SOMEWHERE *UNDER THE RAINBOW*: THE JOURNEY TOWARD CHARITABLE PROPERTY TAX EXEMPTION SOLUTIONS

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I. Introduction

Property taxes are a crucial consideration for any profit-seeking business. Attaining exempt status can be even more crucial for nonprofit organizations and charitable institutions, many of which barely break even or must survive on donations while operating at a loss. These taxes are more mountain than molehill for local governments as well—charitable property tax exemptions cost them between eight and thirteen billion dollars per year.[2] In many regions of the United States, determination of exempt status was a hot issue fifteen years ago until it "fizzle[d] out with little resolution."[3] But since its recent return, it appears likely that significant clarity and progress in this field of tax policy will be achieved this time around.[4] It is probable that in "[o]ne way or the other, most states, and perhaps Congress, will be enacting refinements—if not significant changes—to exemption standards."[5]

Exemptions granted to charities total roughly 1.2 percent of city budgets, on average, and about 0.6 percent of total property tax assessments.[6] There are an estimated 837,000 charitable nonprofit organizations in the United States, each of which is subject to its

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[2] Evelyn Brody, *The States' Growing Use of a Quid-Pro-Quo Rationale For The Charity Property Tax Exemption*, 56 EXEMPT ORG. TAX REV. 3, 269 (2007).

[3] Lawrence E. Singer, *Leveraging Tax-Exempt Status of Hospitals*, 29 J. LEGAL MED. 41, 57 (2008).

[4] *Id.*

[5] *Id.*

[6] Terry Schwadron, *To Tax or Not to Tax? Cities Ask the Billion-Dollar Question*, N.Y. TIMES, Nov. 12, 2007, at H30. (These assessments represent the total value of buildings and land on a locality's tax rolls.)

state's laws.[7] These organizations and their managers, consultants, and advisers "have been uneasily watching renewed congressional and IRS interest in the standards" needed for exempt status.[8] This is the case because, while each state's property tax exemption statute might appear short and clear on first glance, many states have failed to clearly delineate the types of organizations that deserve exemption.[9]

This problem of categorization is the starting point for this discussion. This note will discuss how, in recent years, viewing property tax exemption as "a subsidy granted by government rather than as an inherent entitlement" of nonprofit organizations is increasingly popular.[10] Specifically, it will explore the saga of charitable exemption law in Minnesota, where the state judiciary has put more pressure on previously and prospectively exempt organizations to prove that they deserve the special tax treatment.[11] It will then describe the current state of affairs which followed the Minnesota Supreme Court's landmark *Under the Rainbow*[12] decision. Finally, the note will apply the lessons learned from the Minnesota narrative to other states and into the future, where the form of the taxes themselves may be very different, as "more charities and cities are making deals for payments in lieu of property taxes."[13] The full effects of these changing forces in charitable exemption law remain to be seen, but the forces are very real.

II. Charitable Property Tax Exemptions Generally

First, an introduction is in order. To finance municipal projects, local governments levy property taxes on real property owners.[14] The basic rationale for nonprofit tax exemption is that such organizations "provide a public service or substantially reduce the

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[7] *Id.*
[8] Brody, *supra* note 2, at 288.
[9] *See, e.g.* MINN. STAT. § 272.02, subd. 7 (2006).
[10] *Id.* at 270.
[11] *See* Stephanie Strom, *Tax Exemptions of Charities Face New Challenges*, N.Y. TIMES, May 26, 2008, at A1.
[12] Under the Rainbow Child Care Ctr., Inc. v. County of Goodhue, 741 N.W.2d 880 (Minn. 2007).
[13] Schwadron, *supra* note 6.
[14] BLACK'S LAW DICTIONARY 1498 (8th ed. 2004).

burdens of government."[15] Thus, in a sense, local governments "pay" (by not taxing) these organizations in return for a supposed government service. But why limit these exemptions to nonprofits when for-profit institutions can lessen the burdens on government just as easily, or perhaps even more? The answer lies in the fundamental nature of nonprofit organizations: "A nonprofit organization is a firm. But it is, by law, a firm without claimants to residual profits."[16] This special "nondistribution constraint" is, and has been for centuries, the basic feature that differentiates for-profits and nonprofits from an economics perspective.[17] This constraint is codified in I.R.C. § 501(c)(3) itself.[18] As a result of this perceived unique social value, nonprofits can potentially receive these tax subsidies that for-profit organizations cannot access.[19]

States enact property tax exemptions either in statutory form or in the state constitution, and sometimes in both.[20] The federal exemption cited above is distinct and has a wider scope which prevents taxation of the income of charities.[21] Exempt status under I.R.C. § 501(c)(3) is often necessary to entitle an organization to property tax exemption.[22] However, federal exempt status is hardly sufficient for property tax exemption as a threshold matter.[23] While

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[15] Strom, *supra* note 11.

[16] Evelyn Brody, *Agents Without Principals: The Economic Convergence of the Nonprofit and For-Profit Organizational Forms*, 40 N.Y.L. SCH. L. REV. 457, 535 (1996).

[17] *Id.* at 458.

[18] 26 U.S.C.A. § 501(c)(3) (2006) provides: "Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, *no part of the net earnings of which inures to the benefit of any private shareholder or individual*, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office." (emphasis added).

[19] Brody, *supra* note 16, at 457.

[20] Brody, *supra* note 2, at 269.

[21] Strom, *supra* note 11.

[22] Brody, *supra* note 2, at 275.

[23] *Id.* at 269.

state statutes exhibit wide variety in diction, "they have several features in common. In general, exempt property must be owned and operated by a nonprofit religious, educational, charitable, or . . . healthcare institution, exclusively for exempt purposes."[24]

Much of the difficulty in determining which organizations warrant exemption arises because many statutes lack specific guidance on how to quantify the community benefit provided by an organization.[25] This leaves nonprofits to their own interpretation of how to provide the "right" amount of charitable services that will qualify the organization as exempt.[26] Additionally, no single quantification formula for community benefit can be sufficient because different communities have different types and levels of unmet needs. Property tax exemption policies are set at the state level, but property tax units are local—thus, a "community benefit" burden might be distributed unevenly throughout a state.[27] Property ownership and saturation of charities tends to "cluster in center cities," which means that "the benefits of a particular charity's activities might be enjoyed more broadly than the narrowly bounded municipality that bears the cost of the exemption."[28] These factors make any kind of community benefit metric nearly impossible to implement.

Furthermore, it is often impossible to determine the type of benefit offered by an organization. Determining exempt status based on a mission statement or a firm's articles of incorporation is efficient in theory, but such a system is not feasible. The nature of an institution's community benefit can change over time, and can even be the central issue on appeal from a tax court determination in favor of or against exempt status.[29] An organization's exempt status "depends upon the concurrence of the institution's ownership and use of the property for the purposes for which it was organized."[30] This is often an unexpectedly difficult matter to establish.

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[24] *Id.* at 275.
[25] Singer, *supra* note 3, at 59.
[26] *Id*.
[27] Brody, *supra* note 2, at 270.
[28] *Id.*
[29] *See*, *e.g.*, Battelle Mem'l Inst. v. Dunn, 73 N.E.2d 88, 90 (Ohio 1947) (acknowledging that "[t]he scope of the activities of the institute has become through the years broader and more varied than was originally contemplated by Gordon Battelle").
[30] State v. Willmar Hospital, Inc., 2 N.W.2d 564, 566 (Minn. 1942).

