Oregon State Bar

# NOLS Newsletter

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CONTENTS



## Note from the Chair

*by Kate Kilberg, Catalyst Law LLC, Portland*

Dear Section Members,

Welcome to the Spring 2017 Newsletter from the Nonprofit Organizations Law Section of the Bar! Our theme for this issue is nonprofit property tax issues. Thank you to David Brandon, Robert Manicke, and Nancy Murray for providing some great content.

As always, we would love to hear from you if you would like to increase your participation with NOLS and help keep our Section a rich resource for our community. Please get in touch if you are interested in helping with any of the following projects:

1. Newsletters – We will be publishing another newsletter in the fall, and are looking both for authors and for help with publishing.
2. Website – We would like to be able to update the Section website, and would appreciate help from anyone with an affinity for tech and/or design, or simply a willingness to help.

In addition, please consider using the Section listserv to share what you're working on, post resources or articles that might be of use to the entire group, or ask questions. The listserv can be a great way to build a knowledge base for our entire community. Post contributions at nonprofit@forums.osbar.org.

Wishing you all a wonderful spring and summer!

## Property Tax Exemption for Nonprofits Pitfalls and Planning Points

*by Robert Manicke, Stoel Rives LLP, Portland*

For many nonprofits,[1] Oregon property tax exemption is somewhat of an afterthought. This article gives a brief orientation to some guiding principles before explaining the nuts and bolts of applying for exemption and some common pitfalls.

1 This article uses the term "nonprofit" to refer to an organization exempt from federal income tax and seeking exemption from Oregon property tax based on Oregon's charitable, religious, or educational exemptions as discussed below.

### 1. A Framework for Thinking About Oregon Property Tax Exemption.

#### a. Property Tax Exemption Requires More Than IRC § 501(c) Status.

Property tax exemption, like the tax itself, predates Oregon's statehood.[2] In fact, it also predates the Internal Revenue Code by some 70 years, including what is now Section 501(c)(3). Although the two exemptions share common ancestors dating to the reign of Queen Elizabeth I, they now are at best cousins, with a strong family resemblance but distinct identities.[3] The unique features of Oregon property tax exemption often trip up nonprofit executives, practitioners, and county assessors.

A major difference compared to exemption from income tax is the requirement of exempt "use." Property tax generally is imposed *in rem*, meaning that the property itself—not its owner—is considered to be taxed or exempt.[4] The *in rem* concept also means that it is not sufficient to prove that the property *owner* does charitable work; the *property* also must be used in a way that promotes that work. For that reason, disputes often arise over whether property was diverted to a purpose outside the organization's mission, or left idle.[5]

Originally a single sentence, a number of discrete statutes now confer exemption for different kinds of publicly beneficial use.[6] This article focuses on the property tax exemptions most commonly used by Section 501(c)(3) organizations: the charitable, religious, and educational exemptions.[7] For the most widely used exemptions, Section 501(c) status is necessary but not sufficient, and it certainly is not automatic.

#### b. Property Tax Exemption Requires Proactive and Consistent Attention.

Except in rare cases, a nonprofit must be proactive and persistent in order to obtain and keep property tax exemption. First, the nonprofit needs to apply for the exemption. Deadlines apply, and the assessor has the right to request information and documents to supplement the application. If the assessor denies exemption, the nonprofit can appeal to the Oregon Tax Court, but the nonprofit generally bears the burden of proof that exemption applies. If there is doubt, the law generally requires the court to deny the exemption.[8]

Even after obtaining exemption, a nonprofit needs to be proactive in order to keep it. Common events in the life of a nonprofit can require a new application, including amending a lease, remodeling, and simply changing the way the property is used. Monitoring for these events is especially challenging for thinly staffed organizations, and for nonprofits run by volunteers with frequent turnover. Fortunately for nonprofits, numerous hardship cases have prompted the legislature to enact "bail-out" provisions in the law that allow a nonprofit to apply after the normal deadline.

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2 *Compare* General Laws of Oregon, ch 57 (Jan. 27, 1854), § 4 (Deady 1845-64) (exempting "property of all literary, benevolent, charitable and scientific institutions, incorporated within this state") [cite/quote not verified] *with* ORS 307.130(2) (exempting property of "incorporated literary, benevolent, charitable and scientific institutions"); *see* Robert Manicke, *Property Tax Exemptions in Oregon: Slips and Tips*, Taxation Section Newsletter (OSB), spring 2005, at 1.

3 John Brunyate, *The Legal Definition of* Charity, 61 L Q Rev 268, 269 (1945). [cite not verified]

4 That is why the assessor's main remedy, at least in the case of real property, is to seize the property and sell it, as opposed to forcing the owner to pay the tax from other sources. *See* ORS 311.405 (taxes as lien on property); ORS chapter 312 (foreclosure); *cf.* ORS 311.455 (taxes on personal property as debt owing from owner); ORS 311.651 (same as to certain leased real property).

5 A line of cases holds that property under construction or held in preparation for use may be eligible for exemption. *See Willamette Univ. v. State Tax Comm'n*, 245 Or 342, 345-49 (1966).

