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Cover Page Footnote

 Professor of Law, University of Georgia School of Law. I would like to thank the participants in the Fordham University School of Law Symposium Nonprofit Law, Economic Challenges, and the Future of Charities held in New York on March 30, 2007. I am especially grateful for insights from Evelyn Brody and John Colombo. A special thanks to Kimberly Turner Brennen for her support. This essay benefited from a research grant provided by the University of Georgia School of Law. In the spirit of full disclosure, I acknowledge having worked as an expert consultant and witness on behalf of a number of community care retirement facilities throughout the United States. However, any opinions expressed herein are mine alone and were arrived at independent of any service as a consultant or expert witness.

THE COMMERCIALITY DOCTRINE AS APPLIED TO THE CHARITABLE TAX EXEMPTION FOR HOMES FOR THE AGED: STATE AND LOCAL PERSPECTIVES

*David A. Brennen**

Justice Thomas Dickerson said that a Rye retirement community known as The Osborn did not deserve the property tax exemption it once had because it now caters mainly to "healthy and wealthy" senior citizens. At one time, The Osborn had cared for indigent women and was tax-exempt because it was a charity. But changes in its mission compromised that status, and the judge ruled it no longer qualified because it had gone from a nursing home to a continuing care retirement community catering to the needs of healthy and wealthy seniors.[1]

INTRODUCTION

Historically, federal laws concerning the charitable tax exemption for institutions that operate homes for the elderly have reflected original common law notions of charity. As originally conceived, the charitable tax

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1. This is an excerpt from a newspaper editorial in Utica, New York, concerning the appropriateness of granting property tax exemption to homes for the aged that do not limit admission to elderly persons who are also poor. *See* Editorial, *Preswick Shouldn't Be Tax Exempt*, Observer-Dispatch (Utica, N.Y.), Jan. 26, 2007, at 7A (referring to the decision in Miriam Osborn Mem'l Home Ass'n v. Assessor of Rye, No.17175/97, 2006 N.Y. Misc. LEXIS 3897, at *20–21 (N.Y. Sup. Ct. Dec. 30, 2006) ("Indeed, it is The Osborn that asks this Court to look beyond its original charitable purpose of caring for 'indigent' aged women . . . and expand the definition of charitable use beyond 'a Depression-era soup kitchen or orphanage . . . or alms giving' to include the modern concept of a CCRC [continuing care retirement community] . . . which 'is a setting in which [healthy and wealthy] elderly residents can transition along a continuum of care from independent living to assisted living or skill nursing care, allowing a resident to spend the rest of his or her life residing on one campus without the trauma and dislocation associated with transferring to another health care facility or residential location.'")).

exemption authorized by § 501(c)(3) of the Internal Revenue Code[2] was reserved for institutions that performed activities benefiting the elderly, the poor, the young, religion, and similar eleemosynary causes.[3] Over time, the general public's view of what is charitable has strayed from these origins such that now the term "charitable" is popularly viewed as not including many of the historically charitable functions unless the beneficiaries are also economically distressed. For example, at one time providing housing and care benefits to the elderly was considered legally charitable only if the recipients of the benefits were both elderly *and* poor (or otherwise financially distressed).[4] However, federal tax law is now clear that

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2. See I.R.C. § 501 (2001) which provides,

> (a) Exemption from taxation.—An organization described in subsection (c) . . . shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.
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> . . . .
>
> (c) List of exempt organizations.—The following organizations are referred to in subsection (a):
>
> . . . .
>
> (3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

3. The purposes outlined in § 501(c)(3) as "charitable" are generally believed to be outgrowths of the various charitable purposes identified in the Elizabethan Statute of Charitable Uses as entitled to protection by the Queen. The preamble to the statute provides,

> WHEREAS lands, tenements, rents, annuities, profits, hereditaments, goods, chattels, money and stocks of money have been heretofore given, limited, appointed and assigned, as well by the Queen's most excellent majesty, and her most noble progenitors, as by sundry other well-disposed persons; some for relief of aged, impotent and poor people, some for maintenance of sick and maimed soldiers and mariners, schools of learning, free schools, and scholars in universities, some for repair of bridges, ports, havens, causeways, churches, sea-banks and highways, some for education and preferment of orphans, some for or towards relief, stock or maintenance for houses of correction, some for marriages of poor maids, some for supportation, aid and help of young tradesmen, handicraftsmen and persons decayed, and others for relief or redemption of prisoners or captives, and for aid or ease of any poor inhabitants concerning payments of fifteens, setting out of soldiers and other taxes; which lands, tenements, rents, annuities, profits, hereditaments, goods, chattels, money and stocks of money, nevertheless have not been employed according to the charitable intent of the givers and founders thereof, by reason of frauds, breaches of trust, and negligence in those that should pay, deliver and employ the same . . . .

Statute of Charitable Uses, 1601, 43 Eliz., c. 4 (Eng.).

4. *See* Rev. Rul. 61-72, 1961-1 C.B. 188; Rev. Rul. 57-467, 1957-2 C.B. 313; *see also* Elizabeth C. Kastenberg & Joseph Chasin, *Elderly Housing*, 2004 EO CPE Text 3, *available at* http://www.irs.gov/pub/irs-tege/eotopicg04.pdf ("[I]t was the Service's position that charitable exemption was linked to the concept that only those elderly persons unable to

providing housing and care that satisfies the unique needs of the elderly as a class is "charitable"—even if the recipients of these benefits are not also financially destitute.[5] Thus, the narrowing popular view of what is "charitable" has meant that many activities that are historically and legally sufficient to sustain a claim of federal tax exemption are often (popularly) misunderstood as inadequate to sustain the exemption. The legal view of what is charitable is therefore inconsistent with the popular notion that wealthy, or even middle class, people cannot constitute a charitable class.

These divergent views of "charity" (popular versus legal) cause problems when enforcing tax-exempt laws at the state and local level—especially if the claimed charitable activity involves buying or selling a product or service such as housing and care for the elderly.[6] The business of providing housing and care for the elderly, like any commercial activity, offers the promise of financial gain for an institution that can generate revenues in excess of expenses. Such profits are more likely to occur, however, when the elderly consumers of these housing and care services are well-off. The fact that, under federal law, an elder care facility does not have to limit itself to serving the poor to qualify for the charitable tax exemption increases the likelihood that residents of a charitable elder care facility might be rather well-off. So well-off, in fact, that the financial status of the residents of a charitable elder care facility might be on par with that of residents of similar for-profit facilities. Despite this potential for commercial competitiveness and viability, federal tax law plainly permits this dual existence in the elder care market just as it does in other charitable fields.[7] Indeed, under federal tax law's commerciality doctrine,[8] a

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provide care for themselves without undue financial stress fell under the definition of charitable class.").

5. Rev. Rul. 72-124, 1972-1 C.B. 145; *see also* Kastenberg & Chasin, *supra* note 4, at 3.

6. For a recent discussion of the proverbial "gap" between federal and state law concerning what is "charitable" for tax-exemption purposes, see Evelyn Brody, *The States' Growing Use of a Quid-Pro-Quo Rationale for the Charity Property Tax Exemption*, 56 Exempt Org. Tax Rev. 269 (2007). As Brody explains, "[L]awsuits and legislation . . . asserting tighter definitions for exemption reflect a growing divergence of federal and state policies and a growing acceptance by the states of a quid pro quo rationale for granting exemption." *Id.* at 270.

7. For example, a hospital can operate either as a for-profit or charitable institution. *See* St. David's Health Care Sys., Inc. v. United States, 349 F.3d 232, 234–35 (5th Cir. 2003) (discussing effect of a merger or joint venture between a for-profit hospital and a non-profit "charitable" hospital).

8. The Treasury's statement of the commerciality doctrine is contained in the regulations at Treas. Reg. § 1.501(c)(3)-1(e) (2006), which provides,

> An organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or

charitable entity that engages in a commercial activity is entitled to retain its tax exemption so long as its activities are primarily focused on accomplishing a charitable mission and not on making a profit.[9]

Nevertheless, state and local authorities—including appraisers, assessors, and others—are increasingly taking a dim view of the charitable (and, hence, tax-exempt) nature of elder care facilities in which significant numbers of the residents are wealthy or middle class.[10] State and local officials in Georgia, for example, recently challenged the state property tax exemption of several elder care facilities known as continuing care retirement communities (CCRCs) that were properly classified as tax-exempt charities for federal income tax purposes.[11] Georgia upheld the state tax exemption for the challenged institutions even though the

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business and the size and extent of the activities which are in furtherance of one or more exempt purposes.

