STATE OF ARIZONA

OFFICE OF THE ATTORNEY GENERAL

ATTORNEY GENERAL OPINION By MARK BRNOVICH ATTORNEY GENERAL June 15, 2020	No. I20-009 (R19-007) Re: Commercial use of a school-owned facility and A.R.S. § 42-11104(A)

To: Matthew J. Smith
Mohave County Attorney

Question Presented

Whether commercial use of a school-owned facility constitutes being "used or held for profit," thereby disqualifying the facility from full property tax exemption pursuant to Arizona Revised Statutes ("A.R.S.") § 42-11104(A)?

Summary Answer

Occasional commercial use of a school-owned facility does not necessarily constitute being "used or held for profit," and therefore does not necessarily disqualify the facility from receiving a full property tax exemption pursuant to A.R.S. § 42-11104(A), although more than occasional commercial use could constitute being "used or held for profit."[1]

[1] The question asks whether the commercial use of a school-owned facility constitutes being "used or held for profit," thereby disqualifying the facility from the full property tax exemption under A.R.S. § 42-11104(A), without asking about the first requirement of the statute—that the

Background

The Arizona Constitution permits, but does not require, the Legislature to exempt from taxation the property of "educational, charitable and religious associations or institutions not used or held for profit." Ariz. Const. Art. 9, Sec. 2. With that authority, the Legislature has long chosen to exempt educational properties from taxation. Under A.R.S. § 42-11104(A), "[l]ibraries, colleges, school buildings and other buildings that are used for education, with their furniture, libraries and equipment and the land that is appurtenant to and used with them, are exempt from taxation if they are used for education and not used or held for profit." Thus, in order to determine whether an educational property in Arizona is exempt from taxation, the property must be both "used for education" and "not used or held for profit." *Id.*; *see also Tucson Botanical Gardens, Inc. v. Pima Cty.*, 218 Ariz. 523, 525, ¶ 7 (App. 2008) (analyzing, under a similarly worded statute, whether the property was (1) "used for those purposes" and (2) "not used or held for profit"). Laws exempting property from taxation are to be strictly construed against the exemption, with every ambiguity in the statute to be construed against exemption. *Verde Valley Sch. v. Yavapai Cty.*, 90 Ariz. 180, 182 (1961) (citing *Conrad v. Maricopa Cty.*, 40 Ariz. 390, 393 (1932)). It is also true, however, that the principle of strict construction of exemption statutes should not be used to subvert the underlying desire to exempt certain properties from taxation. *Id.*

Analysis

In analyzing whether commercial use of a school-owned facility constitutes being "used or held for profit," thereby disqualifying the facility from full property tax exemption pursuant to A.R.S. § 42-11104(A), it is important to note that school districts are authorized under A.R.S.

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property must be "used for education." This Opinion, therefore, does not address the "used for education" requirement.

§ 15-1105 to lease school property for consideration "to any person, group or organization for any lawful purpose, including recreational, educational, political, economic, artistic, moral, scientific, social, religious or other civic or governmental purpose in the interest of the community." In doing so, a school district must "charge a reasonable use fee for the lease of the school property," which is defined as "an amount that is at least equal to the school district's cost for utilities, services, supplies or personnel that the school provides to the lessee pursuant to the terms of the lease." A.R.S. § 15-1105(A), (G)(3).[2] Monies received from any such lease of school property must be "promptly deposited with the county treasurer who shall credit the deposits to the civic center school fund of the respective school district." A.R.S. § 15-1105(F). Those funds "may be expended for civic center school purposes[.]" *Id.* A school district may also use the proceeds from the lease of school property for, among other things, "the payment of any outstanding bonded indebtedness of the school district." A.R.S. § 15-1102(A).

