

# Property Tax Exemption for Nonprofits Renting to Nonprofits

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July 15, 2009

**Background.** Through the recent Budget Bill (2009 Wisconsin Act 28), Wisconsin law on property tax exemption was altered in significant ways. The legislative changes were sought to address, in part, issues related to the "rent-use restriction," which is explained below. In brief, the legislation removed the "rent-use restriction" for nonprofits that rent residential housing to low-income persons or that run "retirement homes for the aged"(statute's wording). However the legislation did not alter the part of the law that applies to nonprofit property owners that rent to other nonprofit organizations ("NPtoNPs" for this memo). Without any change to the law, NPtoNPs are subject to "rent use restrictions" and will be affected by the recent decisions that led to unfavorable interpretations of those rules.

**Rent Use Restriction.** WI law bases property tax-exemption for NPtoNPs on how the rental income is used (commonly called the "rent use restriction"). Under §70.11 (a) of the Wisconsin statutes to qualify for property tax exemption the property must be "owned and used exclusively by . . . churches or religious, educational or benevolent associations. . . ." Although the law requires property to be used "exclusively by" the nonprofit, nonprofits may lease their property.

Under § 70.11, "[Except for low-income housing and senior housing that meet statutory requirements], leasing a part of the property described in this section does not render it taxable if the lessor uses all of the leasehold income for **maintenance of the leased property or construction debt retirement of the leased property, or both**, and, except for residential housing, if the lessee would be exempt from taxation under this chapter if it owned the property."

Interpretation of the terms "maintenance" and "construction debt retirement" has been a longstanding issue. In 2008, rulings were issued that narrowly defined these terms. "**Maintenance**" was interpreted to include only expenses related to maintaining the exterior and interior of the specific leased property, such as:

- Cleaning expenses
- Ventilation system repairs and maintenance
- Elevator repairs and maintenance
- Flooring repairs
- Wall repairs and painting
- Refuse collection
- Snow removal
- Property insurance
- Roof replacement
- Building permits
- Window repairs and maintenance

It does not include expenses related to providing support services for tenants or the owner's expenses associated with maintaining the buildings, such as:

- Business insurance
- Debt payments
- Management fees
- Legal fees
- Accounting fees
- Financing fees
- Advertising fees
- Depreciation
- Property additions
- Property acquisitions
- Income taxes
- Franchise taxes
- Corporation taxes
- Real estate taxes
- Staff labor costs for overseeing the property (versus doing the maintenance work)

**Construction debt retirement** has been interpreted to include only debt incurred as part of construction of the property (including remodeling) and the refinancing of that construction but does not include any debts associated with strictly acquisition of the property, operating the property, debts incurred from construction of another property, or purchase of new appliances.

As assessors apply these narrow definitions, NPtoNPs must prove that the rental income is used to pay only allowable expenses. Nonprofit property owners need to keep detailed records of their income and expenses related to each property and insure that the leases are structured so that the rent will cover only allowable expenses.

If the rented portion of the property owned by a nonprofit fails to meet the exemption requirements (both the rent-use restriction and other requirements), the entire property should only be "taxed in-part." The nonprofit should be able to retain its exemption for the owner-occupied portion of the building and to be assessed only on the space that it leases.

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<sup>1</sup> Melissa can be reached through <http://scholznonprofitlaw.com> Deep gratitude is owed to Tim Radelet of Foley & Lardner for his leadership and expert guidance on this issue.