII A, sections 60 et seq., and Property Tax Rules 460 et seq. and is not applicable to ownership for exemption purposes, which is governed by California Constitution article XIII. (See Property Tax Annotation No. 880.0128 and the December 27, 1984, memorandum upon which it is based, copies enclosed.)

From the adoption of Article XIII, section 4, subdivision (b) and the enactment of sections 214 et seq., fee ownership of real property by a qualifying religious, hospital, or charitable organization has been required. As title to the real property in this instance is held by the for-profit organization, and is leased by the for-profit organization to the hospital, fee ownership of the property for exemption purposes is in the for-profit organization and, thus, the property is not eligible for exemption. This is because the owner, as a for-profit organization, is not eligible for an Organizational Clearance Certificate[3], a prerequisite to claiming and receiving the welfare exemption.

[3] Rev. & Tax. Code, § 254.6.

A further basis for ineligibility of the real property for the welfare exemption is that the exemption requires both ownership and use; that is, for property to be granted the welfare exemption, an organization which meets all the requirements for exemption must own the property, and the property must be used for qualifying purposes. If another organization also uses the property, both it and the owner must meet all the requirements for exemption. In this regard, page 14 of Assessor's Handbook Section 267, *Welfare Church and Religious Exemptions* (AH 267) (October 2004), provides, in pertinent part:

> The property will not be exempt unless the owner and the 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.[4] If property is owned by one exempt organization and operated by another exempt organization, each must qualify and file a claim for exemption. [¶ …¶]
>
> **Lease By Non-exempt Owner To Exempt Organizations**
>
> If the operator is not an exempt organization, the portion of the owner's property used by the operator is not eligible for the exemption. However, if the owner of the real property is not an exempt organization, the operator may still receive the exemption as to personal property and improvements it owns if the operator and the property meet the requirements of section 214. Property leased from an owner which is not an exempt organization cannot qualify under the welfare exemption, but may qualify for another exemption which depends solely upon use of the property, e.g., free libraries, museums, public schools, churches and colleges.

Thus, the statute, court cases, and the Handbook contemplate that only property owned and operated solely by exempt organizations will be eligible for the exemption. For this reason also, ownership of the real property being owned by a for-profit organization precludes the property's eligibility for the welfare exemption.

Finally, we also note that another basis for ineligibility of the real property for the welfare exemption because of ownership of the property in a for-profit organization is the recordation requirement of section 261, subdivision (a), which states the following:

> Except as otherwise provided in subdivisions (b) and (c), as a prerequisite to the allowance of either the veterans' or welfare exemption with respect to taxes on real property, the interest of the claimant in the property must be of record on the lien date in the office of the recorder of the county in which the property is located. Failure of the claimant to establish the fact of such recordation to the assessor constitutes a waiver of the exemption.

AH 267 discusses ownership and section 261 at page 13 thusly:

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[4] "Section 214 (a) as construed by *Christ The Good Shepherd Lutheran Church v. Mathiesen*, (1978) 81 Cal.App.3d 355."

> 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: [¶ …¶]
>
> - The property owner must be the owner of record on the lien date.
>
> If the organization owning and operating the property does not qualify for exemption, its property does not qualify, even if it is used for exempt purposes.

Furthermore, AH 267, page 16 states the following regarding the recordation requirement:

> A qualified exempt organization claiming exemption for its real property must have recorded its ownership interest on the lien date in the recorder's office of the county in which the real property is located.[5]
>
> - Failure of the claimant to establish the fact of such recordation constitutes a waiver of the exemption.

Accordingly, the ownership interest in real property of a qualified exempt claimant for the welfare exemption must be recorded in the name of the claimant on the lien date in the office of the county recorder in which the real property is located, and failure to establish the fact of such recordation constitutes a waiver of the exemption. For this reason also, ownership of the real property being in a for-profit organization precludes the property's eligibility for the welfare exemption.

The views expressed in this letter are only advisory in nature. They represent the analysis of the legal staff of the Board based on present law and the facts set forth herein. Therefore, they are not binding on any person or public entity.

Sincerely,

/s/ J. K. McManigal, Jr.

J.K. McManigal, Jr.
Senior Tax Counsel

JKM:yg
J:/Prop/Prec/Welexqal/2013/13-052.doc
Enclosures
cc: Honorable
President, California Assessors' Association
Mr. David Gau (MIC:63)
Mr. Dean Kinnee (MIC:64)
Ms. Lisa Thompson (MIC:64)
Ms. Diane Yasui (MIC:64
Ms. Teresa Quento (MIC:64)
Ms. Terry Leung (MIC:64)
Mr. Todd Gilman (MIC:70)

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[5] "Section 261(a)."