BILL SUMMARY

This bill deems that certain property located within the former Naval Training Center in San Diego used for charitable purposes is eligible for the welfare exemption as specified.

Summary of Amendments

Since the previous analysis, this bill was gutted and amended to the current provisions.

ANALYSIS

CURRENT LAW

Under existing law, publicly owned property is generally exempt from property tax. Additionally, certain property owned and operated by a nonprofit organization for charitable purposes may also be exempt from property tax under the “welfare exemption.” Unlike a nonprofit organization’s leasehold interest in privately owned property, which is generally ineligible for the welfare exemption because of the ownership requirement, a leasehold interest in publicly owned property can be eligible. In the case of publicly owned property, the term “owned” includes a leasehold interest (i.e., a taxable possessory interest). (Tri-Cities Children’s Center, Inc. v. Board of Supervisors of Alameda County (1985) 166 Cal.App.3d 589.)

Certain property located within the former Naval Training Center in San Diego that is owned by the City of San Diego and leased for a 55-year term to a nonprofit organization for its restoration and redevelopment has been found ineligible for the welfare exemption because the lease has been assigned to a for-profit entity formed by the nonprofit in order obtain funding for the renovation of the historic buildings by selling federal tax credits to investors. Some of the tenants located at this property are nonprofit organizations that would otherwise also be able to receive the welfare exemption. Property leased from one nonprofit organization to another nonprofit organization generally remains eligible for tax exemption if both are qualifying claimants for the welfare exemption.

Since one condition for the welfare exemption is that the owner (in this case the lease holder) must not be organized or operated for profit and must be qualified as an exempt organization, under a specific federal or state statute, by the Internal Revenue Service or the Franchise Tax Board, the property is now ineligible for the welfare exemption. The disqualification also extends to the tenants of the property that are nonprofit organizations.
PROPOSED LAW

This bill would add subdivision (j) to Section 214 of the Revenue and Taxation Code to deem that certain property located within the former Naval Training Center in San Diego that is owned by the City of San Diego and leased for a term of 35 years or more to a nonprofit entity, or an entity controlled by that nonprofit entity, qualifies for the welfare exemption on that portion of the property that is being used exclusively for charitable purposes. The partial exemption is available in any year in which the development of the property is being financed with funds made available through the federal New Markets Tax Expenditures or the federal Tax Credit Program for Qualified Rehabilitation Expenditures with respect to Certified Historic Structures.

The partial exemption applies notwithstanding that the property is subleased by the nonprofit entity or the controlled entity to another controlled entity.

An entity is controlled by a nonprofit entity if the nonprofit entity, or an entity in which the nonprofit entity owns 50 percent or more of the stock, profits interest, or capital interests of that entity, is sole general partner or sole managing member of the controlled entity.

This bill includes findings and declarations that a special law is necessary and that a general law cannot be made applicable within the meaning of Section 16 of Article IV of the California Constitution because of the need to resolve the property tax issues imposing severe financial burdens on an entity leasing from the City of San Diego.

IN GENERAL

Welfare Exemption. Under Section 4(b) of Article XIII of the California Constitution, the Legislature has the authority to exempt property (1) used exclusively for religious, hospital, or charitable purposes, and (2) owned or held in trust by nonprofit organizations operating for those purposes. This exemption from property taxation, popularly known as the welfare exemption, was first adopted by voters as a constitutional amendment on November 7, 1944. Section 5 of the California Constitution extends the exemption to buildings under construction if their intended use would qualify for exemption.

When the Legislature enacted Revenue and Taxation Code Section 214 to implement the Constitutional provision in 1945, a fourth purpose, scientific, was added to the three mentioned in the Constitution. Section 214 parallels and expands upon the Constitutional provision by exempting property used exclusively for the stated purposes (religious, hospital, scientific, or charitable), owned by qualifying nonprofit organizations if certain requirements are met. An organization’s primary purpose must be either religious, hospital, scientific, or charitable. Whether it operates for one of these purposes is determined by its activities. A qualifying organization’s property may be exempted fully or partially from property taxes, depending on how much of the property is used for qualifying purposes and activities. Section 214 is the primary welfare exemption statute in a statutory scheme that consists of more than 20 additional provisions. Over the years, the scope of the welfare exemption has been expanded by both legislation and judicial decisions.

The Constitution and statutes impose a number of requirements that must be met before property is eligible for the welfare exemption. In general:

- The property must be irrevocably dedicated to religious, hospital, scientific, or charitable purposes.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE’s formal position.
• The owner must not be organized or operated for profit and must be qualified as an exempt organization, under a specific federal or state statute, by the Internal Revenue Service or the Franchise Tax Board.

• No part of the net earnings of the owner may inure to the benefit of any private shareholder or individual.

• The property must be used for the actual operation of the exempt activity.

