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January 20, 2017

Mr.
 Chief Real Property Appraiser
 County Assessor's Office

Ms.

**Re: *Welfare Exemption, Low-Income Housing
 Assignment No.: 16-224***

Dear Mr. and Ms. :

This is in response to your letters requesting our opinion regarding the proper application of the welfare exemption to the following low-income rental properties in County: River (River), E (E), and Village (Village)¹ (collectively, the Properties). Each property is owned by a limited partnership, with a managing general partner connected to , formerly known as Housing Association (MHC).² The owner of each property has a Memorandum of Understanding (MOU) with a third-party nonprofit social service provider for specific operations on its property, and each property's laundry room is managed by a for-profit laundry operator. For these reasons, the County Assessor's Office (Assessor) has denied the welfare exemption on portions of the properties. HC maintains that the welfare exemption should be reinstated for those portions of the property denied exemption.

¹ Mr. 's initial letter only addressed G , and the Assessor declined to offer additional analysis on the other two properties and laundry room-related issues when given the opportunity. (See letter to , BOE, May 11, 2016 (May Letter) p. 2; see also letter to , Sept. 16, 2016.) Given the similarities between each property's issues, and the information from the Assessor enclosed in Ms. 's letter (see See letter to , BOE, Sept. 13, 2016 (Sept. Letter), enclosures), we analyze all three properties, as well as the laundry room-related matters.

² Ms. refers to HC as an "umbrella organization" of the managing general partners of the Properties. (See Sept. Letter, p. 1.) We assume that HC has authority to enter into agreements on behalf of the owners' managing general partners and does not interfere with the managing general partners' substantial management duties. HC is also a nonprofit organization and was issued an OCC in April 2013 (OCC No.).

Facts***Nonprofit Social Service Providers****River*

River is owned by R , LP (RLP). (Sept. Letter, p. 1.) RLP's managing general partner is R Corporation (RMGP). (*Ibid.*) On October 12, 2006, HC, an umbrella organization of R Corp, entered into a MOU with The G (R3P) for the provision of social service programs for residents of River . (Mem. of Understanding Between Housing Assn. and The Green (RMOU), p. 1.) Both RMGP and R3P are nonprofit organizations that have been granted Internal Revenue Code section 501(c)(3) status, and both hold a valid organizational clearance certificate (OCC) based on exempt charitable purposes.³ RLP holds a supplemental clearance certificate (SCC) for River , with RMGP as its managing general partner.⁴

R3P is a nonprofit entity that provides after-school tutoring, mentoring, spiritual development, and leadership development for under-resourced youth. (R3P's Web site, *About Us*, at <http://> [as of Dec. 2, 2016].) The MOU outlines an understanding through which R3P will provide River residents after-school tutoring four days per week, a teen youth group one evening per week, and adult English as a Second Language (ESL) classes one day per week. (RMOU, p. 1.) The MOU states that MHC "provides community center space to facilitate resident access to needed services and life enrichment properties" and thus "desires to secure" R3P's services, and R3P "works with disadvantaged communities, low income persons, and immigrant groups" and thus "desires to provide" these services. (See *ibid.*)

MHC grants R3P access to the community room, bathroom, and kitchen facilities at River , and refers its residents to R3P for services. (RMOU, § 2, p. 2; *Id.*, § 3(a), p. 2.) No money appears to be exchanged between the parties, but MHC agrees to "work cooperatively with and support" R3P's efforts to submit funding proposals that would extend and expand the program services offered by R3P to River residents. (*Id.*, § 3(b), p. 2.)

Designated representatives from both nonprofits meet once per month to ensure the program is conducted according to its objectives, and R3P is required to provide "a quarterly written report that describes and evaluates the performance of the previous quarter and overall performance to date" and includes feedback and evaluations from program participants. (RMOU, § 7, p. 2.) Either MHC or R3P may terminate the MOU with 30 days' notice. (*Id.*, § 8, p. 3.) The MOU characterizes the relationship between MHC and R3P as that of "independent contractors." (*Id.*, § 13, p. 3.)

³ River Corporation was issued an OCC in December 2003 (OCC No.), and The Green was issued an OCC in June 2014 (OCC No.).

⁴ River Associates, LP, listing River Corporation, as its managing general partner, was issued an SCC in December 2003 (SCC No.).

E

E is owned by *E* Associates, LP (ELP). (Sept. Letter, p. 3.) ELP's managing general partner is *E* Housing Association (EMGP). (*Ibid.*) On November 1, 2012, MHC, an umbrella organization of EMGP, entered into a MOU with AARP Tax-Aide (E3P), a nonprofit service of the AARP Foundation, to provide *E* residents free income tax preparation services. (Mem. of Understanding By and Among AARP Tax-Aide and *E* / Townhomes and *E* Housing Cal. (EMOU), p. 1.) Both EMGP and E3P are nonprofit organizations that have been granted Internal Revenue Code section 501(c)(3) status, however, only EMGP holds a valid OCC based on exempt charitable purposes.⁵ ELP holds an SCC for *E*, with EMGP as its managing general partner.⁶

MHC's overall mission is to "develop and operate [] affordable housing that builds strong and stable communities through resident participation and leadership development," and EMGP expresses a strong interest in supporting the financial capability of its residents. (EMOU, art. I, § B, p. 1.) MHC has identified that many of its residents pay for expensive tax preparation services and are unaware that they are eligible for free certified assistance due to their low-income status. (*Ibid.*) Therefore, in furtherance of its mission, MHC works to make tax preparation services available on-site by securing free income tax preparation by E3P from February to April. (See *id.*, II, § A, pp. 1-2; see also Sept. Letter, pp. 3-4.)