III. The Convergence of Nonprofit and For-Profit

The charitable property tax exemption is no new machination, so why have assessors and courts been recently reevaluating what it means to warrant exemption? One commentator notes that "[o]ne issue is the growing confusion over what constitutes a charity at a time when nonprofit groups look more like businesses, charging fees and selling products and services to raise money, and state and local governments are under financial pressure because of lower tax revenues."[31] Recently, there have been shifting pressures emanating from the resources on which charities depend, and these pressures have forced many nonprofits to act in a more "business-like" way.[32] This apparent convergence of the nonprofit and for-profit sectors can undermine the fundamental rationale for granting property tax exemptions to the former, and the introduction of a wider range of commercial-type activities can cause the public support for such exemptions to wane.[33]

There are many explanations for this perceived convergence of nonprofits and for-profits. An economic account notes that "[f]irms, whether nonprofit or proprietary (or even public), are subject to many of the same economic forces, such as resource dependency, institutional isomorphism, and organizational slack."[34] William Foster and Jeffrey Bradach offer a helpful overview of the economic viewpoint:

> Like their counterparts in the commercial world, managers of nonprofits want to be viewed as active entrepreneurs rather than as passive bureaucrats, and launching a successful commercial venture is one direct route to that goal. Board members, many of whom are accomplished business leaders, often encourage and reinforce that desire. At the same time, many philanthropic foundations and other funders have been zealously urging nonprofits to become financially self-sufficient and have aggressively promoted earned income as a means to "sustainability". . . . As a result, nonprofits

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[31] Strom, *supra* note 11.
[32] Brody, *supra* note 16, at 528.
[33] Brody, *supra* note 2, at 270.
[34] Brody, *supra* note 16, at 535.

> increasingly feel compelled to launch earned-income ventures, if only to appear more disciplined, innovative, and businesslike to their stakeholders.[35]

Both sectors bear strong resemblances to each other, and beyond the nonprofit sector's distinctive nondistribution constraint, the organizational form of a business in each sector can overlap almost entirely.[36] Both sectors operate through agency theory and must respond to both human and market forces.[37]

In addition to economic forces, there are social forces at work as well. "The general enthusiasm for business" that climaxed during the 1990s drove many nonprofits to change gears and pursue profits (and has also impacted the institutions that promote and support those nonprofits).[38] An associate at a Boston nonprofit consulting firm attributed the trend partially to new expectations placed on charitable organizations: "Evaluation is coming up more and more—people are evaluating the work of nonprofits a lot more. It isn't enough that services are provided for an unmet need—there's the 'so what?' effect, and six months later, the work will be evaluated."[39] The associate also observed that "gone is the time when nonprofit employees were boxed into having a certain type of training—now, business people and consultants and other new types of people are being brought in."[40]

Interestingly, the effects of this convergence trend are not apparent in all aspects of a typical exempt nonprofit organization because the services themselves are often unaffected. Jeannie Fox, Deputy Public Policy Director at the Minnesota Council of Nonprofits ("MCN")[41] notes:

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[35] William Foster & Jeffrey Bradach, *Should Nonprofits Seek Profits?*, 83 HARV. BUS. REV. 2, 92 (2005).
[36] *See generally* Brody, *supra* note 16, at 458.
[37] *Id.*
[38] Foster & Bradach, *supra* note 35, at 92.
[39] Telephone interview with associate at nonprofit consulting firm (preferred to remain anonymous), in Boston, Mass. (Sept. 4, 2008).
[40] *Id.*
[41] The Minnesota Council of Nonprofits offers the following mission statement on its website, http://www.mncn.org: "MCN works to inform, promote, connect and strengthen individual nonprofits and the nonprofit sector."

> There is no trend in services offered—the services look the same. But there are external factors that have changed. For example, an organization that used to operate on a block grant system might now have almost a medical model where it will bill others and run on a fee-based system. But the services are the same.[42]

The convergence of nonprofit and for-profit is more observable in the business practices, financing, and management of nonprofits. For example, major adjustments have occurred in many exempt hospitals, which have tweaked their business practices by raising executive compensation to attract and retain qualified executives and adopted rigorous balance sheet focused methodologies.[43] These hospitals have made these adjustments "to survive in the environment created for them . . . . Clearly, a convergence in business practice has occurred between exempt organizations and their proprietary brethren."[44]

The big picture policy predicament behind all this is whether this convergence has created a paradigm in which state legislatures and state judiciaries should cease to recognize the exempt status of nonprofits.[45] To restate the question in terms of the hospital sector discussed above, "might it be the case that differences between exempt and for-profit hospitals—if any—are so small as to no longer merit granting tax-exempt status to hospitals?"[46]

The complexity of the problem is obvious. On the one hand, nonprofits and for-profits are subject to the same social and economic forces, and each in turn seeks "the desire for a reputation as a worthy recipient of future trade, be it donations, purchase of services, government contracts, or labor."[47] At the same time, the initial government-burden-relieving rationale still holds true for many nonprofit organizations regardless of whether they have or have not become more business-like. Despite growing similarities, the sectors are distinct and it will likely stay that way: "Nonprofits

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[42] Telephone interview with Jeannie Fox, Deputy Pub. Policy Dir., Minn. Council of Nonprofits, in St. Paul, Minn. (Sept. 5, 2008).
[43] Singer, *supra* note 3, at 43.
[44] *Id*.
[45] *Id*.
[46] *Id.*
[47] Brody, *supra* note 16, at 461.

will always find a way to deliver their services, and they will always be different than for-profit organizations. They are fundamentally different. The benefit [they create] will always go to the public."[48]

IV. Effects of the Convergence on Exemption Denial

Recent headlines show a direct effect of the changing circumstances: "Despite a long tradition of waiving taxes for charitable nonprofit groups, communities are feeling more pressure to eliminate property tax exemptions."[49] The economic and social forces discussed above have shifted the foundation of the nonprofit sector, and in many cases, exemption denial has followed. Thus, "it's almost like nonprofits are being punished for adapting to a changing economy."[50] Furthermore, recent rumblings across the national legal scene have suggested "a growing acceptance by the states of a quid pro quo rationale" for exemption status.[51] For example, Connecticut localities recently faced budget shortfalls and decreased state aid, resulting in more aggressive property tax collection practices in the last few years.[52]

So to what can one look to find how charitable an organization must be to earn exemption from taxation? This inquiry has changed over time, as "[h]istorically, state approaches to determining satisfaction of their taxexemption [sic] requirements for all practical purposes, involved minimal policing, with states granting state exemption whenever the organization receives federal tax exemption."[53] Merely making medical services "available" to people regardless of ability to pay was a community benefit forty years ago.[54] Yet, the Minnesota Supreme Court held in the 1970s that traditionally charitable activities are those from which people ultimately benefit in an economic sense.[55] That court also stated the less ambiguous proposition that when a nonprofit uses property for

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[48] Fox, *supra* note 42.
[49] Schwadron, *supra* note 6.
[50] Fox, *supra* note 42.
[51] Brody, *supra* note 2, at 270.
[52] *Id.*
[53] Singer, *supra* note 3, at 46.
[54] *Id.*
[55] North Star Research Inst. v. County of Hennepin, 236 N.W.2d 754, 757 (Minn. 1976).

the private financial gain of a class or industry, such organization is not charitable enough for exemption.[56]

While some feel that a broad community benefit test might work better than a more narrow focus on the charitable nature of an organization,[57] charity is still the main focus of courts. The existence of for-profit competitors is also not a dispositive consideration for courts, although it is often taken into account.[58] One way of determining how "charitable" an organization must be is through a multifactor test that some states have synthesized.[59] The test might require a charitable nonprofit to meet certain prerequisites, such as donating services and reducing government burdens.[60] One such state is Minnesota.

