memo file

Prepared by the North Dakota Legislative Council
staff for the Taxation Committee
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CHARITABLE ORGANIZATIONS' PROPERTY TAX EXEMPTION - BACKGROUND MEMORANDUM

House Concurrent Resolution No. 3052 (attached as an appendix) directs the Legislative Council to study the property tax exemption for charitable organizations. The text of the resolution states that the nature and activities of charities and amount of property owned by charities have changed substantially over the years, acquisition of property by charities shifts additional tax burdens to other taxpayers, consideration should be given to what is a charity, consideration should be given to full or partial assessment of property taxes for the value of services provided to charities, and legislation considered in 1997 called these issues into consideration.

CONSTITUTIONAL AND STATUTORY PROVISIONS

The Constitution of North Dakota provides in Article X, Section 5, that ". . . property used exclusively for schools, religious, cemetery, charitable or other public purposes shall be exempt from taxation."

North Dakota Century Code (NDCC) Section 57-02-08(8) provides:

> 8. All buildings belonging to institutions of public charity, including public hospitals and nursing homes licensed pursuant to section 23-16-01 under the control of religious or charitable institutions, used wholly or in part for public charity, together with the land actually occupied by such institutions not leased or otherwise used with a view to profit, and this includes any dormitory, dwelling, or residential-type structure, together with necessary land on which such structure is located, owned by a religious or charitable organization recognized as tax exempt under section 501(c)(3) of the United States Internal Revenue Code which is occupied by members of said organization who are subject to a religious vow of poverty and devote and donate substantially all of their time to the religious or charitable activities of the owner.

It is significant that the study resolution focuses only on the charity exemption under NDCC Section 57-02-08(8). Specific exemptions for other property of organizations that some might consider to be charitable organizations are not included under this study. For example, property of religious organizations is generally exempted by the constitution and specifically exempted by subsections 7 and 9 of Section 57-02-08. Other exemptions are provided for the following:

1. Property used for cemeteries, a public park or monument owned by a military organization, promoting educational and athletic functions by nonprofit organizations at a state educational institution, furnishing potable water to members of a cooperative or nonprofit corporation, a group home owned by a nonprofit corporation, or a licensed early childhood facility.
2. Property owned by lodges, chapters, commanderies, consistories, farmers' clubs, commercial clubs, and like organizations and associations not organized for profit.
3. Property owned by a fraternity, sorority, or organization of college students used exclusively for such purposes (but the exemption is limited only to the portion of the premises used exclusively for places of meeting and conducting the business and ceremonies of the organization).
4. Property of an agricultural fair association not incorporated for profit (but the exemption does not apply to the cost of fire protection services furnished by any municipal corporation in which the property is located).

Concern was expressed by some observers during the 1997 legislative session that this study resolution would affect property of religious organizations. The sponsor testified that the study is not intended to affect any exemptions other than the one for institutions of public charity under NDCC Section 57-02-08(8). Separate statutory exemptions are provided for buildings and land occupied by buildings used exclusively for public worship and any dwellings and land occupied by dwellings belonging to a religious organization intended and ordinarily used for the residence of the bishop, priest, rector, or other minister in charge of the organization's services. The exemption for the church building remains in effect if the building is entirely or partially rented to another tax-exempt organization, provided no profit is realized from the rent. Church real property used for a parking lot by persons attending religious services is also exempt from taxation.

Because the exemption for charitable organizations has several qualifications, it is necessary to examine the qualifications separately and with consideration of its interpretation by court decisions

and opinions of the Attorney General.

EXEMPTION OF LAND

Most property tax exemptions provided by the Legislative Assembly do not apply to land. The reason for this is that Article X, Section 5 of the Constitution of North Dakota provides that ". . . The Legislative Assembly may by law exempt any or all classes of **personal property** from taxation and within the meaning of this section, fixtures, buildings and improvements of every character, whatsoever, upon land shall be deemed personal property. . . ." (emphasis added) This constitutional authority of the Legislative Assembly does include providing an exemption for land upon which buildings are located. However, the same section of the constitution provides that the "property" used exclusively for charitable purposes shall be exempt from taxation. Because this provision is not limited to personal property, it appears both real and personal property of charities is intended to be exempted by the constitutional provision. The Legislative Assembly has consistently exempted both buildings and land owned by charitable organizations. Exemptions provided for other entities generally apply only to buildings and structures and the land upon which the buildings and structures are located remains subject to assessment and taxation.

