

Memorandum

To: Mr. Mike Harris (MIC: 64)
Principal Property Appraiser

Date: December 4, 2009

From: Andrew Jacobson
Tax Counsel

Subject: *Claim for Organizational Clearance Certificate*

Assignment No. 09-185

This is in response to your August 19, 2009, memorandum directed to Mr. Randy Ferris, Assistant Chief Counsel. In your memorandum, you requested that Legal staff review a claim for an Organizational Clearance Certificate (OCC) for _____ Foundation, Inc. (Foundation), a California nonprofit public benefit corporation. Foundation has a single member, _____ P _____, Inc., also a California nonprofit public benefit corporation, which already has received an OCC. In particular, you ask whether the Foundation is organized and operated exclusively for charitable purposes and meets the requirements for an OCC.¹

As discussed in greater detail below, we conclude that based on the evidence provided to us at this time, Foundation is organized and operated for charitable purposes pursuant to Revenue and Taxation Code² section 214, subdivision (a). In particular, Foundation's holding of title to property used by _____ P _____ in pursuance of exempt activities and its provision of administrative support services may qualify as exempt activities under section 214, subdivision (a) because Foundation performs these functions solely to further the exempt activities of _____ P _____. However, Foundation's anticipated fundraising activities should be examined carefully by the relevant county assessors pursuant to the requirements of section 214, subdivision (a)(3).

Facts

On July 30, 2008, Foundation submitted an OCC claim beginning with the 2007-2008 fiscal year. On June 2, 2009, you issued a preliminary finding sheet, in which you requested more information concerning Foundation's relationship with _____ P _____ and about Foundation's own activities. On June 30, 2009, Foundation's representative sent a letter (the June 30, 2009, Letter) discussing the purpose of Foundation and providing responses to questions raised in the finding sheet.

¹ In addition, you asked in the August 19, 2009, Memorandum what guidelines should be followed to determine if an organization qualifies for an OCC if its activities are limited to rental of commercial property to other nonprofit organizations. Our recommendations are provided as part of our analysis of this specific OCC claimant.

² All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

Law and Analysis

California Constitution, article XIII, section 1 states that, unless otherwise provided by the California Constitution or by the laws of the United States, all property is taxable. California Constitution article XIII, section 4, subdivision (b)³ authorizes the Legislature to exempt property used exclusively for religious, hospital or charitable purposes, which is owned and operated by specified organizations. Under section 214, subdivision (a), the welfare exemption is available for property used exclusively for religious, hospital, scientific or charitable purposes that is owned and operated by nonprofit organizations that have been organized and operated for such purposes provided that all the requirements are satisfied.

In order to qualify as "charitable" under section 214, subdivision (a), an organization's purpose and activities must provide a general community benefit whose ". . . ultimate recipients are either the community as a whole or an unascertainable and indefinite portion thereof."⁴ The community benefit test may also be met when an organization that provides only a specific benefit to a limited group of people serves to lessen the burdens of government.⁵

Pursuant to section 254.6, as of January 1, 2004, the Board, acting through the County-Assessed Properties Division (CAPD) reviews the organization and operations and grants an OCC to nonprofit organizations determined to be organized and operated for an exempt purpose. Assuming that CAPD grants an OCC, the assessor may then determine whether the property is used exclusively for exempt purposes.⁶ Welfare exemption recipients must file an affidavit each year with the assessor in order to verify that the property remains eligible to receive the welfare exemption.⁷

Nonprofit organizations that utilize nonprofit public benefit corporation subsidiaries to protect themselves from liability are acting similarly to nonprofit organizations that have created limited liability companies (LLC) to serve as managing general partners of limited partnerships developing low-income housing. As you know, the Legal Department recently issued an opinion stating that both corporations and limited liability companies may qualify for an OCC as the managing general partner of a low-income housing partnership even if that corporation or limited liability company had no employees, assets or liabilities.⁸ Similarly, we have concluded that an LLC without employees, assets or liabilities whose sole purpose is to hold property for a nonprofit member could qualify for an OCC so long it was clearly intended to limit liability relating to the property to the nonprofit member.⁹ The present case represents a logical progression from these cases. We are now asked to determine whether a *single-member, nonprofit public benefit corporation*, one of whose purposes is to hold property for its sole nonprofit member, may qualify for an OCC so long it is clearly intended to limit liability relating to property belonging to the nonprofit member.

³ See also Cal. Const., art. XIII, § 5.

⁴ *Stockton Civic Theatre v. Board of Supervisors* (1967) 66 Cal.2d 13, 22.