V. Background of the Minnesota Saga

Underlying Minnesota's property tax exemption laws is a basic presumption that all property is taxable.[61] Thus, the taxpaying organization bears the burden of proving its entitlement to exempt status.[62] Minnesota has charitable property tax exemption provisions in both its Constitution[63] and its general statutes.[64] Many different

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[56] *Id.* at 759 (quoting Battelle Mem'l Inst. v. Dunn, 73 N.E.2d 88, 92 (Ohio 1947)).
[57] Singer, *supra* note 3, at 44.
[58] Brody, *supra* note 2, at 278.
[59] *Id.* at 279.
[60] *Id.* at 269.
[61] Am. Ass'n of Cereal Chemists v. County of Dakota, 454 N.W.2d 912, 914 (Minn. 1990).
[62] *Id.*
[63] MINN. CONST. art. X, § 1, which provides in part: "[t]axes shall be uniform upon the same class of subjects and shall be levied and collected for public purposes, but . . . institutions of purely public charity . . . shall be exempt from taxation except as provided in this section."
[64] MINN. STAT. § 272.02, subd. 7 (2006) provides: "Institutions of public charity. Institutions of purely public charity are exempt. In determining whether rental housing property qualifies for exemption under this subdivision, the following are not gifts or donations to the owner of the rental housing: (1) rent assistance provided by the government to or on behalf of tenants; and (2) financing assistance or tax credits provided by the government to the owner on condition that specific units or a specific quantity of units be set aside for persons or families with certain income characteristics."

types of property qualify for exemption under these two provisions.[65] Both provisions reference the idea of the "purely public charity." As will become clear, the amorphous definition of this particular phrase is the direct cause of much of the recent fervor over exemption denials in Minnesota and in other states. Even the definition of the constituent word "charity" is explicitly demarcated by the Minnesota Supreme Court as "broad":

> Although the statute does not define "institution of purely public charity," the Minnesota Supreme Court has stated that: [t]he legal meaning of the word "charity" has a broader significance than in common speech and has been expanded in numerous decisions. Charity is broadly defined as a gift, to be applied consistently with existing laws, for the benefit of an indefinite number of persons "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."[66]

Yet, despite the profound lack of clarity about what constitutes a "purely public charity," most Minnesota property tax opinions nevertheless suggest that tax exemption statutes are to be "strictly construed."[67]

However, over the years, many propositions have taken bites out of the uncertainty. For example, Minnesota courts decided many years ago that operating at a loss is not essential for maintaining exempt status.[68] This remains true as long as any profits derived are not used for the benefit of any private individual or group.[69]

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[65] MINNESOTA COUNCIL OF NONPROFITS, CHARITABLE TAX EXEMPTION EDUCATION CAMPAIGN 1 (2008), http://www.mncn.org/charitable_tax_exemption/index.htm (hereinafter *MCN*).

[66] Under the Rainbow Child Care Ctr., Inc. v. County of Goodhue, Nos. C9-05-706, CV-06-743, 2007 WL 148839 at *3 (Minn. T.C. Jan. 18, 2007).

[67] *See, e.g.*, *id*.

[68] Assembly Homes, Inc. v. Yellow Medicine County, 140 N.W.2d 336, 337 (Minn. 1966).

[69] *Id.*

Additionally, courts have held that a worthwhile objective, by itself, does not warrant classification as an organization of purely public charity.[70] Keeping this background in mind, I will begin my discussion of the *Under the Rainbow* narrative with the 1966 *Assembly Homes*[71] decision.

A. The *Assembly Homes* Case

Assembly Homes, on appeal to the Minnesota Supreme Court from a district court decision that denied exemption, involved a church-affiliated nursing home in Clarkfield, a small town in Yellow Medicine County in southwest Minnesota.[72]

The opinion includes much of the Assembly Homes articles of incorporation, which state that its policy is to admit any normal aged persons, chronically ill persons, or invalids regardless of their connection to the church.[73] It retained the right to dismiss anyone who refused to pay its bills.[74] Either county welfare or the Veterans Administration paid for roughly three-fourths of its patients, and the rates it charged were similar to other Minnesota nursing homes.[75] Many of these characteristics will surface again in the *Under the Rainbow* discussion, and thus it is illustrative to compare how the court treated such a facility in the mid 1960s.

The opinion includes several paragraphs quoting the district court opinion that the Minnesota Supreme Court later reversed, making it useful to examine the district court statements as suggestions of what the higher court thought to be an *improper* exercise in exemption denial. The district court, noting that all patients cared for at the facility were charged, did not find the requisite level of charity on the part of Assembly Homes.[76] Rather, in searching for "indicia of charity," the court found only the statement of the home's president that if an applicant were to have no funds, he or she would be admitted anyway.[77] However, there was no record of

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[70] SHARE v. Comm'r of Revenue, 363 N.W.2d 47, 50 (Minn. 1985).
[71] 140 N.W.2d 336 (Minn. 1966).
[72] *Id*. at 337.
[73] *Id.* at 339.
[74] *Id.*
[75] *Id*.
[76] *Id.*
[77] *Id.*

any such charitable treatment in 1963, the year at issue in the case.[78] The lower court also felt that for an organization to be a purely public charity under the Minnesota statute, the charitable service it provides must be "of some substantial amount in relation to the operation of the enterprise."[79]

The Minnesota Supreme Court, in response, offered a counter-explanation that seems to have relied heavily on the *gestalt* of the organization. When it came to private profit, the court took "private" much more seriously than "profit." It found that "the fact that an organization claiming exemption as one of 'purely public charity' operates at a profit derived from charges made to its patients [does not] nullify its status as an institution of 'purely public charity' if under its charter its operations are intended for the benefit of the public generally and thereunder none of such profits can be paid to stockholders or others."[80] The court applied this principle and found that the Clarkfield home fell well within the definition of "purely public charity:"

> Its charter, its bylaws, its policy, and the conduct of its operations established that it was not organized for private profit. It is open to the public and any profits derived from its operations go to the furtherance of its work as a nursing home. Its shareholders cannot receive dividends and hold stock for life and at the death of a shareholder his stock reverts to the corporation. Its charges for services are paid for by individual patients, by county welfare boards, and by the U.S. Veterans Administration. Private donations of money or services also contribute to its maintenance. When all such factors are taken into consideration, it would seem clear that the Clarkfield Nursing Home was exempt from taxation during the year 1963 as an institution of 'purely public charity.'[81]

Forty-one years later, this decision would remain the lone pro-exemption thorn in the side of the *Under the Rainbow* majority.

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[78] *Id.* at 340.
[79] *Id.*
[80] *Id.*
[81] *Id*. at 341.

B. The *North Star* Case

The next major decision leading up to *Under the Rainbow* was the landmark 1975 decision of *North Star Research Institute v. County of Hennepin*.[82] This decision was on appeal from a county district court that had granted a property tax exemption to the North Star Research Institute.[83] The organization was a provider of applied research services with rates fixed at cost plus eight percent.[84] During the time period in question, North Star performed more than half of its applied research at the request of federal and state government agencies but the majority of North Star's clients were private corporations engaged in for-profit business.[85]

The Minnesota Supreme Court clearly stated that just because North Star conducted much of its research for the government and thus it quite literally relieved a government burden, that fact did not necessarily make North Star a "purely public charity."[86] Additionally, the private corporations who received the research product from North Star had the ability to profit directly as a result of the research performed.[87] This implicitly invoked a classic Minnesota case, *Willmar Hospital*,[88] which had held decades earlier that "where the property claimed to be exempt is subject to private control and is devoted to substantial use for private profit, it is not exempt."[89]

Although the points addressed so far indicate that the court was secure in its reversal of the district court and thus its denial of North Star's property tax exemption, the court nevertheless embarked on a tangent concerning "traditional" charitable activities of the sort *not* present in the North Star case itself. The court included a paragraph of dicta that would dominate Minnesota charitable tax exemption law for over three decades. The court stated that, in past decisions involving these traditional charitable undertakings (such as caring for the sick, the aged, or the infirm),[90] it

