State of California

Board of Equalization

Memorandum

To : Ms. Cindy Rambo

Date : July 13, 1989

From : Ken McManigal

Subject : Request for Hearing by 's Land Partnership, Contra Costa County, Appeal No. - Welfare Exemption

Claimant 's Land Partnership has claimed exemption for the 1987-88 and 1988-89 fiscal years for the Partnership's land, APN and APN , in , Contra Costa County, and it has requested a hearing before the Board with respect to staff findings that the land is ineligible for the exemption because:

No articles of incorporation submitted.

No income tax exemption letter under Revenue and Taxation Code section 23701d or Internal Revenue Code section 501(c)(3).

Property not used exclusively for religious or charitable purposes within the meaning of Revenue and Taxation Code section 214.

Property owned by a partnership is not eligible for exemption.

In brief, as partnerships are not designated entities eligible for the welfare exemption and as they cannot and do not meet all of the organizational requirements therefor, partnerships and their properties are not eligible for the exemption.

By Partnership Agreement dated August 31, 1987, the Redevelopment Agency (Agency) and the Corporation of Oakland, a California Corporation (Corporation), entered into a general partnership under the laws of the State of California, known as Land Partnership, for the purpose of owning real property. The Agency contributed land, which it was to and did acquire, and the Corporation contributed adjacent land, which it owned, to the Partnership, which was then to and did lease the above-mentioned parcels to the Corporation for the development and construction of a community facility for the Church of and for parking therefor.

The Partnership Agreement stated, among other things, that:

> "1.07 Promptly after the execution [of] this Agreement, the Partners . . . shall cause to be prepared, filed, and published a certificate of doing business under a fictitious name and such statements of partnership as may be required in order to comply with all applicable laws.
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> "2.01 The Agency and the Welfare Corporation shall have the following percentage interests in the Partnership:
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> |---|---|
> | Agency | 50% |
> | Welfare Corporation | 50% |
> | | 100% |
>
> "3.01 The principal business of the Partnership shall concern ownership and management of the Property, including . . . management of the seventy-five (75) year Lease of the Community Facility Parcel to the Welfare Corporation for the construction and operation of the community facility. The Agency and the Welfare Corporation shall have joint control over the Partnership business except . . . .
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> "3.03 During the terms of the Leases, the Partners shall jointly manage the Property, . . .
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> "4.01(a) The profits, gains and losses of the Partnership shall be apportioned according to the Percentage Interests described in section 2.01 above.
>
> "4.02 It is not anticipated that the Partnership business will generate income in excess of the amount needed to cover Partnership expenses. Should excess income be generated by the Partnership business, a reasonable portion as agreed upon by the Partners shall be retained by the Partnership as a reserve. Any additional income shall be distributed to the Partners annually; provided, . . .

"Distributions shall be allocated between the Partners according to the Percentage Interest of each Partner as described in Section 2.01 above, except . . . .

"5.04 A Partner may voluntarily withdraw from the Partnership without assigning its interest to a third party only with the prior written consent of the other Partner. Upon the withdrawal of a Partner from the Partnership pursuant to this Section 5.04, the Partnership shall be terminated and the withdrawing Partner shall transfer its interest in the Partnership to the remaining Partner. The withdrawing Partner shall not receive any monetary compensation or reimbursement for the transfer of its interest in the Partnership to the other Partner.

"6.01 Liquidation and winding up of the affairs of the Partnership shall occur as follows:

"(a) Management. Upon termination of the Partnership, its business shall continue for the sole purpose of winding up its affairs. The rights and obligations of the Partners with respect to management as set forth in this Agreement shall continue during the period of such liquidation.

"(b) Profits and Losses. Profits and losses of the Partnership during liquidation shall be determined and allocated in accordance with the provisions of this Agreement.

"(c) Distribution of Assets. The assets of the Partnership, excluding the Property, shall be applied or distributed in the following order of priorities:

"(i) For payment of any debts of the Partnership;

"(ii) For payment of advances of each Partner to the Partnership . . . .

"(iii) For return of the cash contributions made by the Partners; and

"(iv) Profits, if any, in accordance with the provisions hereof.

"(d) Distribution of Property. The treatment of the Property shall be as follows:

"(i) The Partnership shall attempt to have the Property resubdivided into the two parcels that were contributed to the Partnership by the Partners, in which event each parcel shall be distributed to the Partner that contributed it to the Partnership, . . .

"(ii) In the event the Partnership is not successful in having the Property resubdivided as provided in [ ] above, the Welfare Corporation shall have the option to purchase the City Right-of-Way . . . .

"(iii) In the event the Welfare Corporation does not exercise the option within the time provided in (ii) above, the Agency shall have the option to purchase the Property at fair market value. . . .

"(iv) In the event the Agency does not exercise the option within the time provided in (iii) above, the Partnership shall sell the Land to a third party, in which event the sales proceeds shall be distributed to the Partners in the same proportion as the ratio of the values of the initial contributions . . . .

"10.08 This Agreement shall be construed in accordance with and be governed by the provisions of the laws of the State of California."