6 Numerous exemptions exist for nonprofit housing alone, many of which are available only in specific localities that have opted into an exemption program defined by state law. *E.g.,* ORS 307.515-.548.

7 *See* ORS 307.130 (charitable and various other uses); ORS 307.140 (religious); ORS 307.145 (educational).

8 *See Emanuel Lutheran Charity Bd. v. Dep't of Rev.*, 263 Or 287 (1972) (applying "strict but reasonable" construction of exemption statutes).

### 2. Nuts and Bolts of Applying for Property Tax Exemption.

At this writing, a single set of forms is used to apply for the charitable, religious, and educational exemptions, as well as others.[9] This portion of the article discusses the main requirements for exemption in the general order in which they appear on the forms.

**Legislative Note: SB 181.** A bill that has passed the Oregon Senate and is pending in the House as of this writing would impose new reporting requirements on most nonprofits seeking the charitable exemption in ORS 307.130.[10] These requirements would apply at the time of initial application as well as each year thereafter. In general, a nonprofit would be required to attach its IRS Form 990 and Oregon DOJ Form CT-12 to its application, as well as an explanation of how the nonprofit satisfies the "primary object" test discussed below, how the nonprofit performs in furtherance of its charitable object, the nonprofit's "gift or giving," and the number of days its property is used for "unrelated" purposes.

#### a. Are the Organizational and Use Requirements Satisfied?

**Status as a Nonprofit Corporation.** Each of the forms asks for copies of the nonprofit's "Articles of Incorporation, By-Laws, and proof of your status as a non-profit corporation." Except for certain limited liability companies,[11] every organization seeking a charitable or educational exemption must be a nonprofit corporation, which means it must have been formed under ORS chapter 65 or under the nonprofit corporation act of another state.[12] The statute for religious organizations does not include this requirement, although many religious organizations are formed as nonprofit corporations.

**Exempt Purpose.** Each of the forms asks the applicant to "describe the purpose of the organization," referring to the charitable, religious, or educational purpose. Most organizations can use as a starting point the description in the application for recognition of federal income tax exemption (IRS Form 1023). It is generally better to create an attachment to hold a thorough description (and all other narrative explanations) than to fit this important piece into the space provided on the form. It is common practice to attach the determination letter from the Internal Revenue Service acknowledging exemption from income tax pursuant to IRC § 501(c)(3), and for newer organizations it also may be helpful to attach at least excerpts of the Form 1023 to show lack of private inurement.[13]

A nonprofit seeking the charitable exemption in ORS 307.130 may need to augment its federal statement of purpose to make it clear that it satisfies the following three Oregon-specific requirements:

1. **Separation of funds committed to charitable use**.[14] Although not commonly litigated, this requirement was cited by the Oregon Supreme Court in *Dove Lewis Mem'l Emergency Veterinary Clinic, Inc. v. Dep't of Rev.*, 301 Or 423, 429 (1986). In practice, the requirement may essentially be a duty to keep books and records with sufficient clarity to allow the assessor or a court to verify whether the remaining requirements are satisfied.[15]

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9 If the nonprofit owns the property, use DOR Form OR-AP-RPPTE. If the nonprofit leases from a taxable owner, use Form 150-310-087. If the nonprofit leases from another exempt organization, use Form 150-310-085.

10 *See* Or SB 181, § 1 (2017).

11 ORS 307.022 allows a limited liability company wholly owned by one or more nonprofit corporations to obtain exemption to the extent that all owners would qualify for exemption. *See also* ORS 63.810 (incorporating the federal tax concept that a limited liability company whose sole owner is a nonprofit corporation is disregarded as an entity separate from that corporation).

12 OAR 150-307-0330(2)(e)(B).

13 *See* OAR 150-307-0120(2)(d).

14 *See* OAR 150-307-0120(2)(c).

15 The court in *Dove Lewis* found "no testimony or evidence to indicate whether a fund was established for the original donation by Lewis or for any subsequent funds received by taxpayer to be administered for the benefit of any charitable purpose. The only reference to a fund is that of a 'building fund,' consisting of monies derived from operating revenue and some donations of an undetermined amount." 301 Or at 429.

2. **Charity as the organization's "primary, if not sole, object."**[16] This requirement generally overlaps with the concept of private inurement in federal tax law. Oregon courts have recognized that even an indisputably charitable organization also may provide paying jobs to its employees and provide other incidental benefits to persons who are not the object of charity. The Oregon Tax Court Regular Division recently stated that the "primary object" test asks whether an organization seeking exemption "exists to enrich the private individuals who own or operate it, or whether it exists to benefit society at large without an eye to private gain."[17] For example, in *Dove Lewis*, the Supreme Court held that a 24-hour emergency veterinary clinic failed the "primary object" test in part because its founders likely received referrals for non-emergency follow-up care.[18]

3. **An element of "gift or giving."** This requirement is perhaps the most confusing and difficult to apply. In a pair of recent cases involving two residential addiction treatment facilities, the Oregon Tax Court declined to apply a quantitative approach. The court instead relied on the following four-factor test[19] for "gift or giving," declaring exemption for one facility but not the other:

