

Tax-Exempt Organizations May Want to Reexamine Their Non-Residential Leases Before 12/31/09 to Maintain Property Tax Exemptions

Recent changes to the laws governing exempt property may bring increased scrutiny to exempt organizations that lease property. Because of these changes, tax-exempt organizations that lease property may want to reconsider these lease arrangements or prepare to have some or all of their property placed on the property tax roll.

Leases Commonplace

Many exempt organizations have leases. An exempt organization may lease or sublease excess space to another exempt organization. An exempt organization may lease the property it uses for its exempt purpose from another exempt entity, sometimes a related entity. For years, these non-residential leases have had to comply with two requirements in order to maintain the tax-exempt status of the leased property.

First, the non-residential leased property must be used by a lessee who would qualify for a property tax exemption if the lessee owned the property. This lessee identity requirement is not generally an obstacle to exempt organizations with respect to most non-residential leases.

The second requirement, sometimes known as the leasehold income clause, can be a more significant problem. The leasehold income clause requires that lease income be used only to pay for property maintenance and/or construction debt retirement. Many exempt organizations are unable to comply with this requirement. Some organizations that lease have no construction debt. In this situation, all income must go to property maintenance. The lease income in these situations often far exceeds the amount the organization needs to spend on property maintenance.

Renewed Enforcement

Historically, most assessors have not enforced the leasehold income clause, but this may change in 2010. Prior to recent changes in the law, enforcing the

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leasehold income clause would mean revoking the exemption for most, if not all, low-income properties and retirement homes. Assessors generally felt concern that they could not pursue violations of the leasehold income clause in non-residential situations without pursuing violations in residential situations. This led to sparse enforcement of the clause in most municipalities.

However, recent changes to the exemption statute will now exempt most residential properties from the leasehold income requirement. In light of this change, assessors are likely to reexamine the exempt status of non-residential leased property. Exempt organizations may want to reconsider their non-residential lease arrangements before the end of the year to determine if the leased property will remain exempt.

Because of these statutory changes, a lease is often not the best way for an exempt organization to achieve its goals and maximize eligible property tax exemptions. In some situations, commercial condominiums or operating agreements may better suit their purposes. These alternatives have been used successfully by exempt organizations in many communities in Wisconsin.

Options for Exempt Organizations

Exempt organizations with leases should consult a tax professional who is familiar with assessment practices, as well as well versed in both Wisconsin property tax exemption law and federal income tax exemption law. If you have any questions about the impact of leases on exempt property, or any other aspect of property tax exemptions, feel free to contact any member of the [Reinhart Property Tax Team](#).

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