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[82] 236 N.W.2d 754 (Minn. 1975).
[83] *Id.* at 754.
[84] *Id.* at 756.
[85] *Id*.
[86] *Id.* at 755.
[87] *Id.*
[88] State v. Willmar Hospital, Inc., 2 N.W.2d 564 (Minn. 1942).
[89] *Id.* at 566.
[90] *North Star Research Inst.*, 236 N.W.2d at 756.

had utilized several factors to help assess the charitable nature of an organization:

> (1) whether the stated purpose of the undertaking is to be helpful to others without immediate expectation of material reward; (2) whether the entity involved is supported by donations and gifts in whole or in part; (3) whether the recipients of the 'charity' are required to pay for the assistance received in whole or in part; (4) whether the income received from gifts and donations and charges to users produces a profit to the charitable institution; (5) whether the beneficiaries of the 'charity' are restricted or unrestricted and, if restricted, whether the class of persons to whom the charity is made available is one having a reasonable relationship to the charitable objectives; (6) whether dividends, in form or substance, or assets upon dissolution are available to private interests.[91]

In an apparent effort to designate these factors as merely interpretive guideposts and not an actual test, the court included a caveat in the companion case of *Mayo Foundation v. Commissioner of Revenue*,[92] decided the same day as *North Star*. It wrote that the factors "are appropriate for the consideration of charitable status. However, the . . . general language of our definitional statements and the identification of factors in our prior cases are only guides for analysis."[93] The court goes on to say that "[e]ach case must be decided on its own particular facts and it is not essential that every factor mentioned in our decisions be present before an institution qualifies for exemption."[94] Nevertheless, as will be apparent in *Under the Rainbow*, the *North Star* factors took on elevated importance as the court, over the years, erected it into the sturdy multifactor test that most saw it as on the morning of December 6, 2007.[95]

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[91] *Id.* at 757.
[92] 236 N.W.2d 767 (1975).
[93] *Id.* at 773.
[94] *Id.*
[95] *Under the Rainbow* was decided by the Minnesota Supreme Court on December 6, 2007.

The other most influential statement in the *North Star* opinion took the form of a generalized observation about the past decisions handed down by the Minnesota Supreme Court. Again commenting on "traditionally" charitable objectives that, it should be noted, were *not* present in the facts of *North Star*, the court surmised that "[t]he tendency of our decisions has been to sustain exemption where these traditionally 'charitable' objectives are being furthered, so long as no individual profits from ownership of the 'charity' are realized and so long as the undertaking is not a subterfuge by which the needs of a select and favored few are accommodated."[96] The *Under the Rainbow* court would address specifically this statement and its strong pro-exemption presumption for traditional charities.

Thus, the consequential portions of the *North Star* opinion happened to be those that dealt with so-called traditional charitable activities. And since North Star's services were fee-for-service research projects, it is not surprising that the court did not use the newly minted (but as yet unnamed) "*North Star* factors" when deciding *North Star* itself. The court was explicit about its decision-making process:

> The main reason for deciding that a research institute such as North Star should not be defined as a public charity is that in the first instance the benefits that may accrue from the research go to the profitmaking entity that pays for that research. Undoubtedly, if that research were made available to the public, we would not hesitate to declare North Star to be a public charity.[97]

Three decades of Minnesota decisions that implemented the *North Star* factors followed. But did the factors ever graduate from interpretive guide to multifactor test?

C. The *Croixdale* Case

Croixdale, Inc. v. County of Washington[98] is a perfect illustration of the unsettled status of both the "purely public charity"

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[96] *North Star Research Inst.*, 236 N.W.2d at 757.
[97] *Id*. at 765.
[98] 726 N.W.2d 483 (Minn. 2007).

definition and the *North Star* factors in the time leading up to *Under the Rainbow*. This case involved the Croixdale assisted living and independent living centers north of Bayport, Minnesota and near the Wisconsin state line.[99] These centers continually and consistently operated at a loss and were dependent on donations to cover losses.[100] Before 2003, Croixdale enjoyed exempt status as an institution of purely public charity, but the county assessor removed the exemption that year based on information provided by Croixdale.[101]

The case began with an exemption denial in tax court, which the Minnesota Supreme Court upheld on January 25, 2007.[102] The tax court, as is customary in Minnesota, applied the *North Star* factors when it made its initial determination.[103] The court explained that the third factor, which looks to whether the beneficiaries of the charity are required to pay for the services they receive, requires that the nonprofit prove that its rates are "considerably less than market value or cost."[104] This requirement is meant to prove that the rates were established with charitable (and not business) purposes in mind.[105] The tax court applied a "market value" comparison and found that Croixdale's rates did not comport with charity to the extent required by the *North Star* scheme, but the Supreme Court took issue with how the tax court had applied the third factor: "In this situation, where testimony indicated that the variety of services and amenities provided by area assisted living centers made it difficult to compare the market value of facilities, the appropriate inquiry should have been whether Croixdale's residents paid less than cost for the services, amenities, and assistance provided to them."[106]

The court's rationale, which favored a cost analysis over a market value analysis, rested on the circumstances Croixdale dealt with during the time at issue.[107] In summary, Croixdale operated out of an obsolete facility and, to provide adequate services, it needed to

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[99] *Id.* at 485.
[100] *Id.* at 486.
[101] *Id.*
[102] *Id.* at 485.
[103] *See id.*
[104] *Id.* at 488(citing Cmty Memorial Home at Osakis v. County of Douglas, 573 N.W.2d 83, 87 (Minn. 1997)).
[105] *Id.*
[106] *Id.* at 489.
[107] *Id.*

construct a new building.[108] The court noted that with all the additional overhead involved in such a construction project, it is plausible that the facility could charge above market rates while still having rates below cost.[109] As the court stated, "[t]he tax court's failure to consider whether Croixdale's services were below 'cost' penalizes Croixdale for becoming more professional and fiscally responsible."[110] Justice Meyer went on to point out that charities would not survive if they were required to be fiscally irresponsible in order to be exempt from property taxes because they would have to depend on perpetual contributions—thus, the enhancements that Croixdale made to its facility should be seen as being "supportive of, not contradictory to, the charitable mission."[111] However, after the sharp disagreement with the tax court's methodology, and after the hint that Croixdale's actions were in support of its charitable mission, the Minnesota Supreme Court nevertheless flunked Croixdale on factor three.[112]

Croixdale is noteworthy for more reasons than its model of a pre-*Under the Rainbow* explication of *North Star* factor three. The case exemplifies the confusion over the purely public charity label in several ways. While the court stated explicitly that "an organization need not prove all six *North Star* factors to establish that it is an institution of purely public charity,"[113] it denied exemption after admitting that Croixdale passed muster on three factors (one, two, and six). Also, even though the Minnesota Supreme Court rejected the tax court's use of the market value analysis in this situation, it not only agreed with the tax court's ultimate conclusion on that factor, but it failed to delineate when a cost analysis is more appropriate than a market value analysis. Finally, the court explicitly referred to the *North Star* factors as "the six-factor test for determining whether [a nonprofit] qualified as an institution of purely public charity."[114]

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[108] *Id.*
[109] *Id.*
[110] *Id.*
[111] *Id.*
[112] *See id.* This is because of testimony that the rates were set to allow the facility to break even, that there was a system in place to ensure that residents paid for the services they received, and that the price for those services was based on the cost of the staff in performing the services. Thus, there was a "close to cost" basis for the rates, but it was not "considerably below cost" as factor three requires.
[113] *Id.* at 491.
[114] *Id.* at 485.