> "(1) Whether the receipts are applied to the upkeep, maintenance and equipment of the institution or are otherwise employed;
>
> "(2) Whether patients or patrons receive the same treatment irrespective of their ability to pay;
>
> "(3) Whether the doors are open to rich and poor alike and without discrimination as to race, color or creed; and
>
> "(4) Whether charges are made to all and, if made, are lesser charges made to the poor or are any charges made to the indigent."[20]

Despite these decisions, however, and regardless of whether SB 181's percentage-of-expenses report becomes law, a nonprofit applicant should consider the quantitative approach used by the Oregon Supreme Court in *Young Men's Christian Ass'n of Columbia-Willamette v. Dep't of Rev.*, 308 Or 644, 654 (1989). In denying exemption, the *YMCA* court found that the value of fee discounts awarded was less than 4 percent of gross revenues, and the ratio of members receiving discounts to those paying in full was less than 8 percent. A nonprofit that exceeds these ratios may find it advantageous to say so in its application.

**Exempt Use.** The application forms ask the applicant to "describe how you will use the property." Oregon law requires the use of the property to "substantially contribute" to achieving the organization's purposes.[21]

This description should allow the assessor to clearly visualize what happens in every portion of the property and how those activities relate to the exempt purpose. For example:

- In an application for a hospital, it is important to draw out facts about space used for purposes other than treatment and recovery of patients. A cafeteria may be exempt even if it is open to the public, if the application shows that it is primarily used by hospital staff, some of whom need to stay on the premises to be available for emergencies.[22]
- In an application for a nonprofit school it is important not only to list the classrooms, but also to explain how other rooms are used to further the educational purpose, i.e., administrative offices enable curriculum

16 *See SW Oregon Pub. Def. Services v. Dep't of Rev.*, 312 Or 82, 89 (1991) (quoting former OAR 150-307.130-(A), now codified as OAR 150-307-0120(4)(a)).
17 *Corvallis Neighborhood Housing Services, Inc. v. Linn Cty. Assessor*, 21 OTR 95 (2013) (judgment vacated on appeal).
18 *Dove Lewis*, 301 Or 423.
19 The test derives from *SW Oregon Pub. Def. Services*, 312 Or at 87, which in turn quoted former OAR 150-307.130-(A), now codified as OAR 150-307-0120(4)(d)(C).
20 *Serenity Lane, Inc. v. Lane Cty. Assessor*, 21 OTR 229, 236 (2013) (internal quotation marks and citation omitted) (exemption granted); *Hazelden Found. v. Yamhill Cty. Assessor*, 21 OTR 245, 251 (2013) (exemption denied).
21 *Young Men's Christian Ass'n v. Dep't of Rev.*, 268 Or 633, 635 (1974).
22 *See* OAR 150-307-0120(5)(d)(A).

planning, recordkeeping, and supervision of teachers and other staff; storage space contains classroom materials, etc. If any outdoor space is not clearly marked for play fields or paved for parking, the description should explain any educational use that occurs there (for example, nature study or classroom gardens).

If the assessor decides that some of the property is not primarily used in furtherance of the exempt purpose, the assessor may disqualify that portion.[23] An example might be a vacant lot acquired for future expansion but not yet under construction and fenced off to prevent trespassing. It is important to be able to define the scope of this portion clearly to avoid disqualification of property that is eligible for the exemption.

**b. Description of the Property.**

**Describing Real Property.** The forms ask the applicant to "attach a list of all real and personal property you are claiming for exemption," including "detailed and complete descriptions of all property claimed and costs." Especially when a nonprofit will lease office space or a portion of a building, and especially when the lease itself is less than clear, it is important to specify the leased premises on the application. The assessor may maintain only one real property account for the entire property, and the description in the application may be the only way to prove which portion is exempt.

**Describing Personal Property.** With respect to personal property, assessors in different counties have taken different approaches as to the level of detail desired in the property description. Most counties do not insist that a church itemize the number of hymnals or that a school specify the number of paper clips. A general list or a reference to "all personal property" may suffice, based on a phone call to the assessor's office. On the other hand, a private college or a medical center may have equipment of sufficient value that the assessor needs a detailed record to satisfy state tracking requirements. An assessor also may question whether particular property is suitable for the exempt use that the nonprofit is claiming.

**c. What Deadline Governs the Application?**

The general deadline to apply for property tax exemption is April 1, if the nonprofit applicant is using the property for exempt purposes by that date.[24] Although there is no firm deadline for an assessor to act on the application, assessors try to grant or deny applications submitted on or before April 1 in time for the status to be reflected on the property tax bill that the assessor will issue in late October.

If the nonprofit acquires the property after April 1 and before July 1, the application is due within 30 days after the date of the acquisition.[25] This deadline reflects the fact that the taxable or exempt status of property is based on its ownership and use on July 1. Property that is exempt on July 1 remains exempt for the entire tax year July 1 through June 30, even if the ownership and use of the property changes during the tax year.[26]

**Planning Tip:** A nonprofit that leases property should be aware that the 30-day window to apply for exemption begins on the date the lease is "entered into."[27] For example, if a nonprofit signs a lease on July 1 that recites that it is "entered into effective as of June 15," the nonprofit should assume that its deadline for application is July 15, not July 30.

