Ohio Tax Talk: Ensuring A Nonprofit's Property Tax Exemption

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Like the federal government and other states, Ohio grants nonprofit organizations the benefit of certain tax exemptions. These include exemptions from the commercial activity tax[1], sales and use tax[2], and in some cases, property tax[3]. However, just as with the federal tax exemption, there are certain requirements for satisfying Ohio's rules for property tax exemption.

Under federal law, a nonprofit organization does not automatically qualify as a tax-exempt 501(c)(3) organization by virtue of organizing as a nonprofit corporation under state law. An organization would need to file an application for tax-exempt status, Form 1023, and maintain a certain level of activities in furtherance of its official charitable purpose. Income from activities deemed outside of the charitable purpose is subject to federal income tax, i.e., unrelated business income tax.

Ohio's real property tax rules work similarly. A nonprofit organization's real property is not automatically tax-exempt because a nonprofit organization owns it. Rather, the Ohio tax commissioner will look to the property's use in determining whether it deserves an exemption from Ohio property tax. Ohio Revised Code Section 5709.12(B) provides a complete property tax exemption for property used exclusively for charitable purposes. While the exemption appears simple, the devil hides in its details.

When it comes to satisfying the exemption's requirements, nonprofits often foot-fault and lose exempt status.
This was recently the case for Dayton Raiders Facilities Inc., or DRFI, a 501(c)(3) taxexempt entity that owns an aquatic center in Ohio[4]. The Feb. 17 Ohio Board of Tax Appeals holding in *Dayton Raiders Facilities Inc. v. McClain* provides a warning to nonprofits that own property in Ohio: Be careful about meeting charitable use exemption requirements or pay the price.

Triggering a property tax obligation can be very expensive for nonprofits since many already operate on a very tight budget. This article provides an analysis of DRFI's pitfalls that led to it losing its

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exemption as well as what other nonprofits can do to protect their exemptions.

Ohio's Charitable Use Property Tax Exemption

Ohio provides a property tax exemption for "[r]eal and tangible personal property belonging to institutions that is used exclusively for charitable purposes."[5] This test can be broken down into two key elements.

First, the property must be owned by a "charitable or educational institution." This requirement is not as simple as being owned by a nonprofit corporation or even an organization that has received federal tax-exempt status under Internal Revenue Code Section 501(c)(3)[6].

Under Ohio law, "[t]he determination whether a property owner qualifies as a charitable institution under R.C. 5709.121 requires examination of the 'core activity' of the institution and determining whether that activity qualifies as charitable for property-tax purposes[7]." Whether an applicant qualifies as a charitable institution is primarily an issue of fact[8].[8] To this end, property owners must prove that the property is used for charitable purposes, which means it is being used to spiritually, physically, intellectually, socially, and economically advance and benefit society without seeking to make a profit[9].

Second, the property's charitable use must be its exclusive use. Ohio Revenue Code Section 5709.121 provides further guidance on the interpretation of the exclusivity requirement, providing a list of situations in which the requirement is satisfied. The list includes making the property available to the public in furtherance of the nonprofit's charitable mission. In its 2001 decision in *True Christian Evangelism v. Zaino*, the Ohio Supreme Court interpreted the exclusivity requirement as a primary use requirement[10]. Nevertheless, this requirement often trips up nonprofits with property in Ohio because leasing the property to for-profit entities or otherwise entering contractual arrangements with for-profit entities concerning the use of the property can taint the exclusivity test.

The Dayton Raiders Facilities Case

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A recent example of a nonprofit failing to satisfy the exclusive charitable purpose test is *Dayton Raiders Facilities Inc. v. McClain* ***[11]***. The case involved a parcel of property housing an aquatic center owned by DRFI, a 501(c)(3) tax-exempt corporation. DRFI acquired the aquatic center in 2015 from the YMCA of Greater Dayton. DRFI opened its aquatics center to the public in furtherance of its charitable mission, which is as follows: To own and operate an aquatic facility and supporting physical fitness training facilities to further the interest and education of children, parents and adults in competitive aquatic sports and physical fitness training within the meaning of 501(c)(3) of the Internal Revenue Code. To encourage and support aquatic programs, aquatic competitions and physical fitness in the Miami Valley and adjoining communities within the meaning of 501(c)(3) of the Internal Revenue Code.

To fund the operation and maintenance of the aquatics center, DRFI structured various revenue streams, including: (1) lease agreements with private swim teams, (2) lease agreements with individual swim coaches, (3) lease agreements with high school swim teams in the area, and (4) membership fees from individual patrons.

Through these revenue streams, DRFI generated more than $230,000 annually in rental income and $500,000 in other income during the 2017-2018 fiscal years. Despite apparently operating the facility within the bounds of its charitable purpose for federal income tax purposes, the state of Ohio looked to whether the use of the property was sufficiently charitable under its own state law standards. DRFI did not have any sort of written policy in place to provide free or even discounted services to low-income patrons who could not afford the membership fees.

