WISCONSIN LEGISLATIVE COUNCIL

Special Committee Staff Brief 04-5

TAX EXEMPTIONS FOR RESIDENTIAL PROPERTY (COLUMBUS PARK)

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Joint Legislative Council *Madison, Wisconsin*

Special Committee on Tax Exemptions for Residential Property (Columbus Park) *September 17, 2004*

STAFF BRIEF 04-5

TAX EXEMPTIONS FOR RESIDENTIAL PROPERTY (COLUMBUS PARK)

INTRODUCTION

The Special Committee on Tax Exemptions for Residential Property (Columbus Park) is directed by the Joint Legislative Council to study issues surrounding the property tax exemption for property leased as residential housing, including: (1) the impact of *Columbus Park Housing v. City of Kenosha*, 267 Wis. 2d 59 (2003) on the exemption; (2) the effect of the exemption on: municipalities, property taxpayers, residents of tax-exempt housing, the availability of financing for development of low-income housing, and benevolent activities of tax-exempt organizations; and (3) any other issues the committee considers relevant. The committee shall develop and recommend legislation relating to these issues as it finds appropriate.

[Mary Matthias, Senior Staff Attorney, and Laura Rose, Deputy Director, Legislative Council staff, for the Joint Legislative Council's Special Committee on Tax Exemptions for Residential Property (Columbus Park) prepared this brief.]

PART I

PROPERTY TAXES IN WISCONSIN

OVERVIEW

The property tax is one of the main revenue sources for Wisconsin government. According to the Wisconsin Department of Revenue (DOR), the property tax accounts for approximately 37% of all state and local taxes collected. In state fiscal year 2001-02, local property tax collections accounted for $6.57 billion of the $17.93 billion in state and local taxes collected.

The units of government authorized to levy property taxes are school districts, municipalities (cities, villages, and towns), counties, technical college districts, and special purpose districts such as tax incremental financing districts. On a statewide basis, school districts account for the greatest percentage of the property tax levy, followed by municipalities and then counties.

Property taxes are levied based on the value of the property, either real or personal, that is subject to the tax. Both local and state government have a role in administering the property tax system. The local tax assessor determines the assessed value of the property in a taxing jurisdiction subject to the property tax. The DOR determines the equalized value (the state-determined full market value) of the property within the taxing jurisdiction.

The amount of property tax paid by a taxpayer is determined by multiplying each $1,000 of the assessed value of the property by the mill rate for the taxing jurisdiction. The mill rate is expressed in dollars of property tax per $1,000 of property value.

The equalized value of the property is used to apportion the values of property among all of the overlying tax districts in a particular jurisdiction. Real property is categorized into residential, commercial, manufacturing, swamp and waste, productive forestland, agricultural, and "other," which encompasses farm buildings and improvements, and the land necessary for their location. All real property is assessed at the level of the property's full market value, except for agricultural land, which is assessed by its use value.

The Wisconsin Constitution gives the Legislature the ability to empower units of government to collect taxes. The Constitution, under the "Uniformity Clause" (art. VIII, s. 1), imposes limitations on how property taxes may be levied.

The Uniformity Clause provides as follows:

> The rule of taxation shall be uniform but the legislature may empower cities, villages or towns to collect and return taxes on real estate located therein by optional methods. Taxes shall be levied upon such property with such classifications as to forests and minerals including or separate or severed from the land, as the legislature shall prescribe. Taxation of agricultural land and undeveloped land, both as defined by law, need not be uniform with the taxation of each other nor with the taxation of other real property. Taxation of merchants'

> stock-in-trade, manufacturers' materials and finished products, and livestock need not be uniform with the taxation of real property and other personal property, but the taxation of all such merchants' stock-in-trade, manufacturers' materials and finished products and livestock shall be uniform, except that the legislature may provide that the value thereof shall be determined on an average basis. Taxes may also be imposed on incomes, privileges and occupations, which taxes may be graduated and progressive, and reasonable exemptions may be provided.