E3P has access to the computer lab and community room, as well as one or more individual office spaces at *E* during agreed-upon dates and times. (EMOU, art. II, § A, p. 2.) E3P must submit reports regarding the number of individuals served, as well as information about the cumulative refund amounts generated by the return preparation work. (*Ibid.*) Either MHC or E3P may terminate the MOU with 30 days' notice. (*Id.*, art. II, § D, p. 2.) The EMOU characterizes the relationship between MHC and E3P as that of "independent contractors." (*Id.*, art. II, § I, p. 5.)

Village

Village is owned by *S* Mutual Housing, LP (GLP). (Sept. Letter, p.4.) GLP's managing general partner is *S* Mutual Housing, LLC (GMGP). (*Ibid.*) On February 1, 2011, MHC, an umbrella organization of GMGP, entered into a MOU with *Program*, also known as *Shelter Program for Women and Children (G3P)* for a "partnership" between the organizations at various affordable housing communities, including *Village*. (Mem. of Understanding Between *Shelter Program for Women and Children*, *Village Associates*, and *Housing Assn. (GMOU)*, p. 1.) Both GMGP and G3P are nonprofit organizations that have been granted Internal Revenue Code section 501(c)(3) status, and both hold a valid OCC based on exempt charitable purposes.⁷ GLP holds an SCC for *Village*, with GMGP as its managing general partner.⁸

⁵ *E* Housing Association was issued an OCC in December 2003 (OCC No.). AARP Foundation has Internal Revenue Code section 501(c)(3) status (EIN).

⁶ *E* Housing Associates, LP, listing *E* Housing Association as its managing general partner, was issued an SCC in December 2003 (SCC No.).

⁷ *S* Mutual Housing, LLC was issued an OCC in March 2016 (OCC No.), and *Program* was issued an OCC in June 2014 (OCC No.).

⁸ *S* Mutual Housing, LP, listing *S* Mutual Housing, LLC, as its managing general partner, was issued an SCC in March 2015 (SCC No.).

G3P is a nonprofit entity that provides services to homeless families, including employment counseling, job search assistance, and other personal development. (Sept. Letter, p. 6.) The MOU outlines an understanding in which G3P will provide services to and rental subsidies for residents occupying a limited number of residential units at G .⁹ Services provided by G3P include weekly case management and in-home services related to independent living skills (such as personal finance, hygiene, safety, and household chores). (See , letter to , Assessor, June 8, 2016; GMOU, § A(2) and (6), p. 2.) The MOU also requires that G3P provide "a quarterly written report that describes and evaluates the performance of the previous quarter and overall performance to date" and includes feedback and evaluations from program participants. (GMOU, § A(10), p. 2.)

G3P refers potential residents to apply for an affordable unit at G , but MHC is the master landlord and all leases are executed directly with GLP. (See letters to , Assessor, March 18, 2016 and June 8, 2016.) Residents referred by G3P have an income of less than 30 percent of the County Area Median Income and pay 30 percent of their income to GLP as rent. (*Ibid.*) The remainder of the rent is subsidized by G3P. (*Ibid.*) G3P also provides case management for the residents. (*Ibid.*) MHC provides on-site office space to G3P at no extra charge. (GMOU, § B(5), p. 3.) The GMOU characterizes the relationship between MHC and G3P as that of "independent contractors." (*Id.*, § K, p. 5.)

The Assessor is concerned that the MOU, and G3P's activity with relation to the property, may disqualify portions of the property (specifically, the units within G used by residents referred by G3P) from the welfare exemption. (See letter to , BOE, May 11, 2016 (May Letter) p. 2.) Mr. 's letter essentially asks whether the MOU subverts the management authority of the managing general partner, resulting in the disqualification of the units housing residents referred by G3P from the welfare exemption for low-income housing under section 214, subdivision (g) (hereafter section 214(g)). (May Letter, p. 3.)

The Assessor's primary concern regarding all three Properties is whether each property meets the "owned and operated" requirements in section 214, because the Assessor interprets section 214 to mean that in low-income housing situations, the owner and operator must be the same entity or have an "agency" relationship (rather than that of an independent contractor). (See May Letter, p. 2; see also , Assessor, emails to , MHC, Jan. 14, 2016, Jan. 26, 2016, and Dec. 7, 2015.) For each of the Properties above, the other welfare exemption requirements as they relate to low-income housing properties (e.g., deed restrictions, financial eligibility of residents, irrevocable dedication and dissolution requirements) are not at issue. (BOE's phone conversation with and , Oct. 26, 2016.)

MHC's position, as stated by Ms. in her September 13, 2016 letter, is that the Assessor improperly denied the portions of the Properties used by the various third-party nonprofit social service providers, and that the services provided by those third parties are incidental to and reasonably necessary for the provision of low-income housing. (Sept. Letter, pp. 2-3, 4, 6.)

⁹ Residents referred by G3P occupied 18 units in 2014 and 11 units in 2015. (See Sept. Letter, p. 5.)

For-profit Laundry Operators

Each of the Properties' owners also has a lease or license with a for-profit laundry operator. (Sept. Letter, p. 6.) ELP has a license agreement with W Laundry Systems, LLC (W);¹⁰ RLP has a lease agreement with W ;¹¹ and GLP has a lease agreement with C Corporation (C).¹² The agreements require W and C (collectively, the Laundry Operators) to install, maintain, and repair the laundry equipment, and pay the owners a fixed percentage of the revenues received from the residents, as outlined in the respective agreements. (*Ibid.*) The laundry rooms are not open to the general public, and are accessible only to residents of the Properties. (Sept. Letter, p. 7.)

