California State
Board *of* Equalization

Legislative Bill Analysis

Senate Bill 588 (Allen)
Date: March 20, 2023 (Amended)
Program: Property Taxes
Revenue and Taxation Code section 214
Effective: Immediate

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Summary: Amends Revenue and Taxation Code (RTC) section 214 to remove the welfare exemption cap of $20 million in assessed value for non-government-assisted low-income rental housing owned and operated by eligible nonprofit organizations.

Fiscal Impact Summary: Based on the information provided by some County Assessors, the current revenue impact is $40,000, but this amount is likely to be higher as it is unclear whether any organizations appear to be over or near the cap at the present time.

Existing Law: Under the California Constitution, all property is taxable unless otherwise provided for by the State Constitution or the laws of the United States.[1] The Legislature may exempt from property taxation in whole or in part property used exclusively for religious, hospital, scientific, or charitable purposes and owned or held in trust by nonprofit corporations or other entities if specific criteria are met.[2]

This exemption is known as the "welfare exemption" and is implemented according to RTC[3] section 214.

Section 214 generally exempts from taxation, subject to certain conditions and qualifications, property (1) owned by nonprofit organizations organized and operated for charitable purposes, and (2) used exclusively for those purposes.

Section 214(g)(1) generally provides that property used exclusively for low-income rental housing owned and operated by nonprofit organizations, including limited partnerships in which the managing general partner is an eligible nonprofit corporation, shall be deemed within the exemption authorized by section 214. The law allows an unlimited exemption for rental housing owned by a nonprofit organization if it receives government financing or low-income housing tax credits.[4] However, the law limits the exemption to the first $20,000,000 in assessed value statewide[5] on low-income rental housing owned by a nonprofit that does not receive government financing or low-income housing tax credits, and 90 percent or more of the occupants are lower income households. This limitation is not per property but rather applies to all low-income rental housing owned by the nonprofit and located in California that does not receive government financing or low-income housing tax credits.

Proposed Law: This bill would remove the above-described limit on the total exemption amount for any property for which a claim is filed and granted for the 2024–25 fiscal year or any fiscal year thereafter

[1] California Constitution, article XIII, section 1.
[2] California Constitution, article XIII, section 4(b).
[3] All statutory references are to the Revenue and Taxation Code, unless otherwise provided.
[4] Revenue and Taxation Code (RTC) section 214(g)(1)(A) and section 214(g)(1)(B).
[5] RTC section 214(g)(1)(C).

if, in addition to the above-described requirement, at least 90% of the property's units are made continuously available to, as defined, or are occupied by lower income households, as defined, at a rent that does not exceed the rent for lower income households, as prescribed by specified law. The bill would require the claimant seeking an exemption pursuant to the bill's provisions to provide to the County Assessor any additional documents and materials requested by the county assessor necessary to evaluate the claimant's eligibility for the exemption.

In General: Under section 4(b) of article XIII of the California Constitution, the Legislature is authorized to exempt from taxation, in whole or in part:

> 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 operated 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.

In exercising the above constitutional authorization, the Legislature enacted section 214, reiterating the constitutional authorization and outlining numerous conditions and qualifications for receiving the exemption, and adding scientific as the fourth qualifying purpose. Section 214 provides that property used exclusively for charitable purposes owned and operated by entities organized and operated for charitable purposes is exempt from taxation if the entities are not owned and operated for profit and the property is used for the actual operation of the exempt activity.

Charitable Purposes. An organization's primary purpose must be either religious, hospital, scientific, or charitable. Whether its operations are for one of these purposes is determined by its activities. The State Supreme Court has broadly construed the charitable purpose aspect of the welfare exemption to include a wide range of activities which benefit the general public.[6] The term "charitable" is not confined to the relief of poverty, but includes all kinds of humanitarian activities, rendered at cost or less, the object of which is the care of the physical and mental well-being of the recipients.

Exclusive Use. The Revenue and Taxation Code does not specifically define the term *used exclusively*; however, the courts have done so in a series of decisions. The California Supreme Court has stated that the phrase "exclusively used" may not be given a literal interpretation to mean that the property exempted must be used solely for the purposes stated to the total exclusion of any other use. The Supreme Court held that *used exclusively* for exempt purposes includes any property which is used exclusively for any activity which is incidental to and reasonably necessary for the accomplishment of the exempt purpose.[7] Courts have applied this precedent to mean that a qualified organization's primary use of its property must be for exempt purposes, and any other uses of property must be related to and reasonably necessary for the accomplishment of the exempt purpose.[8]

Housing Welfare Exemption. Property tax administrators have historically taken a narrow interpretation of the exemption. They have viewed much housing as non-exempt because the property is used primarily

