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July 27, 2000

Attorneys at Law

**Re: The Colleges
Request No.: 99-341**

Dear Mr. _____ :

Your letter to Mary Ann Alonzo, dated October 25, 1999, was referred to me for response. You asked about the eligibility for property tax exemption of land owned by a non-profit corporation, the _____ (“the New CUC”), formed and controlled by the _____ Colleges, nonprofit institutions of higher education whose properties are eligible for exemption under Article XIII, section 3(e) of the California Constitution.

The organizational structure of the _____ Colleges is, to our knowledge, unique in the state and presents some unique problems of analysis in applying the law to the facts. We have analyzed the possibility of exemption pursuant to Article XIII, section 3(e) (the “college exemption”) and section 4(b) (the “welfare exemption”) of Revenue and Taxation Code section 214) and have concluded that although the welfare exemption is not applicable, property owned by the New CUC which is being used by the New CUC as an agent of the _____ Colleges is eligible for the college exemption.

Facts

The title of the property that is the subject of the request is presently in the name of _____ (CUC), a nonprofit public benefit corporation, exempt from income tax pursuant to section 501(c)(3) of the Internal Revenue Code and section 23701d of the Revenue and Taxation Code. CUC is controlled by and dedicated to the service of the _____ Colleges (hereinafter, the CC’s), a cluster of nonprofit institutions of higher education in the area, unique in this country and modeled on the Oxford cluster of colleges in England. Property owned by the CC’s is exempt from property taxes under the “college exemption” of California Constitution Article XIII, section 3(e) and Revenue and Taxation Code section 203.

The CUC currently has two functions. It is used (1) as a graduate educational institution (_____ University) and (2) as the provider of programs and services to all the CC’s.

Because of the first function, the CUC is considered a nonprofit institute of higher education whose property is eligible for the "college" exemption.

The CC's have decided to restructure and split the CUC into two separate entities along functional lines. One of the new entities will be a graduate school; the other will be a nonprofit public benefit corporation exempt under Internal Revenue Code section 501(c)(3), called the (New CUC). The "specific and sole purpose" of the New CUC as stated in its Articles of Incorporation is "to support the activities of the group known as the ' Colleges', presently consisting of University, College, College, Graduate Institute of College, College, and College." The New CUC will perform the support services for the CC's currently performed by the CUC, and a majority of its board of directors will be the presidents and chairs of the boards of the seven CC's.¹ Title to the property at issue will be transferred to the New CUC.

In furtherance of its purpose, the New CUC will carry on the following programs and services for the benefit of the CC's:

1. Bookstore which services the faculty, students and employees of all CC's;
2. Psychological counseling center for all CC students;
3. Maintenance of campus safety services for all CC campuses;
4. Provision of information technology and communications services for all CC's;
5. Maintenance of staff to provide human resources support to centralized programs, employee benefits administration, risk management insurance, expertise on workplace safety, financial services, health education outreach, administration of workers' compensation, real property administration, maintenance of New CUC owned common facilities, administrative leadership through the New CUC CEO's office;
6. Chicano Latino Student Affairs Center and Office of Black Student Affairs for all CC's and main faculty office for intercollegiate Department of Chicano Studies;
7. Ownership of and exterior maintenance of intercollegiate faculty house rented to Faculty House Corporation to operate;
8. Provision of library resources and research and support services for all CC libraries;
9. Interfaith Chaplaincy for all CC students
10. Student Medical Center for all CC students
11. Provision of maintenance, supply and shop services to all CC's
12. Holding land for future CC institutions, some of which is currently being used for educational purposes by a biological field station and a botanical garden open to the public.

Charges for most of the above-listed services will be made to the separate institutions based on a combination of usage and Full Time Equivalent student enrollments. Some medical center services will be billed to students, and maintenance, supply and shop services will be

¹ Although the New CUC bylaws and the Revised Constitution of the Colleges you sent provide for an equal number of "constituent" and "non-constituent" board members ("Overseers"), you stated you would be changing them to give control to the 14 "constituent" board members, who are the presidents and chairs of the boards of the CC's.

allocated to the separate colleges on the basis of square footage and work orders. It is unclear how costs associated with the land holding described in #12 would be handled.

A Revised Version of the Constitution of the _____ Colleges, to which each of the educational institutions -- as well as the New CUC -- will be signatories, provides that the New CUC will bear the following responsibilities:

- “planning and development for the broad advancement of the group”,
- “promoting cooperation among all member institution to enhance the overall educational excellence of the group” ,
- “hold[ing] title to all central facilities which are operated on behalf of member institutions”, “improv[ing] consortial efficiencies and economies through central activities and other cooperative activities among the member institutions”, and
- “tak[ing] the initiative to develop needed resources in support of central programs and services and to provide for such additional facilities as the member institutions may agree upon”,
- “promot[ing] the founding of additional colleges or other educational institutions to enhance the educational quality of The _____ Colleges” ,
- “hold[ing] title, on behalf of all members, to land for the development of new member institutions and central programs and services”,
- “administer[ing] the use of the name “The _____ Colleges” in conjunction with individual programs and activities conducted by the administrations, faculty or students of member institutions.”