A variety of provisions can rescue a nonprofit that fails to timely apply for exemption, but the cost can be significant. The most commonly used exception allows a nonprofit to apply on or before December 31 without any explanation or any showing of good cause.[28] The minimum late filing fee is $200, and the maximum fee is one-tenth of 1 percent of the property's real market value.

23 *See* OAR 150-307-0120(5)(d)(B).
24 ORS 307.162(1)(a); ORS 307.112(4)(a) (lease is from a lessor whose property is ineligible for exemption); ORS 307.166(3)(a) (lessor is tax-exempt).
25 ORS 307.162(1)(c).
26 ORS 311.410(1).
27 ORS 307.112(4)(a)(A); ORS 307.166(3)(a)(A).
28 ORS 307.162(2)(a)(A).

**Planning Tip:** Note that the maximum fee for a late application is not based on the "assessed value" by which property tax is measured under Measure 50. Rather, the late fee is based on "real market value," which typically is much higher in the case of commercial space. Both values are shown on the property tax bill. For example, in Multnomah County, a new commercial building with a real market value of $1 million would have an assessed value of only $481,200. The late fee in that case would be $1,000, not $481.20.

**d. Issues Specific to Leased Property.**

It seems safe to assume that the vast majority of nonprofits occupy leased space. Applying as a tenant raises some specific issues.

**Selecting the Correct Form.** Oregon historically distinguished between property owned by individuals or businesses and property owned by nonprofits in determining whether a nonprofit tenant can obtain exemption for the property it uses. Those distinctions have largely been eroded by waves of litigation and subsequent legislative changes.[29] A nonprofit applying for exemption as a tenant, however, still needs to know and disclose the taxable or exempt status of the property owner because the Department of Revenue as of this writing maintains two separate forms based on this distinction.[30]

**The Market Rent Requirement.** Special rules require a nonprofit tenant to prove that the amount of rent is "below market."[31] At a minimum, this means that the economic benefit of the exemption must inure to the nonprofit tenant, not to the lessor. The statutory language sets a high bar for the nonprofit:

- It must be "expressly agreed within the lease" that the rent has been set below market.[32] To avoid disputes, the lease should acknowledge that the nonprofit tenant intends to apply for property tax exemption and should incorporate the phrase "the rent *** has been established to reflect the savings below market rent resulting from the exemption from taxation" or words to that effect.[33]
- The assessor must be "satisfied" that the rent is below market, and the assessor may insist on "documentary proof," which may include an appraisal, a rent study of comparables, and actual rent data for the property such as current rent paid by nonexempt tenants and historic rent.[34]

Nonprofits and assessors frequently have litigated over whether a "triple net" lease is sufficient proof that the benefit of exemption inures to the nonprofit tenant. In a triple net lease, the tenant is responsible for property taxes and agrees to indemnify the lessor if property taxes are due. This arrangement is helpful *if* there is no dispute that the amount of rent is otherwise set at market rates. However, an assessor may request documentary proof that the baseline rent is not set above market rate.

**Reapplication if Lease Is Amended or Extended.** Many nonprofit tenants may be unaware that exemption for leased property ends after the tax year in which the lease expires.[35] Assessors recently have begun to specify the end date in exemption letters, but the burden remains on the nonprofit tenant to re-apply if the lease is extended.

Another common problem arises when the lessor and a nonprofit tenant agree to a lease amendment, such as a rent increase, adding a small amount of square footage in an office building, an assignment after the lessor has sold the property, or another routine change. These events end the exemption and require the nonprofit to reapply by the deadlines explained above.[36]

29 *See, e.g., Mercy Health Promotion, Inc. v. Dep't of Rev.*, 11 OTR 207 (1989) (discussing origins and separate evolutions of ORS 307.112 and ORS 307.166), *aff'd on other grounds*, 310 Or 123 (1990).
30 *See supra* note 9.
31 ORS 307.112(1)(b); OAR 150-307-0060(6)-(10) (lease is from a lessor whose property is ineligible for exemption); OAR 150-307-0200(6) (lessor is tax-exempt).
32 ORS 307.112(1)(b).
33 *See id.*
34 ORS 307.112(3); OAR 150-307-0060(7)-(10).
35 *See* ORS 307.112(5)(a); OAR 150-307-0060(1).
36 *See* OAR 150-307-0060(1).

**Planning Tip:** A review of leases twice each year should prevent loss of exemption due to routine amendments or extensions. A review in early March can allow time to reapply by April 1 to address changes that occurred since the previous June. A second review in early June should enable a timely application within the 30-day window for post-April 1 transactions.

**Leased Personal Property.** Many nonprofits lease office equipment and other items through the financing arm of a commercial vendor. High-volume equipment lessors often simply pay property tax on the items and factor that cost into the lease. The lessor typically uses standard lease forms and is unwilling to amend the terms to add the express "market rent" language that Oregon law requires. The nonprofit cannot incorporate the leased equipment into the same exemption application it uses for the premises and would need to file separately for the equipment. The potential tax savings often is not worth the additional effort to a smaller nonprofit, but in cases of high-value equipment, the nonprofit should consider the economics of buying the equipment outright in order to claim the exemption.

