

M e m o r a n d u m***PRELIMINARY DRAFT – FOR DISCUSSION PURPOSES ONLY***

To: Honorable Betty T. Yee, Chairwoman
Honorable Judy Chu, Vice-Chair
Honorable Bill Leonard, Second District
Honorable Michelle Steel, Third District
Honorable John Chiang, Controller

Date: July 6, 2007

From: Kristine Cazadd
Chief Counsel



Subject: **Consideration of Policy Change – Welfare Exemption**
“Community Benefit Test” Under Revenue and Taxation Code section 214
July 17, 2007 Board Meeting – Chief Counsel Matters – Item L

Staff seeks the Board’s direction with respect to the interpretation of Revenue and Taxation Code¹ section 214, the welfare exemption. Section 214, subdivision (a), which implements California Constitution, article XIII, section 4, subdivision (b), provides that “[p]roperty used exclusively for religious, hospital, scientific, or charitable purposes owned and operated by community chests, funds, foundations, limited liability companies, or corporations organized and operated for religious, hospital, scientific, or charitable purposes is exempt from taxation” if certain requirements are met. One such requirement is that the charitable activity benefit the community as a whole or an unascertainable portion thereof.”² This requirement is known as the “community benefit test.”³

The Legal Department’s historic interpretation of the “community benefit test” has been to define the relevant community that must be benefited as the State of California. While the question has never been specifically tested in court, it was the Legal Department’s opinion in the past that California courts “would designate the State of California, or a portion thereof, as the relevant ‘community’ in any welfare exemption action which they might be called upon to consider,” and thus a qualified organization’s activities must benefit some Californians to satisfy the community benefit test, and an organization could not qualify for the welfare exemption if “substantially all” its activities benefit persons outside of California.⁴ This opinion was based on several court cases which defined “community” as the California community for other purposes

¹ All statutory references are to the Revenue and Taxation Code unless otherwise specified.

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

³ See Assessors Handbook Section 267, *Welfare, Church, and Religious Exemptions* (Oct. 2004) (AH 267), pp. 2-7 for a general discussion and history of the test.

⁴ We are aware of 6 legal opinions written between 1976 and 1984 opining that the “community” that must be benefited was the California community.

for which a definition of the word “community” was necessary.⁵ It was also based on the logic that since a property tax exemption shifts the tax burden to properties that remain taxable, the term “community” must be defined so as to restrict the exemption to organizations whose activities benefit some Californians in order to be “fair, equitable and in the public interest for the balance of taxpayers to subsidize the exempt property.”⁶ Finally, a narrow definition of “community” was thought to be consistent with the 1944 Proposition 8 ballot measure language which added the welfare exemption to the California Constitution.

Taxpayers, recently, however, reasonably argue for a broader definition of “community,” one which would include charitable activities carried on outside of the State of California, and even throughout the world. They point out that neither California Constitution, article XIII, section 4, subdivision (b), nor section 214 limits the term “community” to California, and that neither contains an express requirement that charitable organizations benefit Californians. They additionally argue that a broad definition of “community” is consistent with the California Supreme Court’s opinion that the term “charitable” both as used in the constitutional language and in section 214 should be broadly construed;⁷ and, further, that such a reading is more consistent with principles of statutory construction. They argue that the words “charitable” and “community” are not static and should not – in the modern world where technology, media, and transportation are continually shrinking the globe – be constrained by early to mid-20th century notions of “community.” It has also been pointed out by nonprofits with an international impact that that even the California Supreme Court, in 1950, recognized that the Legislature intended for the meaning of the words “religious, hospital, and charitable,” as used in section 214, to change with the times.⁸

Finally, proponents of a broad interpretation of “community” argue that, as currently interpreted, by the Legal Department, the welfare exemption discriminates against out-of-state commerce by giving a tax benefit only to in-state activities in violation of the Commerce Clause of the United States Constitution.⁹

