

# COLLEGE EXEMPTION

The College Exemption is available to property used *exclusively* for educational purposes by a nonprofit educational institution of collegiate grade. The property may be either owned or leased, but it must be *used* for educational purposes as of the January 1 lien date. Buildings under construction or renovation, and the land required for their convenient use, and equipment in them may also qualify for the exemption if the intended use when completed will qualify the property for exemption.<sup>1</sup> The College Exemption is provided for in Section 3(e) of article XIII of the California Constitution, implemented by section 203 of the Revenue and Taxation Code.

The exemption is also available to supplemental assessments resulting from new acquisition or new construction, provided the property is put to an exempt use within 90 days of the event giving rise to the supplemental assessment.<sup>2</sup> Additionally, property acquired after the tax lien date by an existing organization, or owned by a newly formed organization after the lien date, is eligible for pro rata exemption from the date of acquisition or formation, whichever applies.<sup>3</sup>

Colleges that are part of the public school system, such as community colleges and state universities, including the University of California, are not exempt under the College Exemption. They are constitutionally exempt as public schools.

Religious seminaries and novitiates may qualify for the College Exemption if they confer a degree; however, if they do not meet the criteria for this exemption, they may qualify for the Welfare Exemption as property used exclusively for religious purposes. Additionally, property owned by a nonprofit college that is used exclusively for purposes eligible for the Welfare Exemption may qualify for that exemption

## DEFINITION

For purposes of this exemption, a *nonprofit educational institution of collegiate grade* is defined as an institution incorporated as a college or seminary of learning that requires for regular admission the completion of a four-year high school course or its equivalent, and confers upon its graduates at least one academic or professional degree, based on a course of:<sup>4</sup>

- At least one year in flight test technology or flight test science, for which the master's degree program has been approved by the California Council for Private Postsecondary and Vocational Education or the Bureau for Private Postsecondary and Vocational Education, or
- At least two years in liberal arts and sciences, or

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<sup>1</sup> Section 5 of Article XIII, California Constitution.

<sup>2</sup> Sections 75.21 and 75.22.

<sup>3</sup> Section 271.

<sup>4</sup> Section 203(b).

- At least three years in professional studies, such as law, theology, education, medicine, dentistry, engineering, veterinary medicine, pharmacy, architecture, fines arts, commerce, or journalism.

A nonprofit educational institution of collegiate grade is one that is conducted exclusively for scientific or educational purposes and no part of its net income inures to the benefit of any private person.<sup>5</sup>

## PROPERTY USES

### EXCLUSIVE USE

One of the basic requirements for this exemption is that the property must be *used exclusively* for educational purposes by a nonprofit educational institution of collegiate grade. The Revenue and Taxation Code does not specifically define the term *used exclusively*, but the courts have done so in a series of decisions. The Supreme Court, applying the rule of strict but reasonable construction, stated that the phrase *exclusively used* may not be given a literal interpretation so as to mean that the property exempted must be used solely for the purposes stated to the total exclusion of any other use.<sup>6</sup> The Supreme Court held that *used exclusively* for exempt purposes includes any property which is used exclusively for any facility which is incidental to and reasonably necessary for the accomplishment of the exempt purpose.<sup>7</sup>

*Cedars* makes it clear that the phrase *incidental to and reasonably necessary for* refers to property that is normally associated with or related to the accomplishment of an exempt purpose. The courts have construed that "used exclusively for the purposes of education" to include any facilities that are "reasonably necessary for the fulfillment of a generally recognized function of a complete and modern college."<sup>8</sup> Exemption would apply for property use that includes, but not limited to, the following:

- Housing for student, faculty, administrators, guests (speakers and parents of students, for example) parking lots
- Golf course primarily used by alumni
- Psychological counseling and medical center for students
- Maintenance of campus safety service, supply and maintenance shops
- Maintenance of staff to provide human resources support to centralized programs, employee services, financial services, or other administrative services
- Interfaith chaplaincy
- Biological field station.

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<sup>5</sup> Section 203(c).

<sup>6</sup> *Cedars of Lebanon v. County of Los Angeles* (1950) 35 Cal.2d 736; *Honeywell Information Systems, Inc. v. Sonoma County* (1974) 44 Cal.App.3d 23, 28.