**3. Common Traps to Avoid.**

In addition to the potential compliance issues discussed above, two preventable problems often affect nonprofits. Both should be avoidable with a twice-yearly review and potential reapplication, as discussed above.

**Change of Use.** The law is somewhat ambiguous as to whether *any* change in use[37] requires a new application, or whether only a change "to a use that would not entitle the property to exemption" triggers reapplication.[38] Regardless, there are endless scenarios in which the use of property changes over time in response to new economic conditions, a changed business model, or simply changes in personnel. For example, a church might decide to allow an addiction recovery group to meet weekly. A school might offer evening courses to parents. A low-income medical clinic might outsource its billing function to a third party whose personnel are on site. A homeless shelter might have

37 *See* ORS 307.112(5)(a) (exemption for property leased from a taxable owner "continues as long as the use of the property remains *unchanged*" (emphasis added)).

38 ORS 307.162(5)(a). [quote is from ORS 307.162(7)]

# Real Property Tax Exemption for Vacant Land

*by Nancy Murray, Law Office of Nancy B. Murray, Portland*

*Vacant land held for development by a charity whose mission includes acquiring land and building and selling homes to low-income individuals is entitled to real property tax exemption under ORS 307.130(2).*

In *Habitat for Humanity of the Mid-Willamette Valley v. Dep't of Revenue*, 360 Or 257 (2016), the Oregon Supreme Court interpreted ORS 307.130(2)(a) to hold that whether property is entitled to tax exemption turns on the "specific charitable purposes of the taxpayer and the function of the property to serve those purposes." *Id.* at 265. Habitat for Humanity of the Mid-Willamette Valley ("Habitat") acquired several lots to develop into housing for low-income individuals. The Marion County Tax Assessor denied tax exemption by relying on a "bright-line rule" from *Emanuel Lutheran Charity Bd. v. Dep't of Revenue*, 263 Or 287 (1972), that the Assessor interpreted as precluding property tax exemption for vacant lots. The Court rejected such bright-line justification and found that because one of Habitat's purposes, as stated in its Articles of Incorporation, was "to acquire vacant lots and build affordable housing on those lots," 360 Or at 259, the vacant land was being used to further Habitat's purpose and was therefore entitled to tax exemption, *id.* at 267.

The case should provide relief to all nonprofits that develop affordable housing and, like Habitat, sometimes hold land for future development as affordable housing. It would be advisable for the articles of incorporation of such nonprofits to include, as Habitat's did, the purpose of acquiring vacant land and developing the land for affordable housing.

Although decided in September 2016, *Habitat for Humanity* arose out of the 2013-14 property tax year. The 2015 legislature passed legislation now codified primarily as ORS 307.513 to effectively impose parameters on how long Habitat and other similar institutions may hold vacant land "for the purpose of building on the land one or more residences to be sold to" qualifying low-income individuals. ORS 307.513(1)(a). The legislation grants relief only to nonprofits that effectively have a track record of having "sold at least one residence to" qualifying low-income individuals within the 10 years immediately prior to a filing for exemption, ORS 307.513(1), and as long as the land and residence are sold to a qualifying individual within seven years, with one option to extend such period for a total of 10 years, *see* ORS 307.513(2)(a).

ORS 307.513 evidences legislative intent to effectively impose an ultimate 10-year limit on how long Habitat and like nonprofits may hold land without building, transferring, and committing it to individual residential uses. The legislation does not apply to nonprofits and other institutions that hold vacant land to develop into multifamily affordable housing to be rented to low-income individuals, as to whom *Habitat for Humanity* should continue to provide relief. However, with respect to the use of developed property for occupancy by low-income tenants, ORS 307.130(2)(a) allows for an exemption but only if granted prior to or as of July 1, 2012. *See* Or Laws 2014, ch 7 (HB 4039). Even such limited benefit sunsets on July 1, 2022 and so remains of concern to housing nonprofits statewide. *See* Or Laws 2016, ch 40 (HB 4081); *see also* Dustin R. Swanson & Robert T. Manicke, *Property Tax Exemption for Low-Income Housing Judgment and Opinion in Corvallis Neighborhood Housing Case Vacated!*, NOLS Newsletter, Spring 2015.

# High Hurdles and Hidden Hazards: Oregon's Unpredictable Property Tax Exemption

*by David J. Brandon, Miller Nash Graham & Dunn LLP, Portland*

Although it is widely understood that tax exemption generally requires more than simply forming an organization as a nonprofit, there remains a somewhat widespread misconception that any organization formed as a nonprofit and described in Section 501(c)(3) of the Internal Revenue Code will likewise qualify for exemption under Oregon's property tax regime.[1] On the contrary, all real and tangible property in Oregon is subject to tax unless specifically exempted.[2] There are a number of such exemptions, but only one in particular precludes assessment of tax on the property of qualified benevolent or charitable institutions.[3] As discussed in this article, qualification for exemption is not a foregone conclusion and many organizations may face significant hurdles to qualification.