Thus, even if *North Star* had not intended to create a multi-factor test, it seems to have happened anyway. These quirks, delivered in *Croixdale* in January of 2007, perpetuated a confused state of affairs that would prove to be ripe for strong statements by the *Under the Rainbow* court later that year. In other words, the table was set—by being left messy.

VI. Under the Rainbow Child Care Center v. County of Goodhue

Under the Rainbow "sent tremors through the not-for-profit world."[115] It involved the Under the Rainbow Child Care Center ("Rainbow"), a state-licensed day care center in Red Wing, Minnesota, southwest of the Minneapolis-Saint Paul.[116] Rainbow provided services for children from infancy through school age and possessed licensure to accommodate up to seventy children at any given time.[117] Minnesota had, for a long time, recognized an objective in ensuring the availability of affordable child care.[118] Rainbow never had realized a profit during any year since its founding, and if it were to do so, that profit would promote its charitable goals.[119] Rainbow met its daily operating expenses through a combination of fees for services, grants, fundraisers, and government payments.[120] Its rates were "at or just below market rates and are subsidized by government assistance payments on behalf of qualifying parents."[121]

The basic issue in the case should come as no surprise. Rainbow sought an exemption from property taxes, and the tax court (and later the Minnesota Supreme Court) needed to make a determination as to whether it qualified as an institution of purely public charity. The tax court granted the exempt status after finding that Rainbow satisfied all six *North Star* factors except the third.[122] In December 2007, the Minnesota Supreme Court disagreed, and made

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[115] Strom, *supra* note 11.
[116] Under the Rainbow Child Care Ctr., Inc. v.County of Goodhue , 2007 WL 148839 at *1 (Minn.Tax 2007).
[117] *Id.*
[118] *Id.* at *2.
[119] *Id.* at *1.
[120] *Id.*
[121] *Id.*
[122] *Id.* at *7.

two additional holdings: (1) "An organization that does not provide goods or services free or at considerably reduced rates as a substantial, not just an incidental, part of its operations is not exempt from payment of real property taxes as an institution of purely public charity;" and (2) "Payments made by a governmental entity for goods or services provided to one of its citizens are not considered donations for purposes of determining whether the entity providing the goods or services is exempt from payment of real property taxes as an institution of purely public charity."[123] Each holding shall be examined in turn.

A. Applying the *North Star* Factors

In enacting the first holding, the court needed to define and limit *North Star*. The awkwardness of the relationship between these two cases is partially because *Under the Rainbow* did not disagree at all with the court's holding in *North Star*. *North Star* dealt with a research institute that performed tasks on a fee for service basis for many private corporations who could profit off of (or even patent) the research, and the Minnesota Supreme Court denied exempt status.[124] *Under the Rainbow*, and every other charitable exemption case in between, would have done the same. Rather, it was the subsequent use of the *North Star* case that led to Chief Justice Anderson's firm stand in *Under the Rainbow*.

The court made clear that the *North Star* factors are merely interpretive guidelines:

> [W]e have referred to all six *North Star* factors in virtually every subsequent case in which the charitable exemption was at issue, and we have recently described the factors as a "six-factor test." As a result, we may have created the impression that all six factors must be examined in every case addressing the charitable exemption issue. But as *North Star* itself illustrates, that is not true.[125]

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[123] Under the Rainbow Child Care Ctr., Inc. v. County of Goodhue, 741 N.W.2d 880, 882 (2007).

[124] *See generally* North Star Research Inst v. County of Hennepin, 236 N.W.2d. 754 (Minn. 1976).

[125] *Under the Rainbow*, 741 N.W.2d at 886.

The court noted that in some cases, some of the factors simply might not be helpful in the court's analysis, and therefore should not be analyzed.[126] By the same token, if other "analytical tools" are available, they should be used if helpful.[127]

Before examining the majority's application of the factors, it is important to keep in mind the shifting tendencies underlying *Under the Rainbow*. The majority directly addressed such a shift in responding to a remark in the dissent that referred to the statement in *North Star* which denoted a pro-exemption tendency in cases dealing with traditionally charitable objectives.[128] The majority dismissed that statement as "only dicta," and said further that "in numerous cases since *North Star* we have declined to exempt from taxation as purely public charities organizations that merely had traditionally charitable objectives and operated without profit to any individuals."[129] The court's words created quite a standard here. Clearly, the court was correct in its dismissal of the *North Star* dicta that holds no precedential value. But by pronouncing that dismissal so explicitly, the court consciously rattled the cage of three decades of tax exemption jurisprudence. In other words, by deliberately marginalizing the previous pronouncement of a pro-exemption tendency, the majority gave Minnesota law a shove toward the presumption of exemption denial that this article discussed early on.[130]

The court's analysis of *North Star* factor three has been the focus of much of the attention paid to the case. Until *Under the Rainbow*, the interplay and comparative weight of the factors caused a great deal of confusion. Do some outweigh others? Are any of the factors essential? The court responded to the uncertainty by answering "yes" to both questions:

> [A]lthough we have often stated that not all of the *North Star* factors must be satisfied in order to qualify for the exemption, some of the factors are, indeed, essential. For example, we cannot envision an organization qualifying as an institution of purely public charity if it makes available to private

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[126] *Id.*
[127] *Id.*
[128] *Id.* at 898-99 (Hanson, J. dissenting).
[129] *Id.* at 888.
[130] *See supra* notes 61-67 and accompanying text.

> interests either dividends, in form or in substance, or assets upon dissolution, and thus fails to satisfy *North Star* factor six.[131]

When factor three itself reared its head, the court applied a rigid "gift"-based structure to it. The court noted that without the element of a gift, true charity cannot really be present, and thus when the court looked at factor three and examined how or if the recipients of the charity must pay for the charity received, the court actually assessed whether the nonprofit conferred a "gift."[132] Ergo, the court held, "if factor three is not satisfied, the organization cannot be found to be an institution of purely public charity."[133] This creation of an indispensible factor implicitly limited *North Star* by disrupting the functioning of the multi-factor test as the court had used it for three decades.

Neither *stare decisis* nor deference to the tax court opinion provided a significant obstacle to the *Under the Rainbow* court changing the status quo, but the majority needed to surmount each in turn. Indeed, the tax court's decision was to be reviewed in a heavily deferential way.[134] But the Minnesota Supreme Court overcame this by holding that the tax court's failure to note that factor three was essential constituted an error of law that was sufficient to overcome the strong deference afforded to the tax court.[135]

The court did not face heavy *stare decisis* opposition, partially because the presumption created by each state's jurisprudence is that taxation is the rule and exemption is the exception. Additionally, when dealing with a six-factor test, any two cases would have to be substantially similar in many ways to warrant a strong precedential force. The court stated, "[w]e are aware of only one case—*Assembly Homes*—in which the purely public charity exemption was granted to an organization that charged a market rate fee to all and some of those fees were paid by government programs."[136] The *Under the Rainbow* court began an assault on *Assembly Homes* by remarking that it predated *North Star*, and thus

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[131] *Under the Rainbow*, 741 N.W.2d at 887.
[132] *Id.*
[133] *Id.*
[134] *Id.* at 884.
[135] *Id.* at 892.
[136] *Id.* at 895.

was decided on an obsolete (and somewhat unclear) methodology.[137] The court then placed the four decade old *Assembly Homes* holding directly in its crosshairs:

> To the extent that *Assembly Homes* stood for the proposition that an organization can be a purely public charity without providing goods or services free or at considerably reduced rates or can qualify for the exemption merely by serving a benevolent purpose on a nonprofit basis, it has been implicitly overruled by numerous subsequent cases discussed above, and today it is explicitly overruled to that extent.[138]

The court was confronted by the way *Assembly Homes* did not accommodate the modern factor three analysis by circumventing the "considerably reduced rate" requirement, and so the majority overruled it.

