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REAL PROPERTY TAX EXEMPTION— CURRENT TRENDS AT THE STATE LEVEL

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The increased demands for, and escalating costs of, our ever widening array of services from all levels of government have caused the government to feverishly search out new sources of revenue. The taxpayer revolt mentality and the related dash of an interesting variety of individuals and groups to the safe harbor of tax exemption have helped channel the government's revenue search to tax exempt organizations. This search has spawned an increase in the level of legislation and litigation, creating great pressure on the tax exempt organization in the 1980's. Today, I will focus my attention on real estate taxes and briefly highlight some recent legislation and litigation.

A survey of legislation across the country indicates that the trend is toward the legislatures' cutting back on some exemptions or at least scrutinizing them more closely in addition to requiring annual application for exempt status.

The courts of the various states have consistently adopted a strict construction approach to the laws exempting certain property from real estate taxation. Although not a new one, this trend is accelerating.

Briefly, I will discuss five areas that may be of interest: first, the requirement of ownership by a qualifying entity and the effects of leasing all or part of otherwise qualifying property; second, the requirement of exclusive use of property for religious purposes and its application to property held for future use; third, the tax treatment of parsonages and other residences of church members; fourth, the treatment of new religions; fifth, the imposition of user charges on exempt properties.

OWNERSHIP

Most states require the owner of the subject property, as a prerequisite to the granting of real estate tax exemption, to be a qualifying entity,

that is, a charitable, religious, educational, or public body. That being the case, it is possible that individuals or groups may try to meet the statutory requirements by creating a mere impression of ownership.

For instance, in a Tennessee case, *In re Appeal of the Church of God at Memphis*, the individuals who deeded the subject property to their church continued to reside on the premises and to make monthly mortgage payments. Although the Assessment Appeals Commission denied exemption on other grounds, it noted that it was influenced by the issue of whether the church actually owned the property.

On the other hand, courts recognize the increasing use of forms of conveyance which do not pass actual title to buyers at the time of conveyance, for example, contract sales accord ownership status when sufficient rights and responsibilities of ownership are undertaken. For instance, the Illinois Supreme Court held that an organization which made a downpayment, substantial monthly payments, and which had assumed liability for potential taxes was the owner of the property for exemption purposes.¹

The ownership test may or may not be met in a situation where the prior owner retains some rights in the property. In a Pennsylvania case, the reservation of the right to live on and make use of the property for life did not destroy its exempt status because the primary use of the property, which had been conveyed to the state, was public. A contrary result was reached by the Supreme Court of Maine in a case involving reservation of rights of access.

Although, in many states, property which otherwise would be exempt loses such status because it has been leased to a nonqualifying entity, ownership by a qualifying entity does not guarantee exemption. For instance, in 1979, Nevada enacted legislation which specifically states that exempt property loses its exemption when leased to a profitmaking organization.

Even without an explicit statutory basis for denying exempt status to property owned by a qualifying organization and leased to a nonqualifying entity, the courts have employed the almost universal statutory formulation of "exclusive use" for qualifying purposes. For example, in *Mason District Hospital v. Tuttle*,² the Illinois court found a medical center, which was owned by a tax exempt hospital and used by private doctors pursuant to a license agreement, to be taxable due to its primarily noncharitable use.

Leasing otherwise exempt property, however, is not necessarily fatal to its tax exempt status. Where the owner is one type of exempt entity and the lessee is a qualifying organization of another type, exemption

¹ *Christian Action Ministry v. Department of Local Gov't Affairs*, 56 Ill. App. 3d 102, 371 N.E.2d 1084 (1977), *aff'd*, 74 Ill. 2d 51, 383 N.E.2d 958 (1978).

² 61 Ill. App. 3d 1034, 378 N.E.2d 753 (1978).

may still be granted. Several examples should be noted. There is 1978 Florida legislation that maintained the tax exempt status for property owned by a governmental entity and leased for strictly literary, charitable, scientific, or religious purposes. There is 1977 California legislation that granted exempt status to property owned by nonprofit organizations, leased to the government and used solely for governmental purposes. There is 1979 Colorado legislation that exempted property owned by governmental entities and leased for use as a public airport, park, market, or fairground.

