

# TAX FREEDOM (FOR SOME)

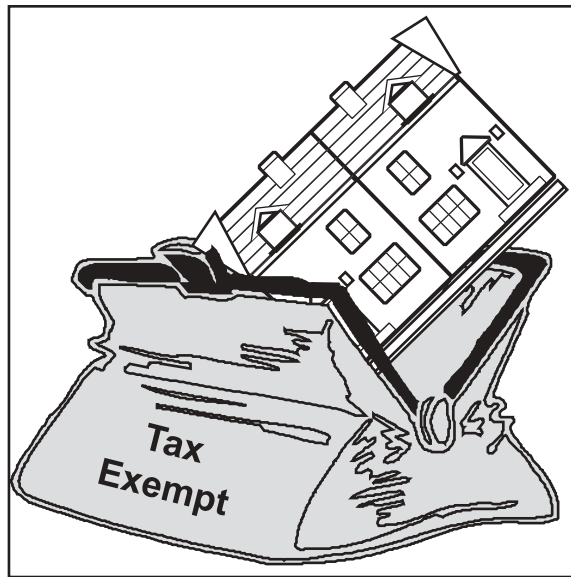
## THE TAX-EXEMPT HOUSING MESS

FREDERIC MOHS

Over 150 years ago, the framers of the Wisconsin Constitution understood the causes of the French Revolution much as we do the lessons of World War II. They knew that the nobility had exempted itself from property tax (*taille*) and the clergy contributed only voluntary payments (*dons gratuits*) leaving the burden of property taxation on the poorest classes who were given no credible justification for the tax exemptions. Distant as we are from the lessons of the French Revolution, many of our leaders have become complacent about the need for tax uniformity and fairness.

Wisconsin citizens will grudgingly pay their property taxes, grumble about the politicians and school boards who are in charge of spending, and then go about their lives for another year; but allow those taxpayers to believe that their neighbor's property is being taxed on a more favorable basis than theirs, or not at all, and those somnolent taxpayers will eventually initiate a revolution of their own with disastrous consequences for Wisconsin's property tax system.

Human nature being what it is, there have always been people who have probed for weak-



nesses in tax uniformity, for their own benefit. The Catholic Church failed to have its television station exempted, and various commercial properties owned by non-profits and churches failed to survive court challenge. However, little by little, non-profit organizations have continued, with some success, to test the uniformity clause, particularly in the area of housing for

the elderly and the low-income.

Tax-exempt housing falls into three general categories. Senior housing that may require deposits of up to \$440,000; low-income housing and special needs housing, such as homes for battered women, drug and alcohol treatment centers, and homeless shelters.

### Special Needs Housing

In that special needs housing is mainly temporary and involves a high degree of services for special needs residents, I will not deal with them here because they bring so many particular and unique issues to the discussion. They make what is already somewhat hard to understand even more complex. That is not to say that this aspect of tax-exempt housing

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should not be considered, but only that I will not address it here.

### **Tax-Exempt Senior Housing**

The easiest issue to approach is "luxury housing for active adults over the age of 55." This type of housing either requires a substantial deposit plus a monthly fee or a monthly rent that is substantial. The residents are screened for economic capacity in order to determine their ability to afford the housing. Commonly, the resident enters into a continuum of care agreement with the tax-exempt organization providing that the resident, should he or she become indigent, would be able to remain in the unit as long as feasible, and then move on to a nursing home or assisted care situation run by the organization until death. Residents who can no longer support themselves are not identified so as to avoid social stigma. In fact, there are very few residents in any of the communities who do need support because of effective financial screening.

These tax-exempts justify their tax-exempt status by pointing to their continuum of care contracts claiming that they are relieving the community from the responsibility for caring for the elderly should they become indigent. This argument fails on two grounds.

First, the community does not provide care for indigent individuals on anything like the level provided by the tax-exempts (i.e. \$300,000-\$400,000 apartments or homes, chauffeuring to the grocery store or beauty parlor, and final care in assisted living or a nursing home of the highest quality). Indeed, the life of the indigent outside the rarified circles of tax-exempt supported senior housing is a good deal grimmer. Nevertheless, the myth that tax-exempts are relieving the community of a real obligation continues to be repeated.