The extent to which this made *Under the Rainbow* a departure from past practices becomes more striking when the facts of the two cases are laid side by side. As mentioned earlier, the policy of Assembly Homes, Inc. was to admit anyone regardless of their connection to the church, and to retain the right to dismiss anyone who refused to pay its bills.[139] The government paid for roughly three-fourths of its patients, and the rates it charged were similar to those of other Minnesota nursing homes.[140] Rainbow had no restrictions on persons who could receive its services, and could pursue collection efforts against those who did not pay for services.[141] Government assistance payments made on behalf of qualifying parents subsidized Rainbow's fees.[142] And the tax court determined that Rainbow's rates were "at or below market rates."[143] The stark similarities in the fact patterns between these two cases,

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[137] *Id.* at 896.
[138] *Id.*
[139] *See supra* notes 72-79 and accompanying text.
[140] Assembly Homes, Inc. v. Yellow Medicine County, 140 N.W.2d 336, 339 (Minn. 1966).
[141] Under the Rainbow Child Care Ctr., Inc. v. County of Goodhue, 2007 WL 148839 at *1 (Minn.Tax 2007).
[142] *Id.*
[143] *Id.*

both of which involve "traditional" charitable activities, is evidence that *Under the Rainbow*'s contrary holding represented a true policy shift.

B. Donations, or "Payments for Services"?

The second holding of *Under the Rainbow*, stating that payments made by government entities for goods and services are not considered donations for purposes of determining whether a nonprofit qualifies as a purely public charity,[144] can likewise be viewed as a policy shift, Public contributions accounted for 20.7% of Rainbow's operating resources in the 2003 tax year, 23.6% in 2004, and 19.4% in 2005.[145] Private contributions (grants, fundraisers, volunteer time) represented 7.8%, 1.6%, and 1.3%, respectively.[146] A key dichotomy surfaced when the court dealt with public contributions—it chose to characterize them as either "donations" or as "payments for services rendered."[147] While payments tied to specific goods or services (and thus are more like payments for services rendered) only benefit the recipient of that service, donations would benefit all the recipients of the organization's charity.[148]

To support its holding, the court noted that Minnesota changed its property tax exemption statute "to expressly state that government rent assistance and financing assistance for low-income housing are not gifts or donations to the owner."[149] The court used this to support the proposition that other forms of government subsidy, like help with child care payments to Rainbow, should not be considered donations.[150] Some critics might also say that if the legislature had wished to bring other forms of government subsidy outside the bounds of "donations," they could have done so explicitly via statute.

The donation and payment for services distinction represented another policy shift by the court. The court did not accept the prior method of analysis and rule on that basis. Instead, by

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[144] *See* Under the Rainbow Child Care Ctr., Inc. v. County of Goodhue, 741 N.W.2d 880, 882 (2007).
[145] 2007 WL 148839 at *1.
[146] *Id.*
[147] 741 N.W.2d at 897.
[148] *See* 2007 WL 148839 at *2.
[149] MINN. STAT. § 272.02, subd. 7 (2006).
[150] *See* 741 N.W.2d at 895.

re-characterizing the previous way of analyzing "donations" to charitable nonprofits and introducing the idea of the non-donation "payment for service," the court created "new" precedent and then simultaneously ruled on the basis of that precedent. In a way that is similar to the court's first holding (that not only is *North Star* factor three essential, but the tax court is retroactively erroneous for having ruled otherwise), arguably another policy shift occurred. The court concluded, "[t]o the extent any uncertainty remains as to the appropriate treatment of government payments, we hold . . . ."[151] In using such powerful and clear language in making its holdings, the court is not bashful in stating that it took the old method of analysis in a new direction.

VII. Lessons from the Minnesota Saga

What really happened here, and what are the consequences? Assistant Goodhue County Attorney Carol K. Lee, who handled the *Under the Rainbow* case at both the tax court and Minnesota Supreme Court levels, was in no way surprised by the result. She states simply, "in our case the organization was behaving as a for profit business."[152] Ms. Lee feels that Rainbow's activities ventured past a previously unidentified tipping point where they could no longer justify tax exemption: "[M]y personal feeling is that this particular case pushed the envelope a little too far for the Court, and they were tightening up their interpretation [of "purely public charity"] and then asking the legislature for assistance in determining what a purely public charity is."[153] Thus, one might view *Under the Rainbow* not as a major policy shift, but rather as a continuation of past analysis in a new era of for-profit-like charities.

Regardless, now that some of the dust has cleared, we can see that *Under the Rainbow* has affected several sectors of society, some more than others. For tax assessors, the impact has been minimal. As Thomas May, the tax assessor for Hennepin County, where Minneapolis is located, observes, "[T]he decision hasn't affected what we do or how we do it . . . . [*Under the Rainbow*] didn't change anything we'd been doing already . . . . I would have

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[151] *Id.* at 898.
[152] Electronic Interview with Carol K. Lee, Assistant Goodhue County Attorney, in Red Wing, Minn. (Sept. 15, 2008).
[153] *Id.*

looked at that case and said [Rainbow] isn't tax exempt anyway."[154] But the fact that Hennepin County might interpret an exemption statute one way does not bear on how other counties might see a situation. This inconsistency is a direct by-product of an unclear definition of purely public charity. The differences can be stark, as "[t]he Department of Revenue surveyed the 87 counties in Minnesota, and there are almost 87 different ways that taxes are assessed. Things are treated differently in different places, especially government funding."[155] Hennepin County, the most populous in Minnesota, has more resources for tax assessment than smaller counties do; it even retains county attorneys that specialize in these areas.[156] Ms. Lee also notes few changes from the perspective of the local government: "Goodhue County has historically been very careful about granting exemptions from property tax. Consequently, we are applying the same methodology we used in the past to the determination of exemptions."[157]

While the assessors go on with business as usual, the nonprofit community "is very concerned that [the decision] had moved the mark."[158] The decision affects any nonprofits that potentially qualify for exemption as purely public charities.[159] Minnesota law still does not clearly define what the phrase "purely public charity" precisely means, and this has led to "a great deal of uncertainty for many nonprofit organizations."[160] Organizations whose services are securely within the traditional notion of charitable activities and who pass all six *North Star* factors remain unaffected. But "human service organizations that deliver residential services through a fee-based system are the most at risk after the decision."[161]

Ms. Lee observes a "very dramatic response from the nonprofit community on both a state wide and national level"[162] despite the already heavy presumption against exemption prior to

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[154] Telephone Interview with Thomas May, Hennepin County Tax Assessor, in Minneapolis, Minn. (Sept. 3, 2008).
[155] Fox, *supra* note 42.
[156] May, *supra* note 154.
[157] Lee, *supra* note 152.
[158] May, *supra* note 154.
[159] MCN, *supra* note 65.
[160] *Id.*
[161] Fox, *supra* note 42.
[162] Lee, *supra* note 152.