9. *See infra* Part III; *see also* Better Bus. Bureau of Wash., D.C., Inc. v. United States, 326 U.S. 279, 283 (1945) ("[I]n order to fall within the claimed exemption, an organization must be devoted to educational purposes exclusively. . . . [A]n important if not the primary pursuit of petitioner's organization is to promote not only an ethical but also a profitable business community. The exemption is therefore unavailable to petitioner."); Living Faith, Inc. v. Comm'r, 950 F.2d 365, 370 (7th Cir. 1991) ("If one of the activity's purposes, however, is substantial and nonexempt (*e.g.*, commercial), the organization will be denied exempt status . . . even if its activity also furthers an exempt . . . purpose."); Presbyterian and Reformed Publ'g Co. v. Comm'r, 743 F.2d 148, 156 (3d Cir. 1984) ("'[T]he presence of profit making activities is not per se a bar to qualification of an organization as exempt if the activities further or accomplish an exempt purpose.'" (quoting Aid to Artisans, Inc. v. Comm'r, 71 T.C. 202, 211 (1978))).

10. Typical of the tenor of recent challenges is the excerpt from a New York state newspaper editorial,

> Cottages and apartments are now being developed on a 40-acre site off Clinton Road that will be marketed to upscale senior citizens. In 2001, a previous Town Board entered into a municipal services agreement with the developer, exempting the project from property taxes. That agreement was revised in 2004, when Preswick decided to charge entrance fees, but it still provides for the tax exemption.
>
> In return, the town, school district and county will receive an annual payment, starting at $55,000 a year, and increasing as Preswick grows in size and operation.
>
> Preswick Executive Director Raymond Garrett says the complex should be tax exempt because it operates under the umbrella of the nonprofit Presbyterian Homes Foundation, Inc. But town resident and planning board member Jerome Donovan has argued that the development does not meet the requirements for tax exemption because it doesn't provide charity care and isn't a licensed health-care provider. Donovan says the exemption would cost the town, county and school district thousands of dollars annually.

See Editorial, *supra* note 1.

11. Although this essay only focuses on CCRCs, the reader should understand that there are many different types of housing arrangements for the elderly, including "Seniors Only" complexes, modular home communities, elderly cottage housing opportunities, shared housing, assisted living communities, skilled nursing facilities, Alzheimer's facilities, senior day care centers, and senior short-term vacation housing. *See* Kastenberg & Chasin, *supra* note 4, at 11–13. Each of these types of facilities may be entitled to seek tax exemption as an elder care facility as outlined in Rev. Rul. 72-124, 1972-1 C.B. 145, and Rev. Rul. 79-18, 1979-1 C.B. 194, or in some other fashion. *See, e.g.*, Rev. Proc. 96-32, 1996-1 C.B. 717 (low-income housing); Rev. Rul. 79-17, 1979-1 C.B. 193 (hospice-type facility); Rev. Rul. 79-19, 1979-1 C.B. 195 (assisting the physically handicapped).

institutions did not limit themselves to providing housing and care for elderly persons who were poor or financially distressed.[12] In so doing, the Georgia courts relied, either intentionally or unintentionally, on federal tax law principles concerning permissible commercial activities by otherwise "charitable" entities.[13] Though the result in Georgia was to uphold the exemption for the CCRCs in that state, the experience in Georgia of property tax officials questioning the legitimacy of the "charitable" claim of these specialized elder care facilities is not unique. State and local property tax officials across the country have for years challenged the charitable tax exemption of CCRCs and similar entities on the grounds that they look like country clubs for the rich or similar *non-deserving* institutions.[14] Challenges to the property tax exemption of CCRCs continue.[15]

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12. *See* Lamad Ministries, Inc. v. Dougherty County Bd. of Tax Assessors, 602 S.E.2d 845, 853 (Ga. Ct. App. 2004); Bd. of Tax Assessors of Ware County v. Baptist Vill., Inc., 605 S.E.2d 436, 441 (Ga. Ct. App. 2004). The author of this essay served as an expert witness on behalf of the CCRC facilities in these two Georgia cases.

13. *See Better Bus. Bureau of Wash., D.C., Inc.*, 326 U.S. at 283; *Living Faith, Inc.*, 950 F.2d at 376; *Presbyterian and Reformed Publ'g Co.*, 743 F.2d at 152.

14. *See, e.g.*, Fredericka Home for Aged v. San Diego County, 221 P.2d 68 (Cal. 1950); Cent. Bd. on Care of Jewish Aged, Inc. v. Henson, 171 S.E.2d 747 (Ga. Ct. App. 1969); Mich. Baptist Homes & Dev. Co. v. Ann Arbor, 223 N.W.2d 324 (Mich. Ct. App. 1974); Alliance Home of Carlisle, PA v. Bd. of Assessment Appeals, 919 A.2d 206 (Pa. 2007); Lutheran Soc. Servs. v. Adams County Bd. for Assessment & Revision of Taxes, 364 A.2d 982 (Pa. Commw. Ct. 1976).

15. *See, e.g.*, Miriam Osborn Mem'l Home Ass'n v. Assessor of Rye, No. 17175/97, 2006 N.Y. Misc. LEXIS 3897, at *6 n.4 (N.Y. Sup. Ct. Dec. 30, 2006) (cataloging states that have dealt with the issue of CCRCs' entitlement to property tax exemption). The states cataloged in the *Osborn* case as having dealt with the issue of property tax exemption for CCRCs include

- Delaware: Presbyterian Homes, Inc. v. Kent County Bd. of Assessment, No. 97A-07-004, 1998 Del. Super. LEXIS 75 (Super. Ct. Jan. 30, 1998) (tax exempt);
- Idaho: Sunny Ridge Manor, Inc. v. Canyon County, 675 P.2d 813 (Idaho 1984) (not tax exempt);
- Illinois: Good Samaritan Home of Quincy v. Ill. Dep't of Revenue, 474 N.E.2d 1387 (Ill. App. Ct. 1985) (not tax exempt);
- Indiana: Wittenberg Lutheran Vill. Endowment Corp. v. Lake County Prop. Tax Assessment Bd. of Appeals, 782 N.E.2d 483 (Ind. Tax Ct. 2003), *petition for review denied*, 792 N.E.2d 48 (Ind. 2003) (tax exempt);
- Iowa: Friendship Haven, Inc. v. Webster County Bd. of Review, 542 N.W.2d 837 (Iowa 1996) (partial tax exemption);
- Massachusetts: W. Mass. Lifecare Corp. v. Bd. of Assessors of Springfield, 747 N.E.2d 97, 105–06 (Mass. 2001) (not tax exempt);
- Michigan: Mich. Baptist Homes & Dev. Co. v. City of Ann Arbor, 242 N.W.2d 749 (Mich. 1976) (not tax exempt);
- Minnesota: Chapel View, Inc. v. Hennepin County, No. TC-5686, 1988 Minn. Tax LEXIS 90 (Minn. T.C. 1988) (not tax exempt);
- Nebraska: OEA Senior Citizens, Inc. v. County of Douglas, 185 N.W.2d 464 (Neb. 1971) (not tax exempt);
- New Hampshire: *In re* City of Laconia, 781 A.2d 1012 (N.H. 2001) (tax exempt);
- Pennsylvania: *In re* Marple Newtown Sch. Dist., 455 A.2d 98 (Pa. 1983) (not tax exempt);
- Tennessee: Christian Home for the Aged, Inc. v. Tenn. Assessment Appeals Comm'n, 790 S.W.2d 288 (Tenn. Ct. App. 1990) (tax exemption denied);

This essay examines the question of how state and local government officials should consider federal tax law principles, like the commerciality doctrine, when they challenge *state and local* property tax exemptions that rely, at least in part, on tax-exempt charitable status for *federal* income tax purposes. In particular, this essay uses the example of CCRCs to consider tax-exempt law's commerciality doctrine in an attempt to discern distinctions between "homes for the aged" that are "charitable," and thus entitled to exemption, and those that are too commercial, and thus not entitled to exemption. In fact, one might say that this issue of the tax-exemption eligibility of CCRCs is a version of John Colombo's quandary about the commerciality doctrine in general—"when . . . commercial activity will be considered in furtherance of an exempt purpose as opposed to simply primarily an unrelated business."[16] Ideally, these distinctions between exempt and nonexempt homes for the aged should be helpful to state and local tax officials who, in the face of shrinking revenues and increasing expenses, seek to deny tax-exempt status to "homes for the aged" that are charitable primarily because they look commercialized and do not necessarily serve the poor.

