STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date:	**05/22/12**	Bill No:	**Assembly Bill 1788**
Tax Program:	**Property**	Author:	**Morrell**
Sponsor:	**Author**	Code Sections:	**RTC 214.1 and 214.2**
Related Bills:		Effective Date:	**Upon enactment**

BILL SUMMARY

This bill allows the welfare exemption to be granted on a retroactive basis for the period of time between the submission of an application for a building permit and the commencement of actual onsite physical construction if construction starts within 12 months of the building permit being approved by expanding the definition of the phrase "facilities in the course of construction."

Summary of Amendments

The amendments since the previous analysis limit its provisions to construction that commences within 12 months of the date on which the building permit is approved.

CURRENT LAW

Under existing law, vacant or unused property of a nonprofit organization that is held for a future use is not qualified for exemption from property tax, even if the intended use will be for exempt purposes and activities. However, the California Constitution was amended to specifically provide that three exemptions can be granted to "**buildings under construction,**" land required for their convenient use, and equipment in them if the intended use would qualify the property for the exemption. Those exemptions are:

- **College Exemption.** Buildings, land, equipment, and securities used exclusively for educational purposes by a nonprofit institution of higher education. *Section 3(e) of Article XIII ("under construction" provisions added by Proposition 14, November 2, 1954)*
- **Church Exemption**. Buildings, land on which they are situated, and equipment used exclusively for religious worship. *Section 3(f) of Article XIII ("under construction" provisions added by Proposition 9, November 2, 1954)*
- **Welfare Exemption.** Property used exclusively for religious, hospital, or charitable purposes and owned or held in trust by corporations or other entities (1) that are organized and operating for those purposes, (2) that are nonprofit, and (3) no part of whose net earnings inures to the benefit of any private shareholder or individual. *Section 4(b) of Article XIII ("under construction" provisions added by Proposition 15, November 2, 1954)*

Currently, these provisions are found in Section 5 of Article XIII of the California Constitution. With respect to the welfare exemption, the provisions of Section 5 are statutorily embodied and expanded upon in Revenue and Taxation Code Sections 214.1 and 214.2. Section 214.1 provides that the welfare exemption is available to **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.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

Section 214.2 specifies that "facilities in the course of construction" require activity connected with the construction or rehabilitation of a new or existing building or improvement that **results in definite onsite physical activity that results in changes visible to any person inspecting the site** where the building or improvement is located. (A court has held that the phrase, "in the course of construction," as used in Section 214.1, includes the digging of trenches for the foundation of a building prior to the lien date.[1]) As long as construction has commenced, the property will be considered "under construction" unless the construction is abandoned. However, if there is a delay in construction due to reasonable causes and circumstances beyond the property owner's control and that occurs notwithstanding the exercise of ordinary care and the absence of willful neglect, then the construction will not be considered "abandoned."

Section 214.2 further provides that "facilities in the course of construction" will include 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.

Additionally, with respect to newly acquired property, Section 75.24 provides that a nonprofit organization has 180 days after the date of change in ownership to qualify for an exemption. This effectively provides a 180-day grace period before construction must commence.

PROPOSED LAW

This bill would amend Revenue and Taxation Code Sections 214.1 and 214.2 to provide that the phrase "course of construction" includes prospective construction or rehabilitation of a new or existing building or improvement as evidenced by application to the local planning or building department for a building permit, where the building or improvement is to be used exclusively for religious, hospital, or charitable purposes. In effect, this would allow nonprofit organizations to receive a property tax exemption on vacant property prior to commencement of actual physical construction provided construction commences within 12 months of the date on which the building permit is approved. However, the exemption would be granted and applied ***retroactively*** to the date of permit application, after it is verified that actual physical construction has commenced.

Any tax, penalty, or interest levied on the exempt portion of the assessment is to be refunded or cancelled, as specified in Sections 271 and 272, for property that was acquired or did not exist on the lien date. Any refund or cancellation of taxes would be limited to the last four years.

BACKGROUND

Related Legislation. AB 722 (Emerson, 2005) proposed allowing the welfare exemption to be granted on a retroactive basis for the period of time between the submission of an application for a building permit and the commencement of actual onsite physical construction by expanding the definition of the phrase "facilities in the course of construction." Under this bill, the exemption would be granted only after actual construction commenced, but retroactively to the date of the building application. In its introductory form, the exemption would have been granted as soon as a building permit application was submitted.

[1] *National Charity League* v. *County of Los Angeles* (1958) 164 Cal.App.2d 241.

