



November 1, 2007

Sherrie Kinkle
State Board of Equalization
450 N Street
P.O. Box 942879
Sacramento, CA 94279-0064

1100 K Street
Suite 101
Sacramento
California
95814

Telephone
916.327.7500
Facsimile
916.441.5507

**Re: Consideration of Policy Change – Welfare Exemption
“Community Benefit Test” Under Revenue and Taxation Code §214**

Dear Ms. Kinkle:

On behalf of the California State Association of Counties (CSAC), I respectfully submit our concerns with the changes to the welfare exemption that are currently under consideration by the State Board of Equalization (the Board). The proposed changes would contravene the intentions of the voters, would bring the Board into direct conflict with California law as it has been passed by the Legislature and interpreted by the courts, and would contradict the Board's own longstanding implementation of the welfare exemption. Further, the change would have a negative impact on the state and local governments, an impact that would be aggravated by a heightened opportunity for abuse and fraud.

In 1944, voters passed Proposition 8, which allowed the Legislature to give a favored tax status to property used for “religious, hospital or charitable purposes.” The official ballot argument in favor of the measure was written by the then-Speaker and then-Speaker Pro Tempore of the Assembly, who had also authored the constitutional amendment in the Legislature. They pointed out that “additional health and welfare services resulting from the exemption...would save taxpayers the entire exemption cost.” They also made their case by pointing out that “the ability of these agencies to serve you is reduced when a share of your contribution given to aid their work is absorbed by the property tax.” The opposition's ballot argument countered that “subsequent exemption from taxation...constitutes nothing less than a subsidy by the entire community affected in which only a small part may have any interest or even be in sympathy.”

These official ballot arguments, besides helping voters of the day decide whether to vote for or against the measure, also give us valuable insight to the authors' and voters' intentions regarding it. The proponents and authors explain to voters that, should the amendment pass, taxpayers would reap the benefits in additional health and welfare services. This would not be the case if organizations whose actions substantially benefited only people outside the state were included in the exemption. The proponents further argue that the agencies in question will serve the voters themselves better if their finances are not encumbered by property taxation. Here again, it is clear from their reference to “agencies [that] serve you” that the intention is to exempt only those organizations that serve those voting, that is, Californians. Even the opponents' arguments show this to be the accepted meaning of the measure by pointing out that the “entire community affected” will be subsidizing the services provided by the exempt organizations. It follows that the “community” in question must be a local one that shares the burden of taxation. Since the taxation in question – property taxation – is one imposed by an area no larger than the state, the community in question must follow suit. From these excerpts, it is clear that the authors and the voters intended to exempt only those organizations that served them and with which they shared a tax base. The Board should not expand the exemption beyond what the voters approved.

The Legislature, which the Constitution authorizes to provide this favored tax status, has made its

intentions clear about how the exemption should be implemented. The constitutional language gives the Legislature the authority to exempt “all or any portion of property” used for the three purposes listed. The Legislature has been well aware that for several decades the Board has not been granting the exemption to organizations whose actions substantially benefit only people outside California. If they thought that the Board was not correctly implementing their will they would have passed law to correct the situation, which they have not.

The Legislature also makes its intent clear in other ways. For instance, in Health and Safety Code §127340 the Legislature finds and declares that “private not-for-profit hospitals meet certain needs of their communities through the provision of essential health care and other services. Public recognition of their unique status has led to favorable tax treatment by the government.” If the Legislature intended the welfare exemption to be provided to community-benefit organizations that serve the global community and not just one or more communities within California, they would not have used the plural form of the word, as they do above. If the community intended was global, then using it in plural would not have meaning. This section of law also highlights a link between the “unique status” of hospitals that serve their communities and the tax benefits they receive. Their position would not be unique if organizations that provided benefits outside of their communities were also given “favorable tax treatment by the government.”

Statutes that implement the tax exemption in question also give direction in interpreting it. Revenue and Taxation Code §214.10 refers to “any nonprofit corporation organized and operated for the...improvement of the job opportunities of low-income, unemployed and underemployed citizens of the communities in which they operate, and otherwise meeting all the requirements of Section 214.” Here again the plural form, communities, is used, indicating a local application of the word. And the use of the word “otherwise” indicates that the preceding phrase is a restatement of §214.

Revenue and Taxation Code §214.14(b)(4), relating to museums' eligibility for the property tax exemption, partially defines “property used exclusively for the charitable purposes of museums” as that which is owned by “a nonprofit association or organization performing auxiliary services to any city or county museum in the state” and that is used for certain activities. This statute, among other things, explicitly extends the tax exemption only to museums that perform auxiliary services for in-state jurisdictions. Not only does this section indicate the underlying intention that the exemption is for organizations that benefit the people of this state, but if the Board were to expand the welfare exemption generally to organizations whose benefit is realized outside of the state, museums providing auxiliary services to out-of-state city and county museums would be left in the strange position of being specifically statutorily excluded from the welfare exemption. Rather than lead to that strained and inconsistent application of the law, the Board should follow the clear intention of the Legislature (and the voters) and leave the definition of “community” as it is.

The courts, whose task it is to interpret the laws passed by the Legislature and the state Constitution, have handed down consistent rulings about how the exemption must be applied. For example, the decision in *Peninsula Covenant Church v. County of San Mateo* states that the “welfare exemption, like all tax-exemption statutes, is to be strictly construed.” (This is a general rule of construction and can be found in many other decisions, including, for instance, *English v. County of Alameda*.) The proponents of the definitional change before the Board are making the claim – as reported in the BOE legal department’s memo dated July 6, 2007 – that “a broad definition of ‘community’ is consistent with the California Supreme Court’s opinion that the term ‘charitable’...should be broadly construed.” But this is a flawed argument, because the California Supreme Court specifies that the broad interpretation of “charitable” is an exception to the widely

understood and published rule of interpreting tax-exemption statutes strictly. There is neither any court decision nor any statute that suggests that “community” should enjoy the same broad interpretation. The word is commonly understood to mean a particular group of people, usually localized. When the word is used in relation to local property taxes, then the localized aspect of it is emphasized.