<sup>7</sup> *Cedars, supra* at page 736.

<sup>8</sup> *The Church Divinity School of the Pacific v. County of Alameda*, 152 Cal App. 2d 496.

Holding of land for future building or any vacant land is not property "in use" and would not qualify.

In some instances, colleges acquire existing apartment complexes whereby students move in as existing tenants move out. Portions or units of such complexes that are used or occupied by tenants not connected with the college are taxable and an allocation of values between exempt and nonexempt uses is required as of the lien date. Section 271 does not apply when such units are converted to college use between lien dates; a unit that is converted to college use between lien dates would not benefit from exemption until the following lien date.

### **EXCLUSIVE USE ALLOWS OCCASIONAL USES UNRELATED TO EXEMPT PURPOSES**

While ongoing uses of an organization's property must be reasonably necessary or in furtherance of the exempt purpose, or they will disqualify the property from exemption, a well-settled precedent has established that occasional uses not within an organization's exempt purpose and activities are not disqualifying. The courts have construed the "exclusive use" test not to foreclose some additional or occasional use of the property which was not within the exempt purpose and activity. The courts' rulings were on other exemptions (Church, Welfare, Public School); however, the exclusive use test would apply to the College Exemption as well.

In *Fellowship of Humanity v. County of Alameda*, the court construed the *exclusive use* requirement for the Church Exemption, to hold that occasional use of the church property for social activities such as dances and dinners did not disqualify the property from exemption. The court observed that:

...however strict the courts may be in determining whether the [primary] use of the property brings it within the exemption at all, if the court once holds that the property generally qualifies for the exemption, it will be extremely liberal in holding that some incidental use does not take it out of the exemption.<sup>9</sup>

However, a case involving the Public School Exemption defined the term rather restrictively. In *Honeywell Information Systems, Inc. v. County of Sonoma*, the court denied the Public School Exemption for a computer system leased to a public school when it was shown that the public school had subleased the system 3 percent of the time to parochial schools and .56 percent of the time to private business. The court stated that while the term *exclusive use* has been interpreted to mean not only primary but also certain types of incidental use as well "... such incidental use must be directly connected with, essential to, and in furtherance of the primary use...."<sup>10</sup> Use by business entities on a regular basis for purposes unrelated to public schools destroyed the exemption even though the use was but a small percentage of the total use.

In *Peninsula Covenant Church v. County of San Mateo*, the court followed the "exclusive use" precedent in the above case, holding that "the clear meaning of section 214 is that at the very

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<sup>9</sup> *Fellowship of Humanity v. County of Alameda* (1957) 153 Cal.App.2d 673, 699.

<sup>10</sup> *Honeywell Information Systems, Inc. v. County of Sonoma* (1974) 44 Cal.App.3d 23, 28.

least the exempt purpose must be the primary use made of the property."<sup>11</sup> Exemption was allowed for a church's community center building primarily used for church activities, but occasionally by non-church members; however, exemption was denied to church-owned recreational facilities including locker rooms, saunas, tennis courts, and a swimming pool used primarily by non-church members. The court stated the primary use of the property was not for the exempt [religious] purpose; therefore, the exclusive use test was not met. The court noted that non-church members were the primary users and the primary use was recreational, not religious or charitable.

A college otherwise qualified for exemption will not receive exemption on that portion of a college rented to other, non-college organizations or persons for meetings, lectures, conferences, workshops, or retreats during the summer. Likewise, portions of the campus used in conjunction with a catering business will not be exempt, even though the employed students receive instruction in the operating of a business. The commercial and fund-raising uses of the property are grounds for denial of exemption.

### **SUMMER CONFERENCE RENTAL**

Some colleges rent out their facilities or portions of the facility during the summer for conferences, workshops, or retreats. The facilities may consist of meeting rooms or centers, lecture halls, library, dining facilities, and living units. The College Exemption specifically states that the property must be exclusively used for educational purposes, which allows certain types of incidental uses. Such incidental uses, however, must be directly connected with, essential to, and in furtherance of the primary use and must be reasonably necessary for the accomplishment of the primary purpose for which the exempt organization was organized.<sup>12</sup>

Property of a college used by others—individuals or organizations that are not colleges—is neither used exclusively by the college for educational purposes nor for incidental uses. As a result, those portions of a college's property used by others are not eligible for the College Exemption.