The most recent case discussing in detail the requirements imposed by the Uniformity Clause is *Gottlieb v. Milwaukee*, 33 Wis. 2d 408, 147 N.W.2d 633 (1967). In *Gottlieb*, the Wisconsin Supreme Court enumerated the following six requirements imposed by the Uniformity Clause:

1. For direct taxation of property, under the Uniformity Clause, there can be but one constitutional class.

2. All within that class must be taxed on a basis of equality so far as practicable and all property taxed must bear its burden equally on an *ad valorem* basis.

3. All property not included in that class must be absolutely exempt from property taxation.

4. Privilege taxes are not direct taxes on property and are not subject to the Uniformity Clause.

5. While there can be no classification of property for different rules or rates of property taxation, the Legislature can classify between property that is to be taxed and that which is to be wholly exempt, and the test of such classification is reasonableness.

6. There can be variations in the mechanics of property assessment or tax imposition so long as the resulting taxation shall be borne with nearly as practicable equality on an *ad valorem* basis with other taxable property.

EXEMPTIONS FROM THE PROPERTY TAX

The Legislature has adopted numerous exemptions for the property tax for both real and personal property, which are set forth throughout ch. 70, Stats. The exemption that is relevant to the Special Committee is s. 70.11 (intro.) and (4), Stats.,[1] which generally exempts property owned and used exclusively by educational institutions, churches, and religious, educational or benevolent associations, including benevolent nursing homes and retirement homes for the aged, women's clubs, historical societies, and certain library associations and fraternal societies.

Prior to enactment of 2003 Wisconsin Act 195 (Act 195), the law provided that if property that was exempt from the property tax under s. 70.11 (4), Stats., was leased, the property retained its tax exemption if three requirements were met:

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[1]A copy of s. 70.11 (intro.) and (4), Stats., is included as part of the initial mailing to members. An electronic copy is available at http://www.legis.state.wi.us/lc/2004studies/TAX/index.htm.

1. The lessee (the person to whom the property is leased) would be exempt from paying property tax if the lessee owned the property. [s. 70.11 (intro.), Stats.] This requirement is commonly referred to as the "lessee identity" requirement.

2. The lessor (the person who owns the property) uses all of the leasehold income for maintenance of the leased property or construction debt retirement of the leased property, or both. [s. 70.11 (intro.), Stats.] This requirement is commonly referred to as the "rent use" requirement.

3. The lessee does not discriminate on the basis of race. [s. 70.11 (4), Stats.]

As explained in Part II, Act 195 amended s. 70.11 (intro.), Stats., to specify that the first requirement -- the lessee identity condition -- does not apply to tax-exempt property that is leased as residential housing.

PART II

COLUMBUS PARK AND SUBSEQUENT LEGISLATION

COLUMBUS PARK HOUSING CORPORATION V. CITY OF KENOSHA

In the City of Kenosha, a dispute arose over whether the Columbus Park Housing Corporation (the Housing Corporation), was exempt from property taxes under s. 70.11 (4), Stats. Columbus Park Housing Corporation is a nonprofit Wisconsin corporation that purchases blighted property, rehabilitates it, and rents it to low-income families who receive federal rent subsidies. The city had assessed and levied taxes against the Housing Corporation, which the Housing Corporation asserted were illegal under s. 70.11 (4).

Kenosha agreed that the Housing Corporation is a benevolent association within the meaning of s. 70.11 (4), Stats., but argued that the statutes nevertheless required it to meet the rent use requirement and the lessee identity condition in order to maintain its tax exemption when it leased property to low-income families. Apparently, until the City of Kenosha raised the issue, those requirements were generally not imposed upon tax-exempt property leased to an individual by a benevolent association and property taxes were not assessed against property utilized in that manner.

