Memorandum

165.0100

To: Mr. H. A. Dickson Date: June 9, 1969

From: Lawrence A. Augusta S- -- XX XXXXXX

Subject: The [L]
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This is in response to your memorandum of April 22, 1969, concerning the tax status of the Lesley Foundation under section 6375 and ruling 40 (Charitable Organizations).

As you are well aware, to qualify for the exemption any organization must meet all four of the requirements set forth in the code and ruling.

Whether the organization meets the requirement that it qualify for the "welfare exemption" is not a problem for sales tax personnel. Either the taxpayer has satisfied the property tax people or he has not. We merely rely on the property tax staff's determination. From what I gather, we are not too concerned with the requirement that they be "formed and operated for charitable purposes" because generally they could not meet the other requirements if they were not so formed and operated. This should be considered, but I doubt if it will present major problems.

Likewise, the requirement that the property sold must have been made, prepared, assembled or manufactured by the organization seems straight forward enough with the added learning of BTGB 59-18.

The other two requirements need more careful analysis.

1. The organization must be engaged in the relief of poverty and distress; and,
2. The organization's sales must be made principally as a matter of assistance to purchasers in distressed financial condition.

The code does not contain the qualification that the purchasers be "in distressed financial condition." Apparently this language was added in the ruling to clarify the meaning of the phrase "of assistance to the purchasers," and conform it to the tenor of the rest of the section. Actually, almost anything could be "of assistance to the purchasers," so this requirement that they be "in distressed financial condition" is a logical and consistent one which I am sure would be given effect by the courts. BTGB 59-18 further explains this qualification as aiding

purchasers "by selling its property at reduced prices." In other words, it is not enough that the sales be "of assistance," they must be of financial assistance.

Since the question is beginning to arise more frequently in regard to homes for the aged, and there currently is not too much learning on the subject, I thought it wise to attempt to define more accurately "poverty and distress" and "distressed financial condition" and set some standards or guidelines for application of those terms.

Considering the problem first from a purely financial viewpoint, annotation 1238.85 says that single persons with annual incomes of $4,000 and married persons with annual incomes of $4, 800 are not in a state of poverty. Annotation 1238.90 advises that individuals with monthly incomes of $300 to $400 are not in a state of poverty.

The state program of Old Age Assistance (OAS) sets a minimum subsistence income of $123.50 ($65 room and board; $58.50 personal needs) and a maximum of $160.50 (up to an additional $37 for room and board) per person regardless of marital status for persons not needing special care. For persons needing minimum to moderate care (known as Group I Care"), the maximum allowable is $182.50 ($128.50 room and board; $54 personal needs). For moderate to intensive care (Group II) the maximum allowable is $197.50 ($153.50 room and board; $44 personal needs), but $9 must come from county or voluntary contributions as the maximum state participation is limited to $188.50.

In each instance, the figure represents the state-established subsistence and any income received from any source (including social security benefits) is subtracted from this figure to arrive at the state contribution. Thus, any person with an income of $198 (except as explained below) would not be in need of financial assistance in the view of the state's social welfare system.

Recognizing that costs vary from area to area, the OAS program allows a county to elect to be governed at the "local rate" for Group I and II recipients. What this means is that any differential payments made by the county from their own funds and any voluntary contributions from relatives not responsible for support under the law, will not be counted as income up to a certain amount in computing the state contribution. The highest "local rate" in Group I is $220 and in Group II $225.

In addition, to qualify for OAS a single person cannot have over $1,200 in personal property and married persons over $2,000. They may not own real property in excess of $5,000 assessed valuation, and that property must be placed in a beneficial use contributing to support of the recipient.

The U.S. Department of Health, Education and Welfare sets the poverty level of income threshold for persons living alone at $l635 ($136.25/mo.) for nonfarm families and $1,141 ($95.41/mo.) for farm families. The figures are $1,565 ($130.41/mo.) and $1,095 ($91.08/mo.) if the person is over 65. For two-member families the threshold income is $2,115 ($176.25/mo.) combined for nonfarm families, and $1,475 ($122.75/mo.) combined for farm families. These figures fall to $1,970 ($164.16/mo.) and $1.380 ($115.00/mo) for persons over 65. (These figures are based on 1966 income. Because of inflation, they should be adjusted upward.)

It seems reasonable to make reference to these figures when defining "poverty" and "distressed financial condition." In the case of homes for the aged, reference is to the financial status of the residents, i.e., do they serve persons whose income is at or slightly above the poverty level? To be as liberal as possible under the circumstances, we should adopt these tests based on the highest level allowed in the OAS program (other than for intensive care units).

1. Incomes of $225-$275 per month are equivocal. They may not be poverty level incomes but the persons can be in distressed financial condition depending on the other circumstances of the case.

2. Incomes in excess of $275 per month will be considered to be above the poverty level, and the persons will be presumed not to be in distressed financial condition.

3. Incomes below $225 per month will be presumed to be below the poverty level.

In determining whether an organization is engaged in the <u>relief</u> of poverty and distress, it shall be considered that providing the basic necessities such as room and board at prices below the usual market value is a form of relief to persons whose income is below or near the poverty level. That is, allowing them to purchase these needs at prices within their income where they would not be able to afford them otherwise.

Persons below or slightly above the defined poverty level are considered to be in a distressed financial condition. Consequently, if an organization were making sales of meals and lodging to persons whose income is below or near the poverty level at reduced prices so as to be of real assistance to the purchasers, it would be engaged in the relief of poverty and distress and would meet the two requirements for the exemption.

