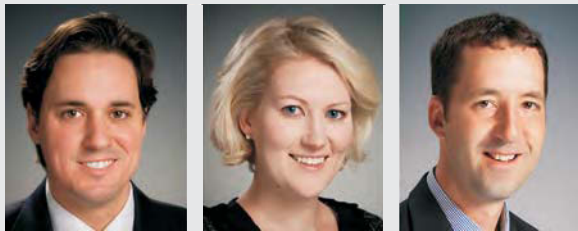


## The Nuts and Bolts Of Property Tax Exemptions for Nonprofits

by Timothy P. Noonan, Elizabeth A. Holden, and Michael E. Reyen



Timothy P. Noonan Elizabeth A. Holden Michael E. Reyen

Timothy P. Noonan is a partner in the Buffalo and New York offices of Hodgson Russ LLP. Elizabeth A. Holden is a partner and Michael E. Reyen is an associate in the real estate and finance practice group at Hodgson Russ.

In this article, the authors examine the allowed exemption for nonprofits, which creates many property tax problems. They outline the basics for submitting an application, the categories of exempt organizations, and the effects of purchasing property from or leasing to an exempt entity.

Regular readers of this column no doubt are used to the typical note on state tax topics such as residency and sales taxes. But here at Noonan's Notes global headquarters, we like to mix it up occasionally, not only to illustrate our depth, but also to keep readers on their toes. And for many tax practitioners, questions regarding property taxes often lurk in the background. Indeed, in many states like New York, the state and local tax guys usually leave the property tax projects to the practitioners in their business or real property groups. But it's still important for the state tax guys to understand how the system works and be aware of potential traps.

The real property tax exemption for nonprofits is one of those areas. Nobody likes to pay property taxes, and in New York, the property tax burden is one of the highest in the nation. Also, in practice, it is generally much harder to move through the tax appeals or dispute resolution process in the property tax system, because the procedures are disjointed and handled on a town-by-town or locality-by-locality basis. So it's important to get the issues right from the get-go.

In this article, we'll cover one problem area in the real property tax field, addressing the allowed exemption available to nonprofits. For regular readers looking for a discus-

sion of the next interesting residency or sales tax issue, never fear — that article will be coming soon to a Noonan's Notes near you.

### I. Timeliness of Application

First, one must know when to apply. That is crucial. When helping nonprofit entities purchase property, it is important to ensure that the application for exemption from real property taxes is submitted promptly after closing. Some clients do not realize the importance of promptly filing the application, and others incorrectly assume that the exemption from real property taxes is automatic if the entity is exempt from federal taxes already. But that is not the case.

**A municipality has little to no discretion to consider a late submission for tax exemption.**

Further, a municipality has little to no discretion to consider a late submission for tax exemption. Due dates for the tax exemption application vary by municipality, but the application is statutorily tied to the tax status date.<sup>1</sup> If a client files late, the exempt status may not become active until the following tax status date, resulting in having to pay property taxes in the intervening period. Consequently, it is helpful to remind a client of its obligation to file the appropriate tax exemption application and see that it is filed promptly after the transaction closes.

### II. Nonprofit Groups Potentially Exempt From Real Estate Taxes

There are two categories of nonprofit groups that are potentially exempt from real estate taxes: mandatory and permissive. New York's real property tax law (RPTL) section 420-a addresses the mandatory class of exempt users. That group includes "a corporation or association organized or conducted exclusively for religious, charitable, hospital, educational, or moral or mental improvement of men,

<sup>1</sup>Real Property Tax Law section 420-a(11) and 420-b(7). The tax status date of the city, town, or county is typically controlling for school district purposes. RPTL section 1302(3).

women or children purposes.” RPTL section 420-b addresses the permissive class of exempt users, which includes real property “owned by a corporation or association which is organized exclusively for bible, tract, benevolent, missionary, infirmary, public playground, scientific, literary, bar association, medical society, library, patriotic or historical purposes, for the development of good sportsmanship for persons under the age of eighteen years through the conduct of supervised athletic games, for the enforcement of laws relating to children or animals.” That group can be taxed by a municipal corporation within which its property is located if the governing board adopts a local law, ordinance, or resolution so providing; however, municipalities cannot target specific property or owners.<sup>2</sup>

### A. Exemption Requirements

There are three basic requirements that must be satisfied to obtain an exemption from real property tax:

- a. the entity must be organized or conducted exclusively for one or more of the purposes enumerated in the statute;
- b. the property must be used exclusively for one or more of those purposes; and
- c. no pecuniary profit may inure to any of the organization's officers, members, or employees, and the property must not be used as a guise for profit-making operations.

#### 1. Organization for Exempt Purpose

To be eligible for the real property tax exemption, the entity must be organized primarily to carry out tax-exempt purposes. Any nonexempt purposes must be incidental to the principal exempt purposes and serve only as an embellishment or adjunct to the primary purposes.