⁵ See *Peninsula Covenant Church v. County of San Mateo* (1979) 94 Cal.App.3d 382, 399; see also *John Tenant Memorial Homes v. City of Pacific Grove* (1972) 27 Cal.App.3d 372, 382 (private retirement home for the elderly lessens the need for a public agency to house them); *Fifield Manor v. Los Angeles County* (1961) 188 Cal.App.2d 1, 20 (private homes for the elderly replace public housing).

⁶ Rev. & Tax. Code, § 254.5, subd. (a).

⁷ Rev. & Tax. Code, §§ 255, 259.5.

⁸ See February 1, 2008, Memorandum, and July 1, 2008, Memorandum.

⁹ See April 20, 2009, Memorandum.

In the present case, Foundation has been created for three separate purposes that we are aware of: (1) holding property for P ; (2) providing administrative support services for petitioner; and (3) serving as a fundraising arm for P . We address these points in turn.

1. Holding property and performing administrative services for a sole nonprofit member.

Foundation's Articles of Incorporation, Article II, Section B provides for the following purposes:

- (1) To promote, support, advance, improve and participate in charitable programs that provide educational, social, vocational, psychological, counseling, medical, housing, shelter and rehabilitation services and care to combat social problems, including alcohol and drug abuse, poverty and homelessness; and
- (2) To assist and participate in the charitable programs operated by P , Inc., a California nonprofit, public benefit corporation exempt from Federal income tax as an organization described by Section 501(c)(3) of the Internal Revenue Code. The assistance provided to P , Inc. *shall include*, but not be limited to *the ownership and maintenance of real property and other assets used by P , Inc., in conducting its charitable programs.* (Emphasis added.)

P 's Articles of Incorporation state its purpose in relevant part as being:

- (a) to effect, promote, and carry out various projects of reeducation and civic re-orientation of both present and former drug addicts and the youth of the community who represent potential drug abusers.
- (b) to assist and work with 'addicts', former 'addicts', and young potential users in obtaining adequate employment, housing, man to man sponsorship, and such other assistance as is deemed necessary for such individuals to successfully adapt to society and maintain their freedom from dependency on drugs.¹⁰

As we have concluded in the April 20, 2009, Memorandum, an organization created solely to hold property may qualify for an OCC provided that its activities are closely linked to those of its single member.¹¹ The Legal Department has recognized that exempt organizations often employ single-purpose LLCs for the sole purpose of limiting their own liability. As we noted in the April 20, 2009, Memorandum, an LLC that holds property for its qualifying organization may be organized for exempt purposes provided that the LLC is organized to limit the liability of the member nonprofit with regard to the ownership and operation of the property, and the member actually performs exempt activities on the property in conformity with the LLC's formative document. Similarly, one of Foundation's primary purposes appears to be limiting liability to P . As Foundation states in one of its submissions, Foundation was created by P in part to "limit potential liability associated with the activities conducted on those properties" that are used by P on which to conduct its exempt activities.¹²

¹⁰ P Articles, art. II.

¹¹ April 20, 2009, Memorandum, p. 3.

¹² Letter, Sushma D. Taylor, CEO Concepts Foundation, Inc. to Franchise Tax Board, April 9, 2008, p. 3.

It is true as you have stated that Foundation leases five California properties to P at what may either be market or less than market rents.¹³ However, due to the close nexus between Foundation and P, we do not believe it is necessary to make a determination as to whether these rents represent market or below-market charges. Indeed, the lease payments appear to be analogous to P's other financial transfers to Foundation, including substantial charitable contributions that are reflected in Foundation's financial statements.¹⁴ Additionally, Foundation has stated in its correspondence that:

The reason that the lease amounts charged to P, Inc. are greater than the minimum maintenance costs associated with the property (given that none of the properties are debt financed) is because many of the charitable programs operated by P, Inc. and supported by the Foundation are funded by service contracts that designate a specified amount of funds for facilities and maintenance.¹⁵

Based on our review of Foundation's Articles of Incorporation and Bylaws, we see sufficient evidence that Foundation and P are using these leases to further P's exempt purposes and believe that Foundation's characterization of these leases as noncommercial in nature should be accepted.

We similarly believe that the provision of administrative support services such as hiring or firing personnel, executing contracts and making investments for a single member may qualify as an exempt activity under section 214, subdivision (a) so long as a strong nexus exists between the corporation and its single member. For example, Foundation notes that it plans to offer grants to groups engaging in mental health activities that would use funds contributed by P.

