



Frequently Asked Questions about Charitable Tax Exemptions in Minnesota

This document is meant to provide information for nonprofit organizations that are currently exempt from paying property tax and/or sales tax in light of recent Minnesota Supreme Court decisions. The answers to these frequently asked questions were written by Gina DeConcini, a partner in the Corporate Finance & Transactions Group at Oppenheimer Wolff & Donnelly LLP and a volunteer with LegalCORPS.

What kinds of charitable organizations are eligible for exemption from paying Minnesota property taxes?

Organizations that qualify as tax-exempt charitable entities under Section 501(c)(3) of the Internal Revenue Code for income tax purposes must still apply separately for exempt status in Minnesota from property and/or sales tax. This exemption request can be denied (or revoked) if the organization does not also operate as a “purely public charity” under Minnesota law.

Note that many kinds of organizations or property that might be viewed as charitable qualify for exemption under separate provisions of Minnesota law and are not affected by the following discussion. Examples of such unaffected properties are those owned and used directly by hospitals; cemeteries; public schools, colleges, and universities; churches and other houses of worship; emergency shelters for victims of domestic abuse; and property used exclusively for a public purpose such as public libraries or public wetlands.

Minnesota law does not contain a clear definition of what does and does not qualify as a “purely public charity,” and this has led to a great deal of uncertainty for many nonprofit entities. The Minnesota Department of Revenue Property Assessor’s Manual (“the Manual”) defines institutions of purely public charity as those that are “administered wholly or exclusively for the benefit of the public, although the property devoted to such use need not be owned by the public.”

The Manual includes a partial listing of organizations that it considers examples of those that do and do not qualify as institutions of purely public charity. Among those listed that do not qualify for exemption (and are therefore taxable) are “commercial and civic organizations, clubs, fraternities, fraternal and benevolent organizations, lodges, and veteran’s groups.” Among those that may qualify are “nursing homes, rest homes, and drug and alcohol treatment centers, if these institutions are widely held, with no gain of any kind going to the members, admission open to all persons without regard to race, religion, or financial ability and support should not rest entirely on the patient’s or guest’s payment, but to a substantial extent on contributions.” The Manual also describes the circumstances under which rental housing property may qualify as a “purely public charity.”

Other than this brief guidance – which clearly does not address the majority of charitable organizations operating within Minnesota – the criteria or “tests” for determining whether an organization qualifies as a “purely public charity” have been historically developed as a result of case law. The three primary Minnesota Supreme Court cases to address this subject include the 1975 *North Star* case and the 2007 companion cases of *Under the Rainbow* and *Afton Historical Society Press*. These cases appear to agree that there are six general criteria that can be used in establishing whether an institution is a “purely public charity,” although they are not clear and even disagree with each other with respect to how many of these criteria are required for a given organization to qualify for a tax exemption, definitions of how to decide whether a given criteria is met, or whether some criteria are to be given more weight than others.

The six criteria (sometimes called the “North Star test” for the case that first listed them) include:

- (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 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 gifts and 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; and
- (6) whether dividends, in form or substance, or assets upon dissolution are available to private interests.

Other than organizations that clearly meet all six of these criteria (a charitable food shelf, for example), there is currently no clear rule for determining whether an organization qualifies for exemption in Minnesota. Because of this uncertainty, the Minnesota Council of Nonprofits and other organizations are encouraging the Minnesota legislature to pass legislation that will give board members and volunteers clear guidance to the question “Is our organization eligible for property tax and sales tax exemption in Minnesota?”

<p>Why is this coming up now? Did the <i>Under the Rainbow</i> and <i>Afton Historical Society Press</i> cases create some sort of a law change?</p>

The exemption from all state taxes for institutions of purely public charity is required by Article X, Section 1 of the Minnesota Constitution and is codified as Minnesota Statute §272.02 (7). There has not been a substantive change to this statute for decades, and there has been no challenge to the principle that purely public charities are and will continue to be exempt from both property and sales tax.