Although leasing otherwise exempt property to a nonqualifying lessee almost always results in forfeiture of the exemption, several states allow a special lessee exemption for property owned by a nonqualifying entity which is leased to a qualifying organization. Legislation granting exemptions to property owned by profitmaking entities but leased to nonprofit organizations and used for particular purposes was enacted in Connecticut, Oregon, Texas, and Washington in 1977, and in California and New Jersey in 1979. This might represent an incentive to obtain lower rents. Only the Oregon and Connecticut statutes related to religious institutions as lessees.

Typical of those states which continue to deny exemption to property owned by a profitmaking entity which is leased to a nonprofit organization is Kansas, whose Supreme Court has declared that the renting of property is a nonexempt use of it, and, therefore, is not being exclusively used for charitable purposes.

In many cases, an exempt piece of property is only partially being used for nonexempt purposes or used by a nonqualifying entity. Most states under those circumstances permit apportionment of the property as partially taxable and partially exempt. In at least two states, however,—Missouri and Nevada—even partial use for nonexempt purposes results in total forfeiture of exemption.

EXCLUSIVE USE

Most states' statutes which grant real estate tax exemption to property owned by religious organizations contain the qualifying phrase "and used exclusively for religious purposes." Many of the courts across the country which have construed the words "exclusively used" have interpreted them to mean "primarily" used. That is, so long as the primary use of the property is for the stated purposes of the qualifying organization, the property is exempt. Primary is distinguished from "secondary" or "incidental" use of the property.

Despite the near uniformity in the use of the phrase "primarily used," its application differs in various states. For example, in *Order*

Minor Conventuals v. Lee,³ a New York court found that the Franciscan Fathers' use of unimproved land as a retreat was "fairly incidental" to the purposes of the organization and, therefore, was primarily used for religious purposes. The District of Columbia Court of Appeals has held that nonuse of five-sixths of a university owned building did not prevent the primary use from being educational. In *Borough of Harvey Cedars v. Sisters of Charity of Saint Elizabeth*,⁴ a New Jersey court found that the property in question was primarily used as a place of rest and relaxation for nuns and clergymen and, therefore, not "reasonably necessary" to furtherance of religious purposes.

The requirement of "exclusive use" creates a question as to the status of property which is not being used at all, but rather, is being held for future and presumably exempt use. That question has been answered differently by various states.

In 1979, Illinois legislation provided that property held by a city, village, or county for future development is exempt. Similarly, a 1979 Maine law exempted land owned by a nonprofit fire company where such land was held in a land acquisition program. In 1979, the Florida Supreme Court held that "vacant land held by a municipality is presumed to be in use for a public purpose," and, therefore, exempt. The Commonwealth Court of Pennsylvania held that thirty or forty acres of undeveloped land surrounding a tax exempt retirement community were also exempt because they were reasonably necessary for expansion.

Conversely, the courts of New Jersey, Washington, Vermont, and Arizona have denied exempt status to undeveloped lands because they were not currently being used for exempt purposes or there were no established plans for development within a reasonable time.

PARSONAGES

There is no noticeable trend toward cutting back the exemption for parsonages among state legislatures. Several states recently have raised the dollar ceiling on the parsonage exemption. In 1976, the Massachusetts exemption was increased from \$70,000 to \$100,000, and in 1979, Rhode Island and Colorado raised their ceilings by \$40,000 and \$10,000, respectively.

Some states are more generous in their treatment of parsonages than of residences and other facilities associated with nonreligious exempt organizations. Under Illinois law, parsonages are exempt, as are convents and monasteries.

For another example, in Maine, 1977 legislation imposing user

³ 64 App. Div. 2d 227, 409 N.Y.S.2d 667 (3d Dep't 1978).

⁴ 163 N.J. Super. 564, 568-69, 395 A.2d 518, 520 (1978).

charges on exempt property specifically exempted parsonages from the imposition of such charges.