### **AUXILIARY OPERATIONS**

As noted above, some colleges may have a catering operation in conjunction with their schools of cooking that offers food service to groups at locations both in their own facilities as well as other locations. The students involved in the catering business receive an educational experience as they learn aspects of entrepreneurial thinking, marketing, strategic planning, food preparation, presentation, and basic business skills. Because the students and college receive monetary compensation for the catering operation, it is a commercial purpose as well as an educational purpose, and as such, that portion of the property used for the catering operation/business is not eligible for the College Exemption.

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<sup>11</sup> *Peninsula Covenant Church v. County of San Mateo* (1979) 94 Cal.App.3d 382, 396.

<sup>12</sup> *Honeywell Information Systems, Inc. v. Sonoma County*, 44 Cal.App.3d 23.

## PROPERTY IN COURSE OF CONSTRUCTION

Section 5 of article XIII of the California Constitution was enacted in recognition of the fact that the College Exemption authorized under section 3(e) of the Constitution does not apply to vacant, unused property held for future qualifying use. However, section 5 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 5 is implemented by sections 214.1 and 214.2. Section 214.1 defines property used exclusively for religious, hospital or charitable purposes to include facilities in the course of construction, together with the land on which the facilities are located as may be required for their convenient use and occupation. Section 214.2 states that, as used in section 214.1, "facilities in the course of construction" includes the demolition or razing of a building with the intent to replace the building with a facility to be used exclusively for religious, hospital, or charitable purposes. "Facilities in the course of construction" must have activity connected with the construction or rehabilitation of a new or existing building or improvement that results in physical changes visible to any person inspecting the site where the building or improvement is located. The phrase *in the course of construction* as used in section 214.1 has been construed to include the digging of trenches for the foundation of a building prior to the lien date.<sup>13</sup>

Construction or rehabilitation, having been commenced and not yet finished, unless abandoned, shall establish that a building or improvement is under construction. Thus, a property undergoing construction or rehabilitation for an extended period of time would continue to be eligible for exemption.

### DELAYS IN CONSTRUCTION

If construction delays are due to reasonable causes and circumstances beyond the assessee's control, such as adverse weather conditions or material shortages, that occur notwithstanding the exercise of ordinary care and the absence of willful neglect, then construction shall not be considered "abandoned." Delays due to a lack of funds by the claimant would not be considered reasonable. If construction has been abandoned, the property is no longer eligible for exemption.

### AGENT OF COLLEGE

A nonprofit organization that is fully controlled by a college can be considered an "agent" of the college, in which case property owned and used by the nonprofit may qualify for the College Exemption, even though the nonprofit itself is not an institution of higher learning. The property, however, must be *used exclusively* for educational purposes and if the agent of that college is:

- Nonprofit
- Completely controlled by the college qualifying under section 203, and

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<sup>13</sup> *National Charity League v. County of Los Angeles* (1958) 164 Cal.App.2d 241.

- Operating the property for the exclusive benefit of the qualifying college(s) and the nonprofit pursuant to the mandate of the organizational documents of both entities.

The agency exists when one entity contracts to act on behalf of another entity and is subject to the other's control. The former entity is the agent and the latter is the principal. To establish the existence of an agency relationship, an agreement or authorization or ratification by the principal is required. Documents such as the entity's constitution, articles of incorporation, bylaws, and/or management agreement are acceptable. The courts have stated that "an agent or representative is liable for the taxes assessed him under the [Revenue and Taxation] Code only in his representative capacity, and if the property is exempt in the hands of the principal it remains exempt in the hands of the agent."<sup>14</sup> If the principal is eligible for an exemption, then the agent is also eligible for the exemption, whether the exemption is on real or personal property or on a possessory interest. The tax savings to the nonprofit property owner directly benefits the college.

## BOOKSTORES

Real property owned by an institution of collegiate grade and devoted primarily to bookstore use is exempt. Additionally, personal property owned or used by a nonprofit corporation operating a student bookstore affiliated with an educational institution as defined in section 203, is deemed property belonging to such educational institution and shall be exempt from taxation.<sup>15</sup>

Where the college and bookstore are separate corporations (the bookstore is a nonprofit entity) and both will receive the College Exemption, each corporation's property, excluding inventory, should appear separately on the roll with its own assessed value and exemption as only the bookstore's personal property is subject to subvention. Thus, the bookstore corporation should file their own property statement and the assessor would enter the values on the roll, then allow the College Exemption.