The concern that has been raised in the wake of the two December 2007 Minnesota Supreme Court decisions of *Under the Rainbow Childcare Center v. County of Goodhue* and *Afton Historical Society Press v. County of Washington* is that these cases appear to create a new standard for determining whether a given organization qualifies for exemption under the existing statute. At the very least, these cases make it clear that the six criteria (listed in the response to the first FAQ) that were articulated in the 1975 Minnesota Supreme Court decision of *North Star*

Research Institute v. County of Hennepin cannot be relied upon in the same manner as they have been interpreted by nonprofit entities (and most assessors) for the 32 years since the *North Star* decision.

Under the Rainbow Childcare Center v. County of Goodhue (“Rainbow”)

This case involved a nonprofit children’s daycare center (Under the Rainbow Childcare Center) located in Red Wing, Minnesota. Its mission statement is to “provide care for children away from their homes,” and the entity has not realized a profit in any of the years of its existence. Under the Rainbow’s practice was to charge tuition for each child attending the center based on average rates for other daycare centers in the county. The tax court found the tuition rates to be “at or just below” market rates.

Under the Rainbow referred families who could not afford its tuition to Goodhue County social services, and its clients included children whose families had sufficiently low incomes and thus received child care assistance payments from various government sources. Although Rainbow’s executive director testified that Under the Rainbow wrote off several thousands of dollars in unpaid childcare payments each year, Under the Rainbow offered no scholarships and had in the past pursued collection efforts against families that were delinquent in their payments.

The tax court initially evaluated Under the Rainbow against the six North Star factors, and found that, because the organization met five of the six factors (all except for factor three, involving whether recipients of the “charity” are required to pay for the services), the daycare did qualify for the property tax exemption. In reversing this decision in favor of the County, the Minnesota Supreme Court stated that the factors of *North Star* were never intended by the Court to be read as having equal weight, and that “an entity cannot be an institution of purely public charity without satisfying North Star factor number three.”

The Court summarized their position by stating that “it is not sufficient that an organization serves a worthwhile purpose, or even that it does so on a nonprofit basis.” The “essence of charity,” the Court said, is the “provision of services as a gift to the recipient.” That said, the Court did concede that the services do not need to be provided entirely free of charge to satisfy factor three, and that a charitable gift should be sufficient if is provided “free of charge or at considerably reduced rates,” with the latter defined as “considerably less than market value or cost.” The provision of these charitable services must not be an incidental part of the organization, and the organization must be able to prove that its intended purpose is to provide a “substantial portion” of its goods and services on a charitable basis. The Court did not define “substantial portion” for these purposes.

Afton Historical Society Press v. County of Washington (“Afton”)

One week after issuing its opinion in *Rainbow*, the Minnesota Supreme Court issued another opinion related to the definition of a “purely public charity” in *Afton*. Unlike *Rainbow*, the Court held in favor of the charity in this decision.

This case involved a publishing house (Afton Historical Society Press) that published some materials for retail sale at a profit, sold others at “substantially less than cost”, and donated other

published materials to charity. Revenues from the for-profit sales were funneled back into the organization and helped to fund the reduced price and donated book projects.

In *Afton*, the tax court also reviewed the facts using the six part North Star factors, but concluded that the entity failed because it only met factors one, four, and six. The Supreme Court disagreed, finding (1) that Afton Historical Society Press also met factor three because a substantial number of its books were sold below cost or given away; and (2) that the organization was allowed to carry on both commercial and charitable functions, as long as the commercial activities were subordinate to its charitable operations. The entire entity qualified for exemption.

To summarize the answer to this FAQ, there has not been a law change, but many charities that have previously received a property tax exemption where the exemption was based on equally weighing each of the North Star factors are now concerned that these two new cases could lead local assessors to re-evaluate their exempt status under the language of the two new cases.

What offices make the initial determinations regarding property and sales tax exemptions?

For property tax, the county assessor's office for the county where the property is located makes the initial decision. For sales and use tax, the Minnesota Department of Revenue Sales and Usage Tax Division (651-296-6181 or 1-800-657-3777) makes the initial exemption decision.

