STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
150 N STREET, SACRAMENTO, CALIFORNIA
(PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082)
TELEPHONE (916) 327-2455
FAX (916) 323-3387

880.0208

JOHAN KLEHS
First District, Hayward

DEAN F. ANDAL
Second District, Stockton

CLAUDE PARRISH
Third District, Torrance

JOHN CHIANG
Fourth District, Los Angeles

KATHLEEN CONNELL
Controller, Sacramento

E. L. SORENSEN, JR.
Executive Director

RECEIVED
MAR 29 1999

March 25, 1999

Attorneys at Law

Re: _____

Dear Ms. :

I have been asked to respond to your December 15, 1998 request for guidance on the application of the welfare exemption to a transaction involving certain real property held by your client, , and the proper procedure for claiming the exemption.

The facts you provided for purposes of our analysis are as follows:

1. On October 26, 1998, the (TPL) purchased all of the stock of (CD-1), a for-profit, closely-held corporation owning 7000 acres of mostly undeveloped coastal property in County, thereby effecting a change of ownership for Prop 13 reassessment purposes.

2. TPL's corporate purpose, as stated in its Articles of Incorporation, are as follows:

> "the specific and primary purpose is to acquire on behalf of the general public open lands devoted to the preservation of native plants or animals, biotic communities, geological or geographical formations of scientific interest or recreation and scenic beauty; secondarily to seek, develop and demonstrate practical ways to insure an ecologically balanced use of the nation's land resources which promotes optimum human living conditions in a biologically healthy living environment; and to do all these things in conformance with the requirements of Section 501(c)(3) of the Internal Revenue Code of 1954 and Sections 23701d and 214 of the California Revenue and Taxation Code, each respectively as now in effect or subsequently amended."

3. TPL's Articles of Incorporation comply with the requirements of Revenue and Taxation Code Sections 214 and 214.01, and the organization has a valid unrevoked letter from the Internal Revenue Service qualifying it as an exempt organization under Section 501(c)(3) of the Internal Revenue Code.

4. From the date TPL acquired the stock of CD-1, it used the property in accordance with the requirements of Revenue and Taxation Code Section 214.02.

5. In contemplation of converting CD-1 to a nonprofit public benefit corporation, TPL requested a federal income tax ruling on capital gains liability from the IRS in August 1998 and received a favorable response on December 16th.

6. On December 31, 1998, Amended and Restated Articles of Incorporation for were filed with the Secretary of State converting the corporation into a nonprofit (CD-2) and effecting a second change of ownership of the property.

7. Tax exemption for CD-2, pursuant to I.R.C. Section 501(c)(3), was applied for in October and is pending.

8. A claim for welfare exemption was filed for CD-2 with the county in December 1998.

9. The Articles of Incorporation of CD-2 state the following specific purpose:

> "to support the T , and shall include, but not be limited to, holding and managing real property for conservation and land preservation purposes, and to carry on other charitable and educational activities allowed by law"[;]
>
> and that should the TPL cease to exist or abandon its charitable purpose,
>
> "the Directors shall designate a publicly supported educational or charitable organization, described in Sections 170(b)(1)(A), 501(c)(3) and 509(a)(1) and (2) or the Internal Revenue Code, in substitution for the T P L ..."

10. CD-2's Articles provide for dissolution to TPL or, its successor, "such corporation, described in such Code provisions [I.R.C. Sections 501(c)(3) and 509(a)(1) and Rev. & Tax. Code Section 214], as shall have been substituted for the T P L as the organization this corporation is operated exclusively to support."

Question

The question we are asked to address is: assuming that the facts recited are true and the Articles of CD-2 are amended to meet the requirements of Section 214, at what point in time, if at all, did the property become eligible for the welfare exemption?

You put forth two alternative dates for our consideration:

(1) October 26th, the date TPL purchased the stock of CD-1, because TPL became at that time the new owner for reassessment purposes under section 64(c); or

(2) December 31st, the date CD was converted from a for-profit corporation owned by TPL (CD-1) to a nonprofit public benefit corporation complying with the organizational requirements of section 214 (CD-2).