Under the Rainbow.[163] Ms. Lee identifies the court's second specific holding, that "the payments [received by Rainbow] were not donations or gifts, they were payment for services rendered," as the source of much of the uproar.[164] Ms. Fox, however, points to the court's first holding involving *North Star*: "Our concern is that this decision narrowly redefined the criteria to be eligible for property tax exemption. The court elevated the third factor to a litmus test. [Nonprofits] want a return to a more pure multifactor test, which is the way it was for three decades."[165] There is some concern that if simple "charity" is the most important factor in property tax exemption, the lure of exemption could drive the behavior of nonprofits in a way that could have serious negative consequences for the delivery of their beneficial services.[166] Such consequences could include the stifling of innovative ways of delivering services if those methods might not "count" for exemption purposes, or nonprofits might reassess their structure to eliminate more economically responsible methods of services if they have to meet some quota of charity given.[167]

Other states have adopted the *North Star* factors.[168] Thus, knowing what is left of *North Star* in Minnesota can tell us a great deal about where other states are likely to head. The case is still "good law" but due to the treatment it received in *Under the Rainbow*, it is clear that it does not apply as a blanket multi-factor test for determining charitable property tax exemption status in Minnesota anymore.[169] Following Justice Anderson's pronouncements, the *North Star* factors are "general guidelines in determining what is a purely public charity. They are certainly open to interpretation."[170] The companion case of *Afton Historical Society Press v. County of Washington*,[171] decided one week after *Under the Rainbow*, took the first step in clearing the unswept *North Star*

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[163] Under the Rainbow Child Care Ctr., Inc. v. County of Goodhue, 741 N.W.2d 880, 891 (Minn. 2007).
[164] Lee, *supra* note 152.
[165] Fox, *supra* note 42.
[166] Singer, *supra* note 3, at 62.
[167] *Id.*
[168] *See, e.g.*, *id.* at 47 n.54.
[169] *See* Under the Rainbow Child Care Ctr., Inc. v. County of Goodhue, 741 N.W.2d 880, 886 (Minn. 2007).
[170] Lee, *supra* note 152.
[171] 742 N.W.2d 434 (Minn. 2007).

debris. The *Afton* court noted that the *North Star* factors did not apply in *North Star* itself, and so the facts of *North Star* act as the first guidepost in determining when the factors should *not* apply.[172] The court wrote:

> We noted two "distinctive characteristics of *North Star* which make its situation so different from those of charities in the traditional sense that reference to" the *North Star* factors was "of limited value." First, we noted that a public benefit "is not the immediate objective of the undertaking" . . . . Second, we noted that "information developed as a result of [North Star's] research is not made available to the public generally or to industry generally," and therefore North Star's research did not have a "public purpose in a sense comparable to such purposes as the relief of poverty and sickness, the general dissemination of knowledge, and the encouragement of religion, science, and the arts."[173]

The court makes clear that *North Star* only applies when traditional charitable activities are at issue.[174] Thus, its run as a catch-all multi-factor test is truly at an end.

Additionally, the court in *Afton* came down in favor of an exemption, but in doing so, it cemented the *Under the Rainbow* factor three analysis.[175] *Under the Rainbow*'s discussion of what it means to be charitable amounted to giving a considerable gift.[176] In other words, "the Minnesota Supreme Court said [Rainbow] had to pay property taxes because, in essence, it gave nothing away."[177] The court provided some factors to be considered in future determinations of whether a gift is given at "considerably less" than value.[178]

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[172] *Id* at 438-39.
[173] *Id.* at 439.
[174] *Id.*
[175] *Id.* at 441.
[176] *Id.*
[177] Strom, *supra* note 11.
[178] Under the Rainbow Child Care Ctr., Inc. v. County of Goodhue, 741 N.W.2d 880, 892 (Minn. 2007). The factors provided outline that 1) Charity must be provided free of charge or at considerably reduced rates; 2) the goods or services cannot be on such a small scale as to be incidentally part

This very issue is one with which many states are currently grappling. Some states' definitions are more settled than others. In Utah, there is a "gift to the community" requirement which mandates that hospitals and nursing homes provide such gifts in an amount higher than what their annual tax liability would have been without exempt status.[179] The *Under the Rainbow* court gives a survey of several other states as well. In Pennsylvania, a purely public charity is a nonprofit that "[d]onates or renders gratuitously a substantial portion of its services."[180]

In Oregon, a required element for exemption is that "the organization's performance must involve a gift or giving."[181] In Illinois, an exempt nonprofit is required to "dispense charity to all who need and apply for it, . . . not provide gain or profit in a private sense to any person connected with it, and . . . not appear to place obstacles of any character in the way of those who need and would avail themselves of the charitable benefits it dispenses."[182] Perhaps the court in *North Star* said it best: "[A]ny definition of 'purely public charity' now devised is inadequate and the ultimate decision is based on a philosophical view rather than any real legal reasoning."[183] This sentiment certainly holds quite true today.

With regard to the day care sector specifically, depending on a specific state's system, an organization might need to rest its exemption on a statutory category marked as education-related activities.[184] One commentator explains that "[s]ome states distinguish custodial day care from educational day care and deny exemption to the former category."[185] A North Carolina statute requires that an exempt child care facility be "wholly and exclusively

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of the organizations operations; 3) the goods or services cannot be provided primarily for a business purpose; and 4) the organization must demonstrate an intent to provide a substantial proportion of goods/services on a charitable basis.

[179] Singer, *supra* note 3, at 53.

[180] *Under the Rainbow*, 741 N.W.2d at 890 (quoting Hosp. Utilization Project. v. Commonwealth, 507 Pa. 1 (1985)).

[181] *Id*. (quoting Sw. Or. Pub. Defender Servs., Inc. v. Dep't of Revenue, 312 Or. 82 (1991)).

[182] *Id*. (quoting Methodist Old People's Home v. Korzen, 39 Ill.2d 149 (1968)).

[183] North Star Research Inst v. County of Hennepin, 236 N.W.2d. 754, 765 (Minn. 1976).

[184] Brody, *supra* note 2, at 282.

[185] *Id*.

used for educational purposes."[186] A Wisconsin court recently held that a day care center, existing as a part of a larger medical center, was not exempt because the medical center was the beneficial owner, and the property was not being used primarily for educational purposes.[187]

VIII. Subsequent Developments in Minnesota

The Minnesota Council of Nonprofits, as well as other organizations, have spearheaded an effort to get the Minnesota legislature to pass legislation that will secure existing nonprofit property tax exemptions and reinstate a definition of "purely public charity" that is more in line with pre-*Under the Rainbow* jurisprudence.[188] The bill, referred to commonly as a "moratorium," prohibits changes in assessment practices and policies regarding the property owned by Minnesota nonprofits.[189]

The moratorium is best explained by those working closely with its development: "We altered our initial strategy from seeking a new statute right after the decision to a moratorium that will last through the '09 legislative session, or until we get a bill, whichever is first. It is a status quo approach for now."[190] The bill passed at the end of the legislative session, and the governor signed it on May 29, 2008.[191] Mr. May noted that "during the moratorium, we have a group including nonprofit providers, Department of Revenue representatives, myself, and others working to come up with new

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[186] *Id*. (quoting In the Matter of the Appeal of Chapel Hill Day Care Ctr., Inc., 551 S.E.2d 172 (N.C. App. 2001)).
[187] *Id*. (quoting Milwaukee Reg'l Med. Ctr. Inc. v. City of Wauwatosa, 720 N.W.2d 161 (Wisc. App. 2006)).
[188] MCN, *supra* note 65.
[189] *Id*. (quoting Omnibus Tax Bill, H.F. 3149B, 85th Leg. Sess. (Minn. 2008).) Subd. 3 provides: "Moratorium on changes in assessment practices. (a) An assessor may not change the current practices or policies used generally in assessing property of institutions of purely public charities. (b) An assessor may not change the assessment of the taxable status of an existing property of an organization of purely public charity, unless the change is made as a result of a change in ownership, occupancy or use of the facility, or to correct an error. For currently taxable properties, the assessor may change the estimated market value of the property."
[190] Fox, *supra* note 42.
[191] MCN, *supra* note 65.

language—to clarify the statute itself."[192] The purpose is "to make legislative language that would define, statutorily, for the first time, what it means to be a purely public charity."[193]