### A. Charitable Institution Property Tax Exemption Generally

The exemption for the property of an institution applies only if the organization is actually qualified as a charitable institution in the conduct of its charitable purpose.[4] Thus, two elements must be met to determine whether property is excluded from taxation under ORS 307.130: the organization seeking exemption must be a charitable institution and the property must be exclusively used in the organization's charitable work.[5]

#### 1. Qualification as a Charitable Institution

Regulations promulgated by the Oregon Department of Revenue clarify that a charitable institution must meet certain requirements. First, the organization must be a nonprofit corporation.[6] It must separately account for

1 All references to the "Internal Revenue Code," "Code," or "IRC" are to the Internal Revenue Code of 1986, as amended, 26 U.S.C.
2 ORS 307.030.
3 ORS 307.130.
4 ORS 307.130(2)(a).
5 *Corvallis Neighborhood Hous. Servs., Inc. v. Linn Cty. Assessor, 21 OTR 95, 100 (2013).*
6 OAR 150-307-0120(2)(a), (b).

resources allocated to charitable purposes.[7] It must not operate for the benefit of its founders or officials.[8] And finally, the organization's bylaws "must require that its assets be used for charitable purposes when the organization dissolves."[9] Many readers will understand that the first, third, and fourth of these regulatory elements will be satisfied by organizations exempt from federal income taxation under Internal Revenue Code Section 501(c)(3).

In contrast, the Oregon Supreme Court limits its inquiry to the following three elements: "(1) the organization must have charity as its primary, if not sole, object; (2) the organization must be performing in a manner that furthers its charitable object; and (3) the organization's performance must involve a gift or giving."[10]

**a. Charitable Purpose**

Courts look to the organization's purpose as stated in its articles of incorporation and bylaws as prima facie evidence of a charitable purpose.[11] The bar appears to be fairly low with respect to satisfying this element. For example, the Oregon Tax Court has found charity to be the sole purpose of an organization where the organization's articles of incorporation stated that "'[t]his corporation is intended to be a charitable corporation,'" the corporation was recognized as tax exempt by the Internal Revenue Service, and the articles of incorporation required use of the corporation's assets for charitable purposes upon dissolution.[12] In fact, the Oregon Tax Court has found a taxpayer's bylaws sufficient to prove the taxpayer's charitable purpose even when the bylaws make only "vague" statements of the taxpayer's intention that the organization be operated for "charitable, scientific and educational purpose[s]."[13]

**b. Performance in Furtherance of Charitable Purpose**

To satisfy the requirement that the taxpayer's activities further its charitable object, the activities of the taxpayer must substantially contribute to a charitable purpose.[14] By regulation, the Department of Revenue has clarified that this requires the organization's activity to be "for the direct good or benefit of the public or community at large."[15] Furthermore, the Department dictates, the organization's activity must not be primarily for the benefit of its members.[16]

The regulation has engendered some angst amongst taxpayers, as the "direct benefit" concept has been used to deny exemption where an organization's mission involves contributing money, property, or services to other nonprofit organizations.[17] "Direct benefit" does not, however, fully capture the dividing line between charitable and noncharitable conduct. The Tax Court clarified that providing an indirect benefit to the public may nonetheless support a claim for exemption if the benefit is provided "for the direct good or benefit of the public rather than primarily for the benefit of the organization's members."[18]

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7 OAR 150-307-0120(2)(c).
8 OAR 150-307-0120(2)(d).
9 OAR 150-307-0120(2)(e).
10 *Sw. Or. Pub. Def. Servs., Inc. v. Dep't of Revenue, State of Or., 312 Or 82, 89 (1991).*
11 *Dove Lewis Mem'l Emergency Veterinary Clinic, Inc. v. Dep't of Revenue, 301 Or 423, 427 (1986).*
12 *Serenity Lane, Inc. v. Lane Cty. Assessor, No. TC-MD 101243C, 2012 WL 880657 at *6 (Or Tax Mag Div Mar. 7, 2012) (brackets in original) (quoting plaintiffs' exhibit); see also, e.g., We Care Or. v. Wash. Cty. Assessor, No. TC-MD 091226B, 2010 WL 4655319 (Or Tax Mag Div Nov. 18, 2010).*
13 *Catland v. Yamhill Cty. Assessor, No. TC-MD 100353B, 2011 WL 664752 at *4 (Or Tax Mag Div Feb. 24, 2011).*
14 *We Care Or., 2010 WL 4655319 at *4.*
15 OAR 150-307-0120(4)(b).
16 *Id.*
17 *See Grantmakers for Educ. v. Multnomah Cty. Assessor, No. TC-MD 021216E, 2003 WL 22119790 (Or Tax Mag Div Aug. 21, 2003).*
18 *The Enter. for Emp't & Educ. v. Marion Cty. Assessor, No. TC-MD 070841C, 2001 WL 36284750 at *3 (Or Tax Mag Div Oct. 16, 2001); Tivnu: Bldg. Justice v. Multnomah Cty. Assessor, No. TC-MD 150486R, 2016 WL 6752345 (Or Tax Mag Div Nov. 15, 2016).*