In other states, however, the courts and legislatures have been less generous regarding parsonages than they have been in their treatment of residences associated with nonreligious exempt organizations.

Pennsylvania, for example, does not allow the exemption for an "actual place of regularly stated worship and the ground thereto annexed necessary for the occupancy and enjoyment thereof" to be extended to parsonages. On the other hand, in Pennsylvania, a college president's home may be exempt despite its similarity in use and function to that of a minister.

In Kentucky, a minister's residence is exempt up to two acres. No similar acreage limitation is placed on property of educational or charitable organizations.

The question of what type of residence qualifies as a parsonage arises occasionally. Some states require that there be a connection between the residence in question and its occupant, and some identifiable, physical church. The Tennessee Assessment Appeals Commission found that a residence which belonged to the Church of God did not qualify as a parsonage because there was no physically embodied "church" with which it could be associated.

In a 1978 Maryland case, the court denied exemption to a residence owned by a religious organization because such residence was used as the home of a minister whose primary occupation was to establish new churches in the area. That is, he was not a minister for an identifiable congregation, and, therefore, his residence was not connected with a particular church. The court interpreted a legislative amendment of the religious exemption which eliminated the words, "used in connection therewith," as eliminating the necessity of physical connection between church and parsonage. The court stated that the amendment did not eliminate the need, however, for an identifiable church associated with the parsonage in question.

Wisconsin apparently does not require a connection with an identifiable church in order for a residence of a minister to be granted an exemption. In *Sisters of Saint Mary v. City of Madison*,⁶ the Wisconsin Supreme Court found that the hospital chaplain, as "spiritual overseer" for the hospital, was a qualified occupant and that it was therefore not necessary to establish that he was a pastor of a particular church.

A final issue in the area of exemptions for parsonages is the matter of who is a qualified occupant. In Ohio, the rector's and the sexton's homes do not qualify for exemption. In South Carolina, the home of the church's

⁶ 89 Wis. 2d 372, 278 N.W. 2d 814 (1979).

director of music and education was not a parsonage although the South Carolina Supreme Court admitted that each church is not limited to one parsonage.

Wisconsin law regarding qualified occupants of parsonages is relatively liberal. By statute, church owned property occupied by pastors, ordained assistants, members of religious orders and communities, or ordained teachers is exempt. A pastor's widow, however, does not fall within any of the above categories.

In 1977, North Dakota enacted broad legislation exempting residences as well as the necessary lands surrounding them, if owned by religious organizations and inhabited by members of such organizations who devote most of their time to that organization's activities.

THE TREATMENT OF NEW RELIGIONS

The courts seemingly are reluctant to deny a religious exemption to an entity which calls itself a religious institution solely on the grounds that the entity is not a valid religion. Instead, they tend to deny such groups exemption on other bases.

In *In re Holland Universal Life Church of Love*,⁶ the Commonwealth Court of Pennsylvania found that the property in question was not used exclusively for religious purposes, as statutorily required for the exemption. The property was a residence which had been deeded to the Holland Universal Life Church of Love but which continued to be used as the residence of the grantor. Although "services" were held on the premises, such use was not sufficient to qualify as "exclusively" for religious purposes.

What is noteworthy about the *Holland Universal Life Church of Love* case is that the court specifically declined to decide whether the entity was a legitimate religious organization. It denied exempt status on the basis of lack of "exclusive use." To determine the validity of a religion as a religion is more controversial than to evaluate exclusivity of use. The latter, therefore, is naturally a safer basis upon which to deny the exemption.

Another case in which the exemption was denied to a "new religion" is the *Church of Right v. State of Washington Department of Revenue*. There, the property in question was deeded by the incorporator of "Overseer of Church of Right, and its Successors, a Corporation Sole," to the "Church." The Board of Tax Appeals found that the property continued to be used as a residence and was not set aside as a place of worship. Although denial of exempt status was based on use considerations, it is at least possible that the Board questioned the validity of the "Church" as a

⁶ 38 Pa. Commw. Ct. 529, 394 A. 2d 665 (1978).

religion in making its decision.