Second, non-profits claim that they are able to provide the continuum of care because of the discounted price involved in the repurchase of units. That is only a small part of the story. The major subsidy that permits senior housing on the level of luxury that is now offered is the substantial subsidy granted to the tax-exempts by the communities that are

not charging real estate taxes on those properties. For example, a \$440,000, 2,250 sq. ft. free-standing house with a two-car garage in Madison's Attic Angel Prairie Point would have been taxed at almost \$10,000. The tax-exempt pays \$600 a year as a payment in lieu of taxes (PILOT) on the house, leaving the City, County and School District \$9,400 a year short for each unit. Taking into account lower prices on some units, we can easily assume that the City is giving up around \$5,000 per unit per year. When multiplied by 2,000 units in the City of Madison, easily \$10 million a year in property tax is being lost.

Non-profits also argue that they make substantial contributions to charities, including low-income housing, and that their own volunteers reduce the cost of providing service to their residents. While the support that non-profit housing providers donate to charities is commendable, it is much less so since a major source of that largess is borne by property taxpayers who are paying to support local governments and school districts. The claim that tax-exempt housing providers gain efficiency because they enlist volunteers is true. It was also true when volunteers helped out non-profits before they slipped into the real estate tax-exempt habit.

The providers of luxury senior tax-exempt housing cannot demonstrate any persuasive evidence that would show that tax-exempt developments produce benefits that are in any way equivalent to the taxes lost. In fact, the tax-exempt senior housing projects are really nothing more than mutual support arrangements for the well-to-do heavily subsidized by taxpayers, both rich and poor.

As a result of the growth in senior tax-exempt housing, a demand for even more has been created as seniors understand the financial advantage of living without paying property taxes. The free market is at work resulting in larger and more luxurious senior housing projects that hardly resemble the more modest earlier versions. It must be understood that the market for tax-free housing reflects the market for housing generally. At Attic Angel Prairie Point, the age limit was abandoned with mere-

ly the statement that the units were developed with people 50+ in mind. It would be a mistake to assume that virtually anything about tax-exempt senior housing will remain in its current configuration. Indeed, some projects are nothing more than luxury apartment houses with all of the net income being used for reduction of debt and maintenance of the facility, and have no provision for accommodating the needs for lower income individuals.

I am hoping that the legislature has the vision and ingenuity equal to that demonstrated by developers of tax-exempt housing. I am hoping that they will be able to look into the future and understand what the property tax system will look like in the future if significant changes are not made immediately.

#### **Low-Income Housing**

Although not as egregious, low-income housing that is escaping property taxation is a problem as well. In many communities, apartment projects were built in order to provide housing for low-income families and individuals. Because of declining federal support, owners of those properties found them difficult to sell and unprofitable to operate. A scheme was developed that would allow those properties to be sold to non-profit organizations who, relieved of the cost of real estate taxes, could pay higher prices to the owners of these properties and could operate them profitably. For instance, the 246 unit Wexford Ridge Apartments in Madison was originally developed as a Section 8 property in 1976. In 1998 the developer, the Tishman Group, contested the assessment, which was over \$7 million, eventually arriving at a compromise with the Madison Assessor for a 1999 assessment of \$6,725,000. That same year, the property was sold to Forward Madison, a non-

profit, for \$7,380,000, or \$655,000 over the recently agreed upon fair value. The effect of exempting residential real estate from property taxation is supposed to be that it would produce a commensurate public good. In this case, it looks like \$655,000 of that public good was shared with Tishman. What started out as a federal government program to support housing for the poor, now receives what is in effect a \$150,000 subsidy from the City of Madison, Dane County, and the Madison School District. This story is being repeated over and over. Some local governments are shouldering more and more of the obligation to house the poor, resulting in a decrease of pressure on the federal government to increase subsidies for low-income housing.

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Antonio Riley, Director of the Wisconsin Housing and Economic Development Authority, appeared before the Legislative Study Committee and testified:

Wisconsin is potentially at risk of losing affordability of 831 rental properties located throughout the state, representing 35,135 units within the next seven years.

Riley estimated that without property tax exemption, residents living in these non-profit, affordable housing projects generally will see a rent increase in the order of \$150 to \$300 per month. Simply taking the average per unit property tax of "\$150 to \$300 per month" equals \$225 per month times the 35,135 units that apparently need to go off of the tax rolls in order to be preserved as low-income times 12 months equals a loss to Wisconsin communities in the staggering amount of \$94,864,500 annually: a subsidy that was, as pointed out to the Committee in a letter from Milwaukee Mayor Tom Barrett, "not decided by the City, but imposed at the State level."