### c. Performance Involves Element of Giving

Qualification as a charitable institution requires not only that the organization have a charitable purpose that is furthered by the organization's operations, but also that the organization's operations actually translate its charitable intentions into "concrete and tangible reality."[19] This inquiry is sometimes reviewed in terms of the extent of the taxpayer's "giving" with relation to its overall income. The Supreme Court of Oregon has found that overall giving of less than 4 percent of a charitable organization's income and a ratio of scholarship members to paying members of less than 8 percent were insufficient to support a finding that the organization was engaged in charitable giving under the property tax exemption.[20] Using this benchmark, the Oregon Tax Court found no element of giving in a case in which only about 10 percent of the taxpayer's patients received a reduced rate for alcohol-abuse treatment.[21] Likewise, a university bookstore's "giving" constituting less than half of 1 percent of its revenues was clearly insufficient to satisfy the third prong of the charitable institution test.[22] In contrast, an organization was engaged in giving to the satisfaction of the court when its total cash and service giving was 58 percent of its total revenue in one year and 83 percent the next.[23]

The element of "giving" can be established by a taxpayer in a number of different ways, including performance of volunteer services or providing services for below-market fees. Substantiating the value of a taxpayer's charitable giving is dependent on the taxpayer's particular circumstances and often implicates guidelines specific to the type of giving engaged in by the taxpayer. Those guidelines can be nuanced and are beyond the scope of this article.

### 2. Use of Property for Charitable Purpose

If the court is satisfied that the organization claiming exemption is a charitable institution, the exemption will apply only to the organization's property that is "actually and exclusively" used for charitable uses.[24] Indeed, to be exempt from property tax, the "charitable use * * * must be the primary as distinguished from the incidental use" and must "substantially contribute to achieving the organization's purposes."[25] In many instances this is a fairly straightforward application. But organizations rarely undertake strictly those activities that fit within the obvious scope of their charitable purpose, particularly where an organization has significant administrative burdens or financial pressures increase time and effort expended on donor solicitation and grant writing. Fortunately, the Oregon Tax Court has been willing to recognize the reality that office space used by organizations to write grants, plan events, and distribute donations can substantially contribute to the organization's charitable purpose.[26]

Another area of confusion for many organizations can arise where donors donate real property to the taxpayer, often through a testamentary gift. Merely holding real property as an investment will rarely qualify for tax exemption, and the recipient organization should take care in this respect, even if the organization intends to use the property for some charitable purpose in the future. Indeed, the Department of Revenue has traditionally denied property tax exemption for vacant property held for future use unless and until construction began on the property.[27] The turning point came in late 2016, when the Supreme Court of Oregon ruled that holding vacant property for future use was

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19 *YMCA of Columbia-Willamette v. Dep't of Revenue, 308 Or 644, 653 (1989) (internal quotation marks and citation omitted).*
20 *Id. at 654.*
21 *Serenity Lane, 2012 WL 880657 at *7; see also Hazelden Found. v. Yamhill Cty. Assessor, 21 OTR 245 (2013) (disallowing exemption for taxpayer that reduced fees for 25 to 30 percent of patients and donated 7 percent of total revenues).*
22 *Portland State Univ. Bookstore v. Multnomah Cty. Assessor, No. TCMD 060824C, 2009 WL 323496 (Or Tax Mag Div Jan. 29, 2009).*
23 *We Care Or., 2010 WL 4655319; see also Or. State Univ. Found. v. Benton Cty. Assessor, No. TC-MD 080847B (Or Tax Mag Div Oct. 5, 2010) (exemption permitted because taxpayer's giving was 65 percent of total revenue).*
24 ORS 307.130(2)(a).
25 *We Care Or., 2010 WL 4655319 at *9 (internal quotation marks and citations omitted).*
26 *See id.*
27 *Habitat for Humanity of the Mid-Willamette Valley v. Dep't of Revenue, 360 Or 257, 262 (2016) (en banc) (citing Emanuel Lutheran Charity Bd. v. Dep't of Revenue, 263 Or 287 (1972)).*

an actual and exclusive use of the property in furtherance of the mission of Habitat for Humanity because part of the charitable mission of the organization is to act as a property developer.[28]

Even in instances where the organization's mission deviates entirely from real property development, vacant or undeveloped property is no longer clearly nonexempt if the organization conducts some level of activity to prepare the property for future use. For example, undeveloped and overgrown land being cleared and developed by a nonprofit organization for future use as a retreat center was deemed to be used for the organization's exempt purpose despite the organization's glacial speed in performing the development activity.[29] Part of this determination hinged on the organization's thin capitalization; it is not likely acceptable for an organization to claim exemption while performing meager preparation activity, if the organization is financially capable of making greater progress.

**B. Potential for Policy Shift**

At the time of this writing, the Oregon legislature is contemplating a number of changes to the property tax exemption regime applicable to charitable institutions. Although the legislature is considering a number of changes, it is by no means certain that any changes will actually occur or what form any such changes would take. Any discussion of proposed legislation, therefore, is meant purely to illustrate the potential for change looming on the horizon.

