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NOTES

Charitable Exemption from Ad Valorem Taxation in Texas

I. CONSTITUTIONAL AND STATUTORY BASIS FOR EXEMPTION

Although the constitution of 1876 provides that taxation of all property in Texas shall be equal and uniform,¹ it gives the legislature the power to exempt from taxation certain enumerated types of property,² including "institutions of purely public charity."³ The constitution, however, renders null and void all laws exempting property other than that listed,⁴ and for this reason it has been held consistently that the legislature is strictly limited⁵ and may not institute exemptions which are not permitted by the constitution.⁶ The legislature exercised its constitutional power in 1876 by enacting a statute exempting charitable institutions,⁷ which, in its amended form, is now embodied in article 7150, section 7.⁸ Subsequently, the legislature enacted sections 14⁹ and 20¹⁰ of article 7150, which exempt societies of fine arts and organizations created for the preservation of historical buildings, respectively.

Because exemption is the antithesis of equality and uniformity in taxation, all legislative exemptions are subject to the rule of strict construction.¹¹ An organization seeking exemption must place itself clearly within both the constitutional and the statutory grants in order to be exempt.¹² Any doubt as to the validity of the exemption

¹ Tex. Const. art. VIII, § 2.

² *Ibid.*

³ The portion of Tex. Const. art. VIII, § 2 which grants the charitable exemptions is read by the courts as saying, "But the Legislature may, by general laws, exempt from taxation . . . all buildings used exclusively and owned by . . . institutions of purely public charity." *City of Houston v. Scottish Rite Benevolent Ass'n*, 111 Tex. 191, 230 S.W. 978, 980 (1921).

⁴ Tex. Const. art. VIII, § 2 states that "all laws exempting property from taxation other than the property above mentioned shall be null and void."

⁵ *St. Edward's College v. Morris*, 82 Tex. 1, 17 S.W. 512 (1891).

⁶ *Dickison v. Woodmen of the World Life Ins. Soc'y*, 280 S.W.2d 315 (Tex. Civ. App. 1955) *error ref.*

⁷ Texas Acts 1876, ch. CLVII, § 5, 8 Gammel, Laws of Texas 276 (1876).

⁸ Tex. Rev. Civ. Stat. Ann. art. 7150, § 7 (1959).

⁹ Tex. Rev. Civ. Stat. Ann. art. 7150, § 14 (1959).

¹⁰ Tex. Rev. Civ. Stat. Ann. art. 7150, § 20 (1959).

¹¹ *City of Wichita Falls v. Cooper*, 170 S.W.2d 777 (Tex. Civ. App. 1943) *error ref.*; *City of San Antonio v. YMCA*, 285 S.W. 844 (Tex. Civ. App. 1926) *error ref.*

¹² *City of Longview v. Markham-McRee Memorial Hospital*, 137 Tex. 178, 152 S.W.2d 1112 (1941); *City of Houston v. Scottish Rite Benevolent Ass'n*, 111 Tex. 191, 230 S.W. 978 (1921); *Morris v. Lone Star Chapter No. 6, Royal Arch Masons*, 68 Tex. 698, 5 S.W. 519 (1887).

is resolved against exemption.¹³ Strict construction, however, should not be applied in such an inflexible manner that it thwarts the intention of the framers of the constitution and the legislature.¹⁴ To guard against this possibility, many jurisdictions have applied a strict rule in determining whether a legislative grant is within the intent of the constitutional framers, but have taken a more liberal approach in determining whether a particular organization is of the character embraced by the statutes. Texas, however, has rejected this method.¹⁵

II. THE REQUIREMENT OF EXCLUSIVE USE

One of the first cases to construe the constitutional provisions for charitable exemptions was *Morris v. Lone Star Chapter No. 6, Royal Arch Masons*.¹⁶ The court denied an exemption because the organization rented part of the building it owned, even though the rents received thereon were devoted to charity. In reaching this decision, the court examined the Ohio constitutional provision exempting charitable institutions, upon which the Texas provision was patterned, and *Gerke v. Purcell*,¹⁷ an Ohio case construing that provision. Ohio courts repeatedly had held that a rental of the charitable premises destroyed the exemption; Texas followed this construction in the *Morris* case.¹⁸ The court also stated that it is unnecessary to determine whether the *nature* of the organization claiming exemption is charitable if it is engaged in rental of property, because that fact alone renders it nonexempt.¹⁹

The 1905 amendment to section 7 of article 715²⁰ appeared to

¹³ *Hedgecroft v. City of Houston*, 150 Tex. 654, 244 S.W.2d 632 (1951); *City of Longview v. Markham-McRee Memorial Hospital*, *supra* note 12.

