

BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA

CENTRAL MONTANA FOUNDATION,)	
)	DOCKET NO.: SPT-2000-3
Appellant,)	
)	
-vs-)	FACTUAL BACKGROUND,
)	CONCLUSIONS OF LAW,
THE DEPARTMENT OF REVENUE)	ORDER and OPPORTUNITY
OF THE STATE OF MONTANA,)	<u>FOR JUDICIAL REVIEW</u>
)	
Respondent.)	

The above-entitled appeal was heard on briefs. The deadline for receipt of briefs was May 10, 2001. The taxpayer's briefs and arguments were prepared by William E. Berger, attorney. The Department of Revenue's (DOR) position was outlined by Stephen R. McCue, tax counsel.

The duty of this Board is to determine whether the property qualifies for an exemption based on a preponderance of the evidence. Central Montana Foundation is the appellant in this proceeding and, therefore, has the burden of proof. Based on the evidence and testimony, the Board finds that the decision of the Department of Revenue is affirmed.

STATEMENT OF ISSUE

Is land owned by Central Montana Foundation, (Foundation) a charitable institution, which the Foundation

leases under a cash lease for commercial agricultural use, entitled to exemption from property taxation?

FACTUAL BACKGROUND

1. Due, proper and sufficient notice was given of this matter, and of its briefing schedule. All parties were given the opportunity to present documentary evidence.

2. Lillian C. Kolar donated the land which is the subject of this appeal to the Foundation with the intention that its rental income would pay for the maintenance of the tennis courts and track at Fergus High School. The property is described as follows:

Land only, described as 480 acres of farm and ranch land in the E2NW4, NE4SW4, W2NE4, SE4NE4, E2SE4 & NW4SE4 of Section 18 and the SW4NW4, NW4SW4 & SW4SW4, less road and other portion of Section 17, all in Township 15 North, Range 18 East, County of Fergus, State of Montana.

3. The Foundation applied for a property tax exemption for the subject property on the grounds that its rental income is used for purely public charitable purposes. (Application #0800400.)

4. On June 19, 2000, the DOR notified the Foundation that its request for a tax exemption had been denied. The letter from Virgil Byford, tax specialist, stated in pertinent part:

Reason for Denial: This property is leased out and used for farming/ranching and, therefore,

does not meet the use requirements of 15-6-201, MCA.

Processing has been completed on the above referenced application and regretfully exemption is hereby denied. The evidence submitted did not support exemption as outlined in Part 2, Chapter 6, Title 15 M.C.A., as amended. If circumstances change such that you can meet the requirements of the above referenced statute, you are invited to apply again in the future.

7. On July 19, 2000, the Foundation appealed that decision to this Board, stating:

The Central Montana Foundaton does hereby appeal the decision of Virgil F. Byford of the Department of Revenue on June 19, 2000 which denied the tax exempt status of certain agricultural property in Fergus County, Montana, referenced in that decision.

The Central Montana Foundation appeals on the grounds that 15-6-201, MCA allows agricultural real property to be exempt from taxation where it and the income is used for purely pubic charitable purposes. This land, and the income is designated for use of Fergus County High School for maintenance of existing facilities.

8. By letter dated July 21, 2000, the Board accepted the Foundation's appeal and so notified the Department of Revenue.

9. On August 18, 2000, Stephen R. McCue, DOR tax counsel, responded to the Foundation's complaint, stating in pertinent part:

The Department denies the allegation contained in the second paragraph of the Complaint that the agricultural real property owned by Central Montana Foundation (the "Foundation") is used for purely public charitable purposes and is,

therefore, exempt from taxation under § 15-6-201, (1) (e), MCA.

The Department alleges that the agricultural real property is not entitled to exemption from taxation under § 15-6-201 (1) (e), MCA, because the real property is leased by the Foundation for farming and ranching purposes. This is not a direct use of the property for purely public charitable purposes as required to claim the tax exemption by § 15-6-201 (1) (e), MCA.