The Foundation's programs, or the Foundation will provide grants and administrative support to P for specific program support identified by such grants.¹⁶

This is similar to other grant-making organizations in which the Legal Department has found that administrative activities were charitable in nature.¹⁷

In the present case, there appears to a tight nexus between Foundation and P with regard to control. While you noted in the August 19, 2009, Memorandum that P has a separate Board of Directors, Foundation's board actually has relatively little independence from P.¹⁸ As was noted above, P is Foundation's sole member:

The corporation shall have one "member" as that term is defined in Section 5056 of the California Nonprofit Public Benefit Corporation Law. The member shall

¹³ August 19, 2009, Memorandum, p. 2; see also Letter, Sushma D. Taylor, CEO Concepts Foundation, Inc. to Franchise Tax Board, April 9, 2008, p. 2.

¹⁴ Foundation's financials, July 2007 through March 2008, show "corporate donations" in the amount of \$4 million and donations of property totaling \$47,450.56. See Letter, Sushma D. Taylor, CEO Concepts Foundation, Inc. to Franchise Tax Board, April 9, 2008, p. 1.

¹⁵ Letter, Sushma D. Taylor, CEO Concepts Foundation, Inc. to Franchise Tax Board, April 9, 2008, pp. 2-3.

¹⁶ Description of Organization Activities, Concepts Foundation Inc., p. 1.

¹⁷ See Annotation 880.0361.

¹⁸ August 19, 2009, Memorandum, p. 3.

be P , Inc., a California nonprofit public benefit corporation. The member shall have those rights and obligations specifically set forth in the Bylaws of the Corporation.¹⁹

P is responsible for approving all candidates for full one-year terms to the Board of Directors.²⁰ Additionally, the president/executive director of P serves on the Board ex officio and must be among the three-to-nine board members.²¹ Indeed, it appears that at least in 2008, P and Foundation both had the same chief executive officer.²² Finally, many major decisions cannot be undertaken by Foundation's board without the authorization of P . The Bylaws of Foundation provide that:

The following actions of the Board of Directors must be approved by the Member [P], or a duly authorized representative of the member, prior to the action being effective:

- (i) Any amendment to the corporation's Article of Incorporation;
- (ii) Any amendment to these bylaws;
- (iii) Any sale or distribution of assets held by the corporation in excess of one hundred thousand dollars (\$100,000);
- (iv) Any plan of merger, consolidation or dissolution for the corporation;
- (v) Any change in the mission or purposes of the corporation.²³

Therefore, while it is true that Foundation has a separate Board from P , P 's control over Foundation is sufficient to create a close nexus between the two corporations that is analogous to qualifying LLCs and their members under Property Tax Rule 136.²⁴

One issue that arises is whether a corporation that holds title and performs administrative functions may satisfy the community benefit test. However, we note that Property Tax Rule 136, subdivision (c)(2) provides that ". . . [t]he organizational language shall specify that the limited liability company is operated exclusively to further the exempt purpose(s) as specified in section 214, of its member(s)." In essence, LLCs pass the community benefit test by furthering the activities of their members. The situation is analogous for a nonprofit public benefit corporation with a single member. Moreover, as the Legal Department has found in the past, providing administrative services, such as grant-making, may itself satisfy the community benefit test through the distribution of grants to other nonprofit organizations.²⁵

¹⁹ Articles of Incorporation, art. VI, Section B.

²⁰ Bylaws, art. 4, § 16(e).

²¹ Bylaws, art. 4, § 1.

²² Letter, Sushma D. Taylor, CEO Concepts Foundation, Inc. to Franchise Tax Board, April 9, 2008, p. 4.

²³ Bylaws, art. 11, § 1.

²⁴ We also note that nonprofit public benefit corporations are subject to their own body of law, making their use more stringent. By contrast, the Corporations Code does not distinguish between for-profit and nonprofit limited liability companies. By creating the entity in the form of a corporation, that corporation is subject to many of the default provisions of the Corporations Code that must be satisfied in order to maintain nonprofit status under California law. For example, Corporations Code section 6010, subdivision (a) requires prior written consent of the Attorney General prior to a merger. By contrast, because the Corporations Code provides only one body of law for limited liability companies, there is no such restriction on mergers by nonprofit limited liability companies. (See Corp. Code, § 17550.)

²⁵ See Annotation 880.0361.

Altogether, the arrangement between Foundation and P shows that P exercises ultimate management control over Foundation's affairs. This is sufficient to establish the close nexus between the corporation and its sole member that is similar to that in our July 1, 2008, Memorandum and April 19, 2009, Memorandum. Therefore, in our opinion, a corporation created to hold property for its single member and/or to provide administrative support services for its single member may be organized and operated for exempt purposes provided all other requirements for an OCC are satisfied.