UNITY OF OWNERSHIP AND USE

The statutory requirement that buildings and land, to be exempt, must be property "belonging to" institutions of public charity requires that the property must be owned by the institution of public charity to be eligible for the exemption (letter from the Attorney General to Grand Forks City Attorney, March 7, 1988) and ownership by an individual renders property ineligible for the charitable property tax exemption (letter from Tax Department counsel to the Minot City Assessor, February 28, 1966, citing *Engstad v. Grand Forks County*, 84 N.W. 577 (N.D. 1900)).

In *Riverview Place, Inc. v. Cass County*, 448 N.W. 2nd 635 (N.D. 1989), the Supreme Court of North Dakota said:

> We have also stated that the determination of whether an institution falls within the exemption is, essentially, a two-step process in which it must be determined "whether the organization claiming the exemption is in fact a charitable one, and whether the property on which the exemption is claimed is being devoted to charitable purposes." (cites omitted) The ownership of the property in question by an institution of public charity does not, by that fact alone, exempt the property from taxation. (cites omitted) Additionally, [t]he mere fact that the services performed by a charitable corporation are also rendered by profit-making organizations [does] not of itself preclude [a charitable organization's] right to tax exemption. (cite omitted) Rather, it is the **use** made of the property . . . which determines whether the property is exempt from taxation. [emphasis in text] The property's use must be devoted to charitable purposes and it must actually be used in carrying out the charitable purposes of the organization claiming the exemption. (cites omitted)

Opinions of the Attorney General and letters of Tax Department legal counsel have reached the following conclusions:

- A nonprofit rural housing corporation using property for rental and charging a fee is not eligible for exemption if a lower rental fee is established for persons in certain age brackets with a limited income and a higher fee is used for those who are not in the age bracket with a limited income. The use is indicative of not using the property for charitable purposes. (1972 North Dakota Attorney General's opinion 392)
- A senior citizens' club is a charitable institution. (Memorandum from Tax Department legal counsel to the State Supervisor of Assessments, March 15, 1978)
- A nonprofit scholarship foundation that promotes and provides for educational opportunities for North Dakota residents who wish to study engineering or science in North Dakota is a public charity. (Letter from Tax Commissioner counsel to the North Dakota Foundation for Engineering and Science Scholarships, May 25, 1956)
- Private institutions, if operated for public charity, are entitled to the exemption, whether or not they are incorporated. (Letter from the Tax Commissioner assistant counsel to Grant County States Attorney, March 17, 1960; letter from Special Assistant Attorney General, State Tax Department, to City Attorney, Valley City, June 5, 1961; letter from State Supervisor of Assessments to Grand Forks County Director of Tax Equalization, May 22, 1992)
- Nonprofit historical societies operated for the public generally are recognized as charitable institutions within the meaning of tax exemption statutes. (Letter from Tax Department counsel to the State Tax Department utilities director, July 20, 1966)
- The YMCA is an institution of public charity. (Letter from the Special Assistant Attorney General, State Tax Department, to the Fargo City Assessor, May 1, 1958; letter from the

Special Assistant Attorney General Office of State Tax Commissioner to the Grand Forks Assistant City Attorney, March 24, 1970)