Kenosha also questioned whether the requirement, in s. 70.11 (4), Stats., that a benevolent association "exclusively use" its tax-exempt property, was met by the Housing Corporation when it leased its property to individual tenants.

The Wisconsin Supreme Court issued a decision on this issue in November 2003, in *Columbus Park Housing Corporation v. City of Kenosha*, 267 Wis. 2d 59, 671 N.W.2d 633 (2003) ("*Columbus Park*").[2] The Court held that the rent use and lessee identity conditions do apply to tax-exempt property leased to individuals. Specifically, the Court held that property owned by the Housing Corporation was not exempt from property tax because it did not meet the "lessee identity condition." In other words, because the low-income tenants would not be entitled to the exemption if they owned the property themselves, the property was not entitled to the exemption when it was leased to the tenants. Although the Court found that the rent use requirement applied to the property as well, it was not necessary for the Court to analyze whether the Housing Corporation met that requirement once it concluded that it failed to meet the lessee identity condition.

In reaching its decision, the Court considered and rejected several arguments, described below, made by the Housing Corporation. The Court explained that in construing tax exemption statutes, taxation of property is the rule and exemption is the exception. Thus, the Court must apply a strict but reasonable interpretation to tax exemption statutes. The Court stated, "since exemption from the payment of taxes is an act of legislative grace, the party seeking the

[2] A copy of *Columbus Park Housing Association v. City of Kenosha*, 267 Wis. 2d 59, 671 N.W.2d 633 (2003), is included as part of the initial mailing to members. An electronic copy is available at http://www.legis.state.wi.us/lc/2004studies/TAX/index.htm.

exemption bears the burden of proving that it falls within a statutory exemption." Thus, any ambiguity in the statute is resolved in favor of taxation.

The Housing Corporation argued that because the Kenosha Housing Authority (the Authority) is involved in the leases on its property in certain ways, and the tenants receive rent subsidies, the tenants should not be considered lessees for purposes of the tax exemption statute. The Housing Corporation pointed out that the Authority is involved in the leasing arrangement by requiring tenants to attend orientation sessions, issuing vouchers to tenants that allow them to participate in the federal Section 8 housing program, inspecting apartments, requiring tenants to report any changes in their income, and adjusting monthly subsidies if a tenant's income changes. The Authority also enters into contracts directly with property owners to make rent payments on behalf of tenants.

The Court rejected this argument and explained that despite the Authority's involvement, the tenants remain lessees for the purposes of the statute. The Court explained that the term "lessee" is unambiguous in the statute and is synonymous with "tenant." The Court observed that even though the low-income families receive rent subsidies, they have all the normal attributes of tenants, such as signing a lease, being entitled to occupancy of the leased property, and being subject to eviction if they default on rent payments. The Court also noted that federal regulations governing the federal Section 8 housing program consider a rent subsidy recipient, not the housing authority through which a subsidy is provided, to be the tenant of the property for which the subsidy is provided.

The Housing Corporation also argued that despite the fact it could not meet the lessee identity condition, it was nevertheless entitled to a tax exemption. The Housing Corporation argued that the court should construe the lessee identity requirement as applying only when a benevolent association leases property to a for-profit business entity, based on the Court's ruling in a prior decision. The Court refused to do so, stating that the decision in the prior case did not support that interpretation and that such an interpretation of the statute in this way would ignore the plain language of the statute. The Court pointed out that the plain language of the statute does not limit applicability of the lessee identity condition to instances in which a benevolent association leases property to a for-profit business entity. The Court noted that the Legislature carved out an exception to the lessee identity requirement in another subsection of s. 70.11, specifically in sub. (3), which provides, in part, as follows:

> …In addition to the exemption of leased property specified in the introductory phrase of this section, a university or college may also lease property for educational or charitable purposes without making it taxable *if it uses the income derived from the lease for charitable purposes*. [s. 70.11 (3) (b), Stats.; emphasis added.]

