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# california loosens its geographically-based restriction on property tax exemptions for nonprofits

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*MSK Client Alert*

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**practice areas**

nonprofit organizations

While California's Board of Equalization continues to deny property tax exemptions to charities that do not "primarily benefit persons within the geographical boundaries of the State of California,"<sup>1</sup> pursuant to a new Letter to the Assessors issued December 7, 2011, the "primarily" standard is met if the charitable activities performed by the nonprofit confer some "meaningful," "important," or "significant" benefit to persons within California.<sup>2</sup>

Known as the "welfare exemption," property used exclusively for religious, hospital, scientific, or charitable purposes, and owned and operated by nonprofits organized and operated for such purposes, generally is exempt from California property tax. The Board's geographically-based benefit requirement for qualification under the welfare exemption is known as the "community benefit test." The 2011 Letter now specifically indicates that "[i]n no event ... is the community benefit test applied on a strict mathematical basis with a threshold over which the test is met (e.g., 50 percent or more of the activities must benefit the California community) and under which the test fails."

In our prior Alert on this issue,<sup>3</sup> we called into question this geographically-based "community benefit test," noting that "the geographical restriction is not provided for in, and indeed appears contrary to, the relevant provisions of the Constitution of the State of California, the Revenue and Taxation Code, court rulings (including Stockton Civic Theater), and the Assessor's Handbook." In the *New York Times* article that followed, I pointed out another major flaw in the Board's geographically-based test: "I think it's clearly a violation of the commerce clause of the Constitution, and it may also be a violation of the equal protection clause, given the uneven application of the standard."<sup>4</sup>

The 2011 Letter is a welcome loosening of the amount of California benefit required by the test. Nonetheless, the need for such "clarification" and the 2011 Letter itself stand as further testament that the test is misguided and should be

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replaced with what the law actually requires – that the charitable activity benefit the community as a whole or an unascertainable and indefinite portion thereof, commonly known as the public purpose test.

In the 2011 Letter, the Board admits that "it is difficult, if not impossible, to determine what exact benefits should be measured in determining whether the California community is served, and thus, to what extent the California community is benefitted. Many activities, in fact, such as scientific research, are not limited to a particular location, nor are the benefits that accrue limited to a particular place or group of people." As a result, "staff does not attempt to quantify the benefit conferred by a particular charitable activity unless the charitable activity easily lends itself to quantification, as, for example, with organizations whose sole activities are making grants." Apparently, the staff is instead in the difficult position of having to make qualitative assessments of the California benefit conferred by the full spectrum of religious, hospital, scientific, and charitable activities engaged in by nonprofits.

Private foundations and other grant-making organizations should carefully consider the fact that the 2011 Letter indicates that the Board will attempt to quantify the extent to which the California community is benefitted by their grants. While the staff apparently finds that grant-making "easily lends itself to quantification," it does not indicate why that is or how such quantification is done. For example, it is unclear how the Board would view a private foundation that makes a "meaningful," "important," or "significant" percentage of its grants to California charitable organizations that all work for international causes.

The 2011 Letter further provides that "[e]ven in situations where quantification of charitable activities benefitting the California community is possible, all facts and circumstances are considered to determine whether the test is met even in situations where the California community receives only a small percentage of benefit from the charitable activities."

It is helpful if not somewhat peculiar that a "small percentage of benefit" can allow an organization to "primarily" benefit California under the test. Nonetheless, it appears that nearly any organization that otherwise qualifies for the "welfare exemption" can characterize something it does as providing a "meaningful," "important," or "significant" benefit to the California community. As a result, whether the benefit is quantifiable or not, the Board's geographically-based community benefit test may effectively be written out of the rulebook by the staff's application thereof – a further indication that it should be done away with entirely and the "public purpose test" reinstated in its place.

In any case, if your nonprofit does not clearly confer some "meaningful," "important," or "significant" benefit to persons within California, you may wish to consider carefully the implications of the State Board's position on your organization's ability to qualify for or maintain its exemption from property tax.

If you have any questions about this Alert, please contact the author or any member of the MSK Charitable Sector Practice Group.



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1. Letter in the author's possession, dated November 17, 2010, from the California Board of Equalization to an organization with international charitable aspirations.
2. California State Board of Equalization Letter to Assessors (12/7/2011), No. 2011/044, herein the "2011 Letter." The 2011 Letter clarifies the "use of the term 'primarily' in the administration and application of the community benefit test to a charitable organization's claimed charitable activities for purposes of the welfare exemption."
3. California Enforces New Isolationist View on Property Tax Exemptions for Nonprofits, MSK Charitable Sector Alert (August 4, 2011). The Alert discussed the California State Board of Equalization Letter to Assessors (5/2/2008), No. 2008/034.
4. Stephanie Strom, *California Scrutinizes Nonprofits, Sometimes Ending a Tax Exemption*, New York Times (August 14, 2011).