The Assessor denied the welfare exemption for those portions of the property used by the laundry operators because they "do[] not meet the requirements for exemption," presumably because they are operated by for-profit entities, which the Assessor believes makes them ineligible for exemption. (See County, *Welfare or Veterans' Organization Exemption Assessor's Finding on Qualification of Property Use*, RMGP (Jan. 14, 2016); County, *Welfare or Veterans' Organization Exemption Assessor's Finding on Qualification of Property Use*, EMGP (Oct. 28, 2015); County, *Welfare or Veterans' Organization Exemption Assessor's Finding on Qualification of Property Use*, GMGP (Jan. 8, 2016).)

MHC's position is that the Assessor improperly denied the portions of the Properties leased and licensed to for-profit laundry operators because the provision of laundry services is incidental to and reasonably necessary for the provision of low-income housing and the laundry operators are acting as agents of the exempt property owners. (Sept. Letter, pp. 6-7.)

Law & Analysis

All property in this state is taxable unless exempted by law. (Cal. Const., art. XIII, § 1.) Article XIII, section 4, subdivision (b) of the California Constitution authorizes the Legislature to exempt property from taxation which is used exclusively for religious, hospital, or charitable purposes, and which is owned and operated by specified organizations. This is known as the welfare exemption, which is primarily implemented by Revenue and Taxation Code section 214. The welfare exemption is made specifically applicable to certain low-income housing properties under section 214(g), which provides in relevant part that:

Property used exclusively for rental housing and related facilities and owned and operated by religious, hospital, scientific, or charitable funds, foundations, limited liability companies, or corporations, including limited partnerships in which the managing general partner is an eligible nonprofit corporation or eligible limited liability company, meeting all of the requirements of this section . . . shall be deemed to be within the exemption . . . and shall be 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

¹⁰ License By and Between E Housing Associates, LP and W Laundry Systems, LLC (Dec. 11, 2013).

¹¹ Lease By and Between River Associates, LP and W Laundry Systems, LLC (June 25, 2011).

¹² Standard Lease of Laundry Space Between C Corp. and Village Apartments, care of Housing (Jan. 27, 2005).

number of residential units in any year . . . [if all other requirements set forth in section 214(g) are met].

(Rev. & Tax. Code, § 214, subd. (g)(1).)

Nonprofit Social Service Providers

Owned and Operated

For property to qualify for the welfare exemption under section 214(g), the owner and operator must be organized and operated for an exempt purpose and the property must be used exclusively for low-income housing purposes. (Rev. & Tax. Code, § 214, subd. (g)(1).) The property may be owned by one entity and operated by a different entity, so long as both entities are organized and operated for an exempt purpose. (*Christ the Good Shepherd Lutheran Church v. Mathiesen* (1978) 81 Cal.App.3d 355, 363 (*Christ the Good Shepherd*); Rev. & Tax. Code, § 214, subsd. (a), (g).) In *Christ The Good Shepherd, supra*, the court held that the phrase, "owned and operated," as used in section 214, subdivision (a) (hereafter section 214(a)), does not require ownership and operation of the property by the same legal entity. That provision "merely reflects the dual constitutional requirements that the property must be both owned and operated by welfare organizations in order to qualify for the exemption." (*Christ the Good Shepherd, supra*, 81 Cal.App.3d at p. 362; Cal. Const., art. XIII, § 4, subd. (b).) Thus, the owner of property may qualify for the exemption, notwithstanding the fact that its property is used by another organization, but both organizations must meet all the requirements for exemption, and the property must be used for qualifying purposes. The same holds true when the property is used for low-income housing. (Property Tax Annot.¹³ (Annot.) 880.0408 (Mar. 4, 2003).)

Procedurally, the BOE first determines whether the owner is organized and operated for an exempt purpose. (See Rev. & Tax. Code, § 254.6, subd. (b).) If so, it grants an OCC. (*Ibid.*) In the case of limited partnerships owning and operating low-income housing, the BOE must also determine whether an organization functioning as the managing general partner of the limited partnership has sufficient management authority to qualify as a managing general partner of the limited partnership. (Property Tax Rules¹⁴ (Rules) 140.2, subd. (a)-(b) and 140.1, subd. (e).) If so, it grants an OCC to the managing general partner, and an SCC to the limited partnership. (*Ibid.*) Any user of the property on a regular basis, with or without a lease agreement, is considered an "operator" of the property. (Assessors' Handbook Section 267, *Welfare, Church, and Religious Exemptions* (Oct. 2004), p. 14.) When an owner and operator are separate entities, only the owner must obtain an OCC and file a claim for the welfare exemption. (*Jewish Community Center Development Corporation v. County of Los Angeles* (2016) 243 Cal.App.4th 700 (*JCC*).) The county assessor then determines whether the operator is organized and operated for an exempt purpose and whether the property qualifies for the exemption based on the use of the property, and grants (or does not grant) the welfare exemption. (See Rev. & Tax. Code, § 254.5, subd. (b).)

¹³ Property tax annotations are summaries of the conclusions reached in selected legal rulings of BOE counsel published in the BOE's Property Tax Law Guide. (See Cal. Code Regs., tit. 18, § 5700 for more information regarding annotations.)

¹⁴ All "Property Tax Rule" or "Rule" references are to title 18 of the California Code of Regulations.