Under the laws of California, Corporations Code sections 15001 through 15045, partnerships are for-profit organizations. In brief, a partnership is an association of two or more persons to carry on as co-owners a business for profit (sec. 15006). A statement of partnership, in the name of the partnership, signed, acknowledged and verified by two or more of the partners may be recorded in the office of the county recorder of any county (sec. 15010.5). The property rights of a partner are his rights in specific partnership property, his interest in the partnership, and his right to participate in the management (sec. 15024), and his interest in the partnership is his share of the profits and surplus (sec. 15026). And, after dissolution, subject to any agreement to the contrary, the liabilities of the partnership rank in order of payment, as follows:

1. Those owing to creditors other than partners,

2. Those owing to partners other than for capital and profits,

3. Those owing to partners in respect of capital,

4. Those owing to partners in respect of profits. (Sec. 15040.)

Conversely, the welfare exemption is for non-profit organizations. Article XIII, section 4(b) of the California Constitution provides that property used exclusively for religious or charitable purposes and owned by corporations or other entities that are organized and operating for those purposes, that are nonprofit, and no part of whose net earnings inure to the benefit of any private shareholder or individual may be exempt from property taxation. Revenue and Taxation Code section 214 thus provides that property so used and owned and operated by community chests, funds, foundations or corporations organized and operated for qualifying purposes can be exempt, but:

An organization must be organized and operated for qualifying purposes, and it cannot be organized or operated for profit (section 214(a)(1));

No part of its net earnings can inure to the benefit of any private shareholder or individual (section 214(a)(2));

Its property must be used for the actual operation of the religious, hospital, scientific, or charitable activity, and

must not exceed an amount of property reasonably necessary to the accomplishment of the exempt purpose(s) (section 214(a)(3));

Its property must not be used so as to benefit anyone through the distribution of profits, payment of excessive charges or compensations, or the more advantageous pursuit of her or his business or profession (section 214(a)(4));

Its property must not be used for fraternal, lodge, or social club purposes (section 214(a)(5)); and

Its property must be irrevocably dedicated to religious or charitable purposes, and upon the organization's liquidation, dissolution or abandonment, its property would have to inure to the benefit of a fund, foundation, or corporation organized and operated for an exempt purpose or purposes (section 214(a)(6)). Property is deemed irrevocably dedicated to qualifying purposes only if a statement of irrevocable dedication to only religious, hospital, scientific or charitable purposes is found in the articles of incorporation of a corporation (section 214.01).

Further in this regard, section 214.8 provides that with certain exceptions, the welfare exemption shall not be granted to any organization which is not qualified as an exempt organization under section 23701d of the Revenue and Taxation Code or section 501(c)(3) of the Internal Revenue Code. An organization shall not be deemed to be qualified as an exempt organization unless the organization files with the assessor duplicate copies of a valid, unrevoked letter or ruling from either the Franchise Tax Board or the Internal Revenue Service, which states that the organization qualifies as an exempt organization under the appropriate provisions of the Bank and Corporation Tax Law or the Internal Revenue Code.

The problem in this instance is that partnerships generally, and Land Partnership specifically, are not non-profit community chests, funds, foundations or corporations, are not organized for religious or charitable purposes, and do not and cannot meet other of the requirements for the exemption:

1. They are organized and, presumably, operated for profit (Corp. Code sec. 15006 and sec. 4.01 of <u>Partnership Agreement</u>). Cf. section 214(1).

2. Net earnings inure to the benefit of partners (Secs. 4.01 and 4.02 of <u>Partnership Agreement</u>). Cf. section 214(2).

3. Their properties are not irrevocably dedicated to religious or charitable purposes. Cf. sections 214(6) and 214.01.

4. They do not have tax letters to the effect that they are exempt from Federal and State income taxes, or either of them. Cf. section 214.8.

In its Request for Hearing, the Partnership states on page 2 that both the Agency and the Corporation are exempt from federal and state income tax and otherwise qualify to hold property under the welfare exemption.* But, as indicated above, it is the Partnership that owns the parcels, not the Agency and the Corporation, and the Partnership acknowledges same on page 2, lines 10 and 11 of the Request for Hearing:

> "The property was contributed to the Partnership in part by the Welfare Corporation and in part by the Agency."

And it is the Partnership as owner of the parcels which must meet all the requirements for the exemption in order for the parcels to be exempt. Such is consistent with the longtime, past practices of staff, the Board, and the courts whereunder they have looked to entities rather than to individual members or components thereof in making determinations concerning the ownership and operating requirements of section 214. And in any event, were the staff or Board to view the Agency and the Corporation rather than the Partnership as the owner of the parcels in this instance, the requirements of sections 261 and 260 of the Revenue and Taxation Code would preclude exemption of the parcels, which are recorded in the name of the Partnership:

> "261(a) 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

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* While the Corporation would qualify thereunder, the Agency, being a governmental agency, would not, but property it owned would be exempt under Article XIII, section 3(b) of the California Constitution.

> 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.
>
> "260 If any person, claiming any exemption named in this article, fails to follow the required procedure, the exemption is waived by the person."