The Department is without knowledge or information sufficient to form a belief as to the truth of the allegation contained in the second paragraph of the Complaint that the income derived from leasing the agricultural real property owned by the Foundation is used for purely public charitable purposes, including use by Fergus County High School for maintenance of existing facilities, and is, therefore, exempt from taxation under §15-6-201 (1) (e), MCA. The Department therefore denies this allegation.

10. From the parties' Stipulated Statement of Facts, dated February 23, 2001:

Lillian C. Kolar of Lewistown, Montana gifted to Central Montana Foundation of Lewistown, Montana, the land described in Exhibit "A" attached hereto and incorporated herein by this reference.

Central Montana Foundation is an organization for benevolent and charitable public purposes. See Exhibit "B" attached hereto and incorporated herein by this reference.

That Central Montana Foundation is an exempt organization under 501 (c) (3) IRC. See Exhibit "C" attached hereto and incorporated herein by this reference.

The land described in Exhibit "A" is agricultural land subject to a Farm Lease Agreement. See Exhibit "D" attached hereto and incorporated herein by this reference.

The income from the Farm Lease Agreement, Exhibit "D", is used for maintenance of the tennis courts and track of Fergus High School See Exhibit "E" and "F" attached hereto and incorporated herein by this reference.

There are no paid employees of Central Montana Foundation except a part time secretary, who is paid from non-restrictive funds.

The Federal tax return for Central Montana Foundation for year 1999 has been recently filed, a copy will be filed with Montana Department of Revenue pursuant to 15-6-201 (2) (a) (ii).

FOUNDATION'S CONTENTIONS

Mr. Berger's initial brief states that the Foundation is a non-profit organization that originated in Lewistown, Montana in 1985 for the benefit of the citizens of Central Montana. These benefits are to promote the "educational, cultural, charitable or benevolent purposes for the benefit, health and improvement of residents of the Central Montana area in such a way that the quality of life in the Central Montana area shall be enhanced." (Exhibit "B", the Central Montana Foundation Amended Declaration of Trust, Article I - Purpose).

To date, the Foundation has accumulated numerous assets which include 480 acres of farm and ranch land. The subject farm and ranch land was received as a gift from Lillian C. Kolar of Lewistown, Montana on June 19, 1999.

The Foundation is not in the business of operating a farm or ranch. The farm is leased on a cash lease basis and the income is directed to Fergus County High School. The Foundation's purpose is to make charitable gifts to enhance life in central Montana.

According to § 15-6-201 (1) (e), the subject land qualifies for exemption from property taxation because it is used for purely public charitable purposes. Mr. Berger recognizes that § 15-6-201 (1) (e) provides that agricultural land cannot be exempt if it is used to produce unrelated business income. Mr. Berger relies upon an IRS ruling which states that income derived from real property owned by a charitable institution is not unrelated when the income was received from a crop share lease, even if the entity did incur some expenses connected with the agricultural property, because the foundation did not engage in active conduct of a farming operation. He maintains that the foundation is merely engaging in activities designed to preserve the quality of land and maintain its long-term value as rental property. (IRS letter ruling TAM 8808002, Exhibit 1) IRS Letter Ruling 8808003 of October 29, 1987 further supports the position that a cash lease does not involve participation by the foundation and the income from the cash lease is not unrelated business income under 512 IRC.

The Foundation does not incur any expenses from operating the farm. The lease is a cash lease and the income from this lease is not unrelated business income. The Foundation attached two IRS Letter Rulings to its brief, which addressed leases of farm land in which the lease income was paid to charitable organization. These IRS Letter Rulings were to demonstrate that the Foundation itself is not involved in crop production and, therefore, does not have unrelated business income. This assertion qualifies the Foundation for exemption under § 15-6-201 (2) (a) (ii), MCA:

(2) (a) (iii) For the purposes of subsection (1) (e): . . . agricultural property owned by a purely public charity is not exempt if the agricultural property is used by the charity to produce unrelated business taxable income as that term is defined in section 512 of the Internal Revenue Code, 26 U.S. C. 512. . .