According to your analysis, "[T]he key question ... is whether ownership by TPL satisfies the ownership requirements of section 214. There is no authority directly on point....[T]he ultimate control by TPL should be determinative, and the welfare exemption should apply from the date TPL acquired ."

"[T]he claim for welfare exemption from property tax as well as the supplemental assessment applicable to the Exempt Property should be effective on October 26, 1998 and thereafter, so long as all the requirements of section 214 are met not later than 90 days after the date TPL acquired ." (See Section 75.22.)

Analysis

For reasons explained below, the first date at which the property or a portion of the property would be eligible for the welfare exemption is December 31, 1998, when the for profit CD-1 was converted into the nonprofit CD-2.

Revenue and Taxation Code Section 214 states that property used exclusively for religious, hospital, scientific, or charitable purposes owned and operated by community chests, funds, foundations or corporations organized and operated for religious, hospital, scientific, or charitable purposes is exempt from property taxation if certain requirements are met. The first step in determining welfare exemption eligibility is to determine if the organization itself qualifies.

In brief, an organization must meet the following requirements:

A. It must be organized and operated for exempt purposes;

B. It must not be organized or operated for profit;

C. The owner organization must have an IRC Section 501(c)(3) or Revenue and Taxation Code Section 23701d letter of exemption;

D. The owner organization's earnings must not benefit private shareholders or individuals;

E. Articles of Incorporation of the owner organization must contain an acceptable statement of irrevocable dedication of the property to exempt purposes;

F. Articles of Incorporation of the owner organization must contain an acceptable Dissolution Clause; and

G. The property owner must be the owner **of record** on the lien date.

If the organization owning and operating the property does not qualify for exemption, its property does not qualify, even if it is used for exempt purposes.

Property Owned by For-Profit CD-1

During the time the property was owned by CD-1, it was not eligible for the welfare exemption. Although TPL purchased all of CD-1's stock in October of 1998, CD-1 continued to be the record owner of the property. As a for-profit corporation, CD-1 did not meet the requirements of A-F, above. Although TPL may have met the requirements of A-F, it was not the owner of the property for purposes of the welfare exemption and it had no recorded interest in the property, as required by G.

Contrary to your claim that "ultimate control" by TPL should be determinative, and the welfare exemption should apply from the date TPL acquired CD-1, nonprofit corporate ownership and use of property are the determinative factors for purposes of the welfare exemption, not "ultimate control."

The California property tax welfare exemption has historically been administered on an entity basis, applying to property owned by community chests, funds, foundations, or nonprofit corporations (Section 214). Unlike the law relating to change of ownership for purposes of reassessment of real property (Section 60 et seq., and particularly, Section 64, subdivision (c)), there is no provision in the welfare exemption statute to allow for the exemption to apply to a majority stockholder of the property owner, whether that stockholder is an otherwise qualifying entity or not.

Moreover, Section 261 of the welfare exemption statutes specifically requires that the claimant's interest in the property be "of record" on the lien date in the office of the recorder in the county in which the property is located. The staff's construction of Section 261, subdivision (a), has been that it is the actual ownership interest of the organization seeking the exemption of the property that must be of record on the lien date. Ehrman and Flavin's Taxing California Property, Volume 1, Chapter 6, Exempt Property, Section 6:35, Ownership and Use of Property,

is to the same effect: "the claimant for the welfare exemption must be the record owner of the property on the lien date,[1] ..."

The "ultimate control" provision of Section 64, subdivision (c) simply does not apply to welfare exemption ownership requirement. The legislative history of Section 60 et seq. discloses that it applies to ownership changes for assessment purposes and not for welfare exemption purposes. Section 60 is found in the Part 0.5, Implementation of Article XIIIA of the California Constitution, of Division 1 of the Revenue and Taxation Code, and follows from and pertains to Article XIIIA of the California Constitution, while exemption statutes, including the statutes pertaining to the welfare exemption, are found in Part 2, Assessment, of Division 1 of the Code and follow from and pertain to Article XIII of the California Constitution.

In addition, during the years Section 60 et seq. have been in effect, statutes pertaining to the welfare exemption and requiring actual ownership of properties have not been amended to expand their applications or the application of any of them. As the recently revised Assessors' Handbook, Section 267, Welfare, Church, and Religious Exemption, indicates, the ownership requirement continues in effect.