A nonprofit corporation organized and operated exclusively for a purpose reasonably incidental to the major purpose of another exempt corporation, although not organized to engage in all the activities of the latter corporation, is exempt. Examples of that include the ownership and operation of properties adjacent to a hospital and its school of nursing used to house hospital personnel,<sup>3</sup> and the ownership and operation of facilities incidental to higher education including food services, book stores, off-campus dormitories, and other recreational services.<sup>4</sup> Single-member limited liability companies that are owned by a not-for-profit also may qualify under some circumstances.<sup>5</sup>

<sup>2</sup>RPTL section 420-b(1)(a).

<sup>3</sup>*St. Joseph's Health Center Properties Inc. v. Srogi*, 51 N.Y.2d 127 (1980).

<sup>4</sup>*In re Faculty-Student Association of Stat University College at Oswego*, 35 A.D.2d 161 (4th Dep't 1970).

<sup>5</sup>New York City Department of Taxation and Finance response to request for ruling FLR-084874.

#### 2. Use for Exempt Purpose

In addition to the requirement that the corporation be organized exclusively to carry out tax-exempt purposes, the real property must be used exclusively for one of the purposes in section 420-a or 420-b. The word “exclusive” means principal or primary, and the use must be reasonably incidental to the principal or primary purpose to qualify. Prospective use also qualifies, so long as (1) the construction of the buildings or improvements is in progress or in good faith contemplated by the corporation or association, or (2) the organization holds the property on the condition that title will revert if a building not intended or suitable for one or more of the organization's purposes is built on the premises.<sup>6</sup> Not surprisingly, exempt use is often a source of contention.

The use inquiry is highly fact specific and therefore determined case by case. Use that has been found reasonably incidental to the principal or primary purpose includes a rabbi's residential use of property, which is considered necessary and reasonably incidental to furthering a congregation's primary religious purpose because of the rabbi's need to be on-call 24 hours a day in addition to the 40-45 hours of time devoted to the congregation every week.<sup>7</sup> Similarly, property owned by a theater company to house staff and actors who work at the theaters has been found reasonably incidental to the primary purpose.<sup>8</sup> Undeveloped property can play an integral part in furthering qualifying charitable activities. For example, an undeveloped parcel qualified for exemption because it was used to shield neighbors from the noise of an animal shelter.<sup>9</sup>

**If any portion of the real property owned by an EO is not used exclusively to carry out one or more exempt purposes, but is leased or used for other purposes, that portion is subject to tax.**

One use that fell short was a nonprofit corporation's acquisition of 430 acres of land for conservation purposes.<sup>10</sup> The court found that the charitable organization failed to demonstrate that the property was primarily used for a public purpose, despite the planting of thousands of trees, development of forest management and stewardship plans, creation of trails, and designation of a part of the property as

<sup>6</sup>RPTL section 420-a(3) and 420-b(3).

<sup>7</sup>*Sephardic Congregation of South Monsey v. Town of Ramapo*, 2008 NY slip op. 678 (2d Dep't 2008).

<sup>8</sup>*In re Merry-Go-round Playhouse Inc.*, 104 A.D.3d 1294 (4th Dep't 2013).

<sup>9</sup>*In re Paws Unlimited Foundation Inc.*, 91 A.D.3d 1173 (3d Dep't 2012).

<sup>10</sup>*In re Ksiazek Chylinski-Polubinski Trust Inc.*, 21 A.D.3d 620 (3d Dep't 2005).

federal wetlands.<sup>11</sup> The court based its finding on the concept that public purpose is not enough — there must also be a public use, which was lacking, along with a demonstration that necessary improvements were in progress or contemplated in good faith. Similar situations have involved purchasing property for use as a bike trail, but failing to demonstrate actual use or suitable improvements in progress,<sup>12</sup> and the failure of a foundation linked to Upstate Medical to use 75 percent of the property for purposes incidental to the hospital, without a suitable improvement in progress.<sup>13</sup>

If any portion of the real property owned by an exempt organization is not used exclusively to carry out one or more exempt purposes, but is leased or used for other purposes, that portion is subject to tax.<sup>14</sup> *In re Lackawanna Community Dev. Corp.*, 12 N.Y.3d 578 (N.Y. 2009), is an illustrative example.<sup>15</sup> In that case, the court of appeals upheld the appellate division's decision that the Lackawanna Community Development Corp., the local development corporation that owned the property, was not exempt from taxation as a result of its lease of the property to a for-profit manufacturer.<sup>16</sup> The court noted that "it is the actual or physical use of the property that the Real Property Tax Law is concerned with when it exempts from taxation property used exclusively for carrying out thereupon one or more exempt purposes."<sup>17</sup>

### 3. Nonprofit Going Concern

The final prong in the analysis of exempt use is whether the nonprofit is being operated as a nonprofit — that is, the corporation's officers, members, or employees do not receive pecuniary profit or compensation beyond that which is reasonable, the organization is not a guise or pretense for pecuniary profit, and the corporation is organized and conducted in good faith for an exempt purpose.