If property is owned by a limited partnership with a qualifying managing general partner and is used exclusively¹⁵ for low-income housing and related facilities, it may qualify for the welfare exemption under section 214(g), even if the property is operated by another organization, as long as both the limited partnership owner and third-party operator meet the section 214 requirements. (See Annot. 880.0408, *supra*.¹⁶)

We have opined that when a qualifying owner employs a third party as its agent to perform its management functions and tend to the owner's affairs rather than those of the third party, we regard the owner as both the owner and operator for purposes of the welfare exemption and the agent as the owner's representative. (See Annot. 880.0160 (Nov. 12, 1987).) In such cases, only the owner need qualify under section 214. (*Ibid.*) Thus, if R3P, E3P, and G3P are agents of the owners of the Properties, only the owners need qualify as exempt organizations under section 214. Here, RLP, ELP, and GLP do qualify as exempt organizations, as shown by their receipt of SCCs, and their MGP's receipt of OCCs.

However, if R3P, E3P, and G3P do not have an agency relationship with the property owners but are considered operators of the property, the property will still qualify for the welfare exemption if both owners and operators are organized and operated for exempt purposes and if the property is used exclusively for low-income housing, as mentioned above. (See Annot. 880.0408, *supra*.)

At River and Village, both R3P and G3P have received an OCC, which while not required, shows that both properties may be considered *operated* by an organization that is organized and operated for an exempt purpose. At E , E3P does not have an OCC; however, E3P is a tax-exempt organization under Internal Revenue Code, section 501(c)(3), which we believe shows that E3P is also organized and operated for an exempt purpose under section 214(a). Therefore E may also be considered *operated* by a qualifying organization.

Additionally, we have previously opined that providing certain services at a low-income housing development, including case management and referrals, counseling, legal services, and life skills training, is incidental to and reasonably necessary for accomplishment of the exempt purpose. (See Annot. 880.0109 (Dec. 11, 2012).) Likewise, in each of these cases, we believe the

¹⁵ Section 214(a) requires that the property for which the welfare exemption is claimed must be *used exclusively* for an exempt purpose by a qualifying organization. The Revenue and Taxation Code does not specifically define the phrase "used exclusively," but the courts have done so in a series of decisions. The State Supreme Court, following a rule of strict, but reasonable construction, determined that "used exclusively" need not be given a literal interpretation so as to mean the property exempted must be used solely for the purposes stated, to the total exclusion of any other use. (See *Cedars of Lebanon v. County of Los Angeles* (1950) 35 Cal.2d 729, 736 (*Cedars*); see also Assessors' Handbook Section 267, *Welfare, Church, and Religious Exemptions* (AH 267) (Oct. 2004), pt. I, p. 24.) Rather, exclusive use may include any use of the property which is "incidental to and reasonably necessary for the accomplishment of the [exempt] purpose." (*Cedars, supra*, 35 Cal.2d at p. 736; see also *Serra Retreat v. Los Angeles County* (1950) 35 Cal.2d 755, 758; *YMCA v. Los Angeles County* (1950) 35 Cal.2d 760, 767.) The court in *Honeywell Information System, Inc. v. County of Sonoma* (1974) 44 Cal.App.3d 23 further held that in order to be exempt, "such incidental use must be directly connected with, essential to, and in furtherance of the primary use." (*Id.* at p. 28.)

¹⁶ This Annotation suggests that both the owner and operator must file claims for exemption; however, this guidance has been overruled by *JCC*. (*JCC, supra.*, 243 Cal.App.4th at pp. 711-713.) An operator is not required to receive an OCC or file a welfare exemption claim in order for the property to receive the welfare exemption. (*Ibid.*) The operator's only requirement is to be organized and operated for an exempt purpose. (See Rev. & Tax. Code, § 214, subd. (a).)

services provided by the service providers, such as after school programs and ESL classes (G3P), tax preparation services (E3P), case management and life skills training (R3P), are also directly connected to and in furtherance of the owners' exempt purposes and therefore may be considered incidental to and reasonably necessary for the operation of low-income housing. Thus, the Properties appear to be used exclusively for low-income housing, which is a qualifying exempt purpose.

Therefore, regardless of whether the R3P, E3P, and G3P are agents of the owners or independent contractors, the Properties appear to meet the requirements of section 214(g)(1).

Managing General Partner

Pursuant to Rule 140.1, subdivision (a)(6)(C), a "managing general partner" for purposes of section 214(g) is defined, in relevant part, as a general partner that has "material participation" in the control, management, and direction of the limited partnership's business. "Material participation" means, in relevant part, that the managing general partner performs "substantial management duties" on behalf of the limited partnership. (Rule 140.1, subd. (a)(7)(B).) A managing general partner performs "substantial management duties" if it actually performs five or more of the duties listed in Rule 140.1, subdivision (a)(10), such as executing contracts, partnership documents, and reports; disposing of property; and borrowing or paying money on behalf of the partnership. (See Rule 140.1, subd. (a)(10)(A)-(L).)

In the May 11, 2016 letter from the Assessor regarding Village, Mr. expressed concern that operation of the property by G3P may "subvert" the management authority of GMGP. (May Letter, p. 3.) In this case, GLP holds an SCC for Village, which indicates that GMGP has been determined to have sufficient management authority to qualify as managing general partner of GLP. (See Rule 140.2.) Notably the "substantial management duties" requirement is not a limitation on whether another nonprofit qualifying organization may operate the property at all. In this case, it appears that G3P, through operation of its program, is "ensur[ing] that charitable services or benefits . . . are provided . . . to the low-income housing tenants" of specific units, which is one of the substantial management duties GMGP may perform to qualify as a managing general partner of GLP. (See Rule 140.1, subd. (a)(10)(L).) However, unless G3P's involvement means that GMGP no longer performs five or more of the required substantial management duties, this alone is not a barrier to Village receiving the welfare exemption on those portions of the property connected to G3P.¹⁷

The same analysis applies to R3P and E3P. Therefore, in our view, since the owners and operators are organized and operated for exempt purposes, and if the Assessor has determined the Properties are being used exclusively for low-income housing purposes, we see no reason why the welfare exemption should not be applied to those portions of the property used by R3P, E3P, or G3P.