¹⁴ *City of Abilene v. State*, 113 S.W.2d 631 (Tex. Civ. App. 1937) *error dismissed*.

¹⁵ *City of Houston v. Scottish Rite Benevolent Ass'n*, 111 Tex. 191, 230 S.W. 978 (1921); *Morris v. Lone Star Chapter No. 6, Royal Arch Masons*, 68 Tex. 698, 5 S.W. 519 (1887). Whether the organization itself is within the intention of the constitutional framers and the legislature is subject to the rule of strict construction.

¹⁶ 68 Tex. 698, 5 S.W. 519 (1887).

¹⁷ 25 Ohio St. 229 (1874).

¹⁸ 68 Tex. at 702, 5 S.W. at 520.

¹⁹ If it can be shown that property belonging to a charitable association, not directly and exclusively used by it in furtherance of its charitable purposes, but partly rented for profit though its resources be exclusively devoted to the objects of charity is not exempt from taxation in our state, it will be unnecessary to determine whether or not appellee can be deemed an "institution of purely public charity," as those words are used in our constitution. *Id.* at 700, 5 S.W. at 519.

The court again emphasized this rule, stating: "This is decisive of the litigation and renders it unnecessary that we should pass upon the question whether appellee is an 'institution of purely public charity' within the meaning of the Constitution." *Id.* at 705, 5 S.W. at 522.

²⁰ The statute originally exempted "all buildings belonging to institutions of purely public charity, together with the lands belonging to and occupied by such institutions, not leased or otherwise used with a view to profit, and all moneys and credits appropriated solely to sustaining such institutions." Texas Acts 1876, ch. CLVII, § 5, 8 Gammel, Laws of Texas

give a more liberal effect to the statute with respect to exclusive use than did the prior form and the decisions under it.²¹ A few lower courts interpreted the amendment to exempt the institution itself, rather than only the buildings owned and used exclusively by it.²² *City of Houston v. Scottish Rite Benevolent Ass'n*²³ dispelled this interpretation, however, by holding that partial use of the building owned by the Benevolent Association by two Masonic Chapters defeated the claim for exemption. The court held that even though no rent was charged, a partial use by an organization not the owner of the building for purposes which were not altogether charitable destroyed the exemption. Though usually cited together as holding that any use by one not the owner defeats exemption,²⁴ the holdings of the *Morris* and *Scottish Rite* cases are distinct.²⁵ *Morris* holds that partial use by a nonowner for any purpose is prohibited if rent is paid. *Scottish Rite* holds that the exemption is destroyed if one not the owner uses the premises for *noncharitable* purposes whether or

276 (1876). The 1905 amendment added after the phrase, "not leased or otherwise used with a view to profit," the words, "unless such rents and profits and all moneys and credits are appropriated by such institutions solely to sustain such institutions." Tex. Rev. Civ. Stat. Ann. art. 7150, § 7 (1959).

²¹ *Santa Rosa Infirmary v. City of San Antonio*, 259 S.W. 926, 931 (Tex. Comm. App. 1924).

²² *State v. Settegast*, 227 S.W. 253 (Tex. Civ. App. 1921), *rev'd*, 254 S.W. 925, (Tex. Comm. App. 1923); *Scott v. All Saints Hospital*, 203 S.W. 146 (Tex. Civ. App. 1918). The effect of such an interpretation would be to exempt the institution whether or not it was carrying on charitable activities at the time, or if charitable activities were being carried on, to do away with the requirement of exclusive use. For example, in *State v. Settegast*, *supra*, the property in question consisted of an estate bequeathed in trust for the purpose of erecting and maintaining a hospital. At the time taxes were assessed against the property the hospital had not been constructed, but all income from the property was being accumulated for this purpose. The court of civil appeals interpreted the amended statute as granting exemption in such situations. Shortly thereafter, the supreme court decided *City of Houston v. Scottish Rite Benevolent Ass'n*, 111 Tex. 191, 230 S.W. 978 (1921), which interpreted the amendment more strictly. The commission of appeals then followed *Scottish Rite* and reversed in the *Settegast* case. See the discussion of the *Scottish Rite* case in text accompanying notes 23 through 27 *infra*.

²³ 111 Tex. 191, 230 S.W. 978 (1921).