**BACKGROUND**

The NTC Foundation, a private 501(c)(3) nonprofit corporation, is charged with the preservation and renovation of 26 historic buildings at the former Naval Training Center in the Point Loma area of San Diego, California. The not-for-profit NTC Foundation has a 55-year lease with the City of San Diego to steward the NTC Arts & Cultural District. The Foundation is responsible for the creation of a civic, arts and cultural center to occupy the renovated buildings. To date, seven of the buildings have been completed.


**Related Sections of Law**

**Revenue and Taxation Code Section 214(g).** This section extends the welfare exemption to property owned and operated by qualifying organizations and used exclusively for rental housing which is occupied by lower income households. Qualifying organizations include limited partnerships in which the managing general partner is a qualified nonprofit corporation meeting the requirements of Section 214, as well as religious, hospital, scientific, or charitable funds, foundations or corporations. Section 214(g) provides a partial exemption equal to that percentage of the value of the property that the portion of the property serving lower-income households represents of the total property. Section 214 (g) allows for a two-entity operational structure, where one entity, a limited partnership, owns the property used for low-income housing, and another entity, an eligible nonprofit corporation, is the "managing general partner of that limited partnership."

**COMMENTS**

1. **Sponsor and Purpose.** This bill is sponsored by the Naval Training Center Foundation to provide an exemption for the nonprofit tenants leasing space at the former Naval Training Center. Under current law, those portions of the former Naval Training Center that have been developed using certain tax credits are now ineligible for the welfare exemption because of the introduction of a for-profit entity into the chain of ownership/leases from the City of San Diego to the ultimate nonprofit tenants. The sponsor notes that the purpose of this bill is to provide a partial exemption to the nonprofit tenants of the 26 historic buildings. Property taxes would be based on the percentage of nonprofit and for-profit uses within the building, with the nonprofit uses exempt from property taxes. The sponsor states that the nonprofit tenants should not be penalized because federal tax credits were used to finance the renovation of the buildings.

2. **Summary of Amendments.** The February 2, 2012 amendments delete provisions related to possessory interests in military housing and add the new provisions related to the welfare exemption as it applies to the former Naval Training Center.

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3. **The former Naval Training Center.** This bill relates to the former Naval Training Center in San Diego. This property was closed by the U.S. Navy and transferred to the City of San Diego in 2000. A portion of this former military base, NTC at Liberty Station, is leased from the city to the NTC Foundation, a nonprofit corporation charged with the preservation and renovation of 26 historic buildings of the former Naval Training Center. The Foundation is responsible for the creation of a civic, arts and cultural center to occupy the renovated buildings. To date, seven buildings have been rehabilitated. There are governmentally imposed restrictions on the types of tenants that may lease property at the center. NTC resident groups include dance companies, theater companies, martial arts, educational groups, multi-disciplinary arts, museums and galleries, as well as private for-profit businesses. 


4. The assignment of the lease from the NTC Foundation to a for-profit entity controlled by the NTC Foundation was necessary to qualify for federal tax credits that helped finance the rehabilitation of the historic buildings but made the property ineligible for the welfare exemption. To finance the rehabilitation, the NTC sold tax credits to investors that could take advantage of the credits to reduce their income tax liability. In order to sell the tax credits, the NTC Foundation was required to create a for-profit entity and assign its lease to the for-profit entity. As explained by the National Trust Community Investment Corporation, tax credits by themselves cannot be sold and nonprofits have no need for tax credits as they have no income tax liability. To transfer tax credits to an investor, the building owner forms a limited partnership (LP) or a limited liability corporation (LLC) with a corporate or individual tax credit investor through which the investor becomes (and must remain) one of the building owners for a 5-year period. Section 47 of the Internal Revenue Code states that the credits can only be claimed by project owners. The investor is then able to claim the federal tax credits generated by the project. In return, the corporate investor makes an equity investment in the project. http://ntcicfunds.com/

5. **Typically a nonprofit organization can lease its property to another nonprofit organization and the property will retain its tax exempt status if both are qualifying claimants for the welfare exemption.** In this case, the existence of a for-profit entity in the chain of leases destroyed eligibility for the welfare exemption. Generally, a nonprofit organization must “own” a property to qualify for the welfare exemption, but this is not the case where the property is publicly owned. Hence, in this situation, the fact the NTC Foundation does not own the property does not preclude the welfare exemption from applying.

**COST ESTIMATE**

With respect to property taxes, the BOE would incur some minor absorbable costs in informing local county assessors, the public, and staff of the law changes.

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REVENUE ESTIMATE

According to the San Diego County Assessor’s office, the current assessed value for the property subject to this bill is approximately $9,000,000. At the basic one percent tax rate, if every tenant leasing space is a nonprofit organization eligible for the welfare exemption, this bill would result in a revenue loss of $90,000. Since this bill extends only a partial exemption, the actual revenue loss is dependent on the makeup of the tenants. About 40% of the tenants are nonprofit organizations that could potentially qualify for the welfare exemption, resulting in an annual revenue loss of $36,000. To date, only seven of the 26 historic buildings have been renovated, thus as more buildings are renovated the revenue loss resulting under this bill would increase.