To qualify for the exemption, the primary purpose of the operation in question must be to relieve poverty and distress. This purpose, of course, does not have to involve only sales of taxable tangible personal property, but the overall purpose must be to relieve poverty and distress. However, the primary purpose of the <u>organization</u> does not have to be the relief of poverty and distress but can be broadly charitable, so long as it is engaged in some measure in

the relief of poverty and distress. In addition, the sales for which it seeks exemption must be made principally as a matter of assistance to purchasers in distressed financial condition. In other words, organizations will not be able to qualify by having a few residents who are poverty stricken.

"Principally" may be subject to certain subjective interpretations relating to motivation, etc., but for our purposes, an objective standard should be used. We would say, therefore, that at least 51 percent of the regular purchasers should be in "distressed financial condition" or it will be presumed the sales are not made principally to benefit such persons. Any organization which serves 66 percent or more persons in distressed financial condition will be presumed to meet the requirement. Between 51 percent and 66 percent the organization must present other proof to substantiate their claim for exemption. A history of more than one year can be used, but it must show a pattern and intent to aid financially distressed purchasers.

Some organizations may be indisputably engaged in the relief of poverty and distress, but do not make sales as a matter of assistance to the purchasers. Typically, such organizations would have fund-raising sales in which not only would they not be selling at bargain prices, but would be relying on the charitable motivation of their customers to induce them to pay inflated prices for the merchandise.

We turn now to the [L] to apply these principles and standards to their operation. The [L] is a nonprofit corporation organized under California general non-profit law for charitable purposes. Their charitable activities originally extended into several areas, but now apparently are restricted to homes for senior citizens. They have been ruled exempt from federal income taxes under IRC section 501(c)(3) and from state income taxes under section 2370l(d). They have also qualified for the "welfare exemption" from property taxes.

In furtherance of their work with the aged, the [L] has built two apartment structures in San Mateo, [PP] and [PT], financed with loans from the United States Government under section 202 of the Housing Act of 1959. [PP] provides housing only, but [PT] serves two meals a day (dinner mandatory) to its guests. It is the sale of these meals that is the subject of our inquiry.

The meals are prepared by employees of the [L] under the direction of a supervisor supplied under contract with [M], a restaurant and cafeteria chain. (In my opinion, this meets the requirement that the articles sold be prepared by the organization.) Foodstuffs are purchased from [M] at their bulk rate to keep costs down. It is important that residents eat the balanced meals provided, as experience has shown they do not always provide themselves with proper nutrition.

The meals and housing are ostensibly provided at or near cost on a nonprofit basis. Currently, the charge for meals is $62.50 per person per month for two meals a day. Room rents are $65 - $80/month for studios and $110 - $120 for one bedroom double occupancy.

The [L] provides direct financial aid to residents who cannot meet the monthly charges in order to secure their federal income tax exemption.

Financial statements indicate a net profit on meals of $1,031.62 in 1967 and a net loss on meals of $2,650.89 in 1969. Net profit on all operations was $17,358.85 on gross receipts of $350,862.51 in 1968 (profit: 4.9%). No allowance for depreciation is made in computing this profit, though a large reserve for repairs is maintained. The loan agreement requires that any cash surplus be transferred to a reserve fund bank account to be applied on the loan. It is thus clear that the facilities of the apartment house and dining room are offered at prices below what one would expect to be a normal commercial level.

Officers of the corporation state that the project is intended to benefit low-middle income elderly persona and families, and they advertise it as such. They also claim that the federal loan is based on such benefit. However, no limitation to low-middle income residents appears in the articles of incorporation, and the advertising brochure states no financial requirement for admission.

It is stated that the average income of the residents is $200 per month. This is not very helpful. What we want to know is whether they are primarily engaged in the relief of poverty and distress which means we want to know the number of persons served whose income is at or below the poverty level. I would appreciate it if the district can secure additional information concerning the distribution of income on the scale from lowest to highest, i.e., how many people are at what level of income. I want to know how many married couples or other persons living together are involved and whether they each have an income of $200 (or a combined income of $400).

LAA:ph

cc: San Francisco – District Administrator
San Mateo – Subdistrict Administrator
Headquarters – Return Review Unit (BC)

Memorandum

165.0100

To: Mr. Donald J. Hennessy
Senior Tax Counsel

Date: November 20, 1989

From: Stella Levy

Subject: Suggested Changes to Annotation 165.0100 and Suggested Additional Annotation

The subject of this memorandum arises out of my recent communication (attached) to Audit Refunds. In analyzing the application of Annotations 165.0140 and 165.0100 to a particular set of facts, I commented (see footnote, page 2) that the statements in Annotation 165.0100 regarding specific incomes in dollar amounts and their significance should be ignored because the annotation was written twenty years ago and the figures are no longer relevant to a determination of whether persons are in "distressed financial condition." Mr. Les Sorensen requested that I provide you with proposed language for a change in that annotation.

My suggested change would be to delete items 1, 2, and 3 in the annotation and to reduce it to the following statements:

"Residences for senior citizens. When determining whether meals served by residences for senior citizens qualify for the charitable organization exemption reference should be made to the financial status of the residents. Persons whose income are near the poverty level are in distressed financial condition. Providing meals at significantly reduced prices so as to be of real assistance to the purchasers is a form of relief of such persons."

I do not know whether there is any interest in new annotations, but if so, I would propose the following, based on the attached memorandum:

Meals Served at Low Income Housing. On site sales of meals to tenants by an organization formed to provide affordable housing to low and moderate income persons are not taxable where the organization meets the requirements of Regulation 1570. The fact that the welfare organization property tax exemption applies to 80.1% of the units constitutes substantial compliance with the requirement that the organization must qualify for the "welfare exemption" from property taxation.

Let's discuss as I have some questions regarding my own suggestions!

SL:cl

Attachment
Cc: E. Les Sorensen, Jr. w/c of attachment