This essay will proceed by first describing the context. That is, Part I describes the growth of the elderly population which has spawned the increased demand for, and supply of, elder care facilities. Part I also

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- Texas: First Baptist/Amarillo Found. v. Potter County Appraisal Dist., 813 S.W.2d 192 (Tex. App. 1991) (not tax exempt); and
- West Virginia: Maplewood Cmty., Inc. v. Craig, 607 S.E.2d 379 (W. Va. 2004) (not tax exempt).

16. John D. Colombo, *Reforming Internal Revenue Code Provisions on Commercial Activity by Charities*, 76 Fordham L. Rev. 667, 679 (2007). Professor Colombo introduces the issue this way:

> The problem is that the regulations under § 501(c)(3) do not tell us anything about when a commercial activity is or is not considered in furtherance of an exempt purpose. Thus, one possible interpretation of the regulations is that in furtherance of is equivalent to substantially related under the UBIT. Or, put the opposite way, one might conclude that any unrelated activity under the UBIT is not in furtherance of, and any substantial amount of unrelated commercial activity therefore creates exemption problems. Certainly, one cannot see related activity as creating exemption problems; if an activity is related for UBIT purposes, then by definition it must functionally advance the organization's exempt purpose, and hence must be viewed as being in furtherance of that purpose. But the contrary proposition (that unrelated activity automatically is not in furtherance of) is not necessarily true. In fact, if this proposition were correct, then the statement in Treasury Regulation § 1.501(c)(3)-1(e) . . . , that an organization may operate a business as long as the primary purpose is not carrying on an unrelated business, makes no sense. If any unrelated business were viewed as not being in furtherance of, then any unrelated business that was substantial would cause an organization to lose exempt status. A substantial business is presumably well short of one that is a primary purpose; therefore, the reference in Treasury Regulation § 1.501(c)(3)-1(e) to an organization losing exemption when an unrelated business becomes its primary purpose would be completely meaningless, because any substantial unrelated business would cause loss of exemption even if that business was not the primary purpose.

Id. at 671–72.

explains how the increased demand for elder care facilities coincides with state and local tax officials' increased need for tax revenue, resulting in a wide-ranging assault on property tax exemptions for elder care facilities nationwide. Part II outlines the federal law that permits facilities that provide housing and care for the elderly to be exempt despite the fact that they do not necessarily serve the poor. Part III explains tax exempt law's commerciality doctrine and how that doctrine permits CCRCs to operate in a commercial environment, yet maintain eligibility for federal tax exemption. Finally, Part IV lists various "lessons learned" that should be helpful to state and local property tax officials in the coming years as the demand for elder care housing facilities increases and the pressure on limited state and local property tax revenues becomes even more pronounced.

I. CONTEXT: PRESSURE TO TAX HOUSING AND CARE FOR THE ELDERLY

A. *The Growing Elderly Population in America*

A close examination of projected demographics in the United States reveals that the elderly population is growing fast. Indeed, the number of elderly persons (those sixty-five years and older) is increasing, the percentage of elderly persons is increasing,[17] and the ratio of working age persons to elderly persons is steadily falling.[18] This growth in the elderly population is primarily caused by two factors. The first factor is that the number of people who actually reach age sixty-five is growing each year. Despite a slight drop in the number of new sixty-five year olds between 1995 and 2005,[19] the number of new sixty-five year olds has steadily increased over the past few decades and is expected to continue increasing until around 2030.[20] After a twenty-year period of decline between 2030 and 2050, the elderly population will likely increase yet again, beginning in 2050.[21] The second major factor contributing to the growing elderly population is increased longevity. Once a person reaches age sixty-five, he or she has a longer life expectancy than was the case only a few decades ago. Thus, today more of us are living into our eighties, nineties, and even hundreds than several years ago.

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17. Kastenberg & Chasin, *supra* note 4, at 1. Government statistics show that between the year 2000 and the year 2030, the overall elderly population in this country (those sixty-five years and older) will more than double—growing from just 12.4% of the population to more than 20%. *Id.*

18. Lawrence A. Frolik & Alison P. Barnes, *An Aging Population: A Challenge to the Law*, *in* Aging and the Law 11, 11 (Lawrence A. Frolik ed., 1999). Working age persons are considered those persons age twenty to sixty-four. *Id.*

19. *Id.* The drop in new sixty-five year olds between 1995 and 2005 is attributed to the low birth rate during the Great Depression in the 1930s. *Id.*

20. *Id.* The increase in new elderly persons occurring between 2005 and 2030 is attributed to the so-called baby-boomer population. *Id.*

21. *Id.* The increase in new elderly persons occurring after 2050 is attributed to the children of baby-boomers reaching age sixty-five and older. *Id.*

The increasing number of older Americans has spawned particular study and focus on elderly populations and subpopulations. Due to its enormous size, the elderly population is often divided into subgroups for study and evaluative purposes. With a group that spans more than thirty years (from age sixty-five to well over age one hundred), there are bound to be special needs associated with some elderly persons that are likely not of great concern for other elderly persons. To facilitate ease of understanding of the special needs of the elderly population, specialists who study elder law and related fields often categorize the elderly into three groups. The groups are commonly referred to as the young-old (those age sixty-five to seventy-five), the old (those age seventy-five to eighty-five), and the old-old (those age eighty-five and older).[22] The young-old group usually consists of people who are newly retired, still physically and socially active, independent, and generally in good health. The old group is usually less active than the young-old group and is more likely to need assistance with daily living tasks than the young-old group. The old-old group is usually the least active of the elderly population, has the greatest health-care concerns, and is the least likely to be able to live independently.[23] Thus, while it can be said that the elderly as a group have special needs, these needs tend to become progressively more pronounced over time as one moves from the young-old to the old-old subgroup of the elderly.

These various factors about the elderly—the growth of the elderly population and the special needs that coincide with the various elderly subgroups—combine to make for a changing world in terms of housing and care for the elderly. Traditionally, the elderly would live on their own, move in with family, or move into nursing homes when they became unable to live alone.[24] However, because of the growing mobility of American families, there is often no family close by who can assist aging relatives. In addition, nursing home care costs are rising at astronomical rates, putting such care out of the financial reach for many aging persons regardless of preretirement income level. As a result, the elderly have begun to seek alternatives to the traditional housing and care needs for their golden years. In the last thirty years or so, many older people have turned to a special nongovernmental alternative concept known as CCRCs as a place to live out the last years of their lives.[25]

B. *CCRCs as a Response to the Special Needs of the Elderly*

CCRCs provide housing and care to the elderly on a progressive needs basis.[26] The goal of the CCRC concept is to provide elderly residents with

22. *Id.* at 12.

23. Christine A. Semanson, *The Continuing Care Community: Will It Meet Your Client's Changing Needs?*, *in* Aging and the Law 186, 186–87, *supra* note 18.

24. *Id.* at 186.

25. *Id.* at 187–88.