Finally, the Revised Constitution prohibits the New CUC “from withdrawing from the _____ Colleges.”

Law

College Exemption

As noted in your letter, Section 3 (e) of Article XIII of the California Constitution exempts from property tax “[b]uildings, land, equipment ...used exclusively for educational purposes by a nonprofit institution of higher education.” (Article XIII, § 3, subd. (e).) The constitutional provision is implemented by sections 203 of the Revenue and Taxation Code.

The California Courts have held that constitutional provisions and statutes exempting property from taxes are to be construed strictly, but reasonably. (*Cedars of Lebanon Hospital v. County of Los Angeles* (1950) 35 Cal.2d 729, 734-735.) The *Cedars* Court held that the rule of strict construction does not require that the narrowest possible meaning be given to the exempting language, rather “*a fair and reasonable interpretation is required, with due regard for the ordinary acceptance of the language employed and the object sought to be accomplished*”. The *Cedars* standard has been used in other exemption cases as well. (E.g. *English v. County of Alameda* (1977) 70 Cal.App.3d 226, 243.)

There are two issues to be resolved in analyzing whether the New CUC property could be eligible for the “college exemption.” The property must be used (1) exclusively *for* educational purposes and (2) *by* a nonprofit institution of higher education (a “college”). Unlike the welfare exemption, the property need not be owned by the college.

Used Exclusively for Educational Purposes. The Courts have applied this rule to construe “property used exclusively for the purposes of education” to include any facilities that are “reasonably necessary for the fulfillment of a generally recognized function of a complete modern college.” (*Church Divinity School v. County of Alameda* (1957) 152 Cal.App.2d 496) Under this test, the courts have exempted housing for faculty and students, a parking lot (*Church Divinity School*, supra, at pages 505-506), and a golf course, used primarily by alumni. (*Board of Trustees of the Leland Stanford Junior University v. County of Santa Clara* (1978) 86 Cal.App.3d 79). The Court rejected the argument that less than 50% use of the golf course by Stanford students destroys its exclusiveness because of the “special relationship of a university to its alumni.” The Court noted that this test permits each educational institution, rather than some governmental entity, to decide which facilities are reasonably necessary for the generally recognized functions of a complete modern college or the fulfillment of its mission and primary purpose. (*Board of Trustees of the Leland Stanford Junior University*, supra, at page 84).

Given the courts’ broad reading of the term “educational purposes”, the property uses described in Activities #2-#11 would likely qualify. The land held for future development (#12), however, is not in “use” and would not qualify -- except that part used for the biological field station and, possibly, the botanical garden.

The bookstore (#1) is covered by two provisions, Revenue and Taxation Code sections 203, subdivision (d), and 203.1. Personal property of an affiliated bookstore, even if owned and operated by a non-college nonprofit, is exempt under section 203.1, and bookstore real property, even if otherwise exempt under section 203, is taxed based upon the ratio of UBTI income to gross income.

Used...by a Nonprofit Institution of Higher Education. Although a nonprofit 501(c)(3) organization controlled by a group of qualifying colleges, the New CUC is itself clearly not “a nonprofit institution of higher education”. In contrast with the flexibility displayed by the courts in interpreting the term “used exclusively for educational purposes”, the courts have strictly construed “non-profit institution of higher education” to be limited to educational institutions of collegiate grade. See section 203, subdivision (b) in this regard. Thus a nursing school operated incidental to a hospital has been found ineligible for the college exemption, even though a college gave degrees and allowed credit for work done at the nursing school. (*Pasadena University v. County of Los Angeles* (1923) 190 Cal. 786; *Lutheran Hospital Soc. Of Southern Cal. v. County Of Los Angeles* (1944) 25 Cal.2d 254.)

Because the New CUC does not itself qualify as a “nonprofit institution of higher education”, the question is whether the property owned and operated by New CUC will be considered to be “used...by” the CC’s so that the property owned by the New CUC can be eligible for the college exemption – in other words, *does the requirement that the property be “used by” a nonprofit institution of higher education mean that the property be actually operated by the*

qualifying college(s) itself or does property owned and operated by a nonprofit controlled by the qualifying college(s) and whose sole purpose is to serve the college(s) come within the scope of the exemption on agency principles?

We believe that the property owned by the New CUC being used for services and programs of the CC's can qualify on the theory that the New CUC is the agent of the CC's.