For-profit Laundry Operators

Courts have not disqualified organizations from receiving the welfare exemption merely because they hire a for-profit contractor or service provider to carry out exempt purposes on their property. (See *Santa Catalina Island Conservancy v. County of Los Angeles* (1981)

¹⁷ The "substantial management duties" requirement, of course, may also be met through compliance with the delegation of authority provision found at Rule 140.1, subdivision (d).

126 Cal.App.3d 221 (*Santa Catalina*.) In *Santa Catalina*, the court held that land owned by the Conservancy, a nonprofit corporation, to preserve open space land for recreational and ecological purposes, was exclusively used for charitable purposes, even though independent contractors used the land for intentionally profit-making motor tours and hunting programs. (*Id.* at p. 243-244). The court found that the motor tours provided instructive opportunities to people who may not otherwise be reached, and that hunting was essential to prevent over-grazing. (*Ibid.*) Therefore, even though the programs were intentionally profit-making, the court found that those activities were incidental to and reasonably necessary for the Conservancy's charitable purposes, and therefore did not detract from the property's use for exclusively exempt purposes under section 214(a). (*Ibid.*)

Based on *Santa Catalina*, we believe it is consistent with section 214 that nonprofit organizations may perform exempt activities through hired for-profit service providers.¹⁸ Even so, the property must "not [be] used or operated by the owner or by any other person so as to benefit any officer, trustee, director, . . . or any other person, through the distribution of profits . . . or the more advantageous pursuit of their business or profession." (Rev. & Tax. Code, § 214, subd. (a) (4).) Although the statute does not define the standard against which "more advantageous" is to be compared, the court in *Scripps Clinic & Research Found. v. County of San Diego* (1997) 53 Cal.App.4th 402 has stated that the legislature "intended to preclude persons from obtaining an excessive benefit or a benefit better than a person might obtain through arm's length negotiation—a benefit more favorable than fair market value." (*Id.* at p. 410.) In that case, the court found that the subject agreements were made in good faith at arm's length negotiations, and no party received excessive compensation, consideration, or other advantage above fair market value, in excess of that which would result from arm's length negotiations with other companies, and the agreements effectively accounted for risks. (*Id.* at pp. 413-415.) For these reasons, the court found that the agreements did not benefit the commercial company through the "more advantageous pursuit of its business." (*Id.* at p. 415.)

In this case, it is our opinion that the Properties' owners' engagement with the Laundry Operators is akin to the motor tours and hunting program in the *Santa Catalina* case, in that exempt organizations have hired for-profit entities that are limited in function to furthering the charitable purposes for which they were hired. Here, the Laundry Operators' activities of operating, maintaining, and managing the Properties' laundry rooms are to be performed in furtherance of the exempt purposes of RLP, ELP, and GLP. We believe the Legislature intended and, if asked, a court would find, that the provision of laundry facilities are incidental to and reasonably necessary for the operation of low-income housing, as evidenced by the fact that "laundry facilities" are specifically referenced in the welfare exemption as "related facilities" exempt from taxation. (See Rev. & Tax. Code, § 214, subd. (g)(3)(B).) Here, use by the Laundry Operators, though operated for profit, is incidental to and reasonably necessary for charitable purposes, and therefore does not detract from the Properties' exempt purposes under section 214(g).

Furthermore, it does not appear that either the Laundry Operators are receiving a "more advantageous pursuit of its business" because their agreements appear to have been negotiated at arm's length, and they appear to be receiving the same benefit that any other entity in the same position would have received, with no excessive advantage and with an effective accounting for

¹⁸ Of course, the nonprofit organization must maintain control over the service providers in an active and ongoing manner such that the activities performed are fulfilling the exempt purpose of the nonprofit organization rather than primarily serving the private for-profit interest of the service provider.

risks. (See *Scripps Clinic & Research Found. v. County of San Diego, supra*; see also *Greek Theater Assoc. v. County of Los Angeles* (1978) 76 Cal.App.3d 768.) Neither of the Laundry Operators may use the Properties independently, and their clientele at those locations is constrained to the residents of the Properties as the laundry rooms are not accessible to the general public. Thus, we believe that those portions of the property used for laundry facilities should also qualify for the welfare exemption.

The views expressed in this letter are only advisory in nature. They represent the analysis of the legal staff of the BOE based on present law and the facts set forth herein, and are not binding on any person or public entity.

Sincerely,

/s/ Amanda Jacobs

Amanda Jacobs
Tax Counsel

AJ:yg

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cc: Honorable
County Assessor

Mr. Dean Kinnee (MIC:63)
Mr. David Yeung (MIC:61)
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DAVID J. GAU
 Executive Director

February 10, 2017

Ms.

**Re: Welfare Exemption, Low-Income Housing – Foundation
 Assignment No.: 16-404**

Dear Ms. :

This is in response to your letter requesting our opinion regarding the proper application of the welfare exemption to Apartments (the Property), real property in County owned by , LP (LP). LP has an Independent Contractor Service Agreement (the Agreement) with Communities , Inc. (C or Provider), a third-party nonprofit social service provider, for specific operations on the Property. LP also has lease agreements with two for-profit laundry operators (past and current) for the management of its laundry facilities. Because of these agreements, the County Assessor's Office (Assessor) has determined the Property only qualifies for a partial exemption. You maintain that the welfare exemption should be reinstated for those portions of the Property denied exemption.

