

Publications

Are 501(c)(3) Nonprofit Organizations Subject to Real Property Taxation?

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Hilary Houston, an associate in the Vorys Columbus office and a member of the tax and probate group, authored an article for the January/February 2021 issue of *Taxation of Exempts*, a Thomson Reuters journal about whether 501(c)(3) nonprofit organizations are subject to real property taxation.

"Nonprofit organizations are often perplexed when they receive tax bills from their local tax assessors for real property taxes. A common question from these nonprofits is: We are exempt from taxes, so why are we receiving tax bills?"

Exemption is not automatic

Rarely does the fact that an organization is a nonprofit automatically exempt that organization from paying real property taxes. Nonprofits often confuse their real property tax liability with their federal income tax liability. Real property taxes are local taxes imposed either by a county and/or, in some instances, by a municipality. An organization's nonprofit status may be important for purposes of qualifying for a real property tax exemption. However, the fact that a nonprofit is recognized by the Internal Revenue Service as being described in Section 501(c)(3) of the Internal Revenue Code is generally not the determining factor and, in some states, it is not even relevant to the analysis.

The general rule in most, if not all, states is that taxation is the rule and exemption is the exception. Accordingly, statutes granting exemptions are strictly construed and applied. State Legislatures that enact legislation to exempt certain taxpayers or certain types of property from paying taxes must be able to justify such exemptions, because tax exemptions indirectly place a larger tax burden on others that are not exempt.

In the case of real property tax exemptions, it means for every property that is removed from the list of taxable property in one taxing jurisdiction, other taxpayers in that taxing jurisdiction, such as

individual homeowners or businesses, pay more tax. This is true because real property taxes are generally imposed to generate a certain amount of revenue — revenue needed for things like libraries, police and fire, municipalities, townships, and school districts. For every property that is not taxed, other properties must be taxed at a higher tax rate to make-up for the lost tax revenue associated with the tax-exempt property. Thus, the question should arguably never be: Why are we being taxed? Instead, the better question is: Why should we not be taxed?

Exemption based on use of property

In Ohio, whether property is exempt from taxation is generally determined based upon the use of the property. While ownership of the property may be relevant, especially in instances of public ownership, how the property is used is generally the focus of the tax officials in reviewing real property tax exemption requests. In fact, real property tax exemptions in Ohio are often referred to as “use-based exemptions.”

In places like California, Pennsylvania, and Massachusetts, both ownership and use are important. California’s State Constitution provides for what is known as a “Welfare Exemption” that exempts from real property taxes property that is used exclusively for religious, hospital, or charitable purposes and owned by corporations or entities that meet certain requirements. In Pennsylvania, certain property is deemed exempt from real property taxes, including property owned by institutions of purely public charity and regularly used by such institutions. Similarly, in Massachusetts, property owned by charitable organizations and occupied and used for charitable purposes is exempt from real property taxes.

Where states allow real property tax exemptions for nonprofit organizations, the question of whether an institution or property use is “charitable” may be at the heart of the review. As noted above, the fact that an institution is recognized by the IRS as a 501(c)(3) is often of little value. Instead, what qualifies as “charity” is often left to a state’s courts to define.

In Pennsylvania, a “purely public charity” may qualify for a real property tax exemption, but a “purely public charity” is not statutorily defined. Rather, the Pennsylvania Supreme Court has defined “purely public charity” using a five-prong test often referred to as the “HUP Test.” To qualify as a “purely public charity,” an entity must meet all five prongs of the test, which includes (1) advancing a charitable purpose; (2) donating or rendering gratuitously a substantial portion of its services; (3) benefiting a substantial indefinite class of persons who are legitimate subjects of charity; (4) relieving the government of some of its burden; and (5) operating entirely free from private profit motive.

The HUP Test is strictly applied. For example, the Commonwealth Court of Pennsylvania denied real property tax exemption to a nonprofit organization whose mission was to assist in the search and recovery of missing children, because the organization failed the fourth prong of the HUP Test that requires an entity to relieve the government of its burden. The trial court noted that it was unclear whether the organization’s members were qualified to assist law enforcement and, regardless, the law does not favor the delegation of law enforcement duties.

In Ohio, property used exclusively for charitable purposes may qualify for real property tax exemption, but “charity” is not statutorily defined. Instead, like in Pennsylvania, “charity” is defined by the courts in Ohio. The Ohio Supreme Court is less precise, however, than the Pennsylvania Supreme Court on what “charity”

means for purposes of real property tax exemptions. According to the Ohio Supreme Court, "charity" is "the attempt in good faith, spiritually, physically, intellectually, socially and economically to advance and benefit mankind in general, or those in need of advancement and benefit in particular, without regard to their ability to supply that need from other sources, and without hope or expectation, if not positive abnegation, of gain or profit by the donor or by the instrumentality of the charity." In other words, it is very much like the old "I know it when I see it" definition that the United States Supreme Court Justice Potter Stewart advanced as the definition of pornography in a case, ironically, also out of Ohio.

Not surprisingly, what qualifies under the somewhat obscure definition of "charity" has been litigated over the years in Ohio. In fact, the Ohio Tax Commissioner appealed a real property tax exemption for the Girls Scouts all the way to the Ohio Supreme Court. The Tax Commissioner had denied real property tax exemption to the Girl Scouts. The court ultimately found that the Girl Scouts and, specifically, the store the Girl Scouts operate to sell uniforms, sashes, badges, and related apparel, qualifies for real property tax exemption as being used for charity. What is most perplexing about this case is that the Tax Commissioner was not just unsure whether the Girls Scouts should qualify for the charitable exemption, but that the Commissioner was so adamant that the organization should not qualify that he appealed a lower tribunal's decision all the way to the Ohio Supreme Court."

View the full article in the January/February 2021 issue of Taxation of Exempts, a Thomson Reuters journal.

About Vorys: Vorys was established in 1909 with just four attorneys and has grown to nearly 375 attorneys in eight offices in Ohio, Washington, D.C., Texas, Pennsylvania and California. Vorys currently ranks as one of the 200 largest law firms in the United States according to American Lawyer magazine.