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May 21, 2012

Opinion No. 12-55

Property Tax Exemption for Low-Income Housing Property

QUESTIONS

1. Is Senate Bill 2944/House Bill 2974, 107th General Assembly, 2nd Sess. (2012) (SB2944), which authorizes real property to be given tax-exempt status when the property is owned by a limited liability company (LLC) or limited partnership and has qualified for low-income housing tax credits to be used for the purpose of providing low-income housing, consistent with Article II, Section 28, of the Tennessee Constitution?

2. Would it be constitutional for real property to be given tax exempt status when an LLC, a limited partnership, or a collection of such business entities forms a non-profit organization for the sole purpose of holding legal title to that real property, and then that non-profit leases the real property back to an LLC that has obtained low-income housing tax credits (per Section 42, Internal Revenue Code of 1986) to apply to that property for the purpose of providing low-income housing?

OPINIONS

1. No, SB2944 violates Article II, Section 28, of the Tennessee Constitution because it purports to extend a property tax exemption to an LLC or limited partnership without regard to whether that entity is charitable in nature. As interpreted by the Tennessee courts, the property tax exemption authorized by Article II, Section 28, requires both that the entity holding the property be a charitable organization and that the entity use the property for the charitable purposes for which it was organized.

2. No, the described scenario does not comply with Article II, Section 28, of the Tennessee Constitution. As a general proposition, the General Assembly has the discretion to determine that a non-profit organization that holds and uses its property to provide low-income housing is entitled to a charitable use exemption for its property. As structured, however, the arrangement envisions that a for-profit LLC will acquire a leasehold interest in the property and use the LLC's tax credits to provide low-income housing. The for-profit entity's operation of its business on the property would disqualify the property for a property tax exemption under Article II, Section 28, regardless of the entity's goal of providing low-income housing to community residents.

ANALYSIS

The Tennessee Constitution authorizes the General Assembly to exempt from taxation such property "as may be held and used for purposes purely religious, charitable, scientific, literary or educational." Tenn. Const. art. II, § 28. The initial question addresses whether this constitutionally authorized exemption would include the real property sought to be exempted from taxation by SB2944. Specifically, SB2944 purports to exempt from ad valorem taxation "[p]roperty of limited liability companies or limited partnerships, wherein there is in effect an 'extended low-income housing commitment,' as defined in Section 42 of the Internal Revenue Code of 1986." We presume that SB2944 refers to for-profit LLCs and limited partnerships because nonprofit entities would not benefit from the tax credits of I.R.C. § 42.[1]

The property tax exemption described in SB2944 does not comply with Article II, Section 28, of the Tennessee Constitution. In order to fit within the Constitution's authorized exemption, property must be both held and used for charitable purposes. No authority exists under Tennessee case law interpreting Article II, Section 28, for extending the authorized exemption to for-profit entities, such as LLCs or limited partnerships. To the contrary, these cases require that the owner of the exempt property be a charitable organization and that the charity use the property for the charitable purposes for which it was organized. *See, e.g., Mid-State Baptist Hosp., Inc. v. City of Nashville*, 211 Tenn. 599, 607, 366 S.W.2d 769, 773 (1963) (holding the basis for property tax exemption is that a charitable organization hold and use property for its charitable purposes). Both the charitable nature of the organization and that organization's charitable use of the property are essential to the exemption. *Id.*

A charitable organization that uses its property to conduct for-profit activities "becomes liable for taxation as any other business establishment." *Id.* at 604, 366 S.W.2d at 772. Conversely, a for-profit business is not entitled to a property tax exemption merely because it uses its property for some charitable purposes. *See Rockingham County v. Board of Trustees of Elon Coll.*, 13 S.E.2d 618, 621 (N.C. 1941) (observing that "[t]he fact that a commercial enterprise devotes its entire profits to a charitable or other laudable purpose does not change the character of its business nor the purpose for which it is held. It is still a commercial enterprise, and is held as such").[2] *See also United Brethren Publ'g Establishment v. Shaffer*, 123 N.E. 697, 698 (Ind. App. 1919) (holding that institution claiming tax exemption "must, itself, be a charitable institution, and not one organized for the purpose of profit, notwithstanding the fact that the proceeds or profits of the business are devoted to a most worthy charitable purpose"). It is the entity's nonprofit status, coupled with its charitable use of the property, that creates the exemption.