Request for Approval of Tax Policy Change and Staff Recommendation

Staff seeks the Board’s consideration of the two competing legal interpretations outlined above. After extensive research and review, the Legal Staff recommends that a broader interpretation of the “community” is not prohibited by law, and is appropriate in light of modern nonprofit organizational purposes, and functionally avoids possible violation of the Commerce Clause. In

⁵ See, for example, *Keech v. Joplin* (1909) 157 Cal. 1 (defining “community” as “people who reside in a given locality in more or less proximity” for purposes of a 1907 law authorizing “communities” to organize special protection districts within counties); *Gist v. French* (1955) 136 Cal.App.2d 247 (defining “community” as “an area as is governed by the same laws, and the people are unified by the same sovereignty and customs” for medical malpractice purposes); and *In re Giannini* (1968) 69 Cal.2d 563 (defining “community” as the State of California for purposes of determining whether certain live performances affronted contemporary community standards of decency.)

⁶ May 25, 1977 Letter from Legal Department.

⁷ See *Lundberg v. Alameda County* (1956) 46 Cal.2d 644; See also *Stockton Civic Theatre, supra* (1967) 66 Cal. 2d 13.

⁸ *Cedars of Lebanon Hospital v. County of Los Angeles* (1950) 35 Cal.2d 729.

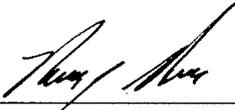
⁹ U.S. Const., art. I, sec. 8, cl. 3.

doing so, staff has prepared a detailed and extensive legal opinion, which, if approved by the Board, would be annotated and used to supersede all previous opinions with contrary analysis and advice.

If approved by the Board, the publication of such opinion would have some impact on county assessors, since the assessors co-administer the welfare exemption. Effective January 1, 2004, all tax exempt nonprofit organizations claiming the welfare exemption for the first time are required to file a claim for an *Organizational Clearance Certificate* with the Board. While it is thus true that the organization must hold a valid Board-issued *Organizational Clearance Certificate* before a county assessor can grant a welfare exemption, it is also true that the assessor may deny an exemption claim, based on non-qualifying use of the property, notwithstanding the claimant's organizational clearance certificate granted by the Board. Consequently, the Board determines whether an organization is organized and operated for exempt purposes and the assessor determines whether the organization's property is used for exempt purposes.¹⁰ Although the "community benefit test" is a matter addressed by the Board in determining whether an organization is organized and operated for exempt purposes, the broader interpretation being suggested would have implications with regard to the assessor's determination as to the "use" of the property.

Because the issue involved is important, and due to the fact that the county assessors have been following Staff's historic interpretation of the "community benefit test" since at least 1976, we recommend that if the Board approves the issuance of the legal opinion, then the Board staff should meet with assessors, staff, and interested members of the nonprofit community to discuss the issues and ramifications of a changed interpretation of the "community benefit test" that includes the global community and assist in developing questions to be addressed and information to be included in a future Letter to Assessors on this matter. Whether or not a rulemaking process ultimately is initiated or the Assessors' Handbook should be amended, convening such a meeting would likely ensure that all interested parties have an opportunity to share their views with the Board on this important matter.

If you need more information or have any questions, please feel free to contact Acting Assistant Chief Counsel Robert Lambert at (916) 324-6593.

Approved: 

 Ramon J. Hirsig
 Executive Director

KEC:RM:pb
 Prop/Rules/ Welfare Exemption
 Chief Counsel/Final/Welfare Exemption

cc:	Mr. Ramon Hirsig	MIC: 73	Mr. Dean Kinnee	MIC:64
	Mr. David Gau	MIC: 63	Mr. Todd Gilman	MIC:70
	Mr. Robert Lambert	MIC: 82		

¹⁰ As of January 1, 2004. (See AH 267, Part I, p. 87.) Prior to January 1, 2004, both Board staff and the county assessors reviewed each welfare exemption claim for organization and operation and use.