What information is required to support consideration for a property tax exemption as an organization of purely public charity?

A nonprofit entity that believes it qualifies for a property tax exemption as an institution of purely public charity must file an application for exemption with the assessor in the district where the property is located on or before February 1 of the assessment year. For most exempt properties, this application must be re-filed every three years. Thus, no matter what year the entity initially filed, re-applications for all properties are due on the same schedule – in 2010, 2013, 2016, etc.

The application for property tax exemption may require the following documentation:

- (1) Proof of 501(c)(3) status;
- (2) Articles of incorporation;
- (3) Financial statements or other documents showing the most recent three years of donations and revenues (generally in the form of IRS Form 990);
- (4) Documentation that goods or services are provided without charge or at less than market value; and
- (5) Evidence that the facility is providing and will continue to provide goods or services to the economically disadvantaged.

In addition, the application asks several questions including:

- (1) Why should the property be granted an exemption?
- (2) Is any part of this property used for commercial purposes?
- (3) Is any part of this property used for residential purposes?
- (4) What is the stated purpose of this entity?

- (5) Is the entity supported by gifts in whole or in part?
- (6) Are the recipients of the organization required to pay for assistance in whole or in part?
- (7) Does the income received from gifts and donations produce a profit?
- (8) Are the beneficiaries of the charity restricted?

For organizations seeking to show that they provide goods or services free or at considerably reduced rates as a “substantial” part of their operations, what constitutes “substantial?”

As discussed above, the *Rainbow* case held that the provision of charitable services “must not be an incidental part of the organization,” and the organization must be able to prove that its intended purpose is to provide a “substantial portion” of its goods and services on a charitable basis. The Court did not define either “incidental” or “substantial portion” for these purposes. Unfortunately, there is therefore currently no clear guidance as to what percentage of a charity’s goods and services must be given away or sold at “substantially less than fair market value.”

How are government funds considered in determining whether an organization’s goods or services are provided free or at considerably reduced rates?

This is currently one of the areas of uncertainty in Minnesota law as a result of the *Under the Rainbow* decision. Because of this lack of guidance, the Minnesota Council of Nonprofits and other organizations are encouraging the Minnesota legislature to pass legislation that will give organizations clear guidance to this issue.

Will county assessors be reexamining exempt property for possible revocation of property tax exemption based on the *Under the Rainbow* decision?

Because the *Rainbow* and *Afton* decisions are so new, there is no data available to indicate whether assessors have begun to re-examine exempt property. The assumption is that these cases will create an incentive for counties to aggressively review all institutions of purely public charity. The Minnesota Council of Nonprofits and other organizations are encouraging the legislature to enact clarifying legislation before a substantial number of nonprofit entities are affected by the new case law.

If an organization is denied a property tax exemption, how is it appealed?

Organizations whose applications for exemption from property tax are denied and those who receive notice from the county assessor that their exempt status will be revoked are entitled to two levels of administrative appeal of the decision.

First, the entity must appeal the decision to the local Board of Appeal and Equalization for the district in which the property is located; if that effort fails, the issue can be appealed to the county Board of Appeal and Equalization for the county in which the property is located. Entities should be prepared to summarize the grounds for their appeal within the appeal request.

Entities that are denied exempt status may also challenge the decision in the Minnesota Tax Court.

For 2008 and 2009 property tax assessments, what dates are relevant for organizations to know whether they have a tax liability?

Property that is exempt from property tax on January 2 of a particular year but loses its exemption prior to July 1 of that same year will be placed on the current assessment roles for that year. Property that is sold or otherwise loses its exempt status after July 1 will not be added to the assessment roles until the following year.

Keep in mind also that property taxes are assessed a year in advance of the year that they are due. Therefore, entities that were considered exempt in the assessment year of 2007 will not have any property taxes payable in 2008, unless the property lost its exempt status after January 2, 2007, but before July 1, 2007.

Entities that lose their property tax exemption after January 2, 2008, but before July 1, 2008, will have property taxes payable in 2009. Entities that maintain their exempt status until after July 1, 2008, will not have property taxes payable in 2009.

