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March 28, 2003

The Honorable Donald E. Williamson
Assessor of San Bernardino County
172 West Third Street
San Bernardino, CA 92415-0310

Attention:

Re: Effective Date of Property Tax Rule 137

Dear Mr. _____ :

This is in response to your letter of September 27, 2002, in which you inquire regarding the effective date of Property Tax Rule 137, Application of the Welfare Exemption To Property Used for Housing. For the reasons discussed below, it is the Board's position that Rule 137 did not constitute a change in, but rather is declaratory of existing law. As Rule 137 merely reflects existing law, it is to be given retroactive effect.

By enacting Proposed Rule 137, the Board clarified the application of existing statutory and case law to housing properties of qualified nonprofit organizations,¹ and established a single uniform statewide standard for determining qualification for exemption of such properties. (Title 18, Public Revenues, California Code of Regulations, section 137) Rule 137 clarifies and interprets sections 4(b) and 5 of Article XIII of the California Constitution and sections 214, 214.01, 214.1, 214.2, 254, 254.5, and 255 of the Revenue and Taxation Code. Section 4 (b) of Article XIII provides for the exemption from property taxation of property used exclusively for religious, hospital, or charitable purposes that is owned or held in trust by qualifying nonprofit organizations operating for those purposes. Section 5 of Article XIII extends the exemption to buildings under construction, land required for their convenient use and equipment in them if the intended use would qualify the property for exemption. Section 214 of the Revenue and Taxation Code implements section 4(b) of Article XIII and imposes a number of requirements which must be met before property is eligible for exemption. The requirement that property is to be used exclusively for the stated exempt purposes by qualified nonprofit organizations is reiterated in subd. (a) of Section 214.

In 1988, the Legislature enacted Section 214, subd. (i), to provide that property used for employee housing shall be deemed exempt to the extent the residential use is "institutionally

¹ "Qualified" nonprofit organizations means tax-exempt organizations meeting all the requirements for the welfare exemption pursuant to section 214 et seq.

necessary” for the operation of the organization. The Legislature stated that section 214, subd. (i) was “declaratory of existing law,” referencing longstanding judicial precedent on this issue. (Stats. 1988, Ch. 1591, Section 2) Thus, the Legislature intended that the provisions of subdivision (i) be consistent with section 214 and with longstanding judicial precedent on this issue. The Board’s language in subdivision (a) of the rule provides that the uniform statewide standard for the “[u]se of property that is incidental to and reasonably necessary for the accomplishment of the exempt purposes of the organization’ includes the use of property that is institutionally necessary for the operation of the organization.” Thus, the standard to exempt housing in Rule 137 is consistent with the requirement of subdivision (i) that it must be institutionally necessary.

The provisions of Rule 137 are based on the same judicial precedent referenced by the Legislature in its statement that section 214, subd. (i) was declaratory of existing law. The California courts have exempted the housing properties of qualified nonprofit organizations, applying two similar statements of the standard for exemption, “incidental to and reasonably necessary for” and “institutionally necessary.” The courts have not distinguished between the meaning of these terms and have used them interchangeably, as illustrated by the holdings of the first four cases exempting housing properties, decided by the California Supreme Court on the same day in 1950.

- The Court held that property used exclusively for hospital purposes includes any facility, which is *incidental to and reasonably necessary* for the accomplishment of hospital purposes.² Applying this standard, the Court exempted housing for interns, resident doctors, student nurses and other hospital employees required to operate the hospital on a 24-hour basis.
- The Supreme Court also applied this standard to exempt housing provided in YMCA dormitories, holding that the dormitories were *reasonably necessary for the accomplishment of the YMCA’s religious and charitable purposes* of promoting good citizenship and Christian ideals and character.³ The Court stated that the fact that the YMCA’s dormitories, as a secondary consideration, also serve the residential purposes of the occupants, does not destroy the effect of their dominant purpose as property used exclusively for religious or charitable purposes within the contemplation of welfare exemption law.
- In *Serra Retreat v. County of Los Angeles*,⁴ the Supreme Court held that the welfare exemption applied to the living quarters at a retreat facility for priests and lay brothers who provided for the needs of persons in attendance at religious retreats. The Court ruled

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

³ *YMCA v. County of Los Angeles* (1950) 35 Cal.2d 760.

⁴ *Serra Retreat v. County of Los Angeles* (1950) 35 Cal.2d 755.

that the provision of housing for retreat personnel is an *institutional necessity* and constitutes property *used exclusively for religious purposes*.