Facts

Nonprofit Service Provider

LP owns the Property, a 97-unit apartment community restricted for low-income tenants. (letter to , State Board of Equalization (BOE), Oct. 10, 2016 (Oct. Letter), pp. 1-2.) LP's managing general partner is Foundation (MGP). LP and Provider entered into the Agreement, effective January 1, 2016, for the provision of social service programs for the residents at the Property. (Independent Contractor Service Agreement (Agreement), p. 1.) Both MGP and Provider are nonprofit organizations that have been granted Internal Revenue Code section 501(c)(3) status, however, only MGP holds a valid organizational clearance certificate (OCC) based on exempt charitable purposes.¹⁹ LP holds a supplemental clearance certificate (SCC) for the Property, with MGP as its managing general partner.²⁰ The president of Provider and the president of MGP appear to be the same individual, . (See Agreement, p. 5.)

Provider is a nonprofit entity "dedicated to providing comprehensive human services to low and moderate income residents living at affordable housing communities." (C 's Web

¹⁹ Foundation was issued an OCC in December 2003 (OCC No.). C received Internal Revenue Code section 501(c)(3) status in April 2007 (EIN).

²⁰ , LP, listing Foundation, as its managing general partner, was issued an SCC in August 2008 (SCC No.).

Site, C's Mission, at <http [as of Jan. 19, 2017].) The Agreement outlines an agreement in which LP will engage Provider to provide services and programs to residents at the Property. (Agreement, p. 1.) Provider's services include comprehensive senior services and activities, afterschool education, computer education, exercise, and outreach. (Oct. Letter, p. 2.)

The Agreement states that LP will grant Provider access to the Property, including the computer room, activities director office, swimming pool, and exercise room. (Agreement, § 1(b), p. 1.) LP has the right to approve or disapprove of the products and/or services provided by Provider, as well as the right to set deadlines for their completion; however, LP "acknowledges that it does not and will not control or direct [Provider] with regard to the manner or means in which [Provider] performs duties under [the] Agreement." (*Ibid.*) Provider provides LP a monthly invoice for all services, activities, and supplies incurred in performing the services under the agreement, and LP agreed to pay Provider a maximum of \$6,756.40 for the 12-month period of January 1, 2016 – December 31, 2016. (*Id.*, exhibit A.) Either LP or Provider may terminate the Agreement with 30 days' notice. (Agreement, § 14, p. 3.) The Agreement characterizes Provider as an independent contractor. (See Agreement.)

You state that the Assessor partially denied LP's welfare exemption claim for portions of the Property used by Provider because the Assessor determined Provider to be an independent operator, not an agent of the owner. (Oct. Letter, pp. 1-2.) Presumably, the Assessor interprets section 214 to mean that in low-income housing situations, the owner and operator must be the same entity or have an "agency" relationship. You believe the Assessor improperly denied the portions of the Property used by Provider, and that the services provided by Provider are incidental to and reasonably necessary for the provision of low-income housing. (Oct. Letter, pp. 3-6.)

For-Profit Laundry Operators

The property manager, the Company, entered into a lease agreement with C Corporation (C) in 2009. (Standard Lease of Laundry Space (Apr. 17, 2009); Addendum to Lease of Laundry Space (Apr. 17, 2009).) LP entered into a lease agreement with C, Inc. (CSC), effective March 1, 2016. (Laundry Room Lease Agreement (Nov. 16, 2015).)

The agreements require C and CSC (collectively, the Laundry Operators) to provide, install, and maintain the laundry equipment at the Property. (Oct. Letter, p. 3.) The Laundry Operators pay LP rents and/or fees for use of the facilities, and are permitted to receive income from the tenants' payments for use of the laundry equipment. (See *ibid.*) The laundry room is not open to the general public, and is accessible only to tenants of the Property. (*Ibid.*)

You state that the Assessor denied the welfare exemption for the laundry room because it was operated by for-profit, independent contractors, which presumably the Assessor believes makes that portion of the Property ineligible for exemption. (Oct. Letter, pp. 1-2.) You believe the Assessor improperly denied the welfare exemption on that portion of the Property because the provision of laundry services is incidental to and reasonably necessary for the provision of low-income housing. (Oct. Letter, pp. 6-7.)

Law & Analysis

All property in this state is taxable unless exempted by law. (Cal. Const., art. XIII, § 1.) Article XIII, section 4, subdivision (b) of the California Constitution authorizes the Legislature to exempt property from taxation which is used exclusively for religious, hospital, or charitable purposes, and which is owned and operated by specified organizations. This is known as the welfare exemption, which is primarily implemented by Revenue and Taxation Code²¹ section 214. The welfare exemption is made specifically applicable to certain low-income housing properties under section 214, subdivision (g) (hereafter section 214(g)), which provides in relevant part that:

Property used exclusively for rental housing and related facilities and owned and operated by religious, hospital, scientific, or charitable funds, foundations, limited liability companies, or corporations, including limited partnerships in which the managing general partner is an eligible nonprofit corporation or eligible limited liability company, meeting all of the requirements of this section . . . shall be deemed to be within the exemption . . . and shall be 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 . . . [if all other requirements set forth in section 214(g) are met].

(Rev. & Tax. Code, § 214, subd. (g)(1).)