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[6] *Stockton Civic Theatre v. Board of Supervisors* (1967) 66 Cal.2d. 13.
[7] *Cedars of Lebanon v. County of Los Angeles* (1950) 35 Cal.2d 729, 736.
[8] *Honeywell Information Systems, Inc*. v. *County of Sonoma* (1974) 44 Cal.App.3d 23; *YMCA* v. *County of Los Angeles* (1950) 35 Cal.2d 760; *St. Germain Foundation* v. *County of Siskiyou* (1963) 212 Cal.App.2d 911; *Greek Theatre Association* v. *County of Los Angeles* (1978) 76 Cal.App.3d 768.

for private residential purposes rather than exempt purposes and is not used exclusively for exempt purposes as required by section 214.[9]

However, the courts have taken a broader view, consistent with the Supreme Court's directive that statutory and constitutional provisions granting exemptions are to be construed strictly but reasonably.[10]

In 1999, the BOE adopted Property Tax Rule 137, *Application of the Welfare Exemption to Property Used For Housing*, effective December 31, 1999. Rule 137 clarifies that the welfare exemption applies to housing and related facilities owned and operated by qualified nonprofit organizations and establishes a single uniform statewide standard for determining qualification for the welfare exemption as it applies to such properties.[11]

In addition, Property Tax Rule 140 further specifies requirements for the welfare exemption for low-income housing properties.

Administration. The State Board of Equalization (BOE) and 58 County Assessors jointly administer the welfare exemption. The BOE is responsible for determining whether an organization is organized and operating for exempt purposes, which qualifies the organization for either an Organizational Clearance Certificate (OCC) or a Supplemental Clearance Certificate (SCC). The County Assessor is responsible for determining whether the use of a qualifying organization's property is eligible for the welfare exemption. The County Assessor shall not grant the welfare exemption for an organization's property unless the organization holds either a valid OCC or SCC issued by the BOE. However, the County Assessor may deny a welfare exemption claim based on non-qualifying use of the property, notwithstanding that the BOE has issued the organization an OCC or SCC. The BOE tracks eligible nonprofit organizations and Limited Liability Companies that hold valid OCCs and SCCs and monitors those organizations for continued eligibility.

Once the BOE issues an OCC or an SCC to a qualified organization, the organization must file a BOE-267 claim for the welfare exemption with the County Assessor where the property is located. The County Assessor is responsible for evaluating the application, determining whether the use of the property meets the statutory requirements for receiving the welfare exemption, and ultimately granting or denying the exemption to claimants.

Under existing property tax law, properties that meet these requirements and are used exclusively for rental housing, including related facilities, are entitled to a partial exemption, equal to that percentage of the value of the property that is equal to the percentage that the number of units serving lower income households represents of the total number of residential units, in any year that specific criteria apply. These criteria include that the property be subject to a legal restriction that provides that units designated for use by lower-income households are continuously available to or occupied by lower-income households at rents not exceeding specified limits.[12]

Background:

Government Financing or Tax Credits: Unlimited Exemption. When a nonprofit organization owns and operates a low-income rental housing property that receives government financing or low-income housing tax credits, all of these properties may be exempt from property tax. Generally, a low-income

[9] Assessors' Handbook Section 267, *Welfare, Church, and Religious Exemptions*, p. 62.
[10] *Ibid*.
[11] *Id.* at p. 65.
[12] Section 214, subd. (g)(1).

rental housing property[13] may qualify for the welfare exemption if they meet a number of conditions enumerated in RTC section 214(g).

No Government Assistance: Capped Exemption. When a nonprofit organization owns and operates a low-income rental housing property that does not receive any government financing or low-income housing tax credits, an exemption is available, but these properties are subject to a statewide cap. The exemption is capped at the first $20,000,000 of assessed value. A particular low-income rental housing property may qualify for the welfare exemption provided:

- **Occupancy.** 90 percent or more of the property's occupants are lower income households, which are described as those whose rent does not exceed the rent prescribed in HSC section 50053. *RTC sections 214(g)(1) and 214(g)(1)(C)*
- **Use Restriction.** The property is subject to an "other legal document" restricting the property's use to low-income housing. *RTC section 214(g)(2)(A)(i) and Property Tax Rule 140*
- **Rents Charged.** The rent charged does not exceed that prescribed in HSC section 50053. *RTC section 214(g)(1)(C)*
- **Property Tax Savings.** The owner certifies that the funds otherwise spent to pay taxes are instead used to maintain the affordability of, or reduce rents for, units occupied by the lower income households. *RTC section 214(g)(2)(B)*
- **Limited Partnerships: Prohibited.** Limited partnerships owning low-income rental housing with a nonprofit organization or LLC serving as the managing general partner are not eligible for exemption under this provision. *RTC section 214(g)(1)(C)*

Historical Qualifications. Prior to January 1, 2000, nonprofit organizations could qualify for a property tax exemption for low-income rental housing by meeting *one* of the following requirements:

1. **Occupancy.** At least 20 percent of the occupants were persons with low income.
2. **Government Financing.** The project was financed with tax-exempt bonds, government loans, or grants.
3. **Tax Credits.** The nonprofit organization was eligible for and received low-income housing tax credits.