All income from the land is devoted to public charitable purposes. The ranch property is directly used for public purposes as its income is entirely designated for charitable purposes and cannot be used for any other purposes.

The taxation of a bequest such as that by Lillian Kolar to the Foundation would diminish the benefit the donor intended.

The Foundation meets the requirements of § 15-6-201 (a) in that it exists for purely public charitable purposes; IRS exemption letter of April 28, 1987 (Exhibit C)

and is, therefore, entitled to exemption from property taxation.

In his reply brief on behalf of the Foundation, Mr. Berger responded to the DOR's position that the Montana Supreme Court decision in *Steer, Inc., v. Department of Revenue*, (1990), 245 Mont. 470, 803 P.2d 601, is dispositive in this matter. Mr. Berger argued that the statute under which *Steer* was decided (§ 15-6-201, MCA) was significantly changed by the 1999 Montana Legislature. § 15-6-201 (2) (a) was changed by adding, among other changes, § 15-6-201 (2) (a) (ii) which now reads: "agricultural property owned by a purely public charity is not exempt if the agricultural property is used by the charity to produce unrelated taxable income." Mr. Berger finds it significant that the legislative has specifically set forth that "agricultural property" has an exemption if owned by a purely public charity. He argued that the 1999 amendment solved the dilemma of the Montana Supreme Court had in *Steer* which produced two dissents. Mr. Berger stated that these dissents contain the language which best sets forth the intent of § 15-6-201, MCA, and its relationship to charitable giving. Justice Sheehy's dissent contained the opinion that the property of an institution of purely public charity is entitled to exemption from taxation and the fact that the

charity holds its property to gain income which in turn is used for charitable purposes should not eliminate the exemption.

DOR'S CONTENTIONS

Contrary to that of the Foundation, the DOR's position is that the subject property does not qualify for tax exemption because the land is not directly used for purely public charitable purposes as required by § 15-6-201 (1) (e), MCA:

*(1) The following categories of property are exempt from taxation: . . .
(e) subject to subsection (2), property that is owned or property that is leased from a federal, state or local government entity by institutions of purely public charity if the property is directly used for purely public charitable purposes . . . (Emphasis supplied.)*

Thus, the DOR argued that the land does not satisfy the "use" test for exemption and relies upon case law in *Steer, Inc., v. Department of Revenue* (1990), 245 Mont. 470, 803 P.2d 601.

Steer involved a non-profit corporation (*Steer, Inc.*) which received donations from individuals. Those donations were used to purchase livestock which were, in turn, placed with farmers who would feed and care for the livestock. This livestock was then sold in *Steer's* name and all profits were forwarded to *Steer, Inc.* The farmers were able to

claim a tax deduction for the expenses associated with the care of the livestock as were the original donors who supplied Steer, Inc. with cash to purchase the livestock. The sales profits, less Steer, Inc.'s administrative and insurance costs, were donated to member evangelical organizations.

In *Steer*, the Montana Supreme Court considered an issue similar to the present as to what constitutes "direct" use of property necessary to satisfy the statutory requirements of § 15-6-201 (1) (e), MCA. The Court found, in *Steer*, that:

[W]hen considering tax-exempt status, it is the use of the property that is determinative rather than the ownership of the property. [Citation.] Steer exclusively used the cattle as a capital investment to produce funds, which in turn, were donated to member evangelical organizations that provide beneficial services to the needy; Steer did not directly use the cattle to feed needy people . . .

. . . We [hold] that Steer's use of its cattle as a capital investment [is] determinative in deciding that it [does] qualify for a tax-exemption based on being an "institution of purely public charity."

Steer, 245 Mont. at 476-77,803 P.2d at 604-605 (Emphasis added.)