How is eligibility for the charitable sales and use tax exemption determined?

Minnesota Statute §297A.70(4)(a)(1) exempts certain sales to nonprofit organizations that are organized and operated “exclusively for charitable purposes” if the purchased items are used in the performance of the charitable function. The Minnesota Department of Revenue considers the tests for determining whether an organization qualifies for the sales tax exemption to be identical to the tests for determining property tax exemption for “purely public charities.” [Decisions in the property tax cases of *Rainbow* and *Afton* have also created a lack of guidance related to determining whether an organization qualifies for sales and use tax exemption in Minnesota.]

This exemption allows purchases on office supplies, furniture, vehicles, computer equipment and other taxed items to be purchased without paying a sales tax. To apply for sales tax exemption, organizations must complete and submit Form ST-16 — Application for Certificate of Exempt Status. Submit the form to Minnesota Department of Revenue, MS 6330, St. Paul, MN 55146.

If an organization is denied its property tax exemption on the basis that it is not a “purely public charity,” will it also lose its sales and use tax exempt status in Minnesota?

As mentioned above, the Minnesota Department of Revenue indicated in Revenue Notice #07-12 that nonprofit entities that are determined not to qualify as “purely public charities” for property tax purposes will also be determined to be ineligible for sales and use tax exemption. The notice, titled “Exempt Status Revocation After Adverse Property Tax Exemption Determination,” was published on October 15, 2007.

This notice also indicates that the Minnesota Department of Revenue considers the tests for determining whether an organization is operated as a “purely public charity” to be identical as that for property tax purposes. “Therefore,” it states, “if there is a final judicial determination that a nonprofit organization has failed to qualify as a charitable organization for property tax purposes it will also not qualify as an exempt charitable organization for sales tax purposes. The

Department will initiate revocation of an exempt status number [for sales tax] that may have been given to the organization.”

The logic of this position raises some interesting questions. For example, if the Minnesota Department of Revenue determines that an organization does qualify as a purely public charity for sales and use tax purposes, should that now serve as sufficient evidence to the county assessor that the entity should also be granted a property tax exemption?

If an organization is denied a sales and use tax exemption, how can it be appealed?

Organizations that are notified that their sales tax exempt status will be revoked are entitled to administratively appeal the decision with the Minnesota Department of Revenue. A request for a hearing should be filed with the Department of Revenue within 60 days of receipt of the Notice of Revocation. Details regarding the form and contact information to be included in the request for hearing are included in the Notice of Revocation. Nonprofit entities should be prepared to summarize the grounds for their appeal within the request for hearing. Entities who are denied exempt status may also challenge the decision in either tax court or civil court.

Where can I get additional information about whether or not my organization is affected by these changes?

Additional information is available on the Minnesota Council of Nonprofits Web site at www.mncn.org. In addition, LegalCORPS, with the assistance of the Minnesota Council of Nonprofits, will be offering brief telephone advice by pro bono attorneys to nonprofits who are concerned about their property and/or sales tax exemption. This service will be launched in February; stay turned to www.legalcorps.org and www.mncn.org for more details.



Answers to these frequently asked questions were provided by Gina DeConcini, a partner in the Corporate Finance & Transactions Group at Oppenheimer Wolff & Donnelly LLP. Gina’s practice focuses on tax planning, controversy and merger and acquisition transactions. She joined Oppenheimer with 14 years of experience in the public accounting field. She also serves as treasurer of the Tax Section of the Minnesota State Bar Association. In addition, she is a frequent speaker on multistate and international tax topics for various professional organizations. She received her J.D., *cum laude*, from the University of Minnesota Law School.

Gina’s efforts were provided in her capacity as a volunteer of LegalCORPS. LegalCORPS assists small Minnesota nonprofits with high-quality, pro bono business legal services they cannot afford. LegalCORPS’ lawyer volunteers assist small nonprofits – whether their mission is in social services, education, cultural and charitable services, promoting economic development or another field. For more information on LegalCORPS, visit www.legalcorps.org.