More Stringent Qualifications. Beginning January 1, 2000, Assembly Bill 1559 (Stats. 1999, Ch. 927) deleted mere "occupancy" by persons with low income as a qualifying condition for the welfare exemption. As a result, to receive a property tax exemption, the low-income housing property must either be financed with government funds or the owner must receive tax credits on the property. Assembly Bill 1559 also imposed higher standards related to restrictive use documentation to substantiate that the property is dedicated to low-income housing. Accordingly, any deed restriction must be recorded, or a public agency must be a party to an enforceable and verifiable agreement regarding property use. Furthermore, "other legal documents" no longer sufficed to impose the necessary use restriction.

[13] Such property may include single-family residences, multi-family residences (e.g., duplex, triplex, fourplex), and apartment complexes.

The Los Angeles Housing Law Project (Project) sponsored Assembly Bill 1559 to address welfare exemption abuse and misuse that permitted the owners of substandard housing properties to obtain a property tax exemption. In the course of investigating various substandard housing properties, this organization discovered that some properties were receiving the exemption under the provision that permits the property to qualify solely on the basis that the rents were low and the residents were low-income households. It was alleged that substandard housing owners were partnering with nonprofit organizations in a limited partnership as a ruse to obtain the welfare exemption or were themselves creating non-profit organizations. Presumably, the rationale for limiting the exemption to properties financed with tax-exempt bonds, government loans, or grants was that these properties would be subject to some level of government oversight, ensuring quality housing for the tenants and preventing creative property owners from obtaining the exemption to avoid paying any property tax.

Exemption Cap. Assembly Bill 1559's changes also revoked the exemption from charitable organizations providing adequate housing because they did not have government financing or tax credits. Consequently, the following year Assembly Bill 659 (Stats. 2000, Ch. 601) reinstated exemption eligibility based on "occupancy" by low-income households with three changes:

1. **Occupancy Threshold.** The occupancy threshold was raised from 20 percent to 90 percent.

2. **Exemption Cap.** An exemption cap was created limiting the exemption amount applied to a taxpayer to $20,000 of tax.[14]

3. **Exclude Limited Partnerships.** Limited partnerships in which the managing general partner is an eligible nonprofit corporation were specifically excluded.

Since the exemption cap was created, few nonprofit organizations that own low-income rental housing have exceeded the cap. Many projects have government financing or low-income housing tax credits and thus are not impacted by the cap. The purpose of making public financing a key condition of receiving a property tax exemption was to help ensure that only legitimate operators were benefiting from the exemption. The purpose of excluding limited partnerships was to prevent the owners of substandard housing from partnering with a nonprofit organization in a ruse to obtain the welfare exemption. The purpose of imposing a $20,000 of tax statewide cap when public financing does not apply was to limit the available exemption to owners that might misuse the exemption by creating a nonprofit organization.

Consent Decree Property Exception. In 2004, the Long Beach Affordable Housing Coalition (LBAHC) unknowingly became impacted by the $20,000 of tax exemption cap. It purchased 12 developments using conventional bank financing. Public subsidies were unnecessary to buy the properties because they were acquired from another nonprofit organization on favorable terms. These properties mitigated the loss of affordable housing related to the construction of the Century Freeway (I-105) in Los Angeles County and had always been exempt from property taxes. Because there were no public subsidies, the properties became taxable, but the maximum exemption could not exceed $20,000 of tax. To remedy this issue, Senate Bill 1284 (Stats. 2008, Ch. 524) modified the law to exclude the cap's application to these properties. Senate Bill 1284 also cancelled all outstanding taxes, including any related interest or penalties, on the properties.[15] SB 1284 did not include refunds because at that time, it was believed that no taxes had yet been paid. However, the lender had paid taxes to avoid a property sale due to tax

[14] $20,000 of tax is equivalent to $2,000,000 in assessed value, using a 1 percent tax rate.
[15] RTC section 214(g)(1)(D).

delinquency. In 2010, Senate Bill 996 (Lowenthal) was introduced to allow the refund of taxes paid, but this bill was not enacted.[16]

In 2016, Senate Bill 996 (Stats. 2016, ch. 836) increased the exemption cap from $20,000 of tax to $10,000,000 in assessed value statewide for lien dates occurring on and after January 1, 2017, and provided for the cancellation of any outstanding ad valorem tax in excess of the $10,000,000 cap and any related penalties or interest imposed between January 1, 2013, and January 1, 2017.