The Court stated:

> This is the exact same exception to the lessee identity requirement that Columbus Park asks this court to judicially graft onto subsection four. The fact that the legislature added this language to subsection three but not subsection four when it reorganized subsection four is a strong indication that it did not wish to exempt charitable organizations that lease property to individuals in order to further their charitable purposes. *Columbus Park*, 671 N.W.2d at 644.

The Housing Corporation also argued that it should be entitled to the property tax exemption as a matter of public policy. It argued that since the lessees are the objects of its benevolent activities, and the low-income families might otherwise be homeless, the Court should create an exception to the lessee identity requirement that would apply if the lessees of property owned by a nonprofit organization are the objects of the organization's benevolence.

The Court responded that although the Housing Corporation's activities are laudable, the Court is not authorized to grant tax exemptions. The Court stated that it is the duty of the Court to apply the policy that the Legislature has codified in the statutes, not to impose its own policy choices. The Court said: "…[W]e must apply the statute as written, not interpret it as we think it should have been written." The Court stated: "Columbus Park remains free to lobby the legislature to create a specific exemption for its circumstances." *Columbus Park*, 671 N.W.2d at 645.

Finally, the Housing Corporation argued that if the Court did not grant the property tax exemption in this case, severe consequences would result because a variety of property owned by benevolent organizations, such as nursing homes, summer camps, and portions of hospitals dedicated to the treatment of drug and alcohol abuse, would be denied tax exemptions.

The Court denied that these severe consequences would result. It stated that, following its reasoning in a prior case, if residents of a facility pay fees for the primary and dominant purpose of receiving services, they are not "lessees" for the purposes of the tax exemption statute, and the tax exemption will continue to apply to that property. However, if the primary purpose of an agreement under which residents make monthly payments is for the use and occupancy of property, rather than the receipt of services, the residents are lessees and the tax exemption does not apply. The Court specifically stated that fees paid by residents of nursing homes, continuing care facilities, hospitals providing alcohol and drug treatment and counseling, and summer camps, are for the primary and dominant purpose of receiving services, and therefore property owned by those organizations will remain tax-exempt.

2003 SENATE BILL 512

In response to the Court's decision, 2003 Senate Bill 512 was introduced on March 1, 2004, by Senators Roessler and Stepp.[3]

The bill, as originally introduced, contained the following provisions:

1. For property tax assessments for 2002, 2003, 2004, and 2005, provided that leasing a part of any property that would otherwise be exempt from property taxes does not render the property taxable (regardless of whether the lessee would be exempt from property taxes if the lessee owned the property), if both of the following apply:

    a. The leased property is residential housing.

[3] A copy of 2003 Senate Bill 512 is included as part of the initial mailing to members. An electronic copy is available at http://www.legis.state.wi.us/lc/2004studies/TAX/index.htm.

b. The lessor uses all of the leasehold income for maintenance of the leased property or construction debt retirement of the leased property, or both.

2. A sunset for the exemption described above, to take effect on January 1, 2006. On that date, the changes made by the bill were to be repealed and the law, as interpreted by the Court in *Columbus Park*, was to be reinstated.

3. A directive to the Legislative Council staff to study the effect of *Columbus Park* on property tax exemptions for property that is leased, pursuant to s. 70.11 (intro.), 2001 Stats., and as affected by the bill. The bill required the Legislative Council staff to report its findings, conclusions, and recommendations to the Legislature no later than December 15, 2004.

2003 Senate Bill 512 was referred to the Joint Survey Committee on Tax Exemptions which held a public hearing on the bill and issued a report on March 4, 2004, determining that the bill is good public policy.

The bill was referred to the Senate Committee on Economic Development, Job Creation and Housing, which held a public hearing and executive session on the bill on March 5, 2004.