2. Fundraising.

While most exempt organizations engage in fundraising of one kind or another, fundraising is not in itself an exempt activity. On one hand, the solicitation of charitable donations is an expected part of the operation of a charity and its presence is often taken as a badge of nonprofit status.²⁶ On the other hand, if fundraising is not carried out within certain statutory limits, it may serve to deny the welfare exemption to a property or a portion of a property or, if it is a primary activity of an organization, it will prevent that organization from receiving an OCC.

Section 214, subdivision (a)(3) provides in relevant part that:

The property is used for the actual operation of the exempt activity, and does not exceed an amount of property reasonably necessary to the accomplishment of the exempt purpose.

(A) For the purposes of determining whether the property is used for the actual operation of the exempt activity, consideration shall not be given to use of the property for either or both of the following described activities if that use is occasional:

- (i) The owner conducts fundraising activities on the property and *the proceeds derived from those activities are not unrelated business taxable income, as defined in Section 512 of the Internal Revenue Code*, of the owner and are used to further the exempt activity of the owner. (Emphasis added.)

For purposes of this subparagraph "occasional use" is defined as:

. . . use of the property on an irregular or intermittent basis by the qualifying owner or any other qualifying organization described in clause (ii) of subparagraph (A) that is incidental to the primary activities of the owner or the other organization.²⁷

Additionally, for purposes of this subparagraph, "fundraising activities" is defined as:

²⁶ See AH 267, pt. I, p. 5.

²⁷ Rev. & Tax. Code, § 214, subd. (a)(3)(B)(i).

. . . both activities involving the direct solicitation of money or other property and the anticipated exchange of goods or services for money between the soliciting organization and the organization or person solicited.

After an OCC has been issued, the county assessor may then apply the "occasional" fundraising provisions of section 214, subdivision (a)(3)(A). However, since fundraising is not an exempt purpose in and of itself under section 214, subdivision (a), an organization will not qualify for an OCC if it performs fundraising as one of its primary activities. Indeed, California courts have long required that the actual purpose and activities of a qualifying organization must be exempt under section 214, subdivision (a), even if all of the funds produced by the non-qualifying activities are used to further an organization's qualifying purposes.²⁸

In present case, Foundation admits that while it does not currently carry out fundraising, it is expected that it will engage in fundraising in the future:

. . . one of the Foundation's exempt purposes is to support the behavioral health programs of P, Inc. by participating in a combined fundraising program to establish and maintain an endowment for the continued support and expansion of necessary behavioral health programs in the San Francisco Bay Area. As part of this program, the Foundation will prepare grant requests and similar solicitation materials for contributions to the Foundation from the general public, private foundations and federal and state government sources. This coordinated campaign is presently in the planning stages by representatives of both the Foundation and P, Inc.²⁹

Foundation also states that its intention is one day to become the principal fundraising organization for P.³⁰

With respect to these future fundraising plans, however, Foundation's CEO erroneously asserts that "the conduct of public fundraising programs unrelated to the property it owns also qualifies as a separate charitable purpose." While the proposed fundraising activities are *not* qualifying charitable purposes under section 214, subdivision (a), a question remains as to whether such fundraising will be carried out with the limits of section 214, subdivision (a).³¹ Because Foundation has not commenced its fundraising to our knowledge, we do not know how much time, space and resources Foundation will devote to these fundraising activities. Moreover, we are uncertain whether Foundation's projected fundraising activities should be considered a principal activity, which would disqualify Foundation from receiving an OCC, or whether they may be secondary activities, which would allow the county assessor to treat these activities as unrelated taxable business income (UBTI) while awarding Foundation a welfare exemption.³²

Therefore, we opine that CAPD should issue Foundation an OCC based on its organization and operations to hold property for P and provide administrative support for P's exempt activities. However, the subject county assessors should, upon the filing of welfare

²⁸ *Cedars of Lebanon Hospital v. County of Los Angeles*, (1950) 35 Cal.2d 729, 746.

²⁹ Letter, Sushma D. Taylor, CEO Concepts Foundation, Inc. to Franchise Tax Board, April 9, 2008, p. 2.

³⁰ Letter, Sushma D. Taylor, CEO Concepts Foundation, Inc. to Franchise Tax Board, April 9, 2008, p. 3.

³¹ See *Cedars of Lebanon Hospital v. County of Los Angeles*, *supra*, 35 Cal.2d at p. 746; Annotation 880.0390.

³² Rev. & Tax. Code, § 214, subd. (a)(3)(A)(i).

exemption claims in their respective counties, determine whether or not property is being used by Foundation for fundraising in a matter that disqualifies it for the welfare exemption.

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