In 2018, Senate Bill 1115 (Stats. 2018, ch. 694) increased the exemption cap from $10,000,000 to $20,000,000 in assessed value statewide for lien dates occurring on and after January 1, 2019, and provided for the cancellation of any outstanding ad valorem tax in excess of the $20,000,000 cap and any related penalties or interest imposed between January 1, 2017, and January 1, 2019.

Commentary:

1. **Removes Cap.** The bill removes the total exemption amount allowed to certain taxpayers that provide low-income housing that is currently statutorily set at $20 million in assessed value per fiscal year.

2. **Lien Date.** The bill proposes to remove the welfare exemption cap of $20 million in assessed value per fiscal year and apply the changes to the lien date occurring on and after the effective date of the bill. As a tax levy, the bill would go into immediate effect and apply to the ensuing lien date (lien date 2024 if enacted in 2023). This could potentially cause taxpayer confusion as the act would go into effect in the middle of the 2023-2024 fiscal year (if enacted in 2023), but would not apply until the January 1, 2024, lien date for the 2024-25 fiscal year.

3. **The BOE Monitors the Statewide Cap.** Nonprofit organizations report their holdings to the local County Assessor via the annual welfare exemption claim form, and County Assessors annually transmit the information to the BOE.

4. **$20,000 of Tax Exemption Cap.** For fiscal year 2016-17, according to information submitted to the BOE, 23 nonprofit organizations received exemptions on property that counted towards the $20,000 tax cap. These 23 organizations owned 55 low-income rental housing properties of various types in 10 counties. Three organizations, located in Los Angeles, Marin, and Monterey Counties, exceeded the cap and were partially taxable.

5. **$10 Million in Assessed Value Exemption Cap.** For fiscal year 2017-18, 18 counties submitted information to the BOE. This information indicates that 23 nonprofit organizations received exemptions on property that counted towards the $10 million assessed value exemption cap. These 23 organizations own low-income rental housing properties of various types in 8 counties. Of these 23 organizations, none of the organizations exceeded the $10 million cap.

6. **One Organization Has Exceeded the Current $20 Million in Assessed Value Exemption Cap and there are Potentially More.** For the fiscal year 2022-23, 24 counties submitted information to the BOE. In one county, one entity exceeded the cap. For fiscal year 2020-21, 19 counties submitted information to the BOE. This information indicates that 14 nonprofit organizations received

[16] RTC section 214.16.

exemptions on property that counted towards the $20 million exemption cap. These 14 organizations own low-income rental housing properties of various types in 8 counties.

7. **No Other Property Eligible for the Welfare Exemption is Subject to an Exemption Cap.** The cap was instituted to address certain taxpayers' misuse of the exemption as it applied to low-income rental housing. In addition to the cap, other restrictions were enacted to reduce exemption abuse, such as excluding limited partnerships, requiring recorded deed restrictions, and requiring regulatory agreements with a public agency.

8. **No Basis for BOE Annual Reporting Requirement.** This bill states its intent to apply the requirements of RTC section 41 with respect to the removal of the exemption cap. However, RTC section 41 only applies to taxes imposed under Parts 1, 10 and 11 under Division 2 of the RTC.[17] These code references refer to sales and use taxes, personal income tax, and corporation tax. RTC section 41 does not apply to property tax. If the reporting requirement is based on RTC section 41, then there is no basis for imposing a reporting requirement since this section does not apply to property tax.

Costs: The BOE would incur base year costs of approximately $29,053 and on-going costs of approximately $5,530 per year to update claim forms; Assessors' Handbook Section 267, *Welfare, Church, and Religious Exemptions*; and Publication 149, *Property Tax Welfare Exemption*.

Revenue Impact: This bill eliminates the current exemption cap of $20 million in assessed value for non-government-assisted low-income rental housing owned and operated by eligible nonprofit organizations.

Based on County Assessor fiscal year 2022-23 data collected by the BOE Property Tax Department staff, 24 counties submitted information to BOE. Data analysis indicated that in one county, an entity did exceed the $20 million cap. The amount exceeding the amount of exemption in this particular case was $4 million. Based on the 1% property tax rate, the elimination of the current exemption for this single county amounts to an estimated revenue loss of $40,000 (1% × $4 million).

While only one entity has exceeded the cap, information from reporting assessors indicates that there are at least 13 organizations with who have received exemptions on property that counts toward the $20 million exemption cap. Therefore, it is likely that the revenue loss could be greater should these entities acquire more property.

Qualifying Remarks. The revenue impact to local jurisdictions could grow as organizations acquire more property that would have otherwise been subject to the $20 million cap, or if the assessed values over time exceed $20 million due to the application of the annual inflation factor of up to 2 percent.

This revenue estimate does not account for any changes in economic activity that may or may not result from the enactment of the proposed bill.

[17] RTC section 41 (a).