26. *See* Kastenberg & Chasin, *supra* note 4, at 15 ("[A] CCRC provides a commitment to take care of residents regardless of any changes in their health, for as long as they reside

the opportunity to maintain a high level of independence while ensuring availability of progressive care when needed.[27] A typical CCRC resident will enter the facility as an independent living resident, usually as a young-old elderly resident.[28] As time passes, the CCRC resident may need some assistance with daily life tasks and, thus, may move into an assisted living portion of the CCRC facility—either temporarily or permanently. Finally, when the elderly person reaches the old-old group, it is more likely that he or she will require nursing home care, which is also provided at the CCRC facility.[29] Throughout this period, each resident is often entitled to access recreational facilities, social activities, congregate meals, housekeeping services, and similar amenities all within the confines of the CCRC facility.[30] These items may be provided by the CCRC staff or by volunteers. Thus, the CCRC concept allows for pooling of monies of healthy residents upon entry to insure the availability of these amenities and long-term care benefits to residents as the need arises.[31]

The financing of CCRCs is a critical part of their success (or failure) and the aspect that often raises tax concerns.[32] A CCRC can organize either as a nonprofit or for-profit institution.[33] Regardless of organizational structure, CCRCs are financed primarily by payments from residents. Residents typically pay an upfront fee called an entrance or endowment fee.[34] The purpose of this fee is to provide a source of funds to pay for future services for residents.[35] This initial endowment fee may be partially or totally refundable within the initial term of a resident's stay, but it is eventually nonrefundable. In addition to the endowment fee, CCRC residents pay a monthly fee. The monthly fee is typically used as a type of rent payment for current uses. The monthly fee may rise over time to meet rising costs.[36] Practically all new CCRCs require residents to qualify financially—based on life expectancy, current assets, and current income—to pay the entrance fee and the anticipated monthly fees. However, a key distinction between nonprofit and for-profit CCRCs is that nonprofit facilities are prohibited from evicting elderly residents who become unable

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in the community. Within the CCRC, there are three types of care available, providing a phased approach to elderly living accommodations: [independent living, assisted-living, and skilled nursing care].").

27. Semanson, *supra* note 23, at 188; *see also* Kastenberg & Chasin, *supra* note 4, at 14 ("Usually designed for persons with substantial financial resources, these communities enable residents to remain as their care needs change over time.").

28. *See supra* Part I.A (discussing subcategories of elderly populations).

29. Semanson, *supra* note 23, at 187.

30. *Id.* at 188.

31. *Id.* at 188–89.

32. *See* Kastenberg & Chasin, *supra* note 4, at 17.

33. Semanson, *supra* note 23, at 188.

34. Kastenberg & Chasin, *supra* note 4, at 14 ("The entrance fee can range from $50,000 to $450,000 (which may or may not be refundable) . . . .").

35. Semanson, *supra* note 23, at 189.

36. *Id.* at 190; *see also* Kastenberg & Chasin, *supra* note 4, at 17–18.

to pay the required monthly fee.[37] This non-eviction requirement essentially means that a nonprofit CCRC must provide housing and care to its elderly residents for their lifetime.

Because of the nonprofit CCRCs lifetime commitment to provide housing and other care to its residents, these facilities are under tremendous pressure to make certain that they accurately project financial needs so as to ensure their financial viability far into the future. This salient fact has many implications. For instance, a new CCRC must set its endowment fees and monthly fees at actuarially sound levels. As a result, a new CCRC may be unable to offer admission to residents who do not have sufficient assets or future income to afford to move into the facility. This, in turn, may result in a resident population that consists primarily of middle income and wealthy individuals. As a nonprofit CCRC facility ages, however, it should be better able to allow admission to others outside of the middle income and wealthy class due to established fund-raising practices which take time to produce charity care funds. Despite this financial reality, many government officials and those who are unfamiliar with CCRCs often view the facilities as housing for the wealthy and, thus, do not typically think of CCRCs as traditionally charitable. This is especially true for state and local property tax officials who, relying on popular notions of what is "charitable," often view CCRCs as inappropriate recipients of the benefits of property tax exemption.

C. *The Ever-Increasing Demand for Local Property Tax Revenues*

As state and local government officials garner less political support for raising tax rates,[38] these officials are now seeking new strategies to increase tax revenues without raising tax rates or enacting new tax laws. Historically, expanding the interpretation of what is taxable has been the primary means of accomplishing this so-called invisible revenue-raising objective. For most state and local governments, this generally means making determinations that more "stuff" is taxable under existing tax laws than previously thought. Such actions are seen as invisible because, while the increased revenues are clearly visible, no one can point to any instance of a tax increase in the form of higher rates or new tax laws. Hence, no one must take the political blame for "raising taxes" during a time of increasing tax revenues.

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37. *See* Rev. Rul. 79-18, 1979-1 C.B. 194; *see also* Kastenberg & Chasin, *supra* note 4, at 10 ("An important concept in Rev. Rul. 79-18 is financial security of the residents. More specifically, the community must be committed to an established policy of maintaining in residence any person who becomes unable to pay the regular charges, through the organization's own reserves or funding from private and governmental units or the general public.").

38. *See CBS Evening News: Alabama's Shocker Politics* (CBS television broadcast June 25, 2003), *available at* http://www.cbsnews.com/sections/eveningnews/main3420.shtml (search for "Alabama's Shocker Politics"; then follow "Alabama's Shocker Politics" hyperlink).

A more nuanced approach to this method of political maneuvering is to increase overall tax revenues by increasing the number of taxpayers. One way in which state and local tax authorities are increasing the number of taxpayers is by forcing certain charitable organizations to pay state and local taxes even though they are exempt from the requirement to pay federal taxes. Though state and local governments are not required to grant tax exemption to entities that have federal tax exemption, many of these nonfederal tax authorities adopt language in their laws that essentially allows the state or local tax exemption to piggyback on the federal tax exemption. Thus, even though a particular charity may be tax exempt for federal income tax purposes, that charity's local tax official may seek to collect property taxes from the charity anyway. This is precisely what is happening in the CCRC industry. The following two sections of this essay describe the federal law that permits homes for the aged to be tax exempt (Part II) and the commerciality doctrine which supports the notion that CCRCs can operate in a way that serves charitable purposes, thus maintaining charitable tax exemption (Part III).

II. THE "HOMES FOR THE AGED" TAX EXEMPTION

At its base, a nonprofit tax-exempt CCRC facility is a type of "home for the aged."[39] Thus, these facilities must comply with the legal requirements for such facilities in order to maintain federal charitable income tax exemption. The Internal Revenue Service (IRS) has issued three significant revenue rulings concerning federal charitable tax exemption for organizations like CCRCs that provide housing and care for the elderly: Revenue Ruling 57-467 (the 1957 ruling), Revenue Ruling 61-72 (the 1961 ruling), and Revenue Ruling 72-124 (the 1972 ruling). These three rulings show, in the context of the "homes for the aged" exemption, just how the IRS has expanded its view over the years of what constitutes "charitable" for 501(c)(3) tax exemption purposes. Under this expanded view of "charitable," CCRCs, like all homes for the aged, are not required to have resident populations that are poor in order to maintain federal tax exemption so long as the CCRCs cater to the unique needs of the elderly.

In the 1957 ruling, the IRS concluded that a home for the aged that did not accept "charity" (poor) residents was not entitled to tax exemption.[40] The bylaws of the organization involved in the 1957 ruling permitted acceptance of guests under two different plans—a life care plan and a monthly boarding plan. Under each plan, the guest pays a nonrefundable (after one month) $500 admission fee, plus additional fees over time. The additional fees under the life care plan are computed on an actuarial basis and require that any property acquired by the guest after moving into the home be turned over to the tax-exempt organization. The additional fees under the monthly boarding plan are set at a minimum of $100 per month

39. *See supra* Part I.B (discussing corporate forms of CCRC facilities).
40. Rev. Rul. 57-467, 1957-2 C.B. 313.

and if a guest fails to pay the monthly fee on time, he or she is required to leave the home. Guests under both plans are also required to make out a will which names the tax-exempt organization the "exclusive residuary legatee" and the organization's treasurer as executor.[41]

Significantly, the tax-exempt organization in the 1957 ruling did not accept any guests who did not, or could not, pay the fees required under one of the two plans. The organization's total income came from guest fees and other contributions. The IRS refused to grant exemption to the tax-exempt organization described in the 1957 ruling because the bylaws effectively "bar the acceptance of charity guests and require the discharge of guests who fail to meet their monthly payments."[42] The refusal to accept charity guests and the requirement to discharge guests who failed to pay meant that, for federal tax purposes, the tax-exempt organization in the 1957 ruling was not sufficiently "charitable" at that time.