An exception arises with regards to a bookstore property that generates unrelated business taxable income. Pursuant to section 202(c), property tax exemption is not allowed on that portion of the property determined to be generating any unrelated business taxable income, as defined in section 512 of the Internal Revenue Code. Sections 512 and 513 of the Internal Revenue Code define the following terms (summarized as it applies to a non-profit college or university bookstore):

- *Unrelated business taxable income*—the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less the deductions allowed which are directly connected with the carrying on of such trade or business.
- *Unrelated trade or business*—the conduct of which is not substantially related to the exercise or performance by the organization of its education purpose or function constituting the basis for its exemption under section 501 (of the IRS Code) *except* that such term does not include any trade or business which is carried on, in the case of an

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<sup>14</sup> *Pacific Grove – Asilomar Operating Corporation v. County of Monterey*, 43 Cal.App.3d 675.

<sup>15</sup> Section 203.1.

organization described in section 501 (c)(3) (includes nonprofit college or university by the organization primarily for the convenience of its members, students, patients, officers, or employees.

### **NON-TAXABLE INCOME FROM BOOKSTORE**

Notwithstanding the definitions set forth in the IRS Code stated above, non-profit college or university bookstores may not be subject to the unrelated business income tax in accordance with IRS Code section 513(a)(2). It is arguable as to what merchandise in a bookstore is or is not supplied primarily for the convenience of its students or employees. It is recommended the assessor inquire with the Internal Revenue Service on a case-by-case basis as to whether or not certain merchandise held for sale is subject to the unrelated business income tax. Thus, notwithstanding section 202(c), although a bookstore may produce unrelated business income, property tax on that portion of the property that produces the income may be exempt if the IRS does not consider the unrelated business income from the bookstore as taxable income.

### **TAXABLE INCOME FROM BOOKSTORE**

If the assessor has determined that certain merchandise in a bookstore does in fact generate taxable income, property tax is levied on that portion of the bookstore property determined to be generating such income. To determine the portion of the bookstore that is taxable, a ratio of the unrelated business taxable income to the bookstore's gross income should be established. That percent shall then be the maximum percentage of the bookstore property on which a property tax can be levied.<sup>16</sup>

At the end of a fiscal year when unrelated business income has been generated, if the bookstore is operated by a nonprofit organization, the nonprofit entity must submit to the assessor copies of the organization's most recent tax return filed with the Internal Revenue Service.<sup>17</sup>

### **LEASED PROPERTY**

The College Exemption is available whether the property is owned or leased by the claimant. Either the lessee or the lessor may claim the exemption; however, pursuant to section 202.2, any reduction in property taxes on such leased property for which an exemption was granted must benefit the lessee. Section 202.2 applies to taxes on leased real and personal property used by colleges, public schools, and free libraries and museums, but does not apply to property leased to organizations claiming the Church, Cemetery, Welfare, or Veterans' Organization Exemptions.

The exemption may benefit the lessee in the following three ways:

- The lessee receives a reduction in rental payments.
- The lessee receives a refund from the lessor of a portion of the rental payment, if already paid, in an amount equal to the reduction in taxes.

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<sup>16</sup> Section 202(c).

<sup>17</sup> Section 202(c).

- The lessee may file a claim for refund of taxes paid by the lessor under section 5096; however, the lessee shall be deemed to be the person who paid the tax, and the refund shall be made directly to the lessee.

The lease or rental agreement should specifically provide that the exemption is taken into account in fixing the terms of the agreement. If the lease does not state this fact, and the taxes were already paid by the lessor, the lessee shall receive a reduction in rental payments or a refund in an amount equal to the reduction in taxes.<sup>18</sup>

If the lessor does not claim the exemption, or is denied the exemption because the lease does not specifically provide for a reduction in rents or refund of taxes paid, the lessee may file a claim for refund under section 5096 (permissible refunds) with respect to taxes paid by the lessor on the property. The lessee shall be the person deemed to have paid the tax<sup>19</sup> for purposes of sections 5097 and 5140 and the full amount of taxes paid by the lessor would be refunded to the lessee, notwithstanding any late filing penalty pursuant to section 270.