A final case whose facts and holdings are similar to the two above described cases is *In re Appeal of the Church of God at Memphis*, in which the Tennessee Assessment Appeals Commission found that the property was used primarily as a residence for those individuals who gave the property to the "Church," and for that reason, it denied exemption. The Commission did note explicitly, however, that the only activity of the church was to license other ministers of the church and that the congregation, commencing in 1978 with seven people and growing to fifteen by 1979, was not sufficiently established to be an institution.

Some courts do deny the exemption directly on the grounds that the organization is not a religion. For instance, the Missouri Supreme Court denied exemption to property owned by the Church of Scientology because it found that the church was merely an applied philosophy with a religious connotation rather than an actual religion. Exhibiting the "trappings and accouterments of an organized religion" was not enough. To qualify for the exemption, the organization, at a minimum, had to demonstrate "a belief in and devotion to a Supreme Being."

Property of an organization which encourages religious beliefs may or may not qualify for the exemption for religious institutions. The New York courts, for example, have determined that Bible Societies are not religious for property tax exemption purposes unless they can show a legal relationship or direct association between activities and a recognized religion.

In Illinois, an organization called the Inter-Varsity Christian Fellowship Association, the stated purpose of which was to encourage belief in Jesus Christ among college students, was granted an exemption as both a religious and charitable organization. Apparently, encouraging religious beliefs, at least beliefs in a well-established religion, may be sufficient for purposes of finding that an organization is entitled to the exemption for religious institutions.

IN LIEU OF "FEES AND USER CHARGES"

In order to enable municipalities to obtain funds needed for the provision of essential services, while at the same time maintaining property tax exemptions, the legislatures of many states have enacted laws enabling municipalities to impose user charges on otherwise exempt property. Such user charges are not substitutes for property taxation, but rather, cover only those essential services for which the charges are imposed. Generally, user charges cover the costs of water and sanitation, fire and police protection, and highway maintenance. They do not pay for education or welfare. User charges are not a new device, but now more and more states are allowing their municipalities to impose them upon ex-

empt property, and municipalities which had not previously imposed such charges are now doing so. For example, in 1977, Vermont and Maine enacted such legislation, as did South Carolina in 1978, and Connecticut in 1979. New York enacted enabling legislation in 1971, but implementation of that law apparently has been delayed repeatedly.

A variation on the imposition of user charges is the authorization for a municipality to accept "in lieu" payments. Generally, "in lieu" payments are made by the state to a municipality located on state owned property. For instance, in 1977, New Jersey legislation authorized such payments. A new application of "in lieu" fees may be seen in 1978 and 1979 legislation in Maryland and Colorado, respectively, under which property owned by a governmental entity, but leased to a profit-making organization retains exempt status, provided that the profit is shared with the municipality.

Similarly, municipalities are attempting to disguise illegal taxation of tax-exempt organizations as legitimate regulations. For example, the Village of Justice in southwest Cook County, Illinois, capped 10 years of creative efforts to obtain revenue from local cemeteries by adopting an elaborate cemetery regulation ordinance. The result of the ordinance was that the Village charged fees to pay for the cost of regulation and imposed the regulation to ensure payment of the fees. The scheme has been struck down by the courts, but the battle goes on.

In sum, the eighties will see increased pressure on the real estate tax exemption. This pressure will come from more stringent application of existing limitations on existing exemptions and more expansive construction of exemptions. We can also expect new kinds of limitational devices.

This trend should be viewed as part of the broader trend toward reducing the tax advantages of exempt organizations across the board and substituting government for the private sector in the provision of social welfare and educational services. For the churches, this means an effort to confine religion within the narrow perimeter of the church building itself. It seems that the challenge for church lawyers is quite clear.

Before I conclude, I should state that this survey of what is going on in the states has been made by looking at books and not by calling people in the various states in order to find out what really is happening. The survey, therefore, may be superficial in that respect, but I thought the overview might be useful. If anyone has any corrections or additional information with respect to what is occurring in his or her state which the published cases do not adequately reflect, I would be happy to hear from you during the discussion.

Thank you.