In the 1961 ruling, the IRS concluded that a tax-exempt organization that, to the extent of its financial ability, established and operated a home to provide care to the elderly who "lack[ed] adequate financial means to provide for themselves without distress" was entitled to federal tax exemption.[43] The tax-exempt organization involved in the 1961 ruling required applicants to the home to provide proof of good character and, even though it was dedicated to caring for the aged who lacked financial ability to adequately do so, ensured that applicants could afford to make the required monthly payments. The monthly payments were less than the cost of services and the facilities were modest. The organization in the 1961 ruling did not provide free care, nor did it provide reduced cost care for those unable to pay established rates. Nevertheless, the organization in the 1961 ruling was structured so as to satisfy the needs of its elderly residents to the extent of its financial ability without regard to cost and as much below cost as viable.[44]

The IRS correctly noted in the 1961 ruling that charging something for services and not providing free services for indigents does not prevent an organization from qualifying for 501(c)(3) tax exemption.[45] Indeed, just as it has recognized in other areas such as health care, the concept of "charity" for 501(c)(3) tax-exempt purposes may also include providing services at

41. *Id.*
42. *Id.*
43. Rev. Rul. 61-72, 1961-1 C.B. 188.
44. *See id.*
45. *See id.*; *see, e.g.*, Comm'r v. Battle Creek, Inc., 126 F.2d 405, 406 (5th Cir. 1942) ("It is also usual for hospitals and sanitariums to charge those able to pay for services rendered, in order to pay the expenses of the institution, while not denying treatment to others unable to pay anything."); Intercity Hosp. Ass'n v. Squire, 56 F. Supp. 472, 474 (W.D. Wash. 1944) (hospital organization entitled to exemption under I.R.C. § 101(6) [predecessor to § 501(c)(3)] despite Bureau of Internal Revenue finding that a charge is made for rendered services in almost every case); Sonora Cmty. Hosp. v. Comm'r, 46 T.C. 519, 526 (1966) ("Of course, a 'charitable' hospital may impose charges or fees for services rendered . . . .").

below cost.[46] Thus, despite its lack of services to the poor, the organization in the 1961 ruling was deemed "charitable" because it provided, to the extent of its financial ability, services at below cost which satisfied special needs of the elderly who could not provide these services for themselves without financial hardship. This special focus on providing special services to the elderly who would otherwise have financial difficulty doing so themselves is what, according to the IRS, distinguished the facts of the 1961 ruling from the prior 1957 ruling.[47]

In the 1972 ruling, the IRS concluded that a tax-exempt organization that provides (under the sponsorship of a church) housing, nursing, and other elder care services to persons older than sixty-five, who pay an entrance fee and monthly charges, is entitled to federal 501(c)(3) tax exemption.[48] The organization in the 1972 ruling had a board of trustees composed of church leaders, was self-supporting, had fees that vary according to size of accommodations, and only admitted residents who were able to pay. Nevertheless, once admitted, residents were not discharged solely because of their inability to continue making monthly payments. Instead, the organization tried to cover the loss of payment from these residents by using its reserves, seeking support from state and federal welfare programs, and/or seeking contributions from the sponsoring church and the general public. The tax-exempt organization in the 1972 ruling charged its residents just enough to amortize indebtedness, maintain adequate reserves, and set aside money for a limited expansion as community needs dictated.[49]

Most notably, the IRS recognized in the 1972 ruling that "the aged, apart from considerations of financial distress alone, are also, as a class, highly susceptible to other forms of distress in the sense that they have special needs because of their advanced years."[50] Thus, an organization that satisfies these special nonfinancial needs attendant with the elderly is just as charitable as an organization that provides "direct financial assistance in the sense of relief of poverty."[51] Accordingly, the IRS, in the 1972 ruling, adopted the following rule: An organization that devotes its resources to the operation of a home for the aged will qualify for charitable status if it

46. *See* Fed'n Pharmacy Servs., Inc. v. Comm'r, 625 F.2d 804, 808 (8th Cir. 1980) (denying tax-exempt charitable status to a pharmacy that "[never] offered [nor] is committed to offer[ing] its products to any customer below cost").

47. Later, in 1964, the Internal Revenue Service (IRS) issued a clarifying Revenue Ruling in which it concluded that "[a]n entrance fee paid, in addition to a required lump sum life-care payment, as a prerequisite to obtaining" admission to a "home for the aged, must be included along with the required lump sum life-care payment to the home in determining whether the home" meets the "below cost" requirement of Revenue Ruling 61-72. Rev. Rul. 64-231, 1964-2 C.B. 139.

48. *See* Rev. Rul. 72-124, 1972-1 C.B. 145.

49. *See id.*

50. *Id.*

51. *Id.*

operates in a manner designed to satisfy the three primary needs of aged persons for housing,[52] health care,[53] and financial security.

Though housing and health-care needs are rather self-evident, the IRS took special care to elaborate on what it means by "financial security" by outlining two conditions that must be met in order for the financial security requirement to be satisfied.[54] "Financial security" refers to an elderly person's need for protection against financial risks associated with advanced years.[55] The first condition that satisfies "financial security" is that the organization commits to a written or "in-practice" policy of not evicting persons who become unable to pay regular charges after being granted admission.[56] Maintaining these after-admitted non-payers may be done by utilizing organization reserves, seeking funds from governmental welfare units, or soliciting contributions from sponsoring organizations or others.[57] The second condition that satisfies "financial security" is that the organization operates so as to provide its services to the elderly at the lowest cost possible, taking into account the organization's debt payments, financial reserves to insure the future life care of residents and appropriate community expansion needs, and the existing resources of the organization.[58] Importantly, the amount of any fee—whether entree fee, founder's fee, or monthly fee—must be considered in relation to all items of expense (including indebtedness and reserves) in order to determine if the organization is operating at the lowest possible cost.[59]

A CCRC that operates in a manner described above in Part I of this essay ordinarily fits squarely within the confines of the 1972 Revenue Ruling and is entitled to federal income tax exemption under § 501(c)(3) of the Internal Revenue Code. The key factor is whether or not the facility is organized to meet the unique needs of the elderly residents, including housing, health-

52. *Id.* ("The need for housing will generally be satisfied if the organization provides residential facilities that are specifically designed to meet some combination of the physical, emotional, recreational, social, religious, and similar needs of aged persons.").

53. *Id.* ("The need for health care will generally be satisfied if the organization either directly provides some form of health care, or in the alternative, maintains some continuing arrangement with other organizations, facilities, or health personnel, designed to maintain the physical, and if necessary, mental well-being of its residents.").

54. *See id.*

55. *Id.*

56. *Id.*

57. *Id.* The 1972 Revenue Ruling notes that

> [A]n organization that is required by reason of Federal or state conditions imposed with respect to the terms of its financing agreements to devote its facilities to housing only aged persons of low or moderate income not exceeding specified levels and to recover operating costs from such residents may satisfy this condition even though it may not be committed to continue care of individuals who are no longer able to pay the established rates for residency because of a change in their financial circumstances.

Id. (citing National Housing Act, Pub. L. 90-448, § 236, 82 Stat. 476, 498 (1968) (codified at 12 U.S.C. § 1715z-1 (2000)).

58. *Id.*

59. *See id.*

care, and financial security needs. Among the most important indicators of compliance with this factor is whether the facility has a policy of not evicting residents who become unable to pay, whether fees are set actuarially at a level to make little to no profit, whether any profits that are made are used to reduce the costs of operating the facility, and whether residents are easily moved from independent living to assisted living to nursing units as needed. In essence, the most important indicators of compliance with the unique needs of the elderly requirement of the 1972 ruling are those factors that seek to ensure that the commercial aspects of the CCRC operation do not become more important than the charitable mission. In other words, CCRCs, because they are engaged in commerce, must also comply with the strictures of the commerciality doctrine in order to maintain federal income tax exemption. As the remainder of this essay reveals, state and local decisions concerning CCRCs' entitlement to property tax exemption often rely, at least implicitly, on aspects of federal tax-exempt law's commerciality doctrine in reaching their conclusions.