Nonprofit Social Service Provider

For property to qualify for the welfare exemption under section 214(g), the owner and operator must be organized and operated for an exempt purpose and the property must be used exclusively for low-income housing purposes. (Rev. & Tax. Code, § 214, subd. (g)(1).) The property may be owned by one entity and operated by a different entity, so long as both entities are organized and operated for an exempt purpose. (*Christ the Good Shepherd Lutheran Church v. Mathiesen* (1978) 81 Cal.App.3d 355, 363 (*Christ the Good Shepherd*); Rev. & Tax. Code, § 214, subds. (a), (g).) In *Christ The Good Shepherd, supra*, the court held that the phrase, "owned and operated," as used in section 214, subdivision (a) (hereafter section 214(a)), does not require ownership and operation of the property by the same legal entity. That provision "merely reflects the dual constitutional requirements that the property must be both owned and operated by welfare organizations in order to qualify for the exemption." (*Christ the Good Shepherd, supra*, 81 Cal.App.3d at p. 362; Cal. Const., art. XIII, § 4, subd. (b).) Thus, the owner of property may qualify for the exemption, notwithstanding the fact that its property is used by another organization, but both organizations must meet all the requirements for exemption, and the property must be used for qualifying purposes. The same holds true when the property is used for low-income housing. (Property Tax Annotation²² (Annot.) 880.0408 (Mar. 4, 2003).)

Procedurally, the BOE first determines whether the owner is organized and operated for an exempt purpose. (See Rev. & Tax. Code, § 254.6, subd. (b).) If so, it grants an OCC. (*Ibid.*) In the case of limited partnerships owning and operating low-income housing, the BOE must also

²¹ All further statutory references are to the Revenue and Taxation Code, unless otherwise specified.

²² Property tax annotations are summaries of the conclusions reached in selected legal rulings of BOE counsel published in the BOE's Property Tax Law Guide. (See Cal. Code Regs., tit. 18, § 5700 for more information regarding annotations.)

determine whether an organization functioning as the managing general partner of the limited partnership has sufficient management authority to qualify as a managing general partner of the limited partnership. (Property Tax Rule²³ (Rule) and 140.1, subd. (a).) If so, it grants an OCC to the managing general partner, and an SCC to the limited partnership. (Rule 140.2, subd. (a)-(b).) Any user of the property on a regular basis, with or without a lease agreement, is considered an "operator" of the property. (Assessors' Handbook Section 267, *Welfare, Church, and Religious Exemptions* (Oct. 2004), p. 14.) When an owner and operator are separate entities, only the owner must obtain an OCC and file a claim for the welfare exemption. (*Jewish Community Center Development Corporation v. County of Los Angeles* (2016) 243 Cal.App.4th 700 (JCC).) The county assessor then determines whether the operator is organized and operated for an exempt purpose and whether the property qualifies for the exemption based on the use of the property, and grants (or does not grant) the welfare exemption. (See Rev. & Tax. Code, § 254.5, subd. (b).)

If property is owned by a limited partnership with a qualifying managing general partner and is used exclusively²⁴ for low-income housing and related facilities, it may qualify for the welfare exemption under section 214(g), even if the property is operated by another organization, as long as both the limited partnership owner and third-party operator meet the section 214 requirements. (See Annot. 880.0408, *supra*.²⁵)

We have opined that when a qualifying owner employs a third party as its agent to perform its management functions and tend to the owner's affairs rather than those of the third party, we regard the owner as both the owner and operator for purposes of the welfare exemption and the agent as the owner's representative. (See Annot. 880.0160 (Nov. 12, 1987).) In such cases, only the owner need qualify under section 214. (*Ibid*.) Thus, if Provider is an agent of LP, only LP need qualify as an exempt organization under section 214. Here, LP does qualify as an exempt organization, as shown by its receipt of an SCC, and MGP's receipt of an OCC.

However, Provider does not have an agency relationship with LP because the Agreement characterizes Provider as an independent contractor. Since Provider is not an agent it is an operator of the Property, and the Property will qualify for the welfare exemption only if both owner and operator are organized and operated for exempt purposes and if the Property is used exclusively for low-income housing, as mentioned above. (See Annot. 880.0408, *supra*.) Here,

²³ All "Property Tax Rule" or "Rule" references are to title 18 of the California Code of Regulations.

²⁴ Section 214(a) requires that the property for which the welfare exemption is claimed must be *used exclusively* for an exempt purpose by a qualifying organization. The Revenue and Taxation Code does not specifically define the phrase "used exclusively," but the courts have done so in a series of decisions. The State Supreme Court, following a rule of strict, but reasonable construction, determined that "used exclusively" need not be given a literal interpretation so as to mean the property exempted must be used solely for the purposes stated, to the total exclusion of any other use. (See *Cedars of Lebanon v. County of Los Angeles* (1950) 35 Cal.2d 729, 736 (*Cedars*); see also Assessors' Handbook Section 267, *Welfare, Church, and Religious Exemptions* (AH 267) (Oct. 2004), pt. I, p. 24.) Rather, exclusive use may include any use of the property which is "incidental to and reasonably necessary for the accomplishment of the [exempt] purpose." (*Cedars, supra*, 35 Cal.2d at p. 736; see also *Serra Retreat v. Los Angeles County* (1950) 35 Cal.2d 755, 758; *YMCA v. Los Angeles County* (1950) 35 Cal.2d 760, 767.) The court in *Honeywell Information System, Inc. v. County of Sonoma* (1974) 44 Cal.App.3d 23 further held that in order to be exempt, "such incidental use must be directly connected with, essential to, and in furtherance of the primary use." (*Id.* at p. 28.)

²⁵ This Annotation suggests that both the owner and operator must file claims for exemption; however, this guidance has been overruled by JCC. (*JCC, supra*, 243 Cal.App.4th at pp. 711-713.) An operator is not required to receive an OCC or file a welfare exemption claim in order for the property to receive the welfare exemption. (*Ibid.*) The operator's only requirement is to be organized and operated for an exempt purpose. (See Rev. & Tax. Code, § 214, subd. (a).)

Provider is a tax-exempt organization under Internal Revenue Code section 501(c)(3), which we believe shows that Provider is organized and operated for an exempt purpose under section 214(a). Thus, the Property may be considered *operated* by a qualifying organization.