The Partnership then states on page 3 of the Request for Hearing that denying the exemption to the Partnership serves no substantive purpose since the Corporation could have retained its own parcel and leased the Agency's parcel and been able to qualify the parcels for the exemption. While such may be true, that is not how the Agency and the Corporation chose to proceed in this instance; and it is what the actual situation is, not what it might have been, that must be addressed. As to the matter of two property tax-exempt entities combining ownership and/or use of property and resulting in the property not being eligible for any exemption, generally, such is a matter for the Legislature. For exemption, prior to the 1977 addition of Revenue and Taxation Code section 214.6, which allowed certain exempt governmental entities to use properties of qualifying, welfare-exempt organizations and still receive the welfare exemption, property owned by welfare-exempt organizations and used by government entities was not exempt. And, prior to the 1985 addition of Revenue and Taxation Code section 214(e), which allowed certain colleges to own properties used by other organizations for qualifying religious, hospital, scientific, or charitable purposes and activities and still receive the welfare exemption, property owned by a college and used by welfare-exempt organizations for qualifying purposes and activities was not exempt.

As for other statements made by the Partnership:

> (1) Pg. 4. "See also Christ the Good Shepard [sic] Lutheran Church v. Mathiesen (1978) 81 Cal.App.3d at 355, 358 holding that property retained its exemption when leased by one tax-exempt owner to another."

As hereinafter indicated, the court held that in order to qualify for the welfare exemption property must be both owned and operated by welfare organizations, which is not the case here.

> (2) Pg. 4. "Likewise, the Partnership falls within the general parameters of the rule that property held by an agent or trustee will be assessed as if held by the real owner. If property is exempt in the hands of the principal, it remains exempt in the hands of the agent."

There is nothing in the Partnership Agreement, General Lease, or other documents declaring or implying any principal or agent relationship between the Agency and the Corporation. To the contrary, the Partnership Agreement specifically defines and limits the authority of each partner in sections 3.05 and 5.01.

> (3) Pg. 6. "There has been no suggestion that the Partnership is organized for profit."

To the contrary, as indicated above, partnerships are, by definition organized for profit (Corp. Code, sec. 15006).

> (4) Pg. 8. "Nothing in the California Code of Regulations or elsewhere imposes any further requirement for granting the welfare exemption which is not met here."

As indicated above, section 214.8 requires an income tax exemption letter, which the Partnership does not have.

> (5) Pg. 8. "The Assessors' Handbook (AH 267, Welfare Exemption (1985)) classifies the Revenue and Taxation Code provisions concerning low-income housing partnerships not as authorizing an otherwise ineligible form of ownership, but as extending exemption to a specific use of property. Assessors' Handbook AH 267, supra, p. 40."

Neither page 40 nor any other page of the Handbook addresses low-income housing partnerships because section 214(g), which refers, among other things, to rental housing owned by limited partnerships, not general partnerships, was added in 1987 whereas the Handbook was adopted in 1985, two years earlier.

As has been noted in previous welfare exemption matters, the exemption is both an "ownership" and a "use" exemption, 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 and the property must be used by both for qualifying purposes. In this latter regard, page 7 of Assessor's Handbook AH 267, Welfare Exemption, provides in pertinent part:

> ". . . 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 it meets the requirements of Section 214. Property leased from an owner which is not an exempt organizations is not exempt under the welfare exemption, . . ."

The owner-operator requirement has been considered by the Court of Appeal in Christ the Good Shepherd Lutheran Church v. Mathiesen, 81 Cal.App.3d 355. Consistent with the above, the court held, among other things, that an owner of property may qualify for the exemption notwithstanding the fact that its property is leased to and operated by another organization, but that the property must be both owned and operated by welfare organizations in order to qualify therefor.

Thus, while the Partnership is not a qualifying, exempt organization, property owned by the Corporation, including improvements and personal property, can receive the exemption if all the requirements for the exemption as to that property and the Corporation are met.

Finally, according to the general lease between the Partnership and the Corporation for the parcels:

> "2.6(a) Subject to Section 2.6(c), as part of the consideration for this Lease, Lessee shall pay during the entire Lease Term, at its own cost and expense, as the same become due and payable and before any fine, penalty, interest, or other charge may be added thereto for the nonpayment thereof, all real estate taxes, . . ."

Thus, as section 2.6(a) indicates, the Partnership, the Agency, the Corporation, and/or their attorneys were aware of section 214, the requirements thereof, and the possibility/probability/certainty that the Partnership would not meet all the requirements thereof; and their provision for this event consisted of the insertion of section 2.6(a) in the

lease to provide that the lessee Corporation would, as part of the consideration for the lease, pay all property taxes for the property.

Please present the Partnership's Request for Hearing, copy attached, to the Board in an upcoming Welfare Exemption Claim Matters Agenda. As it is the staff's position that partnerships do not meet the requirements for the exemption and that the Partnership and its properties are not eligible for the exemption for the reasons hereinabove set forth, staff is of the opinion that the Request for Hearing should be denied.

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Attachment

cc: Mr. John W. Hagerty
Mr. Verne Walton
Mr. James Barga
Mr. William Minor
Ms. Janice Masterton