III. THE COMMERCIALITY DOCTRINE

Tax-exempt law's commerciality doctrine provides that a charitable institution may conduct what looks like a commercial activity but still be entitled to charitable income tax exemption under federal law so long as the activity is conducted in a manner that does not significantly advance non-charitable purposes.[60] The commerciality doctrine emanates from the term "exclusively" as used in § 501(c)(3) of the Internal Revenue Code.[61] According to § 501(c)(3), in order to obtain tax-exempt charitable status under federal law an institution must be, among other things, "organized and operated *exclusively*" for "charitable" or other specified purposes.[62] The term "exclusively" has a specialized meaning in this context; it really means "primarily."[63] Thus, it is not necessary that an institution seeking tax-exempt charitable status be "exclusively" charitable, only that it be "primarily" so.

Better Business Bureau of Washington, D.C., Inc. v. United States[64] is most often cited with respect to the meaning of "exclusively."[65] In the

60. *See* Treas. Reg. § 1.501(c)(3)-1(e) (2006). For examples of cases that deny tax-exempt status, see *Better Business Bureau of Washington, D.C., Inc. v. United States*, 326 U.S. 279, 283–84 (1945), *Living Faith, Inc. v. Commissioner*, 950 F.2d 365 (7th Cir. 1991), and *Presbyterian and Reformed Publishing Co. v. Commissioner*, 743 F.2d 148 (3d Cir. 1984).

61. *See supra* note 2.

62. *See id.* (emphasis added).

63. *See* Darryll K. Jones, Steven J. Willis, David A. Brennen & Beverly I. Moran, The Tax Law of Charities and Other Exempt Organizations: Cases, Materials, Questions and Activities 152 (2d ed. 2007) ("It is more likely that the judiciary simply cleaned up the statute by defining 'exclusively' as 'primarily' and, in the process, created a *de minimis* exception to the exclusivity requirement.").

64. 326 U.S. 279 (1945).

Better Business Bureau case, the U.S. Supreme Court recognized that "the presence of a single [non-charitable] purpose, if substantial in nature, will destroy [entitlement to] the exemption."[66] So, even though the statute says "exclusively,"[67] courts interpret that as really meaning "primarily," or more accurately, without a substantial non-charitable purpose.[68] It is not clear how one measures substantiality,[69] but it is clear that this interpretation of the term "exclusively" permits a charity to engage in at least a de minimis amount of activity that is not "charitable."[70]

In addition to its explicit recognition of the permissibility of small amounts of non-charitable activity by charitable institutions, *Better Business Bureau* also subtly introduced an enduring statement of the commerciality doctrine. In concluding that the institution in *Better Business Bureau* was not sufficiently charitable, the Court noted that the institution's "important" or "primary" pursuit was pursuit of profit—what the Court called "commercial hue."[71] As the Court explained,

> The commercial hue permeating petitioner's organization is reflected in . . . the charter provisions dedicating petitioner to the promotion of the "mutual welfare, protection and improvement of business methods among merchants" and others and to the securing of the "educational and scientific advancements of business methods" so that merchants might "successfully and profitably conduct their business."[72]

Thus, while the Better Business Bureau's activities may have incidentally advanced the charitable purposes of educating the public about business and creating ethical business firms, its fundamental objective was to make its business members more profitable.[73] That primary goal of profitability, as

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65. Technically, the *Better Business Bureau* case concerned exemption from the social security tax, not the income tax. However, as the U.S. Supreme Court explains, Congress intended to exempt from the social security tax "only those organizations exempt from the income tax" as charities. *Id.* at 284.

66. *Id.* at 283.

67. I.R.C. § 501(c)(3) (West 2001); *see supra* note 2.

68. *See Better Bus. Bureau of Wash. D.C., Inc.*, 326 U.S. at 283.

69. *See* Manning Ass'n v. Comm'r, 93 T.C. 596 (1989) (between ten percent and twenty percent nonexempt activity is highly suspect); World Family Corp. v. Comm'r, 81 T.C. 958 (1983) (less than ten percent nonexempt activity is probably acceptable); Church in Boston v. Comm'r, 71 T.C. 102, 107 (1978) (more than twenty percent nonexempt activity is probably too much).

70. *See* Jones et al., *supra* note 63, at 152–55.

71. *See Better Bus. Bureau*, 326 U.S. at 283–84.

72. *Id.* (citation omitted).

73. The Court in *Better Business Bureau* explained,

> Petitioner's activities are largely animated by this commercial purpose. Unethical business practices and fraudulent merchandising schemes are investigated, exposed and destroyed. Such efforts to cleanse the business system of dishonest practices are highly commendable and may even serve incidentally to educate certain persons. But they are directed fundamentally to ends other than that of education. Any claim that education is the sole aim of petitioner's organization is thereby destroyed.

Id. at 284.

opposed to education, was not something that Congress intended to exempt from taxation in § 501(c)(3).

It would be a mistake, though, to conclude from the "commercial hue" reference in *Better Business Bureau* that one cannot conduct a commercial activity and still be exempt. The problem in *Better Business Bureau* was not simply the fact that the organization made a profit for its members through commercial activity; the problem was that the organization's significant objective *was* to make a profit. Indeed, the regulatory codification of the commerciality doctrine recognizes that a charity may conduct a trade or business that may constitute a substantial part of the charity's activities.[74] However, the trade or business activity, if it is substantial, must have a charitable purpose. That is, the operation of the trade or business must be "in furtherance of the organization's exempt purpose or purposes" as opposed to in furtherance of a profit motive.[75]

With *Better Business Bureau* as the typical starting point for analysis in cases involving the commerciality doctrine, later cases elaborate on the nuances of the doctrine.[76] One important development concerns institutions that conduct apparently charitable activities but make a net economic profit in the process. Does the organization's profit or series of profits mean that the organization is no longer charitable because it is too commercial? The commerciality doctrine does not explicitly or implicitly prohibit the making of a profit per se—neither an occasional profit nor a series of profits. Neither does the doctrine encourage profit making. In applying the doctrine, one simply considers the presence or absence of profit as one factor in assessing the charitable or non-charitable nature of the organization's activities. This factor is to be considered with other factors in deciding whether a particular organization's activities violate the commerciality doctrine. In making such decisions, the concern is not with making profits that inappropriately go to private participants in the charitable venture or to others—for that is the concern of the prohibitions against private inurement[77] and private benefit.[78] Instead, the presence of a profit, especially a series of profits, *may* indicate that the organization has a prohibited profit motive—but not necessarily. Some courts have determined that the commerciality doctrine was not violated even though

74. *See* Treas. Reg. § 1.501(c)(3)-1(e)(1) (2006).

75. *Id.*

76. *See, e.g.*, Living Faith, Inc. v. Comm'r, 950 F.2d 365 (7th Cir. 1991); Presbyterian and Reformed Publ'g Co. v. Comm'r, 743 F.2d 148 (3d Cir. 1984); Fed'n Pharmacy Servs., Inc. v. Comm'r, 625 F.2d 804 (8th Cir. 1980); *see also* Jones et al., *supra* note 63, at 152–261 (discussing the commerciality doctrine).

77. *See generally* Jones et al., *supra* note 63, at 290–344.

78. *See id.* at 345–400.

the organization made significant profits,[79] while others reached the opposite conclusion despite the absence of any profits.[80]

In *Presbyterian and Reformed Publishing Co. v. Commissioner*, the U.S. Court of Appeals for the Third Circuit refused to uphold the U.S. Tax Court's revocation of tax-exempt status of a religious publisher solely because the publisher became very profitable over time.[81] In *Presbyterian and Reformed Publishing*, a religiously oriented publishing company had incorporated in 1931 to disseminate Bible teachings of the Presbyterian Church.[82] The IRS granted the publisher tax-exempt charitable status in 1939 after noting that its publications were all religiously affiliated and that its income "derived from subscriptions, contributions and gifts."[83] For its first thirty years, the religious publisher maintained close ties to the Presbyterian Church, though not under its official control, and either lost money or made very little money.[84] However, the publisher started to make some profits in 1969 when it published works by a previously obscure Presbyterian author.[85] These small profits continued to grow over the next several years into significant profits.