The exemption of property used for educational purposes is not for the benefit of the private owner who may rent the property for said purposes, but for the advantage of the nonprofit school which may be compelled to rent property rather than to buy land and erect buildings to be used for the maintenance of its schools.

## **\$1 PURCHASE OPTION AFTER LEASE TERMINATION**

If a property is leased to a college and if a qualified lessor exists, section 251 provides for a one-time filing for the exemption. A *qualified lessor* is a lessor under a contract designated as a lease between that lessor and an entity using property which qualifies for the property tax exemption provided for by subdivision (d) or (e) of Section 3 of article XIII of the California Constitution (free library, museum, public schools, non-profit colleges) under which the lessee has the option at the end of the lease term of acquiring the property described in the lease for \$1, or any other nominal sum.

The lessor should complete form BOE-263-A, *Qualified Lessors' Exemption Claim*, have the lessee complete and sign an affidavit attesting to the use of the property, and attach a copy of the lease to the exemption claim. The lessee may use the sample affidavit on the back of form BOE-263-A. If there is more than one lessee on the same property, a separate affidavit must be used for each lessee. The claim must be filed with the assessor within 120 days of the commencement date of the lease. Once these requirements have been met, the lessor is not required to file an exemption claim with respect to that lease unless the option terms of the lease change.<sup>20</sup> Additionally, the lessor no longer needs to report the property on the *Business Property Statement*; the assessor should enroll the property as belonging to the exempt entity.<sup>21</sup>

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<sup>18</sup> Section 202.2.

<sup>19</sup> Section 202.2.

<sup>20</sup> Section 251(b)(3).

<sup>21</sup> Section 442(c).

This one-time filing is not available to instances where at the end of the lease ownership is retained by the lessor, or the property is merely available for purchase by the lessee (college) at a price other than a nominal sum. The one-time filing does not apply to any other exemptions such as the Welfare, Church, Cemetery, or Veterans' Exemptions.

## **FILING REQUIREMENTS**

### **BOARD FORMS**

The Board-prescribed claim form BOE-264-AH, *College Exemption*, must be used when the claimant owns and uses the property for educational purposes. If the property is being leased, the claimant should use form, BOE-263, *Lessors' Exemption Claim*. The exemption will not be allowed unless the institutional lessee also provides an affidavit attesting to the use of the property. The back of the form contains a sample affidavit that may be used. If there is more than one lessee, a separate affidavit from each lessee is required.

If the property is being leased from a qualified lessor where the lessee may purchase the property for a nominal sum at the end of the lease, the lessor must file form BOE 263-A, *Qualified Lessors' Exemption*. As discussed above, an affidavit also must also be completed by the lessee to complete the claim.

### **FILING PERIOD**

The claim forms for the College Exemption and the Lessors' Exemption must be filed annually with the assessor between the January 1 lien date and 5:00 p.m. on February 15 to receive the full exemption for the year.<sup>22</sup>

### **LATE FILING**

If the claim is filed after February 15 but on or before the next succeeding lien date, 90 percent of the exemption may be allowed, subject to a maximum total of \$250 for tax, penalty, and interest. If the claim is filed after the next succeeding lien date, 85 percent of the exemption may be allowed, but also subject to the same \$250 maximum.<sup>23</sup>

The \$250 maximum tax, penalty, and interest for late-filed claims for exemption apply per claimant per county, regardless of the number of parcels, locations, or assessments within the county. For supplemental assessments, the \$250 maximum is per event.

The qualified lessors' exemption claim (for property that may be purchased for \$1 or another nominal sum) must be filed with the assessor within 120 days of the commencement date of the lease.<sup>24</sup>

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<sup>22</sup> Section 255.

<sup>23</sup> Section 270.

<sup>24</sup> Section 251(b)(1).

## **AFFIDAVIT**

The affidavit for the College Exemption must show that:<sup>25</sup>

- The educational institution is of collegiate grade and is not conducted for profit.
- The grounds for which exemption is claimed are those within which its buildings are located. The exempt grounds need not be contiguous or in one tract.
- The property for which exemption is claimed is used exclusively for the purposes of education.

Any additional proof of the facts stated may be required by the assessor.

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<sup>25</sup> Section 258.