Much of the testimony and debate around the bill revolved around two related issues: (1) whether the bill should include a "means test"-- in other words, should the tax exemption for property leased as residential housing be limited to property with "low-income" residents, or a certain mix of low-income and other residents; and (2) whether the sunset should be removed.

Although many legislators and persons testifying to the committee stated that a thorough discussion and debate regarding a means test would be worthwhile, it was not feasible to do so in the limited time remaining in the legislative session. Therefore, the bill contained the directive for a Legislative Council study to be conducted. It was argued that inclusion of the sunset date in the bill would act as an incentive to ensure that all interested parties would participate meaningfully in such a debate, and therefore it should be retained. However, others, including WHEDA, argued that the inclusion of the sunset would render the exemption so tenuous that it would make it extremely difficult for WHEDA, and other providers of low-income housing, to obtain financing for low-income housing initiatives and thus would negate any positive impact of the bill on the availability of low-income housing in the state.

After extensive discussion, the Senate committee voted to delete the sunset by adopting Senate Amendment 1, on a vote of Ayes, 5; Noes, 0.[4]

Senate Amendment 1 does the following:

1. Deletes the sunset provision in the bill.

2. Makes a technical correction to the provision in the bill requiring a Legislative Council study. The bill directs the Legislative Council "staff" to study the issue. The

[4] A copy of Senate Amendment 1 to 2003 Senate Bill 512 is included as part of the initial mailing to members. An electronic copy is available at http://www.legis.state.wi.us/lc/2004studies/TAX/index.htm.

amendment deletes "staff." This clarifies that the bill requires a traditional Legislative Council study.

The committee voted to recommended passage of the bill, as amended, on a vote of Ayes, 5; Noes, 0.

On March 9, 2004, the Senate passed the bill on a vote of Ayes 32; Noes, 1. On March 11, 2004, the Assembly concurred in the bill on a vote of Ayes, 90; Noes, 9.

The bill was enacted as 2003 Wisconsin Act 195, described below.

2003 WISCONSIN ACT 195

2003 Senate Bill 512, as amended, was enacted as 2003 Wisconsin Act 195, and took effect on April 23, 2004.[5] The Act provides that the lessee identity requirement does not apply to tax-exempt property leased as residential housing. In other words, property that would otherwise be exempt from property taxes, that is leased as residential housing, does not become taxable solely because the lessee would not be exempt from property taxes if the lessee owned the property. Under the Act, this new provision applies to all future tax assessments and applies retroactively to assessments as of January 1, 2002.

Act 195 does not amend the "rent use" requirement. Therefore, tax-exempt property that is leased as residential housing remains subject to the statutory requirement that all of the lease income must be used for "maintenance of the leased property, construction debt retirement of the leased property, or both."

[5] A copy of 2003 Wisconsin Act 195 is included as part of the initial mailing to members. An electronic copy is available at http://www.legis.state.wi.us/lc/2004studies/TAX/index.htm.

PART III

OTHER LEGISLATIVE PROPOSALS DRAFTED IN RESPONSE TO COLUMBUS PARK

In addition to Senate Bill 512, three other proposals, described below, were drafted in response to the Court's decision in *Columbus Park*. None of the proposals received a public hearing.

2003 ASSEMBLY BILL 963

2003 Assembly Bill 963 was introduced by Representative Berceau and others; cosponsored by Senator Lassa and others.[6] The bill does all of the following:

1. For property tax assessments for 2002, 2003, 2004, and 2005, provides that leasing a part or all of any property that would otherwise be exempt from property taxes does not render the property taxable (regardless of whether the lessee would be exempt from property taxes if the lessee owned the property), if the leased property is housing. The bill does not require the lessor to use the leasehold income for any particular purpose to be eligible for the exemption.