An agent is one who contracts to act on behalf of another and is subject to the other's control. (*City of Los Angeles v. Meyers Bros. Parking System, Inc.* (1975) 54 Cal.App.3d 135, 138.) In the possessory interest case of *Pacific Grove – Asilomar Operating Corp. v County of Monterey* (1974) 43 Cal.App.3d 675, the tax exemption on state property was in effect extended to the interest of a nonprofit organization operating on exempt state property under the control of and with the sole purpose of benefiting the principal. In the *Asilomar* case, the court found that a nonprofit organization that had been established for the sole purpose of managing a state conference ground functioned as agent of the state so that the organization did not have a taxable possessory interest. As the court stated in *Asilomar*, “it is clear in California that an agent or representative ‘is liable for the taxes assessed him under the Code only in his representative capacity, and if the property is exempt in the hands of the principal it remains exempt in the hands of the agent. [citations omitted].” The court found that “[t]he relationship that exists between the state and respondent is that of principal and agent”, and used the following test: “[i]n determining whether an agency relationship exists between parties to a business enterprise, which is the subject of an agreement between them, the right to control is an important factor. [Citations.] If, in practical effect, one of the parties has the right to exercise complete control over the operation of the other, an agency relationship exists; the former is the principal and the latter the agent. [Citations].”

To establish the existence of an agency relationship, an agreement or authorization or ratification by the principal is required (see Witkin, 2 Summary of California law, 9th Ed, “Agency and Employment”, section 37), and “whether an agency relationship has been created is determined by the relation of the parties as they in fact exist by agreement or acts and the *primary right of control* is particularly persuasive. (Emphasis added.)” (*Pagan v. Spenser* (1951) 104 Cal.App.2d 588-593.)

The relationship between the CC's and the New CUC is set forth in the Revised Constitution of the Colleges, New CUC Articles of Incorporation and bylaws and is remarkably similar to that of the state and the nonprofit Asilomar as outlined in their management agreement. By adopting the Revised Constitution, the college principals are authorizing the New CUC to act as their agent in owning and operating the property. We see no reason why the agency principle invoked in the Asilomar case (“property exempt in the hands of the principal is exempt in the hands of the agent”) should not apply equally in the context of the college exemption. Like the management agreement between Asilomar and the state, the New CUC Articles of Incorporation and bylaws define its organizational purpose and restrict its operations to benefit its principals – namely the CC's. Like the Asilomar arrangement in which the board of directors is appointed by a state official, the Board of Overseers of the New CUC is controlled by the presidents and board chairs of the member colleges. Also like the Asilomar “concession”, The Consortium is a unique entity.

We would find the following actions, proposed by you, sufficient to document an agency relationship between the New CUC and the Colleges:

- Amendment of the bylaws of the New CUC to provide for a majority of Constituent Overseers on the Board and Executive Committee and to require that a majority of Constituent Overseers is required for a quorum.
- Amendment of the bylaws of the New CUC to include the provisions from the Constitution of the Colleges which describe the role of the New CUC in the institution, replacing the term “group” and member institutions” with “ Colleges.”
- Adoption of the Revised Constitution by the constituent colleges.

Welfare Exemption

You also requested, as an alternative, that we consider the application of the “welfare exemption” to the New CUC property. This analysis would apply in the event that the assessor disagrees with our conclusion that the college exemption can be applied to the New CUC’s property by means of the agency analysis. We conclude that the welfare exemption would not be applicable to the New CUC.

The legislature, in its implementation of Section 4(b), clearly indicated its desire to restrict the exemption available for properties used for higher education to the confines of section 3(e). Section 214 provides, “Except as provided in subdivision (e) [property **owned** and operated by a qualifying college and used exclusively for religious, charitable, scientific or hospital purposes], **this section shall not be construed to enlarge the college exemption.**” (Emphasis added.) New CUC is not itself a qualifying college, and we would not want to apply the agency principals described above to override the legislature’s expressed intent to restrict the welfare exemption.

Conclusion

Property used exclusively for educational purposes by a nonprofit institution of higher education includes property owned and used by an agent of that college if the agent is: (1) nonprofit, (2) controlled by college(s) qualifying under section 203, and (3) operating the property for the exclusive benefit of the qualifying college(s), pursuant to the mandate of the organizational documents of the qualifying college(s) and the nonprofit. In such a circumstance, the tax savings to the nonprofit landowner directly benefits the college(s).

The views expressed in this letter are only advisory in nature; they represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or any public entity. You would be well advised to seek an opinion from the assessor of the county in which the New CUC property is located before making organizational changes to conform to this opinion.

July 27, 2000

Sincerely,

/s/ Susan Scott

Susan Scott
Tax Counsel

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Cc:

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