

Michigan: State Supreme Court clarifies test for charitable institution tax exemptions



David M. Kall | Thursday, July 13, 2017

In the case *Baruch SLS, Inc. v. Tittabawassee Township*, the Michigan Supreme Court addressed the test that the state's courts apply to determine whether an entity qualifies as a charitable institution entitled to real and personal property tax exemptions. In so doing, the court vacated the Tax Tribunal's and the Appellate Court's decisions and granted exemption. The vacated decisions had held that Baruch SLS Inc., a non-profit corporation that operates an adult foster care facility called Stone Crest Assisted Living, did not qualify for exemption for the 2010-2012 tax years at issue.

Background

As set forth in the opinion, Stone Crest Assisted Living is a specialized care unit with programs for the aged, developmentally disabled, physically handicapped, and mentally ill. It offers its patients room, board, supervised personal care, and assistance with medications, but does not admit those who require isolation, restraint, or constant professional nursing care, unless the applicant is being admitted to hospice.

All of Baruch's residents have some ability to pay and all qualify for Social Security. Baruch nonetheless argued that its admissions decisions are not based upon an applicant's ability to pay. Baruch does offer financial assistance for eligible residents by way of its Income Based Program, which requires residents to disclose income information and may reduce a resident's monthly rate on the basis of his or her income. Although its policy is that at any given time, 25 percent of available rooms can be used for residents in the

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Income Based Program, Baruch claims that it veers from this policy, and the eligibility mandates, on an ad hoc basis.

Baruch also adheres to a faith-based philosophy, but it is not affiliated with any denomination or church, and it does not consider race, religion, color, or national origin in admissions.

In the lower courts

The Tax Tribunal denied Baruch tax-exempt status for its real and personal property tax liabilities on the grounds that it did not qualify as a charitable institution. To support its denial, the Tax Tribunal cited a 2006 Michigan Supreme Court decision that established a six-factor test for making this determination. The factors are the following:

1. A “charitable institution” must be a nonprofit institution.
2. A “charitable institution” is one that is organized chiefly, if not solely, for charity.
3. A “charitable institution” does not offer its charity on a discriminatory basis by choosing who, among the group it purports to serve, deserves the services. Rather, a “charitable institution” serves any person who needs the particular type of charity being offered.
4. A “charitable institution” brings people’s minds or hearts under the influence of education or religion; relieves people’s bodies from disease, suffering, or constraint; assists people to establish themselves for life; erects or maintains public buildings or works; or otherwise lessens the burdens of government.
5. A “charitable institution” can charge for its services as long as the charges are not more than what is needed for its successful maintenance.
6. A “charitable institution” need not meet any monetary threshold of charity to merit the charitable institution exemption; rather, if the overall nature of the institution is charitable, it is a “charitable institution” regardless of how much money it devotes to charitable activities in a particular year.

In particular, the Tax Tribunal held that Baruch did not satisfy factors three, five, and six, and concluded that:

- Baruch offered its charity on a discriminatory basis, in violation of the third factor.
- Baruch had not proven that its rates were not more than what was needed for its successful maintenance, in violation of the fifth factor.
- The overall nature of Baruch’s operation was commercial, in violation of the sixth factor.

Baruch appealed, and the appellate court affirmed the Tax Tribunal’s conclusion with respect to the third factor, agreeing that Baruch’s policies were discriminatory within the group it served. The appellate court reversed the Tax Tribunal’s holding on the fifth and sixth factors, a result which neither party asked the Supreme Court to review. For that reason, the Supreme Court only addressed the question of whether Baruch offered its charity on a discriminatory basis.

The Court’s analysis

To qualify for real and personal property tax exemption under Michigan law, MCL 211.7o(1), property must be “owned and occupied by a nonprofit charitable institution . . . [and] occupied by that . . . institution solely for the purposes for which [it] was incorporated.” In other words, the property must be owned by a charitable institution and used for exempt purposes as well.

In the Baruch case, the Michigan Supreme Court thus addressed whether Baruch is a charitable institution. The court first stated that its 2006 decision did not mean that an entity must offer its services entirely for free. The court even went so far as to point out other decisions in which it perceived that the Tax Tribunal had denied a taxpayer exempt status solely on the basis that its services were not free.

The court further stated that its 2006 decision caused lower courts to mistakenly require a taxpayer to select its recipients using only arbitrary criteria, such as first-come, first-serve. The court noted that because charitable institutions cannot serve everyone, a taxpayer must select its beneficiaries, or customers, on some basis. The court viewed the third factor, that a charitable institution must offer its services on a nondiscriminatory basis without regard for a consumer’s ability to pay, as colliding with the

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fifth factor, which permits it to charge a fee to maintain its viability.

The court resolved this tension among factors in a manner that arguably allows charitable institutions to discriminate based upon a consumer's ability to pay. That is, the court held that the fifth factor, not the third, should guide a court's rationale regarding fees, and that a taxpayer need not offer its services for free in order to qualify for exempt status; that would be "unrealistic and unsustainable." As a result, an institution's interest in raising revenue and its own "successful maintenance" may allow it to turn away those who cannot pay and still maintain real and personal property tax exemption.

In selecting its customers, the court banned restrictions or conditions on charity "that bear no reasonable relationship to an organization's legitimate charitable goals." The court added that this "'reasonable relationship' test should be construed quite broadly to prevent unnecessarily limiting the restrictions a charity may choose to place on its services." As the court explained,

Any reasonable restriction that is implemented to further a charitable goal that passes factor four is acceptable. While this test is quite deferential to the charitable institution, we note that charity is, by definition, 'a gift.' ...The Legislature has deemed gifts that are beneficial to members of society worthy of encouragement. A deferential test is warranted given that the tax statute itself is silent as to the restrictions a charity may or may not place on its services. ...Therefore, we hesitate to stringently limit charitable institutions.

This "loose construction" principle for property tax exemption runs contrary the Michigan Supreme Court's longstanding precedent including an earlier pronouncement in *Retirement Homes of Detroit Annual Conference of United Methodist Church, Inv. v. Sylvan Tp., Washtenaw County* (1982). There, the Supreme Court denied exemption for apartments that were reserved for healthy seniors who were able to pay rent and other charges in order to live there. The court in *Retirement Homes* cited its cases dating back to 1915 for the proposition that "a property tax exemption is in derogation of the principle that all property shall bear a proportionate share of the tax burden and, consequently, a tax exemption will be strictly construed [against exemption.]"

Nonetheless, under the Baruch case, "the key question a court must ask...is whether the restrictions or conditions the institution imposes on its charity bear a reasonable relationship to a permissible charitable goal," the Court opined that "Baruch's conditions will fail only if they are not reasonably related to a permissible charitable goal under factor four."



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