The IRS revoked Presbyterian and Reformed Publishing Co.'s tax exemption in 1980 primarily because of the large profits.[86] The Tax Court affirmed,[87] noting in particular the publisher's "soar[ing] net and gross profits" since 1969, failure to lower "prices to encourage a broader readership," and sale of books to and from a commercial publishing house.[88] On appeal, the Third Circuit rejected the Tax Court's principle reliance on the profitability of the publisher as a basis for concluding that it was too commercial. The Third Circuit explained that it doubted "any . . . exempt operation could ever increase its economic activity without forfeiting tax-exempt status under such a definition of non-exempt

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79. *See, e.g.*, Presbyterian and Reformed Publ'g Co., 743 F.2d 148 (finding significant profits, but not a commerciality doctrine violation).

80. *See Living Faith, Inc.*, 950 F.2d 365 (finding a commerciality doctrine violation without a finding of profit).

81. *Presbyterian and Reformed Publ'g Co.*, 743 F.2d 148.

82. *Id.* at 150.

83. *Id.*

84. *Id.* at 151.

85. *Id.* ("Beginning in 1969, . . . P & R experienced a considerable increase in economic activity as a result of the sudden and unexpected popularity of books written by Jay Adams, a Westminster Theological faculty member.").

86. *Id.* ("After an audit, the IRS issued a revocation of P & R's tax-exempt status in 1980 on the grounds that P & R was not 'operating exclusively for purposes set forth in 501(c)(3)' and was 'engaged in a business activity which is carried on similar to a commercial enterprise.' The IRS made this revocation retroactive, to apply from January 1, 1969 onward.").

87. *Id.* ("The Tax Court affirmed the revocation . . . but held that the IRS abused its discretion in making the revocation retroactive to 1969. Instead, it set the effective revocation date at 1975, based upon its declaration that as of that year P & R 'had acquired a truly commercial hue' and the company 'was aware . . . that IRS agents had been raising serious questions [about its exemption].'").

88. *Id.* at 152.

commercial character."[89] The Third Circuit concluded that Presbyterian and Reform Publishing Co.'s use of its profits for expansion of its publishing activities was consistent with a charitable purpose. Thus, despite significant profits by Presbyterian and Reformed Publishing Co. after years of financial struggle, the court apparently accepted that the profits simply occurred as a by-product of activities that had charitable purposes.

In apparent conflict with the holding in *Presbyterian and Reformed Publishing*, the U.S. Court of Appeals for the Seventh Circuit in *Living Faith, Inc. v. Commissioner* affirmed the Tax Court's revocation of tax-exempt status of an organization operating two religious restaurants and health food stores, despite the fact that the facilities made no operating profit.[90] Living Faith was established in 1986 to "keep[] with the doctrines of the Seventh-day Adventist Church."[91] Although it is associated with the Seventh-day Adventist Church,[92] Living Faith is "independent from the church and receives no direct funding" from the church.[93] Living Faith's primary activity is the operation of two vegetarian restaurants and health food stores. Living Faith's facilities—though open to the general public—employ Seventh-day Adventist management, maintain good relationships with the local Seventh-day Adventist Church, and distribute Seventh-day Adventist materials to customers in its stores and restaurants. In addition, managers must have business knowledge and training, the facilities set prices at market rates, and the facilities distribute information on the franchise company that licenses its name to the Living Faith stores and restaurants.[94]

The Seventh Circuit in *Living Faith* concluded that, despite its operating losses and admirable religious objectives, Living Faith conducted its activities in a commercial manner.[95] The primary indicator of the commercial nature of Living Faith's activities was its direct competition with other restaurants in the shopping center in which it operated.[96] The

89. *Id.*

90. *See* Living Faith, Inc. v. Comm'r, 950 F.2d 365 (7th Cir. 1991).

91. *Id.* at 367.

92. *Id.*

93. *Id.*

94. *Id.* at 367–68 ("These two facilities . . . are open to the public, and operate under the name 'Country Life.' Country Life is a worldwide chain of independently operated restaurants and food stores. Living Faith is licensed to use the name, without charge, by Oak Haven, Inc., a wholesale food distributor. Oak Haven's guidelines require Country Life facilities to employ Seventh-day Adventist management and maintain a good working relationship with the local Seventh-day Adventist Church. They also require that management have business ability, undergo six months training in operating a Country Life restaurant, and maintain good business relations with suppliers and the community.").

95. *Id.* at 376–77.

96. *Id.* at 373 ("It is significant that Living Faith is in direct competition with other restaurants. 'Competition with commercial firms is strong evidence of the predominance of non-exempt commercial purposes.'" (quoting B.S.W. Group, Inc. v. Comm'r, 70 T.C. 352, 358 (1978))).

competition, according to the court, was reflected in Living Faith's market-level pricing structure, distribution of promotional material for its franchise company, and distribution of religious material that also contained commercial marketing messages.[97] Other indicators of Living Faith's so-called "strong 'commercial hue'" were its large advertising budget, lack of charitable solicitation plans, and lack of charitable donations.[98] Though the court in *Living Faith* agreed that an operating loss like that suffered by Living Faith is an indicator of lack of commercial hue, such losses can be discounted when they occur in the early stages of operations.[99]

Based on this brief rendition of the relevant aspects of federal tax-exempt law's commerciality doctrine, it is apparent that a nonprofit CCRC can easily cross the line from tax exempt to non-tax exempt by not complying with the strictures of the doctrine. For instance, a CCRC that makes a profit, as the taxpayer in *Presbyterian and Reformed Publishing* did, is not necessarily too commercial so long as it takes steps to adjust its fee structure to reduce future profits. This can be done by either increasing services or lowering fees. Though sustained profits over a long period of time might cause a problem, occasional and small profits are not in and of themselves problematic. By the same token though, *Living Faith* demonstrated that a CCRC with an operating loss is not necessarily noncommercial. If it can be shown that the CCRC is operated in a commercial manner despite the lack of profits, then the manner of operation might result in loss of exemption due to violation of the commerciality doctrine. The bottom line is that a CCRC must operate in such a manner as to primarily advance its charitable purpose of providing for the unique needs of the elderly. If a CCRC is operated in a manner which indicates that it has a non-charitable primary objective, it will not be entitled to charitable tax exemption at the federal level.

IV. CASE STUDIES: GEORGIA AND PENNSYLVANIA

Given the significant variation in state and local tax authorities' approaches to granting property tax exemptions, it would be nearly impossible to suggest that a particular analytical approach is *correct* in all cases. An organization that is properly classified as a tax-exempt charity for federal law purposes is not guaranteed to qualify for state property tax exemption because each state makes its own decisions concerning this special privilege.[100] In fact, in some states, the state legislative grant of property tax exemption for a taxpayer does not necessarily result in actual

97. *Id.*

98. *Id.* at 373–74.

99. *Id.* at 374 ("Although Living Faith is correct that a failure to show a profit is relevant in determining the presence or absence of commercial purposes, it is only one factor among several, and does not per se entitle an organization to exempt status. This is especially so where, as here, the lack of profits occur during an organization's early period of existence." (citations omitted)).

100. *See generally* Brody, *supra* note 6.

tax exemption for the taxpayer unless the local property tax official determines that the property is used appropriately.[101] Thus, not only are the fifty state-level decisions as to how to authorize property tax exemptions separate from the federal determination of 501(c)(3) exempt status, but in each of these states it is oftentimes a local tax official who has the final word about a particular property tax exemption for a particular taxpayer.

Nevertheless, some themes can be discerned from some cases. One common theme is how states generally deal with the issue of a CCRC that might have a profitable independent living section and an unprofitable nursing home unit. Under federal law, as explained in Part III, the commerciality doctrine does not preclude charitable status for an organization merely because it makes a profit, nor does it automatically grant such status to an organization that loses money.[102] What is important for federal income tax exemption purposes is what types of efforts were used to generate the profit or the loss. Because of the difference between an income tax and a property tax, state and local authorities deal with an aspect of this issue that federal authorities do not face: What if the property *used for* the independent living facility generates a profit and the property *used for* the nursing home facility generates a loss even though both properties are part of a single CCRC? Georgia and Pennsylvania recently addressed this issue, and both states reached a similar result—look at the CCRC as a complete integrated unit.

