

January 30, 2008

The Honorable Betty Yee
State Board of Equalization
450 N Street, MIC: 71
Sacramento, CA 95814

**Re: Consideration of Policy Change – Welfare Exemption
“Community Benefit Test” Under Revenue and Taxation Code §214
February 1, 2008, Board Meeting – Chief Counsel Matters**

Dear Ms. Yee:

On behalf of the California State Association of Counties (CSAC), I respectfully submit our strong opposition to the welfare exemption changes under consideration at your February 1 meeting. The proposed changes would contravene the intentions of the voters, would bring the Board into conflict with California law as 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 their memo dated January 11, 2008, to which I will refer throughout this letter, your staff has presented a complete history of the exemption, which I will not repeat here. They introduce and conclude their analysis with by noting that “a continued interpretation of the 'community benefit test' requiring that charitable activities be performed primarily within the state's boundaries is reasonable” (p. 5) and “the current interpretation...is both rational and defensible” (p. 12). I submit that the evidence to overturn long-set policy ought to be incontrovertible. That is certainly not the case here. On the contrary, every indication is that the current interpretation be retained.

The businesses seeking this tax break argue chiefly that you and your fellow Board Members should dramatically extend your interpretation of the community benefit exemption because the meaning of the word “community” has changed. They say that that our globe is “continually shrinking”, presumably figuratively, and that we should not be “constrained by early to mid-20th century notions of 'community'”. This claim is not true. While it has gained a faddish, buzzword sense, the “usual and ordinary” meaning of “community” is the same as it ever was – a discrete group of people who share certain characteristics, be they geographical, professional, or otherwise. Only when speaking imprecisely or through metaphor – such as saying that our globe is “continually shrinking” – can the word be used to mean the whole world. Tax regulations by nature properly shun both imprecision and metaphor. When used in the context of government, and specifically in relation to the local taxation of land, the word “community” must have a the sense of a discrete geographic area. For these businesses to seriously argue this point is absurd.

On the fifth page of their memo to you, your staff states that “a review of...judicial authorities does not compel” the current interpretation. Yet two pages earlier, buried in a footnote, they state “we are aware of six legal opinions written between 1976 and 1984 opining that the 'community' that must be benefited is the California community.” That footnote is appended to the paragraph where they explain the legal reasoning that led to and has sustained the current interpretation of the exemption. All the reasons outlined in that section are convincing, both separately and together, and neither the proponents nor your staff ever counter any of them nor explain why you should suddenly discard a sound, valid, and time-tested legal position.

The staff memo spends several pages explaining all the reasons that the word “charitable” is broadly construed. However, the word in question is “community”. The memo seems to ignore the fact that the courts have given a very specific reason why “charitable” should be construed broadly in this context, which is that it is construed that way so many other places in the law; “community”, on the other hand, is defined nearly everywhere in law as a discrete geographical area. And again, this is especially the case when referring to a local tax on real property. Also, when the courts allow a “broad” meaning for “charitable” they still restrict the term considerably, excluding many nonprofit organizations that benefit their communities. But the interpretation of “community” that the proponents seek could not be any broader, since it would include the entire Earth.

The staff memo notes the Supreme Court's statement that “the rule of strict construction generally applicable to tax exemption laws must prevail here” as long as “it would [not] establish too severe a standard and defeat the apparent object of the law...Rather the construction of the law, though strict, must also be reasonable.” Clearly, the current interpretation is not so severe that it defeats the object of the law, and, as your staff explicitly notes earlier in their memo, the current interpretation is reasonable.

A central point in this 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 not only shows further judicial mandate, but also reiterates a connection that voters understood when they authorized the Legislature to enact the 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.

The eighth page of the staff memo restates another argument from the proponents that communities – and note that they use the term to mean groups of people in discrete geographic areas – are benefited by being able to give donations and work for the organizations. This is so far outside of the obvious intent of the law as to be another absurd argument.

On the same page, the businesses seeking this tax break claim that activities such as environmental cleanup and wetland protection in Mexico benefit Californians. But if their activities are found to benefit Californians then they qualify for the tax exemption as it is currently being implemented, so this argument has no bearing on the discussion at hand, and the fact that the proponents make such strained claims indicates that they know their chief argument – that the word “community” now means the whole world, not a community – is not persuasive.

The memo from your staff ignores statutory language that confirms the current interpretation. This is puzzling since, as a regulatory body, the Board is governed by statute, and since so many instances of statute suggest that this exemption should not be expanded as proposed.

First of all, the constitutional language gives the Legislature the authority to exempt “all or any portion of property” used for charitable purposes; notably, it does not require that all charitable property be exempted. 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.

In instances relating to this exemption, such as Health and Safety Code §127340 and Revenue and

Taxation Code §214.10, the Legislature refers to “communities” served by particular types of institutions. If the Legislature intended the welfare exemption to extend to community-benefit organizations that serve the whole world and not just one or more communities within California, they would not have used the plural form of the word “community”. If the community intended was global, then using it in plural would not have meaning at this pre-galactic stage of our history.

Revenue and Taxation Code §214.14(b)(4), relating to museums' eligibility for the exemption, partially defines “property used exclusively for the charitable purposes of museums” as that which is owned by an organization “performing auxiliary services to any city or county museum in the state”. 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 interpretation of “community” as it is.

One of arguments put forth is that the current interpretation of the community benefit test defies the dormant Commerce Clause by giving an advantage to charities that benefit residents of the state. However, if that's the case, wouldn't the proponents challenge the interpretation in court instead of making their case to a regulatory body bound to follow state law? In fact, as your staff points out in the third page of their memo, “the question [of whether the community in question is the State of California] has never been tested in court”. We submit that this is because the proponents know very well, despite their arguments here, that they would not prevail in such a case. Your staff managed to find a case involving a somewhat similar Maine law that was struck down on these grounds, but on the tenth page of the memo, they debunk this claim by pointing out clear differences between Maine's law and California's.

In addition to all of the reasons above, there would also be insurmountable administrative problems in implementing the change in question. 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 tax break. The proposed change would also cause county assessors to realize considerable implementation costs, as several have noted in their letters to the Board.

The businesses proposing the change have suggested implementing a new, paper-only review for themselves, but it seems perverse to make it more difficult for charitable organizations to which this law definitely applies to take advantage of it than for those about which there is considerable debate. This just shows how eager the proponents are to secure a tax break for themselves.

Please contact me at your convenience and I will be happy to explain our position further. 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