The DOR thus concludes that the Supreme Court has found that the property must be directly used for the charitable purpose of the charitable organization in order to qualify

for exemption. That is, the livestock would have to have been donated directly to needy people, i.e., by butchering the cattle and providing the meat directly to them. Since Steer, Inc. used the cattle as an investment, and used only the profits from its investment to donate to member evangelical organizations to provide beneficial services to the needy, its cattle did not qualify for tax exemption under § 15-6-201 (1) (e). The DOR's contention is that the statutory use test, as applied in *Steer*, should guide this Board in deciding the case at hand.

The Foundation owns land which is leased for agricultural purposes to a commercial farming operation (Exhibit "D"). The cash proceeds from the farm lease received by the Foundation are used for its charitable purposes. These purposes are the "educational, cultural, charitable or benevolent purposes for the benefit, health and improvement of residents of the Central Montana area in such a way that the quality of life in the Central Montana area shall be enhanced." (Exhibit "B", the Central Montana Foundation Amended Declaration of Trust, Article I - Purpose).

The DOR argued that, similar to *Steer*, the property itself is not directly used for the charitable purposes of the Foundation. The property is not used, for example, to

conduct agricultural classes for local farmers using the land, at no profit to the Foundation. The crops grown on the land are not donated and feed directly to the needy. The DOR cites these as examples of how the land might be directly used to achieve the stated public charitable purposes of the Foundation.

The DOR does not concede the issue of unrelated business income production by the Foundation, but it does believe the IRS Letter Rulings referenced by the Foundation serve to bolster the Foundation's position that it is not involved in crop production and therefore does not have unrelated business taxable income under I.R.C. § 512. However, the DOR's position is that both the use test and the unrelated business income test must be satisfied in order to qualify for exemption. The Foundation does not meet the "use test" of § 15-6-201 (1) (e), MCA, in that its land is not directly used to achieve its stated public charitable purposes.

BOARD'S DISCUSSION

The Board concludes that the subject land does not qualify for exemption based upon its failure to meet the statutory requirements of § 15-6-201 (1) (e), MCA. The Board also looked to the *Steer* case referenced by the DOR for guidance in its determination.

The land in question is not directly used to accomplish its charitable purposes. A strict adherence to the controlling statute (§ 15-6-201 (1) (e), MCA), which this Board is required to do, leads it to the conclusion that a direct relationship between the use of the land and the stated charitable purposes does not exist.

The Board does not dispute the charitable intentions of the Foundation and finds it to be an unfortunate circumstance, indeed, that its charitable giving may be negatively impacted.

CONCLUSIONS OF LAW

1. The State Tax Appeal Board has jurisdiction over this matter. **§15-2-301, MCA.**

2. **§15-2-302, MCA. Direct appeal from department decision to state tax appeal board - hearing. (2)(a)** Except as provided in subsection (2)(b), the appeal is made by filing a complaint with the board within 30 days following receipt of notice of the department's final decision.

3. **§15-6-201, MCA. Exempt categories. (1)** The following categories of property are exempt from taxation: ... **(e)** subject to subsection (2), property that is owned or property that is leased from a federal, state, or local governmental entity by institutions of purely public charity if the property is directly used for purely public

charitable purposes. (Emphasis supplied).

4. *Steer, Inc. v. Department of Revenue* (1990), 245 Mont. 470, 803 P.2d 601.

6. The appeal of the taxpayer is hereby denied and the decision of the Department of Revenue is affirmed.

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ORDER

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the subject property shall remain on the tax rolls of Fergus County pursuant to § 15-6-201(1)(e), MCA.

Dated this 1st day of June, 2001.

BY ORDER OF THE
STATE TAX APPEAL BOARD

(S E A L)

GREGORY A. THORNQUIST, Chairman

JERE ANN NELSON, Member

LARRY L. BROWN, Member

NOTICE: You are entitled to judicial review of this Order in accordance with Section 15-2-303(2), MCA. Judicial review may be obtained by filing a petition in district court within 60 days following the service of this Order.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 1st day of June, 2001, the foregoing Order of the Board was served on the parties hereto by depositing a copy thereof in the U.S. Mails, postage prepaid, addressed to the parties as follows:

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