

Nonprofit Alert - Winter 2007

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AFTER NEW PROPERTY TAX RULING, "PURELY PUBLIC CHARITIES" MUST BE PURER STILL TO QUALIFY FOR PROPERTY TAX EXEMPTION

On Thursday, December 6th, the Minnesota Supreme Court ruled that to qualify for property tax exemption, a nonprofit organization must provide—as more than an incidental part of its activities—**services that are free of charge or at considerably reduced rates**. Because the identical standard also applies to sales tax exemption, the ruling has important implications for most nonprofits. Exemption from income tax is not affected, however, as that standard is more broad and ties directly to an organization's exemption from federal income taxation under Internal Revenue Code Section 501(c)(3).

The case, *Under the Rainbow Child Care, Inc. v. County of Goodhue*, is a significant development in the area of property and sales tax exemption for nonprofit organizations because it articulates a more stringent standard for such exemption than previous cases would indicate.

FORMER LAW

The past case law in Minnesota required an examination of six factors, called the Northstar factors, but provided that no single factor was determinative of whether an organization was an "institution of purely public charity" and thus qualified to receive an exemption from property tax. Those factors are:

1. whether the stated purpose of the undertaking is to be helpful to others without immediate expectation of material reward
2. whether the entity involved is supported by donations and gifts in whole or in part
3. whether the recipients of the "charity" are required to pay for the assistance received in whole or in part
4. whether the income received from gift, donations and charges to users produces a profit to the charitable institution
5. whether the beneficiaries of the "charity" are restricted or unrestricted and, if restricted, whether the class of persons to whom the charity is made available is one having a reasonable relationship to the charitable objectives
6. whether dividends, in form or substance, or assets upon dissolution are available to private interests

CHANGED BY THE COURT



In *Under the Rainbow*, the Court held that the third Northstar factor must be met to qualify for exemption. The Court stated:

The factor three inquiry, the extent to which the recipients of the charity are required to pay for the assistance received, tests for a value that is fundamental to the concept of charity—that is, whether the organization gives anything away. Because this is a core characteristic of an institution of public charity, we now clarify that the third factor must be satisfied if an organization is deemed to be an institution of purely public charity.

As a result, to qualify for property tax exemption, an organization must now provide as more than an incidental part of its activities services that are free of charge or at considerably reduced rates. "Considerably reduced rates" means "considerably less than market value or cost." However, when applying this standard to the Under the Rainbow Child Care Center, the Court rejected the taxpayer's argument that it operated the center substantially below cost, and instead engaged in an analysis of the child care center's rates compared to its local competitors. Based on this analysis, the Court concluded that Under the Rainbow's rates were not "substantially below market" and that it therefore did not qualify for property tax exemption. Notably, the "market" in which Under the Rainbow operated consisted of only three nonprofit day care centers in Red Wing; the Court, however, rejected the notion that the nonprofit status of those centers should be taken into account in determining the "market" rate for such services.

Neither property tax nor sales exemption are automatic and both may be reviewed and corrected at any time, subject to the taxpayer's appeal rights. Revocation of either exemption would require administrative action by the applicable local government (for property tax) or the Minnesota Department of Revenue (for sales tax), both of which require advance notice and trigger appeal rights for the taxpayer. In addition, if the exempt status of property were to be revoked, it would not result in taxes payable until the following year.

The Minnesota Council of Nonprofits has convened an effort to propose legislation to address the issues created by this court decision. Gray Plant Mooty attorneys are participating in that effort and will provide updates on those activities. See www.mncn.org.

For questions or additional information, please contact Sarah Duniway or Jennifer Reedstrom Bishop.

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