Low-income housing projects tend to be located in cities that are already strapped for cash. Meanwhile, suburban communities that have not permitted the development of low-income housing are immune from shouldering any part of the burden. Looking forward into the future, it is easy to predict that almost all low-income housing developments will be owned by tax-exempts, in that it will be virtually impossible for conventional developers to compete with non-profits that not only do not pay income tax, but are exempt from real estate taxes. If eventually, all low-income housing, and then, of course, moderate-income housing, is exempted from real estate taxation, the financial shift to the remaining taxpayers will be enormous.

If low-income housing is to be supported, it should not be supported through tax immunity but by appropriations that are broadly-based and share the burden of taking care of the poor by rich and poor communities alike. The current system not only relieves pressure on the federal and state government to support the poor, but also will only lead to a decline of certain municipalities and school districts, while privileged tax islands go unscathed.

### **Legislative Background**

After 150 years of statehood, how did we get into this pickle? Basically, in an obscure statutory environment, developers of tax-exempt real estate kept pushing the limits of tax-exempt privilege. Different local assessors interpreted their statutory responsibilities differently. The La Crosse assessor believed that the statutes required him to deny applications for tax-exempt housing, while the Madison assessor obtained advice that virtually the same application should be approved. Thus, little by little, and then in ever increasing numbers, housing units of all types were either eliminated from or never appeared on the tax rolls. Numerous attempts were made to resolve this confused situation legislatively, but were blocked by heavy lobbying on behalf of the tax-exempts. And when I say tax-exempts, I am not referring only to lobbying by tax-exempt housing providers, but also by lobbyists for tax-exempt hospitals, churches, and other organi-

zations like YMCAs and YWCAs who fear that any action limiting tax-exempt status might lead to an erosion of the tax-exempt status enjoyed by their own organizations.

Finally, the City of Kenosha brought a case—*Columbus Park Housing Corporation v. City of Kenosha*—that made its way all the way to the Wisconsin Supreme Court. That case, decided on November 19, 2003, ruled that indeed the tax-exempts should have been paying real estate taxes on all of their residential units all along. The ordinary taxpaying public hardly noticed, but the tax-exempts flew into action. They hired powerful lobbyists in Madison who descended on the legislature with a fury that has seldom been witnessed.

In the absence of any pushback by the general taxpaying public, legislative leadership proposed a bill that would reverse *Columbus Park* and grant tax-exempt status to the non-profits but would provide for a sunset during which time the legislature would study the issue. Amazingly, Governor Doyle claimed that he would veto the bill if it contained a sunset and late at night under great pressure from the lobbyists, the legislature caved in and passed 2003 Wisconsin Act 195 which forgave all past taxes and exempted residential real estate of the tax-exempts. The legislature did, however, set up a legislative study committee that would report to the legislature with recommendations.

The power of the tax-exempt lobby once more showed its might when six of the nine public members on the study committee turned out to be representatives of, or developers of, tax-exempt housing. The three taxpayer-oriented members are Mary Reavey, the Milwaukee assessor; Gregg Hagopian, an assistant Milwaukee city attorney; and me.

The legislators on the committee (Representative Jeff Fitzgerald, Chair; Representative Mark Gottlieb; Senator Jeffrey Plale; Representative Leah Vukmir; Representative Terese Berceau; Representative Ann Nischke; and Senator Cathy Stepp) clearly can see that the current system produces obscure unaccountable and inadequate public benefits in relation to the tax revenue lost and

they can see that it is unfair to have a shrinking part of the population supporting local government and school districts. On the other hand, the vision of a tax-exempt housing project going into default is also daunting.

If, instead of proceeding to claim real estate tax exemption on the basis of their non-profit status, non-profits had come to the legislature promising certain public benefits in exchange for public support no one would ever come up with the arrangement that eventually developed. I believe that the legislators on the study committee understand this, but are struggling to visualize how to unwind the current system and replace it with one that is more equitable and accountable. To the extent there are benefits to society as a result of tax exemption, these legislators will want to be careful to provide some kind of continued support even though it might not be by way of tax-exempt status. Even though the tax-exempts have been pushing the envelope, and in spite of the controversy that has surrounded this issue for years, the tax-exempts will claim that they have been relying on assurances, at least as they interpret them, from the Legislature, that their operations are tax-exempt. Actually, the tax-exempts want to relax constraints on their development even more. Currently, there is a ten-acre limit for tax-exempt projects. Just watch the tax-exempts try to eliminate that limit.

The tax-exempts like things the way they are and portray a picture of great personal and institutional upheaval if anything changes. Can the legislators conceive of a way to wean tax-exempt housing developers away from their privileges when those organizations have shown no inclination to cooperate in any way? I believe the answer can be yes if the taxpaying public begins to understand they have been

treated unfairly and will communicate their dissatisfaction to the legislature.

