Property Taxes & Non-Profits

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The tax status of real or personal property owned or used by charitable non-profit organizations can get complicated when there are multiple private and public entities involved with the property. Is property exempt if is owned by a non-profit organization and leased to other non-profits? What if it is leased to a mixture of non- and for-profit organizations? Does it matter if the non-profit organizations are 501(c)(3) certified? What if a government owns the property and leases it to a non-profit?

This blog attempts to unravel some knotty non-profit problems.

Before we dive into the details of specific situations, here's a quick overview of the relevant property tax law provisions.

Only the General Assembly may create property tax exemptions. See Article V, Section 2(3) of the N.C. Constitution. This means that all local governments must play by the property tax rules created by the General Assembly; counties and municipalities are not permitted to get creative and develop their own property tax exemptions.

The broadest property tax exemption aimed at non-profits is G.S. 105-278.7. This exemption covers "real and personal property used for educational, scientific, literary or charitable purposes."

The statute offers definitions for these terms, but they are nebulous at best. For example, a charitable purpose is defined as "*one that has humane and philanthropic objectives; it is an activity that benefits humanity or a significant rather than limited segment of the community without expectation of pecuniary profit or reward. The humane treatment of animals is also a charitable purpose."*

Reasonable people can differ on what might qualify as "charitable" under this standard. For our purposes, let's assume that any service offered for free or at reduced rates to a reasonably large swath of the population will qualify.

The list of agencies which could qualify for this exemption is even less well defined and includes charitable, historical, scientific, literary, and "benevolent" (?) associations as well as "nonprofit

community or neighborhood organization[s]."

Note that the exemption requirements do not turn on being certified as a 501(c)(3) organization by the Internal Revenue Service. Such federal tax certification is helpful to demonstrate that a particular organization is charitable and therefore eligible for this exemption, but it is not necessary. Nor is it sufficient; the mere fact that an agency is 501(c)(3) certified does not necessarily mean that its property satisfies the property tax exemption requirements.

Another more limited exemption for non-profits is G.S. 105-278.6, which applies only to real and personal property owned by a YMCA, a home for the aged or infirm, an orphanage, an ASPCA, a reformatory school, a monastery or convent, a non-profit life saving or rescue squad, or a non-profit organization providing housing for low-income residents. Note again that 501(c)(3) certification is not required.

Under both exemptions, the property in question must be both owned by a qualifying organization **and** must be used for a qualifying exempt purpose. In this post I analyze a recent N.C. Court of Appeals decision on the ownership requirement. I discuss the use requirement in this blog post.

Property tax exemptions are not all-or-nothing propositions. If only a portion of a property owned by a non-profit satisfies the use requirements, that portion can be exempt and the rest of the property can be taxable. G.S. 105-278.7(d).

Now let's apply these general principles to a few specific situations involving non-profits.

1. A Charitable Non-Profit Organization Owns the Property

The property tax status of the property will depend on how the property is used.

If the property is used for charitable purposes by the non-profit owner, it will be exempt.

If the property is leased to another charitable non-profit for free or for nominal rent ($1/month, for example) and used by that other non-profit for charitable purposes, then the property will also be exempt. G.S. 105-278.7(a)(2) permits a non-profit owner to allow another non-profit to use the property "gratuitously" and still retain the exemption.

But if the owner non-profit leases the property either (i) to an individual, a government, or a for-profit entity or (ii) to a non-profit and charges more than nominal rent, then the property should be taxable.

2. A Charitable Non-Profit Organization Leases Property From Another Owner

The property tax status of the property will depend on who owns the property.

If another charitable non-profit organization owns the property, then the situation is the same as #1 above: the property should be exempt from property taxes if the rent is $0 or some nominal amount. If anything more than nominal rent is charged by the non-profit owner, then the property will be taxable even if the tenant is using the leased property for charitable purposes.

If an individual or a for-profit entity owns the property, the property will taxable even if that owner is allowing a non-profit to use the property for free or for below-market rent. The owner might be able to claim an income tax deduction for the rent discount offered to the non-profit, but the property will be still be subject to property taxes.

If a government owns the property, the property itself will be exempt. G.S. 105-278.1, the exemption for property owned by a local, state or federal government, does not contain a use requirement. All property owned by a government is exempt regardless of how it is used.

However, with exempt government property we need to worry about the potential taxable status of the leasehold interest in that property. Normally, leasehold interests are not taxable. But a leasehold interest in exempt property is taxable under G.S. 105-273(31), a concept I discuss here.

When a government leases property to a for-profit entity, that leasehold interest should be taxable to the for-profit entity. The value of that leasehold interest generally depends in part on the rent charged. If the rent is at market value then the taxable value of the leasehold interest will normally have no taxable value. If the rent is below market value, the leasehold interest will likely have some taxable value. The Carolina Panthers NFL team, for example, pays over $300,000 in property taxes each year on its $1/year leasehold interest in the (exempt) land owned by the city of Charlotte on which the Panther's stadium sits.

A leasehold interest in government property held by a charitable non-profit and used for charitable purposes should be exempt from property taxes under G.S. 105-278.7. But if a non-profit were to lease property from a government and then sublease that property to an individual or a for-profit entity, then the non-profit's leasehold interest in that exempt government property could be taxable because it is not being used for charitable purposes. The taxable value of that leasehold interest will likely depend on the rent charged by the government.

Clear as mud, isn't it? Perhaps this table might help . . .

Property Owner	**Lessee**	**Is Property Exempt or Taxable?**
Charitable non-profit	Charitable non-profit	Taxable, unless the rent is $0 or nominal amount
Charitable non-profit	Government, individual, or for-profit entity	Taxable
Individual or for-profit entity	Charitable non-profit	Taxable

Government	Charitable non-profit	Exempt, but leasehold interest held by the non-profit could be taxable if the property is subleased to an individual or a for-profit entity

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