- Blue Cross of North Dakota is not an institution of public charity. (Letter from the Tax Commissioner legal counsel to Nilles, Oehlert & Nilles, October 4, 1956)
- If a property is used partly for the charitable purposes of the public charity owner of the building and partly for other uses, the dominant use determines the use of the property for purposes of the exemption. (Letter from the office of State Tax Commissioner Chief Counsel to the Grand Forks States Attorney, May 11, 1979)
- An assessment may be prorated if it can be shown that parts of the property are used exclusively for charitable purposes. (1978 North Dakota Attorney General's opinion 127)
- The area of a public hospital leased to the University of North Dakota for a family practice center is part of the teaching hospital's charitable use. (1976 North Dakota Attorney General's opinion 183)
- A parking lot owned by a public hospital and used for free parking by employee and hospital visitors is exempt as a necessary part of a modern urban hospital. (1978 North Dakota Attorney General's opinion 127)
- The part of a public hospital leased to a private clinic, operating for profit, is not exempt because it does not have a use which directly assists the public hospital in achieving its charitable purpose. (1978 North Dakota Attorney General's opinion 127)
- A residence owned and used by a public hospital as a residence for a chaplain is not used for charitable purposes. (Letter from the State Tax Commissioner counsel to the Minot City Auditor, September 22, 1970)
- A "public hospital" may include housing for resident doctors, even though a doctor's family also lives there, provided it is reasonably necessary for the efficient operation of the hospital. (Letter from the Special Assistant Attorney General, State Tax Department, to the Fargo City Assessor, February 4, 1958)

USE WITH A VIEW TO PROFIT

In the *Riverview Place* decision, the North Dakota Supreme Court said:

> . . . When a charitable organization charges a fee for its services and operates at a small net profit which is reinvested back into the organization's charitable operations, those facts do not automatically disqualify the entity's property from an exemption on the basis that it was operated "with a view to profit," as the concept of charity encompasses "something more than mere almsgiving" and therefore a "benevolent association is not required to use only red ink in keeping its books and ledgers."

The following conclusions have been reached in application of the exemption by the Attorney General and the Tax Department:

- Only the amount of land that is reasonably required for a site for the buildings and improvements used for charitable purposes is eligible for the exemption. Excess land used to pasture cattle is "used with a view to profit." (1929 North Dakota Attorney General's opinion 162)
- The meaning commonly given to "not used with a view to profit" is that no individual stockholder or investor will receive any kind of profit or gain or dividend from the operation of the charity. It does not mean that the charity cannot make some type of charge for certain services. (Letter from the Tax Department counsel to the Minot City Assessor, February 28, 1966)
- Occasional rental of property owned by a public charity and rented for nonexempt purposes does not destroy the tax-exempt status of the property. (Letter from the Special Assistant Attorney General, Office of State Tax Commissioner, to the Grand Forks Assistant City Attorney, March 24, 1970)
- If a charitable organization leases a building to another charitable organization at rent substantially below market rental rates so as to constitute financial assistance to the lessee charitable organization, then a charitable use by the lessor can be established. (Letter from the State Supervisor of Assessments to Central NoDak Development Corporation, July 24, 1989, citing *United Way v. Douglas County Board of Equalization*, 337 N.W.2nd 103 (Neb. 1983))
- A used clothing store operated by a public charity is not exempt because it is used for profit rather than the charitable uses of the charitable institution. (Letter from the Special Assistant Attorney General to the Senior Appraiser, Office of Grand Forks City Assessor, March 14, 1975)

ACTUAL OCCUPANCY OF LAND

Under NDCC Section 57-02-08(8) the exemption applies only to "the land actually occupied by such institutions". Under this limitation, opinions have been given that vacant lots owned by institutions of public charity are not exempt because they are not

"actually occupied" by the charitable institution (letter from the Special Assistant Attorney General for the Tax Department to the Tax Commissioner, October 30, 1957) or by a public hospital (letter from the Tax Commissioner legal counsel to the Bismarck City Assessor, April 10, 1968).

VALUATION OF EXEMPT PROPERTY OF CHARITABLE ORGANIZATIONS

For many years, state law has required valuation by assessment officials for all exempt property. However, assessment officials have generally not assessed that property, and the reason given is that they believe it is more productive to devote limited time and resources to valuation of taxable property. For this reason, only a limited amount of information has been available from a few jurisdictions on values of exempt charitable property.