The Legislative Audit Bureau, at the behest of the study committee, is preparing an analysis of how much tax is being lost as a result of the non-profit, tax-exempt housing scheme. The study will not only indicate how much tax is being lost, but on what kind of properties and where. That study should elicit more public interest. Cities, counties, and school districts that are strapped will be able to take a look at just what they are giving up so that they can measure the benefits of their tax-exempt housing against those lost resources. Particularly in the case of low-income housing, the

Legislature will have information that could lead it to examine other mechanisms for supporting low-income housing that fall more equitably among the taxpayers of Wisconsin.

In many ways, the legislation enacted in response to the *Columbus Park* decision had made matters worse. Although there is a study underway, the ever-optimistic developers of tax-exempt housing now believe that they have a format for the

legitimate development of tax-exempt housing. Developers of housing that does not fit under the current law will certainly seek to expand it to cover their needs and the needs of their customers. The philosophy behind the current law is so weak, and so unaccountable, and is based on such unsupportable myth that it will be easy for others to argue "well, if they get it with such weak arguments and unaccountable results, how can I be denied?"

Non-profit housing providers have made a great point about the fact that they are "non-profit" as a distinction that should spare them from the responsibility of paying property taxes. They portray "non-profit" as equivalent

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to a charitable organization. Hopefully, the legislature will not be persuaded that non-profit status guarantees that the public interest will be served. The New York Stock Exchange is a non-profit and we just witnessed Mr. Grasso receiving a salary of \$29.5 million that he is still trying to get away with. Unlike a church or other organization that requires donations for its existence, a tax-exempt housing operation is free standing. There are no church elders who argue over whether or not the rectory needs a new roof or how much to pay the minister. Tax-exempts are commonly run by small boards of directors that may make decisions in their own self-interest. That is not to say that most of them do, but certainly, there are already abuses. For instance, when it comes time for the administrator's salary or the management fee to be paid for the developer of the property, or whether or not the manager and the board members and spouses should all go to the annual conference in some warm spot during the winter comes up, who is going to say no? There is big money here and no one is watching. The grants of tax exemption are permanent and unaccountable. In short, they make it possible for the tax-exempts to make fools out of every remaining residential property taxpayer. Hopefully, the public in Wisconsin will wake up and communicate their concerns to their legislators.

The old saw about making laws and making sausage, could not be more appropriate when examining the legislative and judicial history having to do with tax-exempt housing over the past ten years. It makes a mockery of the declaration of state policy as defined in 59.57(2), "to preserve and enhance the tax base in counties and municipalities. . . ." What is needed is an escape from the past legislative history and arguments over arcane details of taxation and a refocusing on where the public should end up in this exercise.

I believe that the legislature should determine—except for special needs housing, such as parsonages, homeless shelters, etc.—that all housing should be taxed. Wisconsin should rely on the homestead tax credit to meet the needs of low-income citizens, whether or not

they live in properties sponsored by tax-exempts. This would avoid the patent unfairness between the current practice, which provides an advantage to some low-income citizens that cannot be enjoyed by others. A benefit of this approach is that it clearly identifies who is being helped and by how much. It allows for modifications in the plan to meet changing needs. It is transparent and the public will know where their money is going. The homestead credit solution has the additional benefit of spreading the burden for assisting those in need more broadly, which should make communities more willing to accept properties that house low-income Wisconsinites.

I do not mean to be critical of middle- and upper-income elderly or low-income families who live in tax-exempt housing. They are merely responding to the deal that is being offered them. An adjustment in the financial arrangements of luxury senior housing, including repricing of units and arrangements for long term care with insurance, are tools that can permit those residents to reach their goals while at the same time, reestablishing themselves as property taxpayers. Although these will be resisted, they will work for almost everybody. Residents of low-income housing can be supported in other ways that will not increase the residents' burden.

Up until last March, tax-exempts have understood that their claim to tax exemption might be subject to challenge and indeed, repricing strategies are contained in most of the documentation for senior housing. Since the passage of Act 195 in March, everyone understands that the study committee will undoubtedly recommend some changes. If no action is taken now, the tax-exempts will rightly claim that they have been led into a position of reliance on their tax-exempt status. Unwinding the tax-exempt housing mess will never be easier than it is right now. This is the time to reestablish tax uniformity in Wisconsin and to reconstitute all Wisconsin citizens, young and old, rich and poor, as taxpaying full participants in our representative democracy, and in the support of our public school system, which is so important as its foundation.