One of the more innocuous proposals would require the Department of Revenue to conduct a study of the property tax exemption for nonprofit corporations.[30] Although the Bill hasn't generated much buzz or gained much traction in the legislature, it is indicative of a growing sense of suspicion relating to perceived abuse of the charitable exemption. To curb any perceived abuses and improve compliance, a separate proposal would require charitable institutions to file information returns with the county assessors, describing the institution's basis for exemption and enclosing the organization's most recent Form 990.[31] While the additional reporting concept is good in theory, additional reporting could increase administrative burdens on organizations in the state and may be used to undermine exemptions for qualified applicants. For instance, one version of the Bill limits the applicant's explanation of its basis for exemption to 100 words. This approach may work well on Twitter, but is not as useful for describing complicated economic and legal concepts.

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28 *Id. at 266-68.*
29 *Circle of Children v. Lane Cty. Assessor, No. TC-MD 150500C, 2017 WL 519562 (Or Tax Mag Div Feb. 8, 2017).*
30 HB 2052 (2017).
31 SB 181 (2017).

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# Upcoming Events

TWENTY-NINTH

NORTHWEST PLANNED GIVING ROUNDTABLE

ANNUAL CONFERENCE

— Save the date for the 2017 Annual Conference —

Thursday, September 28, 2017
Hilton Portland & Executive Tower,
921 Southwest 6th Avenue, Portland, Oregon
8:00 a.m. — 5:00 p.m.

# IRS Updates

## New Tax Benefit for Benefit Companies

*by Kimberly Pray, Catalyst Law LLC, Portland*

Benefit companies now enjoy a new tax advantage over traditional corporate entity types. In October 2016, the IRS announced that benefit companies' advertising expenses are deductible as a business expense, even when the payment is made to a nonprofit organization.[1]

In 31 states, businesses have the option to incorporate as a "benefit company." The designation allows owners and corporate boards to make decisions based on more than just profitability, but requires additional reporting requirements.

As a result of the new IRS position, benefit companies now could enjoy a tax advantage over traditional legal entities. Under Section 162 of the Code, benefit corporations can deduct 100 percent of their gifts or payments to charity as an ordinary and necessary business expense, even if the payments are made to nonprofits, provided those gifts or payments 1) are made with a reasonable expectation of financial return, and 2) bear a direct relationship to the benefit company's trade or business.

The "promotional payments" deductible could encourage benefit companies to contribute to nonprofits because of the advantage over simply making a charitable gift. Under Section 170 of the Code, corporate charitable gifts, made without receiving anything in exchange, are generally limited to 10 percent of the corporation's taxable income. Individuals' charitable contribution deductions are generally limited to 50 percent of the taxpayer's contribution base. For benefit companies taxed as corporations or partnerships, the 100 percent deduction for payments made to nonprofit organizations as a business expense clearly presents an exciting opportunity.

To differentiate a charitable gift from a promotional payment, a benefit company needs to consider its return on investment. For example, benefit companies need to document promotional payments in writing, such as in corporate minutes or correspondence to the recipient. Also, benefit companies need to make sure the expected return is commensurate with the amount paid. For example, just as with any business expenditure, a $100,000 expense likely does not justify the sale of $100 in goods or services.

1 General Information Letter 2016-0063

# Moratorium on IRS Guidance

*by Kate Kilberg, Catalyst Law LLC, Portland*

At a conference in New York sponsored by the Practising Law Institute on February 13, 2017, Treasury and IRS officials discussed two new Trump administration policy changes limiting substantive IRS guidance for "a while." The first policy is the administration's unusual "one-in, two-out" executive order, which generally requires agencies to eliminate two regulations for every new regulation issued. The second policy regarding the freeze of all regulation comes from a January 20 White House memorandum issued by Chief of Staff Reince Priebus.[2]

Robert Wellen, IRS Associate Chief Counsel (Corporate) said, "The Chief Counsel's office has been in communication with Treasury about how this kind of regime might affect the tax regulatory process…. Discussions continue. Read your newspaper. I don't know how this is going to come out." He added that the restriction on new guidance is "very broad" and that the IRS is no longer submitting guidance to the Federal Register or to the Internal Revenue Bulletin beyond the most routine administerial guidance, such as updates to interest rates or mileage allowances. He noted that the agency will continue to release private letter rulings and chief counsel advice memoranda.

On another panel at the same conference, Treasury Deputy Tax Legislative Counsel Krishna Vallabhaneni explained that the lack of new guidance was related to the new administration's "interest in pushing tax reform, and so at least in the Office of Tax Policy, that's going to be taking a lot more bandwidth than in prior years…." He went on to say, "[I]t doesn't make a whole lot of sense to throw resources at putting out new regulations based on the old tax rules." Vallabhaneni said he will not be reviewing the projects on the priority guidance plan as he typically does every year, and that the Office of Tax Policy has been engaged in tax reform efforts.[3]

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2 https://www.whitehouse.gov/the-press-office/2017/01/20/memorandum-heads-executive-departments-and-agencies

3 For more information, see http://info.taxnotes.com/no-substantive-irs-guidance-coming-for-a-while-official-says?_hsmi=43888826&_hsenc=p2ANqtz-8ANcYKiZfkyDROZQye2518kwiRlTHz686dRcnD24JntUAT93wxsujyF41JOGYW8iGtsqYt3OfjkpeT7zXLfnjOaICmZA&utm_content=43863173&utm_medium=email&utm_source=hs_email&submissionGuid=9d933e7f-0491-4fe0-9f5b-760286601e5c