In 1995 Senate Bill No. 2081, the Legislative Assembly provided a statutory mechanism to allow the growth in tax-exempt property to be reflected in the growth in the amount that may be levied by political subdivisions beginning in 1999, under the reasoning that expanded amounts of exempt property require additional services from local governments and levying authority is required to meet the increased demand. During the 1995-96 interim, assessment officials pointed out concerns with this requirement to the interim Taxation Committee. Assessment officials said valuation of all exempt property is an excessive demand because it requires assessment of township, county, city, state, and federal roads and property that would never be subjected to taxation and pointed out concerns with other aspects of the requirement with regard to specific types of property. An amendment to the requirement was enacted in 1997 House Bill No. 1341. Under the amendment, local assessment officials will be required to establish valuations for property exempted from taxation as new or expanding businesses under NDCC Chapter 40-57.1; improvements to property under Chapter 57-02.2; or buildings belonging to institutions of public charity, new single-family residential or townhouse or condominium property, property used for early childhood services, or pollution abatement improvements under Section 57-02-08. These valuations must be in place for taxable year 1999. This means information should become available during this interim that could be reviewed by the taxation committee with regard to valuations for exempt charitable organization property.

SUGGESTED STUDY APPROACH

The sponsor of the study resolution testified during standing committee consideration of the resolution that it was introduced to address concerns with accelerating property tax burdens, growing amounts of exempt property being acquired by charitable organizations, the need to examine what constitutes a "charitable" organization, and other issues that were raised during consideration of 1997 House Bill Nos. 1289 and 1460, both of which failed to pass but generated a substantial amount of interest and discussion. House Bill No. 1289 would have eliminated the exemptions for property acquired, constructed, or improved by the state or a charitable organization after June 30, 1997, unless the exemption is specifically approved by the governing body of the city, for property within city limits, or the governing body of the county, for property outside city limits. House Bill No. 1460 would have amended the exemption for property of charitable organizations by eliminating the exemption for any portion of a building not used exclusively for charitable purposes and by providing that an organization is not a charitable organization if it pays wages exceeding $75,000 to any person employed in the state during the taxable year.

To gather information on the issues to be considered in this study, the committee may wish to seek information from:

- Assessment officials concerning the valuation of property of charitable organizations and problems encountered in application of the exemption.
- Representatives of political subdivisions concerning the effects on local tax bases of property owned and acquired by charitable organizations and concerning whether charitable organizations should be subject to partial assessment for the value of certain services such as fire and law enforcement protection.
- Representatives of charitable organizations concerning the benefits they provide to the public and also relating to their finances, operations, and property acquisition.
- Representatives of taxpayers concerning the tax burden shifted to them as the result of acquisition of property by charitable organizations.

Fifty-fifth Legislative Assembly, State of North Dakota, begun in the Capitol in the City of Bismarck, on Monday, the sixth day of January, one thousand nine hundred and ninety-seven

HOUSE CONCURRENT RESOLUTION NO. 3052
(Representatives Tollefson, Soukup, Brown, Grosz)
(Senators Mutch, Naaden)

A concurrent resolution directing the Legislative Council to study the property tax exemption for charitable organizations.

WHEREAS, the Constitution of North Dakota provides that property used exclusively for charitable purposes is exempt from taxation; and

WHEREAS, North Dakota statutes have provided property tax exemptions for property of institutions of public charity and the nature and activities of charities and amount of property owned by charities have changed substantially over the years; and

WHEREAS, acquisition of property by charities removes the property from the tax rolls and shifts additional tax burdens to remaining taxable property; and

WHEREAS, uncertainty exists regarding the appropriate interpretation of the statutory term "institutions of public charity" and whether charities should be subject to full or partial assessment of property taxes for the value of certain services provided for their benefit; and

WHEREAS, legislation considered by the Fifty-fifth Legislative Assembly indicated a need for thorough review of application of the property tax exemption for property of charities;

NOW, THEREFORE, BE IT RESOLVED BY THE HOUSE OF REPRESENTATIVES OF NORTH DAKOTA, THE SENATE CONCURRING THEREIN:

That the Legislative Council study the property tax exemption for charitable organizations; and

BE IT FURTHER RESOLVED, that the Legislative Council report its findings and recommendations, together with any legislation required to implement the recommendations, to the Fifty-sixth Legislative Assembly.

Filed March 19, 1997