AB 3075 (AR&T, 2004) proposed granting the welfare exemption to properties on a retroactive basis for the period between the submission of an application for a building permit and the commencement of actual physical construction.

AB 783 (Maddox and Mountjoy, 2003) would have provided that the phrase "course of construction" includes the period subsequent to an owner filing a completed application for a building permit with an appropriate local agency for purposes of qualifying for the property tax welfare exemption. As introduced, the bill would have expanded the phrase in the "course of construction" to include activities such as "seeking" permits, environmental studies, government entitlements and approvals, financing, and contractors.

AB 2662 (Bogh, 2002) would have amended Section 214.1 to specify that property already in the course of construction will not be considered “abandoned,” and therefore no longer eligible for exemption, if due to financing delays or delays in governmental approval. These provisions were removed from this bill by the May 17, 2002 amendments.

AB 1559 (Ch. 927, Stats. 1999, Wiggins) added Section 214.15 to provide a limited extension of the welfare exemption to vacant land. In this case the charitable purpose of the organization is acquiring and holding real property for the future construction/rehabilitation of single or multifamily residences for sale at cost to low-income families. Section 214.15 provides:

> (a) Property is within the exemption provided by Sections 4 and 5 of Article XIII of the California Constitution if that property is owned and operated by a nonprofit corporation, otherwise qualifying for exemption under Section 214, that is organized and operated for the specific and primary purpose of building and rehabilitating single or multifamily residences for sale at cost to low-income families, with financing in the form of a zero interest rate loan and without regard to religion, race, national origin, or the sex of the head of household.
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> (2) With regard to paragraph (1), the Legislature finds and declares all of the following:
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> (A) The **exempt activities** of a nonprofit corporation as described in subdivision (a) **qualitatively differ** from the exempt activities of other nonprofit entities that provide housing in that the exempt purpose of a nonprofit corporation as described in subdivision (a) is **not to own and operate** a housing project on an ongoing basis, but is instead to make housing, and the land reasonably necessary for the use of that housing, available **for prompt sale** to low-income residents.
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> (B) **In light of this distinction, the holding of real property** by a nonprofit corporation as described in subdivision (a), for the future construction on that property of a single or multifamily residence as described in that same subdivision, **is central to that corporation’s exempt purposes and activities.**
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> (C) In light of the factors set forth in subparagraphs (A) and (B), **the holding of real property** by a nonprofit corporation described in subdivision (a), for the future construction on that property of a single or multifamily residence as described in that same subdivision, **constitutes the exclusive use of that property** for a charitable purpose within the meaning of subdivision (b) of Section 4 of Article XIII of the California Constitution.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the author. The author notes that since the state constitution was amended to allow the exemption to be extended to properties in the course of construction, "the permitting process for construction projects has grown dramatically, increasing costs and delaying construction projects. As a result, the entities that California voters intended to insulate from taxation in order to foster their growth are being increasingly hit with substantial property tax obligations." According to the author, this bill would "exempt non-profit and charitable organizations from property taxation while attending to environmental, cultural, and other permitting requirements" and "ensure that entities operating solely in the public interest will have the financial means necessary to perform their vital functions, these entities should not be unduly penalized for their efforts."

2. **Amendments.** The May 22, 2012 amendments limit the provisions of this bill to construction that commences within 12 months of the date on which the building permit is approved.

3. **Generally, property is not eligible to receive the welfare exemption unless it is *used* by a nonprofit entity for exempt purposes and activities.** Vacant or unused property held for future construction does not qualify for the welfare exemption since it is not being "used" for an exempt purpose and activity. For example, a nonprofit organization may have enough funds to acquire land, but not enough to commence their construction project. Consequently, these properties are subject to property tax.

4. **The law allows the welfare exemption to commence as soon as the property is "under construction."** A relatively minor preparatory activity that results in physical changes visible to any person inspecting the site, such as grading vacant land or tearing down a building, can be undertaken for the purpose of complying with the requirement that the property be in the course of construction for purposes of qualifying for the property tax exemption provided that such construction continues to proceed and is not abandoned.

5. **In addition, for new purchases, the law provides a 180-day window period before construction must commence.** With respect to a newly acquired property, an organization has up to 180 days from the date of purchase to begin demolition or construction on property designated for a future exempt use and qualify for a full exemption on a supplemental assessment pursuant to Section 75.24.