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[1] Under Tennessee law, limited liability companies may be organized as nonprofit, *see* Tenn. Code Ann. §§ 48-101-701 to 708 & Tenn. Code Ann. §§ 48-101-801 to 809, or as for profit, *see generally* Tenn. Code Ann. §§ 48-201-101 to 48-248-606. In Tennessee, for-profit LLCs are taxed in the same manner as for-profit corporations. *See* Tenn. Code Ann. § 48-211-101. The Internal Revenue Code exempts from the payment of federal income taxes corporations and foundations "organized and operated exclusively for . . . charitable . . . purposes." I.R.C. § 501(c)(3).

[2] Similar to the Tennessee Constitution, the North Carolina Constitution authorizes the North Carolina General Assembly to exempt "property held for educational, scientific, literary, cultural, charitable, or religious purposes." N.C. Const. art. V, § 2(3).

Thus, property that is owned and used by an LLC or limited partnership, as contemplated by SB2944, is not being held and used for a charitable purpose within the meaning of Article II, Section 28. The entity's for-profit status is fundamentally inconsistent with the charitable use exemption, even if some of the entity's activities serve the greater good of the community, such as by providing housing to low-income residents.

The second question concerns the constitutionality of legislation that would grant a property tax exemption to property owned and held by a non-profit organization that then leases the property to an LLC that provides low-income housing to community residents using low-income housing tax credits under Section 42 of the Internal Revenue Code. Tennessee courts have recognized that "the Tennessee Constitution does not define the term 'charitable,'" and "[t]his fact necessarily allows the Legislature some discretion in determining the meaning of the term." *Club Sys. of Tenn., Inc. v. YMCA of Middle Tenn.*, No. M2004-01966-COA-R3-CV, 2005 WL 3479628, at *7 (Tenn. Ct. App. Dec. 19, 2005). The term "charity" has been defined as

> a gift, to be applied consistently with existing laws, for the benefit of an indefinite number of persons, either by bringing their hearts under the influence of education or religion, by relieving their bodies from disease, suffering or constraint, by assisting them to establish themselves for life, or by erecting or maintaining public buildings or works or otherwise lessening the burdens of government.

Id. (quoting *Baptist Hosp. v. City of Nashville,* 156 Tenn. 589, 592, 3 S.W.2d 1059, 1060 (1928)).

Accordingly, in its discretion, the General Assembly could grant a property tax exemption to non-profit organizations that hold and use property for the purpose of providing low-income housing to community residents. The General Assembly reasonably could conclude that the provision of low-income housing assists residents to establish themselves for life and otherwise lessens the burdens of government. In fact, the General Assembly already has created a property tax exemption for certain non-profit corporations that use their property to provide permanent housing for low-income persons with disabilities and low-income elderly persons. *See* Tenn. Code Ann. § 67-5-207. Moreover, Tennessee courts have held that housing may qualify as a charitable purpose. *American Heritage Apartments, Inc. v. Bennett*, No. M2003-02595-COA-R3-CV, 2005 WL 1996623, at *5 (Tenn. Ct. App. Aug. 18, 2005) (citing *Christian Home for the Aged, Inc. v. Assessment Appeals Comm'n,* 790 S.W.2d 288 (Tenn. Ct. App. 1990)). A number of other states likewise have granted property tax exemptions for certain organizations that provide low-income housing. *See, e.g., In re Mental Health Ass'n,* 221 P.3d 580 (Kan. 2009); *New Orleans Towers Affordable Hous. Corp. v. Kahn,* 744 So. 2d 50 (La. Ct. App. 1999); *In re Association for Neighborhood Rehabilitation, Inc. v. Board of Assessors,* 917 N.Y.S.2d 734 (N.Y. App. Div. 2011); *Orange County Appraisal Dist. v. Agape Neighborhood Improvement, Inc.,* 57 S.W.3d 597 (Tex. App. 2001).[3]

[3] It should be noted that, in all of the cited cases, the party claiming the exemption was a nonprofit entity.

In the scenario described in your request, however, the non-profit organization does not hold and use its property for the purpose of providing low-income housing. Instead, the non-profit organization leases the land to an LLC that, in turn, provides low-income housing to community residents using low-income housing tax credits under Section 42 of the Internal Revenue Code. Inasmuch as the LLC using the tax credits is a for-profit entity, this scenario fails to meet the Constitution's requirement that the land be both held and used for charitable purposes. *See* Tenn. Const. art. II, § 28. Although the LLC is providing a valuable service to the community, it is doing so on a for-profit basis, which would disqualify its use of the property as charitable. Moreover, even if the non-profit organization's property could qualify for exempt status, this would not relieve the for-profit LLC from taxation on its leasehold interest in the property. *See* Tenn. Code Ann. § 67-5-502(d) (assessing as real property any "interest that the lessee may have in and to the improvements erected upon land where the fee, reversion, or remainder therein is exempt to the owner").

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