Ms. Lee, attorney for Goodhue County, remarks that "considering the reaction to the case I am not surprised that the legislature instituted a moratorium."[194] She notes that the difficulty in the case mostly centered around the word "purely" in the definition of "purely public charity," and that perhaps "the legislature could provide some relief [for nonprofit organizations] outside of that definition."[195] It is clear that post-*Under the Rainbow* charitable property tax exemption law is uncharted territory. Ms. Lee advocates a future policy return to judicial focus on the operation of an organization: "If the North Star factors continue to be used as they were prior to this case, I think that the Court needs to look behind a bare assertion that the factors are met to determining how the organization operates. This would require the nonprofit organization to open its books to the Court and to the County."[196] The one certainty is that "there is a lot of confusion all the way around, for both assessors and nonprofits. But nonprofits need to have stability in their budgets."[197]

IX. Alternative Proposals & Note on Massachusetts Exemption Law

The trend toward business-like nonprofit behavior and the uncertainty over what an exempt nonprofit should look like are issues seen all over the United States. The question affects everyone: "If a nonprofit organization gets an exemption, other taxpayers are going to have to pick up the slack. This obviously impacts the public purse and individual taxpayers."[198] Not surprisingly, there has been a smattering of suggestions for alternative regimes that would no longer require states to adhere to a slippery statutory definition of an exempt charity. Richard Scruggs, a Mississippi plaintiffs' attorney who brought suit against nearly twenty nonprofit hospitals, offered

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[192] May, *supra* note 154.
[193] Fox, *supra* note 42.
[194] Lee, *supra* note 152.
[195] *Id.*
[196] *Id.*
[197] Fox, *supra* note 42.
[198] Lee, *supra* note 152.

an interesting suggestion.[199] The essence of Scruggs' ideology was that property tax exemption law has created an implied contract between nonprofit institutions and the federal government whereby the nonprofits must provide a certain minimal level of charitable services in exchange for exempt status.[200] His claims that the hospitals had breached that implied contract were largely dismissed due to the private litigants' lack of standing and the implied contract argument was rejected.[201] But the suit still exemplifies new ways in which exempt organizations can be conceptualized, and it offered a fleeting suggestion of a novel way in which an organization could be seen as failing in its duty to society although Scruggs' "minimal" level of charity would likely face the same line-drawing issues as current "purely public charity" jurisprudence does.

Another approach, suggested by Mark Hall and John Colombo, proposes that certain expenditures would entitle an organization to tax deductions or tax credits.[202] This "charitable activities" approach would disregard an organization's official nonprofit or for-profit status entirely, and might eliminate many of the modern anxieties caused by the convergence of for-profit and nonprofit organizational practices.[203] However, such systems would run the risk of being quite unwieldy and complex.[204]

For many nonprofits, "lying between the shelter of property tax exemption and the exposure of fully taxable status is the shadowy realm of [agreements to make payments in lieu of taxes, or] PILOTs."[205] For some, the solution to slippery "exempt charity" definitions lies entirely outside the realm of property taxes, and instead in these voluntary PILOT agreements.[206] PILOTs come about by negotiation between a municipality or state and an organization, and "[a]s in any negotiation, either party could be making the concession. In some cases, PILOTs represent an erosion of statutory tax exemption; in other cases, they forestall the imposition of tax,

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[199] Singer, *supra* note 3, at 54.
[200] *Id.* at 55.
[201] *Id.*
[202] *See generally* Mark A. Hall & John D. Colombo, *The Charitable Status of Nonprofit Hospitals: Toward a Donative Theory of Tax Exemption*, 66 WASH. L. REV. 307, 395-396 (1991).
[203] Singer, *supra* note 3, at 60.
[204] *Id.*
[205] Brody, *supra* note 2, at 286.
[206] *Id.* at 269.

and so are synonymous with giveaways."[207] The types of institutions likely to sign on to a PILOT system are usually those of the "traditional" charitable activity category alluded to in *North Star*, with a focus mainly on hospitals, educational institutions, and retirement or medical care facilities for the elderly.[208] Universities located in cities often direct funding into development projects in the surrounding community, which can be seen as a type of payment in lieu of taxes (but without the government acting as a financial intermediary).[209]

The city of Boston first used PILOTs systematically in agreements between itself and Harvard and the Massachusetts Institute of Technology in 1925.[210] Since those agreements, PILOTs have expanded into many areas. They can take a wide variety of forms and, in the absence of a statutory agreement, which is rare, the PILOTs are often inconsistent among nonprofit institutions even within a given area.[211] Massachusetts continues to be a leader in the advancement of PILOTs: "A government group in Boston, which relies on property taxes for revenue more than most cities, is studying alternatives to tax exemptions. It has discussed policies that might distinguish between university properties used for academics and other uses, for example."[212] Boston has been creative in working out agreements whereby an organization might make a hefty PILOT for services that Boston already provides on a widespread basis, such as trash collection or municipal emergency services.[213]

Other examples of recent Massachusetts PILOT activities include a 2002 enterprise by the Worcester City Council to consider seeking PILOTs from the city's large charities.[214] Also in 2002, Harvard declared a new principle of "generous payments" in PILOT form for newly acquired property that would have previously been taxed.[215] This came about from an agreement with the municipal government of Watertown by which Harvard had acquired a large

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[207] *Id.* at 286.
[208] *Id*. at 288.
[209] *Id.*
[210] *Id.* at 287.
[211] *Id.* at 286.
[212] Schwadron, *supra* note 6.
[213] *Id.*
[214] Brody, *supra* note 2, at 287.
[215] *Id.*

plot of land.[216] PILOTs are an intriguing alternative regime, but they are not without critics, who are concerned that voluntary agreements that are drafted without proper public oversight should not receive public funding.[217]

X. Conclusion

Federal and local governments have always viewed charitable nonprofit organizations as agents of social good, cultural enrichment, and help to those with unmet needs, but "as communities struggle over diminishing revenue, whispers to eliminate tax breaks have grown louder."[218] This note has attempted to pose a fundamental question: after understanding that formal differences between for-profit and nonprofit organizations are diminishing, should the law then be amended to treat the two sectors similarly by curbing property tax exemptions for the latter?[219] One problem the note examined is that "charity" has different meanings and tax policies have different nuances when different types of nonprofits are considered.[220] The traditionally charitable day care center might pose entirely different questions than a less traditionally charitable "public voice" organization. Even within the traditionally charitable realm of the nonprofit spectrum, there are key differences in services, management, and funding between, say, hospitals and educational centers.

Looking toward the future, it appears that "[t]he challenge to the nonprofit sector is reconciling . . . other institutional influences with conflicting economic goals, and convincing the public that nonprofit organizations continue to remain deservingly 'different.'"[221] The extent to which *Under the Rainbow* made that challenge more difficult for Minnesota nonprofits remains to be seen. Ms. Lee predicts that all Minnesota counties will be taking a new look at their assessment procedures, and she suspects that "nonprofits are also analyzing their practices and making adjustments where

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[216] *Id.* Harvard agreed to pay $3.8 million per year in PILOTs, continuing until 2054, with nothing dependent on Harvard's use of the property.
[217] *Id*. at 288.
[218] Schwadron, *supra* note 6.
[219] *See* Brody, *supra* note 16, at 536.
[220] *See* Singer, *supra* note 3, at 61.
[221] Brody, *supra* note 16, at 536.

necessary."[222] This is an important way in which the Minnesota story echoes that of the forty-nine other states, and [it] illuminates social, economic and policy forces that are likely to shape property tax exemption law wherever it currently exists. It is an important story to tell, with many chapters still to come. While the PILOT frontier cropping up beside it will someday have the influence to relieve (or possibly compound) the uncertainty, the charitable tax exemption frontier continues to be something of a wilderness.[223]

[222] Lee, *supra* note 152.

[223] *See* Brody, *supra* note 2, at 288 ("The solution to many disputes between property-owning charities and the municipalities they inhabit is often more likely to be 'political' than legal, such as the agreement to make payments in lieu of taxes.").