2. Sunsets the provision described above on January 1, 2006.

3. Provides that starting on January 1, 2006, the following property is exempt from property taxes and that leasing a part or all of such property does not render it taxable (regardless of whether the lessee would be exempt from property taxes if the lessee owned the property):

    a. Property that is a "qualified residential rental project," as defined in the bill. A qualified residential rental project under federal law is, generally, a project that rents at least 20% of its residential units to individuals whose income is no more than 50% of the area median gross income or rents at least 40% of its residential units to individuals whose income is no more than 60% of the area median gross income.

    b. Property that is "special housing," which is defined as property owned by a sec. 501 (c) 3. nonprofit organization that is used as a homeless shelter, domestic violence shelter, or transitional housing facility.

The bill does not require the lessor to use the leasehold income for any particular purpose in order to qualify for either of these exemptions. The bill does not contain a sunset date for these exemptions.

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[6] A copy of 2003 Assembly Bill 963 is included as part of the initial mailing to members. An electronic copy is available at http://www.legis.state.wi.us/lc/2004studies/TAX/index.htm.

2003 ASSEMBLY BILL 947

2003 Assembly Bill 947 was introduced by Representative Black; cosponsored by Senator Risser.[7]

The bill provides that leasing a part of any property that would otherwise be exempt from property taxes does not render the property taxable (regardless of whether the lessee would be exempt from property taxes if the lessee owned the property), if the property is any of the following:

1. Property that is owned and used exclusively by a church or a religious, educational, or benevolent association.

2. Property that is owned by a nonprofit organization that holds property for the purpose of building or rehabilitating structures for sale to low-income persons.

3. Property that is owned by a benevolent association and used exclusively as a nursing home, a residential care apartment complex, a community-based residential facility, a facility in which persons reside pursuant to a continuing care contract, or low-income housing under the federal "safe harbor" regulations.

In order for the exemptions to apply to leased property, the lessor must use all of the leasehold income for the maintenance and operation of the leased property or debt (rather than "construction" debt, as under current law), retirement of the property, or both.

The bill's provisions apply retroactively to January 1, 2002. The bill does not contain a sunset date.

2003 SENATE BILL 527

2003 Senate Bill 527 was introduced by Senators Risser and Coggs; cosponsored by Representatives Gunderson, Black, and Van Roy.[8]

The bill provides that leasing a part of any property that would otherwise be exempt from property taxes does not render the property taxable (regardless of whether the lessee would be exempt from property taxes if the lessee owned the property), if the property is any of the following:

1. Property that is owned and used exclusively by a church or a religious, educational, or benevolent association.

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[7] A copy of 2003 Assembly Bill 947 is included as part of the initial mailing to members. An electronic coy is available at http://www.legis.state.wi.us/lc/2004studies/TAX/index.htm.

[8] A copy of 2003 Senate Bill 527 is included as part of the initial mailing to members. An electronic copy is available at http://www.legis.state.wi.us/lc/2004studies/TAX/index.htm.

2. Property that is owned by a nonprofit organization that holds property for the purpose of building or rehabilitating structures for sale to low-income persons.

3. Property that is owned by a benevolent association and used exclusively as a nursing home, a residential care apartment complex, a community-based residential facility, or housing for older persons that satisfies the requirement for homes for the aged under an Internal Revenue Service ruling.

4. Property that is a "qualified residential rental project," as defined in the bill. A qualified residential rental project under federal law is, generally, a project that rents at least 20% of its residential units to individuals whose income is no more than 50% of the area median gross income or rents at least 40% of its residential units to individuals whose income is no more than 60% of the area median gross income.

5. Property that is "special housing," which is defined as property owned by a sec. 501 (c) 3. nonprofit organization that is used as a homeless shelter, domestic violence shelter, or transitional housing facility.

In order for the exemptions to apply to leased property, the lessor must use all of the leasehold income for the maintenance and operation of the leased property or debt (not construction debt, as under current law), retirement of the leased property, or both.

The exemptions above apply to all qualifying leased property, not only property that is leased as housing.

The bill's provisions apply retroactively to January 1, 2002. The bill does not contain a sunset date.