TAX

TAX EXEMPTION AND CHARITABLE PURPOSE – ANYTHING NEW?

by Mark D. Lansing

The Ohio Supreme Court recently issued a trilolgy of decisions – *Breeze, Inc. v. Testa*, Slip Op No. 2017-Ohio-7801 (2017); 2350 *Morse, LLC v. Testa*, Slip Op No. 2017-7800 (2017); and *250 Shoup Mill, LLC v. Testa,* 140 Ohio St.3d 98 (2016). All three cases dealt with a substantially similar business model and property arrangement; yet, each came to three different resolutions applying the same standard.[1] Interestingly, all three decisions were arguably rendered moot for the type of educational institutions involved due to the 2011 amendment to R.C. 5709.07(A)(1).

All three cases involved a complex arrangement of community schools and related entities. At the head of the arrangement was a nonprofit corporation, New Plan Learning, Inc. ("New Plan"), which was the sole owner of all three Petitioners (as well as other similar entities) that held title to property used by community schools. The business model involved was as follows: after a community school received authorization to operate in an area, New Plan identified an available facility. It then facilitated the purchase of the facility through a subsidiary that held title (e.g., Breeze, Inc.), which then leased the property to the community school. The title-holding entity collected rent from the community school. The rental income was used to pay the mortgage for the property. Any surplus passed to New Plan for its use in support of all of its affiliated community schools.

In all three cases, the rental income exceeded expenses. For 2350 Morse, LLC, the undisputed testimony was that the lender required rental income to be 115% of the operating expenses. Based on this testimony, and the evidence in record, 230 Morse, LLC was determined to be entitled to the exemption. For 250 Shoup Mill, LLC, since operating expenses were only eighty percent (80%) of rental income; the BTA found that the operation was for a profit motive. The Ohio Supreme Court affirmed this finding as being reasonable. Finally, in Breeze, Inc., the matter was reversed and remanded for the BTA to determine whether Breeze, Inc. had a "view to profit."

Former R.C. 5709.07(A)(1) provided a tax exemption for "[p]ublic schoolhouses, the books and furniture in them, and the ground attached to them necessary for the proper occupancy, use, and enjoyment of the schoolhouses, and not leased or otherwise used *with a view to profit*."[2] (Emphasis added.) Ohio cases stress that "with a view to profit" is in line with the plain meaning of that phrase: "If the lease is intended to generate profit for the lessor, the property does not qualify for exemption." (Emphasis added.) *Anderson/Maltbie Partnership v. Levin*, 127 Ohio St.3d 178, 2010-Ohio-4904, 937 N.E.2d 547, ¶ 33. According to the Ohio Supreme Court, the key inquiry is whether "with a view to profit" should focus on the aim or intention of the lessor.

In Breeze, Inc., the evidence was that it sought to minimize the rent so the school would "have more money to serve the kids." As a result, the rent payment was adjusted on occasion in light of the school's budgetary needs. Further, when the school was unable to pay, rent was deferred and sometimes written off completely. In explaining its three decisions, the Ohio Supreme Court centered on the statute's plain language that made, during the years in question, both the public schoolhouse and the charitable-or-public-use exemption hinge on the intent of the lease arrangement. It recognized that neither the tax commissioner nor the BTA paid much heed to that testimony. Instead, the tax commissioner concluded, without explanation, that Breeze had collected "substantial market-rate rent" and so had "clearly" entered the lease with a view to profit. The BTA's focus was found to be slightly different, as it concluded merely because there was an "excess of rental income over expenses" that was distributed not only to Horizon (the community school that leased from Breeze, Inc.), but also, to other community schools, the lease had been done with a view to profit.

In *250 Shoup Mill, L.L.C. v. Testa*, 147 Ohio St.3d 98, 2016-Ohio-5012, 60 N.E.3d 1254, the Supreme Court noted the monthly mortgage-loan, debt-service-coverage, and rental-income amounts for the property, for the tax year at issue, were all examined. As the property-related expenses were no more than 80 percent of the rental income for the property during 2010, it concluded the BTA and the tax commissioner could reasonably have found a view to profit in the leasing arrangement as to tax year 2010. However, for both 250 Shoup Mill and Breeze, Inc., the Ohio Supreme Court found that the mere fact the rental income exceeded expenses had some relevance, but was not determinative of whether the property was leased with a view to profit. The overriding focus had to be on the intent of the lessor. Excess rental income over expenses was relevant only to the extent it shed light on the lessor's intention regarding the lease.

Accordingly, in Breeze, Inc., since the testimony about the purpose of Breeze's lease to the school was not disputed, and such testimony was bolstered by other evidence about Breeze's relationship with the school, including that it had adjusted rent to help the school's budget and sometimes deferred or wrote off rent that was due, the case was remanded to the BTA for further proceedings. The BTA had ignored this evidence of the lessor's intent. Thus, the BTA's decision was found to be "unreasonable or unlawful," as it had ignored Breeze's evidence of its intent regarding its lease, and erroneously focused on the mere fact that there was an excess of rental income over expenses.

Going forward these cases only have meaning for charitable or other exemption cases that must demonstrate any income collected was not "with a view for profit."

[1] *Breeze, Inc., supra*, was remanded to the Board of Tax Appeals (BTA) for further review on the lessor's intent; *2350 Morse, LLC, supra*, was determined to be exempt; and *250 Shoup Mill, LLC, supra*, was affirmed as not being exempt.

[2] Under R.C. 5709.12(B), property "used exclusively for charitable purposes" is exempt from taxation. And R.C. 5709.121(A)(2) provides that real property "belonging to a charitable or educational institution * * * shall be considered as used exclusively for charitable or public purposes by such institution," if the property "is made available under the direction or control of such institution * * * for use in furtherance of or incidental to its charitable, educational, or public purposes and not with the view to profit."

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