6. **This bill would allow a property to begin receiving the welfare exemption prior to actual onsite physical construction, but only on a retroactive basis.** Specifically, it would include the period between the submission of an application for a building permit and the commencement of actual physical construction. For purposes of the revenue estimate, we have estimated that nonprofits would become eligible to receive the exemption six months earlier than under existing law. In practical application, depending upon the specific timing of each specific case, a nonprofit may have to pay property taxes on their vacant land and then later receive a refund of those taxes back to the date of the building application. Taxes would be owed for the period of time between the date of purchase and the building permit application date.

7. **"Equipment" in facilities**? This bill also extends the exemption to equipment in a facility that is under the course of construction. The practical effect of this language is unclear. Once the facility is under construction, the entire property is eligible for exemption, presumably including any equipment inside that facility. Clarification of any issues concerning the exemption of equipment would better assist property tax administrators understand the issue this language is attempting to address. Has equipment in the course of construction that is built onsite not been exempted?

8. **Determining the date of the building permit application for purposes of retroactivity.** In cases where there are multiple possible building permit application dates**,** precision would be helpful to avoid implementation ambiguities. Building permit procedures vary among localities. Some permits expire if construction is not commenced after a set period of time (for example 180 days to 2 years) and a new permit must be issued. Other localities allow building permits to be "renewed." How this is interpreted could make a difference in the number of years the exemption may be granted retroactively. Should the county grant the exemption from the date of the first permit or the second? What if a permit was renewed multiple times? Should the county grant the exemption from the initial permit date or the most recent renewal date?

9. **This bill does not apply to property that qualifies for exemption under the college exemption or the church exemption.** It is likely that these entities will seek similar legislation in the future to similarly extend these provisions to those types of properties.

10. **Certain vacant property is eligible for the welfare exemption**. Specifically, Section 214.15 provides that vacant land acquired or donated to organizations, like Habitat for Humanity, for the future construction of a single or multifamily residence that will be sold at cost with zero interest loans constitutes the exclusive use of that property for a charitable purpose within the meaning of the California Constitution. However, in this situation, the charitable activity of the organization is the acquisition of vacant land to construct homes that will subsequently become subject to property taxation upon acquisition by low-income families. In contrast, most entities eligible for the welfare exemption are long-term owners of properties and the exemption from property taxation for their properties will likely apply indefinitely.

COST ESTIMATE

The BOE would incur absorbable costs (less than $10,000) in informing and advising county assessors, the public, and staff of the change in law and addressing ongoing implementation questions and issues related to this new provision.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

The welfare exemption includes property that is used exclusively for religious, hospital, scientific, or charitable purposes and is owned and operated for those purposes by qualifying nonprofit organizations. Currently, the welfare exemption also applies to facilities under construction—along with the land on which the facilities are located—to be used exclusively for these purposes.

Under this bill, the definition of course of construction would be expanded to include the period subsequent to an owner filing a completed application for a building permit, but before actual construction occurs on a retroactive basis. Staff estimates, based on information from several counties, that the period of time until actual construction takes place is, on average, at least six months.

The revenue effect of extending the course of construction period is difficult to estimate with any degree of certainty. County assessors do not maintain assessed value statistics for properties obtained by nonprofit organizations that have filed a completed application, but have yet to begin construction. The number of these types of construction projects can vary from year to year. Consequently, the total assessed values of these projects statewide will similarly fluctuate. We cannot predict the number of properties, and the value, that would be exempt under this bill in the future. We cannot predict the number of repealed or renewed building permits or the number of properties with delays of construction needing more than the six month period estimated above. We can, however, attempt to make some assumptions with regard to the amount of property under consideration and give an indication of the order of magnitude of the revenue impact.

Based on information provided by county assessors over the course of several years beginning in 2003-04, staff estimates the total value of property statewide that does not currently qualify for the welfare exemption, but would qualify as of an earlier date under this bill, amounts to between $90 million and $800 million. This represents the assessed values of several major properties acquired by nonprofit organizations as either bare land or existing facilities that require modification.

Calculating a statewide estimate, and multiplying the amount by ½ of the fiscal year, gives the following estimated affected value range and revenue impact:

Estimated Assessed Value		Avg. Delay in Const.		Basic 1% Property Tax Rate	Revenue Impact
$90 million	x	½	x	1%	$450,000
$800 million	x	½	x	1%	$4,000,000

REVENUE SUMMARY

If property is considered in the course of construction as of the date the property owner applies for a building permit, this bill would reduce property tax revenues from the basic 1 percent property tax rate by between $450,000 and $4 million annually.

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