No Arizona case addresses whether commercial use of a school-owned facility constitutes being "used or held for profit," thereby disqualifying the facility from full property tax exemption pursuant to A.R.S. § 42-11104(A). At least one Attorney General Opinion recognizes that "in some instances property owned by [a] school district may be taxable." Ariz. Att'y Gen. Op. I89-070, 1989 WL 266992 (1989). A few Attorney General Opinions have opined as to whether leases by schools to certain for-profit entities were lawful under A.R.S. § 15-1105(A). *See* Ariz. Att'y Gen. Op. I02-003, 2002 WL 470840 (2002) (lease to a for-profit company that provided dental services could serve a "civic purpose," specifically referencing the example of a company providing dental services at an isolated school district where children may have limited

[2] Under A.R.S. § 15-1105(B), a district may permit the uncompensated use of school property by any school related group, including student political organizations, or by any organization whose membership is open to the public and whose activities promote the educational function of the district.

access to dental services); Ariz. Att'y Gen. Op. I84-136, 1984 WL 61335 (1984) (school district could enter into a long-term lease of school property to a private business for the purpose of establishing a plant nursery and retail store from which students could study aspects of the plant industry, provided that the project fell within the curriculum requirements established by the State Board of Education). These opinions and the applicable statutes relating to the leasing of school property, together with the statutes governing the use of proceeds from such leases, suggest that it is possible for school districts to lease school property to commercial users while still satisfying the "not used or held for profit" requirement in A.R.S. § 42-11104(A).

Support for this conclusion can be found in *Tucson Botanical Gardens, Inc. v. Pima County*, 218 Ariz. 523. *Tucson Botanical Gardens* involved a claim under A.R.S. § 42-11116, which provides an exemption for the property of, among others, botanical gardens that are qualified as non-profit charitable organizations under I.R.C. § 501(C)(3) if the property was "not used or held for profit." The county assessor had denied the exemption for parts of the garden, including a gift shop that sold non-educational items (t-shirts, stationary, salsa seasonings, hats, etc.), as well as meeting rooms that were rented occasionally to third parties for non-charitable purposes (weddings, private parties, and meetings) and that were used occasionally to exhibit art for sale from which the garden received a commission. *Tucson Botanical Gardens*, 218 Ariz. at 526, ¶ 10.

With respect to whether the sales of non-educational goods in the gift shop and renting out the meeting rooms from time to time might cause those properties to be considered "used or held for profit," the court rejected the Assessor's argument that that income disqualified those

spaces from receiving an exemption.[3] The court relied upon a 1997 amendment to A.R.S. § 42-11154, which stated that a non-profit organization's status may be established by a letter of determination issued in the organization's name either by the Internal Revenue Service or the Arizona Department of Revenue. The court, interpreting Section 11154 alongside Section 11116 concluded that where a valid non-profit organization is the sole owner and only user of a property, as with the gift shop in the case, the property is exempt under Section 11116. 218 Ariz. at 528, ¶ 16. And, where "a non-profit organization owns and is the primary user of its property but allows occasional use of the property for non-exempt purposes," the non-profit organization is still "the 'organization using the property' under A.R.S. § 42-11154(2)," meaning that the non-profit status controls and the property is not "'used or held for profit.'" *Id*. at 527–28, ¶¶ 19–21.[4]

In short, the court concluded that when a non-profit organization is the primary user of a property it owns, but allows occasional use of its property for non-exempt purposes, the property does not lose its tax exempt status for being "used or held for profit," so long as the organization's non-profit status under A.R.S. § 42-11154 is proved and all other requirements of the tax exemption statute are met. 218 Ariz. at 528, ¶ 20.

Conclusion

Occasional commercial use of a school-owned facility does not necessarily constitute being "used or held for profit," and therefore does not necessarily disqualify the facility from receiving a full exemption under A.R.S. § 42-11104(A), although the facts of any particular case,

[3] *Tucson Botanical Gardens* notably drew attention to the fact that the garden did not realize a profit from either the gift shop or renting out the meeting rooms. 218 Ariz. at 528, ¶¶ 1, 3

[4] In 2018, the Department of Revenue was removed from the statute, meaning that the letter of determination must now come from the Internal Revenue Service. 2018 Ariz. Sess. Laws, ch. 338, § 38.

and the matching of those facts to the statutory schemes discussed above, will drive the outcome in any particular instance, and more than occasional commercial use could constitute being "used or held for profit."

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