The proponents argue that because “charitable” has been ruled to be construed broadly, the community in question should similarly be broadly construed, so broadly in fact as to include the entire Earth. However, the reason that California courts have ruled that “charitable” be construed broadly is because it has been done that way in other areas of the law (for instance in estate disputes such as *In re Estate of Halm* and *In re Estate of Coleman*) and for other tax exemptions (for instance, *Scripps, etc.*, *Hospital v. California Employment Comm.* relating to the exemption from unemployment insurance taxes). Following the courts’ logic, the Board should adhere to its current definition of “community” because – as the BOE legal department’s memo dated July 6, 2007, points out – the current opinion (by which “an organization could not qualify for the welfare exemption if ‘substantially all’ its activities benefit persons outside California”) “was based on several court cases which defined ‘community’ as the California community for other purposes for which a definition of the word ‘community’ was based.” In other words, “charitable” is construed broadly in other areas of law, therefore it also is in this area. “Community” is construed to mean California in other areas of law, therefore it should also be in this area.

A central point in this whole debate is nicely reviewed in *Clubs of Cal. for Fair Competition v. Kroger*, where the court found that California courts consistently “have based the exemption on the theory that the institutions lessened ‘the burdens of government’ to the benefit of the entire community, by performing a service that government would otherwise been required to provide” (citations omitted). This reiterates a connection that voters understood when they authorized the Legislature to enact the community benefit tax exemption in 1944. That is, the tax break was not conceived as a moral reward, but a pragmatic policy realization that these charitable organizations are providing services for which the government would otherwise be responsible. Clearly, this would not be the case if the services being provided were not within the state.

Beyond these constitutional, statutory, and judicial arguments are pragmatic ones. The proposed change has the potential to remove a significant amount of property from the tax rolls, so the cost to schools (and therefore the state General Fund) and local governments could be significant. In 1944, the voters were assured that the impact to local governments would be minimal. The argument in favor stated that “exemption of these charities from taxation would mean a loss to counties of only 2/10ths of 1%.” It is also worth noting that in 1944 counties, cities, schools, and some special districts had the authority to set their own tax rates.

Perhaps most seriously, there would be insurmountable administrative problems. The Board would need to either take the word of the advantaged organizations that their actions benefit the global community, or else they would need to devise and implement a worldwide investigatory body. Fraud and abuse would be easy to perpetrate, and could only be detected through expenditure of considerable public resources. The purpose of the exemption was to free governments from spending our taxes on services provided by charitable organizations, not require extraordinary expenditure to effectively and fairly implement the exemption. The proposed change would also cause county assessors to realize considerable implementation costs. Ironically, these costs would lead directly to decreased revenue, and thus a resultant decrease in public services, since their purpose would be to expand the scope of a tax exemption to those that do not directly benefit their communities.

Some organizations that would benefit from the change have apparently speculated that the exemption, as everyone has understood it for over 60 years, might violate the commerce clause of the U.S. Constitution by favoring in-state operators over others. However, in passing the 1944 measure, voters aligned California policy with the other 47 states that existed at the time, and a cursory search does not indicate that any of these laws have been found unconstitutional. Even if the policy were unconstitutional, the appropriate remedy would not be to expand the exemption beyond what the voters approved and the Legislature implemented, it would be to strike down the measure or refuse to implement it at all. Also, the appropriate forum for challenging the constitutionality of a state policy is the courtroom, not a regulatory body. It is questionable whether the Board has authority to expand a tax exemption beyond what is authorized by the state constitution and statutes. It is also worth noting that, as quoted from *Lundberg v. Alameda County*, “a presumption is in favor of constitutionality of an act of the Legislature, and the invalidity of the act must be clear and unquestionable before the act can be declared unconstitutional.” Given the considerable debate over this issue, it does not seem “clear and unquestionable” that the exemption should be struck down.

The proponents argue that neither the California Constitution nor Revenue and Taxation Code §214 limits “community” to California, but these are not the only sources of binding law. As noted above, the courts have consistently found that this benefit is limited to organizations whose actions benefit Californians. This body of case law prohibits a broader interpretation of “community.” Not only that, but the Legislature has had ample opportunity – decades in fact – to indicate that the Board’s longstanding interpretation is incorrect, but have shown no inclination to do so.

Proponents also argue that our globe is “continually shrinking” (presumably figuratively) and that we should not be “constrained by early to mid-20th century notions of ‘community.’” But the word “community” is still most commonly understood to mean a localized group of people. Those who speak about a conceptual “global community” are using a buzzword that merely dramatizes the fact that people and information can move quickly around the world in a way never before possible. That the word is sometimes used this way in popular culture should not affect the administration of California tax law. The fact remains that the tax exemption was conceived – and passed by voters – as a pragmatic policy realizing that these community organizations relieve the government of services and therefore get a tax break. Besides which, the use of “community” as a global concept constitutes the distinct minority of modern usage; it is most commonly understood the way it always has been.

If there are arguments for the change to which I have not responded in this letter, it is only due to oversight. Please contact me at your convenience and I will be happy to help in any way I can. I appreciate your thoughtful and thorough consideration of our concerns.

Sincerely,



Jean Kinney Hurst
Legislative Representative

cc: Richard Moon, Board of Equalization (MIC 82)
Bruce Dear, Assessor, County of Placer