Even if Section 60 et seq., and particularly Section 64, subdivision (c) were to be applied to welfare exemption ownership requirements, the recordation requirement of Section 261 could not be met because the property was never recorded in TPL's name.

Additionally, the requirement of Section 261 itself is a further indication that the legislature did not intend to look through an entity or entities to consider "ultimate control" for welfare exemption purposes. Had it intended to do so, it would have had to provide for recordation in the name of any entity in which a claimant had "ultimate control" in addition to recordation in the name of the claimant since, as evidenced above, the recordation of property in the name of the other entity would always preclude exemption pursuant to Section 261(a).

Property Owned by Nonprofit CD-2

From the time CD-1 was converted to CD-2, the obstacle presented by for-profit ownership was eliminated. CD-2's qualification depends upon its compliance with the requirements listed above.

A and B. As described in its Articles, CD-2 appears to be organized and operated for exempt purposes and not for profit.

C. CD-2's income tax exemption letter was applied for in October of 1998.

D. Presumably, nonprofit CD-2's earnings, if any, will not benefit private shareholders or individuals.

[1] Revenue and Taxation Code Section 261.

E and F. As submitted, the Amended and Restated Articles of Incorporation and By Laws of CD-2 meet the requirements of Section 214(a)(6) and 214.01, requiring an acceptable statement of irrevocable dedication. The Articles provide for dedication of CD-2's property "to charitable and educational purposes meeting the requirements for exemption provided by Section 214 of the Revenue and Taxation Code."

The Amended and Restated Articles' provision for dissolution of corporate assets meets the requirement of Section 214 (a)(6). (Dissolution is to "the T P L provided that it is then described in Sections 501(c)(3) and 509(a)(1) of the Internal Revenue Code, and provided that it then meets the requirements of Section 214 of the California Revenue and Taxation Code. If the T P L is not then as so described, distribution of the remaining assets shall be made to such corporation, described in such Code provisions, as shall have been substituted for the T P L as the organization this corporation is operated exclusively to support.")

(While Articles of Incorporation are controlling for welfare exemption purposes, the corporation's Bylaws should be consistent with its Articles of Incorporation in these regards.)

G. Presumably, the property continues to be recorded in the name of , qualifying the now nonprofit CD-2 as the owner of record of the property.

Once the organizational requirements are met by nonprofit CD-2, all of the use requirements of section 214 et seq. for the property must also be met for the property to be eligible for the exemption.

Effect of Post-Lien Date Acquisition

Because the conversion took place in the middle of the 1998-99 fiscal year and after the 1998 lien date, it will be treated as a post lien date acquisition, and Section 271 will apply to allow the tax to be canceled or refunded on a pro rata basis "if the property is of a kind that would have qualified for an exemption if it had been owned by the organization on the lien date" -- even if the qualifying organization did not exist on the lien date.

Similarly, the supplemental assessment against CD-2 will be subject to exemption under Section 75.21 and 75.22, giving "the person claiming the exemption," 90 days **after** the change in ownership to meet the qualifications. CD-1, however, would meet with the same obstacle to exemption from supplemental assessment for the period between TPL's purchase of the CD-1 stock and the conversion of CD-1 to CD-2, as it would for its claim for exemption for the 1998-99 regular roll assessment.

In conclusion, as you may know, the welfare exemption requires an annual filing by the claimant with annual review by this Board and the county assessor. Until such time as the claim for exemption and all supporting documents are filed and reviewed by the Board's staff, we cannot make a final determination. Assuming that all the requirements for exemption are met, however, we believe that that part of nonprofit CD-2's property used exclusively for charitable purposes and activities will be eligible for the welfare exemption.

Since the Assessor may deny the claim of an applicant the Board finds eligible for the exemption (Rev. & Tax. Code Section 254.5), you may also wish to obtain the opinion of the Assessor.

Sincerely,

Susan Scott
Tax Counsel

SAS:jd
h:/property/precdnt/welexqal/1999/04sas.doc

cc:

Mr. Dick Johnson, MIC:63
Mr. David Gau, MIC:64
Mr. Jennifer Willis, MIC:70
Mr. Pete Gaffney, MIC:64