One of DRFI's directors even testified that DRFI's mission is to make a profit, which was a very damaging fact. The director further testified that of the approximately 300 children who are enrolled at the aquatics center, only 10 to 20 families receive a reduced membership rate given their financial need.

DRFI argued that the aquatics center qualified for the charitable use property tax exemption because of its nonprofit ownership; the Ohio tax commissioner and the Ohio Board of Tax Appeals disagreed. The commissioner concluded that, given the various

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revenue streams the center had and the lack of official policy for low-income families in the area, DRFI's primary use for the aquatics center is to lease the pools and other center assets to organizations and to offer
services for a fee, e.g., membership fees.

The BTA agreed with the commissioner and noted that "ownership by a non-profit (or even a tax-exempt non-profit) is not dispositive because exemption turns on the actual use of the property; mere ownership by a non-profit is insufficient[12]."

Utilizing this principle, the BTA concluded that DRFI's ownership of the property was not dispositive for purposes of eligibility for the exemption; rather, DRFI's revenue streams suggested the property was being used to make a profit, making it ineligible for the exemption.

Ensuring Your Property Qualifies for the Charitable Use Exemption

As *Dayton Raiders* shows, maintaining the charitable use property tax exemption is not as easy as showing that the owner of the property is a nonprofit corporation. Instead, the burden is on the taxpayer to show that the property is being used exclusively for a charitable purpose. This means to advance and benefit society spiritually, physically, intellectually, socially and economically without seeking to make a profit.

If a nonprofit organization exclusively uses its property to further its own charitable purposes, the exemption should apply. However, the property owner may still need to prove that its use of the property is sufficiently charitable under Ohio law. Nonprofit organizations may be asking how they can lease or make their property available to other users without spoiling its property tax exemption.

First, the nonprofit organization should be aware of the specific use of the property. In other words, who is using the property and what kind of activities are occurring there? Whether the property is being used directly by the owner or another party, the owner should understand and be able to document how the property is being used to advance and benefit society spiritually, physically, intellectually, socially and/or economically.

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Second, the nonprofit should keep detailed records of which areas of the property are being leased to the for-profit entity. At least one nonprofit taxpayer has been successful in arguing that only the portion of its property leased to the for-profit entity was excluded from the exemption; the remainder of the property remained exempt[13].

Third, the nonprofit should be mindful of the fees it is charging to its tenants and users. In *Dayton Raiders*, the BTA focused on the rates that DRFI was charging to tenants. The court found that leasing the property at market rates meant that the activity was primarily commercial, not charitable. Also, the fact that the DRFI representative admitted to the BTA that the organization was leasing the facility out to generate a profit ended up being a fatal flaw in the taxpayer's argument that it was operating the facility for charitable purposes.

DRFI could have bolstered its position that it was acting charitably by providing free or discounted membership to low-income individuals in the community.[14] The BTA found that providing reduced membership rates to only 10-20 families, out of the 300-350 participants, was insufficient. Hence, by making services and use of the property available to those in need, regardless of their ability to pay, can also support a taxpayer's charitable use exemption.

Conclusion

Nonprofits owning property in Ohio should evaluate the decision in Dayton Raiders and the discussion in this article to ensure that their property meets the requirements of the charitable use property tax exemption under Section 5709.12(B). If a nonprofit organization owns property that is not currently tax-exempt and may be qualified for exemption, it should consider filing an exemption application.

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[1] See ORC § 5751.02(A) (not including non-profits within the definition of persons upon
which the tax is levied).
[2] See ORC § 5739.02(B).
[3] See ORC § 5709.12.
[4] *Dayton Raiders Facilities, Inc. v. McClain, Ohio BTA* Case No. 2019-295, 2021 WL
681718.
[5] ORC 5709.12(B).
[6] *Summer Rays, Inc. v. Testa*, 2017-Ohio-7901, ¶ 13, 98 N.E.3d 935, 940–41.
[7] *Rural Health Collaborative of S. Ohio, Inc. v. Testa*, 145 Ohio St.3d 430, 2016-Ohio-508,
50 N.E.3d 486, ¶ 23, citing *Dialysis Clinic, Inc. v. Levin*, 127 Ohio St.3d 215, 2010-Ohio5071, 938 N.E.2d 329, ¶ 22.[8] Summer Rays, Inc., at 940–41.
[9] See *Planned Parenthood Assn. v. Tax Commr.,* 5 Ohio St.2d 117 (1966), paragraph one of the syllabus.
[10] See *True Christianity Evangelism v. Zaino* (2001), 91 Ohio St.3d 117.
[11] 2021 WL 681718.
[12] *Dayton Raiders Facilities, Inc. v. McClain*, 2021 WL 681718, at *2.
[13] See *Heartland Educ. Cmty., Inc. v. Testa*, BTA 2012-277 (9-3-2014), 2014 WL 5406458. (concluding that a property is eligible for the charitable use exemption where "[t]he record demonstrates that most of the uses of the property, with the exception of the café, are used for such a charitable purpose. Although [the taxpayer] does charge a fee, in some instances, for uses of the meeting spaces and for educational classes, it is clear that such fees are merely to recoup a portion of the costs associated with making the space available.")

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