The last category is intended to prevent a corporation from claiming to operate for an exempt purpose, but otherwise conducting itself as a for-profit corporation.<sup>18</sup> Excess cash flow from operations is acceptable, so long as it is used to further the charitable purpose — that is, the profit-making aspect is incidental to the organization's main ex-

empt purpose. Examples of exempt uses that generate excess cash flow include operations of animal boarding operations,<sup>19</sup> dormitories,<sup>20</sup> and thrift shops.<sup>21</sup>

### III. Transactions Between For-Profit and Not-For-Profit Entities

These issues arise in business deals as well. When representing a for-profit entity that is purchasing property from a nonprofit entity, it is important to keep in mind that the purchaser will be responsible for its pro rata share of taxes for the remainder of the tax year under RPTL section 520,<sup>22</sup> which states, "Whenever any person, association or corporation not otherwise entitled to an exemption from taxation acquires title to real property which is exempt, in whole or in part from taxation, such property shall be immediately subject to taxation and shall be taxed pro rata for the unexpired portion of any fiscal year during which said transfer occurred." The statute is intended to address situations when nonexempt purchasers receive a benefit as a result of good timing that they would not otherwise be entitled to.

The old rule, which was owner friendly, stated that if property were exempt as of the tax status date, the new owner would not be subject to pro rata taxes for the applicable tax year, despite how it used the property. Now, for-profit purchasers can expect to receive from the municipality a "520 letter" advising them of their pro rata share of the remaining year's taxes based on an assessment of the value as of the date of transfer and their right to a review of the assessment and reclassification, if appropriate.<sup>23</sup> The prorated tax is then included in the following year's tax bill.

If the transaction is between two nonprofit entities that qualify for exemption, the property is likely to continue its exemption.<sup>24</sup> Legislation is pending to add a paragraph to RPTL section 420-a and 420-b to allow municipal corporations to adopt a local law to provide nonprofit organizations that purchase real property tax relief during the year in which they purchased the property, either in the form of a credit if the purchase occurs after the levy of taxes or exemption for that tax year if the purchase occurs before the

<sup>11</sup>*Id.* at 621-622.

<sup>12</sup>*In re Chautauqua Rails to Trails Inc.*, 231 A.D.2d 878 (4th Dep't 1996).

<sup>13</sup>*Upstate Properties Development Inc. v. City of Syracuse*, 27 Misc. 3d 1205(A) (Sup. Ct. Onondaga City 2010).

<sup>14</sup>See RPTL section 420-a(2) and 420-b(2).

<sup>15</sup>Hodgson Russ represented the city of Lackawanna.

<sup>16</sup>*Id.*

<sup>17</sup>*Id.* at 581.

<sup>18</sup>See *Hudson Institute Inc. v. Cernese*, 39 A.D.2d 576 (2d Dep't 1972) (corporation organized to conduct research and analysis regarding national security and international order was operating as a guise or pretense for making a profit for itself and its staff and did not qualify for tax exemption); *Valeria Home Inc. v. Cook*, 28 A.D.2d 283 (2d Dep't 1967) (property was willed to be used as a convalescence home for the poor but actually operated as a vacation resort).

<sup>19</sup>*In re Paws Unlimited Foundation Inc.*, 91 A.D.3d 1173 (3d Dep't 2012).

<sup>20</sup>*In re Faculty-Student Association of Stat University College at Oswego*, 35 A.D.2d 161 (4th Dep't 1970).

<sup>21</sup>*Salvation Army v. Town of Ellicott Bd. of Assessment Review*, 100 A.D.2d 361 (4th Dep't 1984).

<sup>22</sup>See also RPTL section 494, which contains a similar rule for cities with a population of at least 1 million.

<sup>23</sup>RPTL section 520(2); 8 Op. Counsel SBRPS No. 26.

<sup>24</sup>11 Op. Counsel SBRPS No. 42 (transfer of property from a municipal corporation to an industrial development agency, both exempt entities, resulted in the property remaining exempt and RPTL section 520 not being applicable).

levy.<sup>25</sup> The purchasing nonprofit would be required to submit its application within 30 days of the transfer of title. The practical effect of that kind of law is to allow nonprofits to either avoid paying taxes in the year of purchase altogether or recoup any prorated taxes that were paid by the seller and adjusted at closing.

#### **IV. Leases to Not-For-Profit Entities**

Occasionally, a for-profit entity owns the property but leases it to a nonprofit. That can still be workable if the property is leased to a nonprofit that would otherwise be exempt under the RPTL if it owned real property, so long as "any moneys paid for such use do not exceed the amount of carrying, maintenance and depreciation charges of the property or portion thereof."<sup>26</sup>

---

<sup>25</sup>2013-2014 regular sessions law A 6392.

<sup>26</sup>RPTL section 420-b(2).

#### **V. Conclusion**

Like any area in the state and local tax field, practitioners must understand the nuances of the rules in order to effectively advise their clients, especially in this area, where so much of the procedure is handled at the local level. Failing to timely file an exemption application or provide the proper information can have devastating effects on a nonprofit entity.

Further, challenging an exemption denial is difficult. The denied entity is up against the general rule that exemption statutes are strictly construed against the property owner, and the petitioning property owner has the burden to prove its entitlement to an exemption.<sup>27</sup> Nonprofit entities that purchase property should be made aware of the gravity of the application and encouraged to seek assistance with the process. ☆

---

<sup>27</sup>See *Upstate Properties*, 27 Misc. 3d 1205(A) at \* 6.