Additionally, we have previously opined that providing certain services at a low-income housing development, including case management and referrals, counseling, legal services, and life skills training, is incidental to and reasonably necessary for accomplishment of the exempt purpose. (See Annot. 880.0109 (Dec. 11, 2012).) Likewise, in this case, we believe the services provided by Provider, such as senior services and activities, afterschool programs, computer education, and exercise are directly connected to and in furtherance of LP's exempt purposes, and therefore may be considered incidental to and reasonably necessary for the operation of low-income housing. Thus, the Properties appear to be used exclusively for low-income housing, which is a qualifying exempt purpose.

Therefore, regardless of whether Provider is an agent of LP or an independent contractor, the Property appears to meet the requirements of section 214(g)(1).

We note that the president of Provider and the president of MGP appear to be the same individual, _____, who signed the Agreement between Provider and LP in his official capacity. Section 214, subdivision (a)(4) requires that the property must "not [be] used or operated by the owner or by any other person so as to benefit any officer, trustee, director, . . . or any other person, through the distribution of profits . . . or the more advantageous pursuit of their business or profession." "More advantageous," as discussed in further depth below, has been interpreted to include "a benefit better than a person might obtain through arm's length negotiation." (See *Scripps Clinic & Research Found. v. County of San Diego* (1997) 53 Cal.App.4th 402, 410.) However, because we have received no information to the contrary, we assume that section 214, subdivision (a)(4) is not at issue.

For-profit Laundry Operators

Courts have not disqualified organizations from receiving the welfare exemption merely because they hire a for-profit contractor or service provider to carry out exempt purposes on their property. (See *Santa Catalina Island Conservancy v. County of Los Angeles* (1981) 126 Cal.App.3d 221 (*Santa Catalina*).) In *Santa Catalina*, the court held that land owned by the Conservancy, a nonprofit corporation, to preserve open space land for recreational and ecological purposes, was exclusively used for charitable purposes, even though independent contractors used the land for intentionally profit-making motor tours and hunting programs. (*Id.* at p. 243-244). The court found that the motor tours provided instructive opportunities to people who may not otherwise be reached, and that hunting was essential to prevent over-grazing. (*Ibid.*) Therefore, even though the programs were intentionally profit-making, the court found that those activities were incidental to and reasonably necessary for the Conservancy's charitable purposes, and therefore did not detract from the property's use for exclusively exempt purposes under section 214(a). (*Ibid.*)

Based on *Santa Catalina*, we believe it is consistent with section 214 that nonprofit organizations may perform exempt activities through hired for-profit service providers.²⁶ As mentioned above, the property must not be used or operated to benefit any person through the

²⁶ Of course, the nonprofit organization must maintain control over the service providers in an active and ongoing manner such that the activities performed are fulfilling the exempt purpose of the nonprofit organization rather than primarily serving the private for-profit interest of the service provider.

more advantageous pursuit of their business or profession. (See Rev. & Tax. Code, § 214, subd. (a)(4).) Although the statute does not define the standard against which "more advantageous" is to be compared, the court in *Scripps Clinic & Research Found. v. County of San Diego* (1997) 53 Cal.App.4th 402 has stated that the legislature "intended to preclude persons from obtaining an excessive benefit or a benefit better than a person might obtain through arm's length negotiation—a benefit more favorable than fair market value." (*Id.* at p. 410.) In that case, the court found that the subject agreements were made in good faith at arm's length negotiations, and no party received excessive compensation, consideration, or other advantage above fair market value, in excess of that which would result from arm's length negotiations with other companies, and the agreements effectively accounted for risks. (*Id.* at pp. 413-415.) For these reasons, the court found that the agreements did not benefit the commercial company through the "more advantageous pursuit of its business." (*Id.* at p. 415.)

In this case, it is our opinion that LP's engagement with the Laundry Operators is akin to the motor tours and hunting program in the *Santa Catalina* case, in that an exempt organization has hired for-profit entities that are limited in function to furthering the charitable purposes for which they were hired. Here, the Laundry Operators' activities of providing, installing, and maintaining the Property's laundry equipment are to be performed in furtherance of the exempt purposes of LP. We believe the Legislature intended and, if asked, a court would find, that the provision of laundry facilities are incidental to and reasonably necessary for the operation of low-income housing, as evidenced by the fact that "laundry facilities" are specifically referenced in the welfare exemption as "related facilities" exempt from taxation. (See Rev. & Tax. Code, § 214, subd. (g)(3)(B).) Here, use by the Laundry Operators, though operated for profit, is incidental to and reasonably necessary for charitable purposes, and therefore does not detract from LP's exempt purposes under section 214(g).

Furthermore, it does not appear that either of the Laundry Operators are receiving a "more advantageous pursuit of its business" because their agreements appear to have been negotiated at arm's length, and they appear to be receiving the same benefit that any other entity in the same position would have received, with no excessive advantage and with an effective accounting for risks. (See *Scripps Clinic & Research Found. v. County of San Diego*, *supra*; see also *Greek Theater Assoc. v. County of Los Angeles* (1978) 76 Cal.App.3d 768.) Neither of the Laundry Operators may use the laundry facilities independently, and their clientele is constrained to the Property's tenants as the laundry rooms are not accessible to the general public. Thus, we believe that those portions of the Property used for laundry facilities should also qualify for the welfare exemption.

The views expressed in this letter are only advisory in nature. They represent the analysis of the legal staff of the BOE based on present law and the facts set forth herein, and are not binding on any person or public entity.

Sincerely,

/s/ Amanda Jacobs

Amanda Jacobs
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