- In the fourth case, the Supreme Court held that the living quarters of personnel who cared for the needs of nursing home residents were exempt as a matter of *institutional necessity*.⁵

Further, the California Supreme Court has defined the “institutional necessity” or “institutionally necessary” standard to mean that property is “incidental and reasonably necessary” for the accomplishment of the exempt purposes of the organization.”

“...[t]he conclusion is inescapable that the portion of plaintiff’s building used to furnish housing accommodations for the essential retreat personnel is properly classifiable as property ‘used exclusively for religious purposes.’” As property so viewed, plaintiff’s provision of living quarters for its needed retreat personnel as an institutional necessity—a facility incidental to and reasonably necessary for the accomplishment of its religious and charitable purposes...” (Emphasis added)⁶

Citing *Serra Retreat*, the appellate courts have held exempt temporary low-cost housing for missionaries, clergy, and other religious workers and their families as property *used exclusively for the church’s religious and charitable purposes*; and, dormitories and related facilities for persons assembled for religious instruction as exempt within the organization’s religious purpose, while housing for caretakers was exempted as institutionally necessary.⁷

Thus, the Courts have applied essentially the same judicial standard for nearly fifty years to determine whether residential property of qualified nonprofit organizations may qualify for exemption. Such property may be exempt if there is an *institutional necessity*, defined by the Supreme Court as property *used exclusively* for the exempt (religious, charitable, hospital) purpose, which includes any facility *incidental to and reasonably necessary* for the accomplishment of the exempt purpose.⁸ The holdings of these cases support the Board’s position that the courts have used these terms interchangeably and that they constitute a single standard for the exemption of property used for housing. “Institutionally necessary” means a facility “incidental to and reasonably necessary for,” and vice versa. Thus, subdivision (a) of Rule 137 is consistent with the decisional law of this state, and with section 214, subd. (i). As noted above, the Legislature codified this judicial standard by enacting section 214, subd. (i) to provide that residential property owned by a qualified nonprofit organization is exempt if *institutionally necessary* for the operation of the organization.

⁵ *Fredericka Home for the Aged v. County of San Diego* (1950) 35 Cal.2d 789.

⁶ *Serra Retreat*, supra at page 759.

⁷ *House of Rest of the Presbyterian Church in the USA v. County of Los Angeles* (1957) 151 Cal. App. 2d, 523; *St. Germaine Foundation v. County of Siskiyou* (1963) 212 Cal. App. 911.

⁸ *Serra Retreat*, supra at page 759.

Ordinarily, a regulation or statute that is declaratory of existing law has no impact on the Board's and assessors' practices and application of the provision. However, prior to the adoption of Rule 137, the Board, Board staff and county assessors had interpreted section 214, subd. (i) and the above judicial precedent strictly or narrowly to deny exemption to most housing of qualifying nonprofit organizations, at least in part, on the grounds that it was used primarily for private residential purposes.⁹ The California Supreme Court, on the other hand, had construed statutory and constitutional provisions granting exemption from taxation strictly, but reasonably, in decisions granting exemption to the housing properties of nonprofit organizations. The Court ruled that "[t]he rule of strict construction does not require that the narrowest possible meaning be given to words descriptive of the exemption, for a fair and reasonable interpretation must be made of all laws, with due regard for the ordinary acceptance of the language employed and the object sought to be accomplished thereby."¹⁰ Nonetheless, the application of a strict standard, rather than a strict, but reasonable standard by the Board and the assessors in their interpretation of exemption law, statutory and constitutional provisions, as well as judicial decisions, had resulted in the exemption of very few housing properties of qualified nonprofit organizations. Thus, while the Board's adoption of Rule 137 is consistent with existing law, it is a departure from the Board's past practice and application of the law in relation to the exemption status of property used for housing.

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, and are not binding on any person or public entity.

Sincerely

/s/ Mary Ann Alonzo

Mary Ann Alonzo
Senior Tax Counsel

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⁹ The courts have ruled that some uses of property are qualified for exemption although such uses are different from the exempt purpose of the nonprofit organization. For example, a hospital, with a purpose of operating a hospital facility to provide such medical care to the community, may qualify for the welfare exemption, property used to house employees. The Cedars Court held exempt the hospital's property for housing student nurses, hospital interns, and resident doctors, as an incidental [use] that is reasonably necessary to the accomplishment of the hospital purpose. (*Cedars, supra* at page 741.)

¹⁰ *Cedars, supra* at page 735.