In Georgia, in *Board of Tax Assessors v. Baptist Village, Inc.*,[103] the court held that a home for the aged property tax exemption will be upheld without regard to either "the level of care provided" to the elderly or the "profitability of a part of a home's operation."[104] In *Baptist Village*, a

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101. *See, e.g.*, Va. Code Ann. § 58.1-3650 (2007). The statute provides,

> A. The real and personal property of an organization designated by a section within this article and used by such organization exclusively for a religious, charitable, patriotic, historical, benevolent, cultural or public park and playground purpose as set forth in Article X, Section 6 (a) (6) of the Constitution of Virginia, the particular purpose for which such organization is classified being specifically set forth within each section, *shall be exempt from taxation so long as such organization is operated not for profit and the property so exempt is used in accordance with the purpose for which the organization is classified.*

Id. (emphasis added).

102. *See supra* Part III (discussing various aspects of tax-exempt law's commerciality doctrine).

103. 605 S.E.2d 436 (Ga. Ct. App. 2004).

104. *Id.* at 439. The Georgia property tax exemption statute reads as follows:

> (a) The following property shall be exempt from all ad valorem property taxes in this state:
>
> . . . .
>
> (12)(A) Property of a nonprofit home for the aged used in connection with its operation when the home for the aged has no stockholders and no income or profit which is distributed to or for the benefit of any private person and when the home is qualified as an exempt organization under the United States Internal Revenue Code, Section 501 (c) (3), as amended, and Code Section 48-7-25, and is subject to the laws of this state regulating nonprofit and charitable corporations;

nonprofit charitable institution owned property that contained a CCRC that had different levels of care for the elderly—independent living, assisted living, and nursing care. In order to live in the independent living villas, a resident had to be over sixty-five years of age, pay a development fee of $89,000 to $99,000, and agree to pay monthly maintenance fees. All Baptist Village residents, including those in the independent living villas, assisted living quarters, and nursing care units, had equivalent access, for a fee, to certain on-site services such as a clinic, computer club, cafeteria, and beauty shop. Even though Baptist Village did not legally assume responsibility for lifetime care of independent living residents, it did offer some practical advantages to those residents in the event that they became infirm or otherwise unable to care for themselves. Thus, Baptist Village allowed independent living residents, regardless of ability to pay, to move into the assisted living or nursing care areas if their circumstances required it. Baptist Village never asked any independent living resident to leave for any reason. Baptist Village performed these elder care duties while operating at or near a financial loss. Agreeing with the trial court, the Georgia Court of Appeals concluded that Baptist Village's independent living villas were equally as entitled to property tax exemption as were the assisted living quarters and the nursing care units because all portions of the Baptist Village elder care operations were interconnected with one another. Additionally, the fact that the independent living villas may have shown some profit does not change the fact that Baptist Village operated the villas in furtherance of its goal of providing elder care services to the elderly.

Similarly, in Pennsylvania, in *Alliance Home v. Board of Assessment Appeals*,[105] a CCRC that was organized as a nonprofit corporation and was admittedly a charitable entity under state law, lost its property tax exemption for the independent living portion of its facility because that portion of the facility earned a profit from operations.[106] The state tax

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(B) Property exempted by this paragraph shall not include property of a home for the aged held primarily for investment purposes or used for purposes unrelated to the providing of residential or health care to the aged.

Ga. Code Ann. § 48-5-41(a)(12)(A)–(B) (2007).

105. 919 A.2d 206 (Pa. 2007).

106. The Pennsylvania property tax exemption statute provides,

(a) General Rule.—An institution of purely public charity is an institution which meets the criteria set forth in subsections (b), (c), (d), (e) and (f). An institution which meets the criteria specified in this section shall be considered to be founded, endowed and maintained by public or private charity.

(b) Charitable Purpose.—The institution must advance a charitable purpose.

. . . .

(c) Private Profit Motive.—The institution must operate entirely free from private profit motive.

. . . .

(d) Community Service.—

(1) The institution must donate or render gratuitously a substantial portion of its services.

. . . .

(e) Charity to Persons.—

officials argued that the CCRC had to show that it used each parcel of its property, including the independent living parcel, for charitable purposes. However, the CCRC taxpayer argued that it is not necessary to look at each parcel in isolation to determine if the corporation is charitable if the parcel is part of a larger facility and the independent living parcel advances the charitable function of the larger facility. The Supreme Court of Pennsylvania held that because the independent living parcel in the CCRC facility advanced the charitable purpose of providing a comprehensive care scheme for CCRC residents, then that portion of the facility was also charitable.[107]

In each of these two states, notice how the ultimate decision about entitlement to the property tax exemption turns on whether, in the case of Georgia, the facility is operated *in furtherance of* the charitable mission and, in the case of Pennsylvania, the facility *advances* the charitable purpose. Each of these states has a tax-exemption statute that does not mandate that state law follow federal law for exemption determination purposes. This analytical approach is quite similar to the federal income tax

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(1) The institution must benefit a substantial and indefinite class of persons who are legitimate subjects of charity.

. . . .

(f) Government Service.—The institution must relieve the government of some of its burden.

. . . .

(g) Other Nonprofit Entities.—A nonprofit parent corporation, together with all of its subsidiary nonprofit corporations, may elect to be considered as a single institution in meeting the criteria set forth in this section . . . .

. . . .

(h) Parcel Review.—

(1) Nothing in this act shall affect, impair or hinder the responsibilities or prerogatives of the political subdivision responsible for maintaining real property assessment rolls to make a determination whether a parcel of property or a portion of a parcel of property is being used to advance the charitable purpose of an institution of purely public charity or to assess the parcel or part of the parcel of property as taxable based on the use of the parcel or part of the parcel for purposes other than the charitable purpose of that institution.

(2) Nothing in this act shall prohibit a political subdivision from filing challenges or making determinations as to whether a particular parcel of property is being used to advance the charitable purpose of an institution of purely public charity.

(i) Standards.—An institution of purely public charity may conduct activities intended to influence legislation provided that no substantial part of the activities of an institution of purely public charity shall consist of carrying on propaganda, except as otherwise provided in section 501(h) of the Internal Revenue Code of 1986 (26 U.S.C. § 501(h)), or participating in or intervening in, including the publishing or distributing of statements, any political campaign on behalf of or in opposition to any candidate for public office as such limitations are interpreted under section 501 of the Internal Revenue Code of 1986 (26 U.S.C. § 501).

10 Pa. Cons. Stat. Ann. § 375 (West 2006).

107. *See Alliance Home of Carlisle*, 919 A.2d at 226 ("Although the independent living facility, if it were viewed in isolation or as a separate institution, might not on its own qualify as a purely public charity, its role in the comprehensive care scheme provided by appellant is consistent with, is tied to, and advances appellant's charitable purpose.").

exemption analysis for commerciality doctrine issues. Thus, it appears that, even though federal law is different and not directly applicable, state and local property tax officials are guided in some fashion by the principles of federal law on property tax exemption matters.

V. LESSONS LEARNED

How can federal law principles of tax exemption for "homes for the aged" assist state and local tax officials when faced with the property tax exemption of a CCRC facility? This essay suggests four primary lessons for state and local tax authorities. While we certainly do not want federal law to dictate how state and local law should be interpreted, there should be some way for local property tax exemption standards to properly account for well-established federal tax exemption standards.

- Lesson 1: CCRCs do not have to serve the poor in order to be "charitable."
- Lesson 2: New CCRCs do not have to provide free or reduced price admission to residents if finances do not permit.
- Lesson 3: No set fee or reduced care percentage is required to maintain "charitable" status; the guiding principle is that free and reduced services are provided to the extent of the financial ability of the facility.
- Lesson 4: CCRCs offer a continuum of care and, thus, the fact that one portion of the facility is profitable does not change the nature of the analysis which requires one to examine the entire operation to determine if it is conducted in a charitable manner.