²⁴ *City of Longview v. Markham-McRee Memorial Hospital*, 137 Tex. 178, 152 S.W.2d 1112 (1941); *David Graham Hall Foundation v. Highland Park Independent School Dist.*, 371 S.W.2d 762 (Tex. Civ. App. 1963) *error ref. n.r.e.*

²⁵ *Santa Rosa Infirmary v. City of San Antonio*, 259 S.W. 926 (Tex. Comm. App. 1924), contains an explanation of the holdings of the *Morris* and *Scottish Rite* cases:

But as the constitution requires the property, as a prerequisite to its right to exemption, to be exclusively used by the charitable institution, it is apparent that if any part of it is rented out and the relation of landlord and tenant created, that very fact would necessarily destroy the exclusive use necessary to be retained by the owner to bring its property within the plain terms of the Constitution, and it has been therefore held, as it was in [the *Morris*] . . . case and in *State v. Settegast* . . . that the leasing of all or any part of a charitable institution's property to those not themselves engaged in a wholly charitable work, or the occupancy of even a part of the property by others under what amounts to an equivalent situation [citing *Scottish Rite*] . . . destroys the exempt character of the property, and it is plain that in those cases there could have been no other holding. *Id.* at 931, 932.

not rent is paid for such use.²⁶ Despite sweeping statements implying that even free use by a nonowner whose purposes are charitable will destroy the exemption,²⁷ there has been no direct holding to this effect.

III. INSTITUTIONS OF PURELY PUBLIC CHARITY

The constitution does not define the phrase "institutions of purely public charity" in its exemption provision. Furthermore, no statutory definition existed until the 1905 amendment of the implementing statute. The amendment, carried through to section 7 of article 7150, included the following definition:

An institution of purely public charity under this article is one which dispenses its aid to its members and others in sickness or distress, or at death, without regard to poverty or riches of the recipient, also when the funds, property and assets of such institutions are placed and bound by its laws to relieve, and administer in any way to the relief of its members when in want, sickness and distress, and provide homes for its helpless and dependent members and to educate and maintain the orphans of its deceased members or other persons.²⁸

An interesting question is whether this statute is an exclusive definition of the constitutional term "institution of purely public charity." Evidently, the legislature does not feel that section 7 is exclusive because in subsequent sections it grants numerous exemptions which do not fit the section 7 definition and which apparently have no constitutional basis other than the public charity provision.²⁹

The courts have made only feeble attempts to define the constitutional phrase, "institutions of purely public charity." In *Scottish*

²⁶ That the *Scottish Rite* case is so restricted is illustrated by the fact that the court examined the nature of the Masonic chapters before determining the exclusive use issue. Had the rule been as broad as sometimes construed, the court could have decided the case without such a consideration because, as held in *Morris*, use by a nonowner would have been decisive. See note 19 *supra*.

²⁷ See cases cited note 24 *supra*.

²⁸ Tex. Gen. & Spec. Laws 1905, ch. 127, § 6. This amendment to the 1876 statute is now embodied in Tex. Rev. Civ. Stat. Ann. art. 7150, § 7 (1959).

Use of the word members is conspicuous in § 7. Legislative history of the bill, which might explain the emphasis given the word, is not available. Clearly the word "member" is not meant to limit recipients to that class. It is more likely that the word was placed in the statute to answer the question of whether an institution would qualify for exemption if its members were the *primary* recipients of the charitable benefits. This question was raised and answered affirmatively by the supreme court. *City of Houston v. Scottish Rite Benevolent Ass'n*, 111 Tex. 191, 230 S.W. 978, 981 (1921). However, even though charity is limited mainly to members of the organization, there still must be a substantial public benefit. *Id.* at 981.

²⁹ The Constitution provides that only public property, religious property, places of burial, educational property, and institutions of charity may be exempted. Tex. Rev. Civ. Stat. Ann. art. 7150 (1959) exempts, among other things, art galleries, § 14, Texas Federation of Women's Clubs, § 19, American Legion and other veteran's organizations, § 20.

Rite,³⁰ the supreme court stated that an organization must meet three criteria in order to be such an institution: it (1) must make no gain or profit, (2) must accomplish ends wholly benevolent, and (3) must benefit persons indefinite in number by preventing them from becoming burdens on the community or state.³¹ The court suggested further that a charity would be "public" if it affected all the people of the community or state by assuming to a material extent that which otherwise might become the obligation or duty of the community or state.³² This was the first appearance in Texas of the *quid pro quo* theory of exemption. The importance of the *quid pro quo* standard was lessened, however, when the case ultimately was decided on the basis of exclusive use.

In *Santa Rosa Infirmary v. City of San Antonio*³³ the court examined section 7 much more closely than in any previous case and interpreted it as requiring that: (1) dispensation of the relief must be without regard to the poverty or riches of the recipients and (2) the property or assets of the charity must be bound by its laws to dispense aid to persons in time of need.³⁴ Apparently the court assumed that the Infirmary met the constitutional requirement of a public charity. Nevertheless, it is significant that after holding that Santa Rosa Infirmary qualified under section 7, the court further justified the exemption by stating that the hospital relieved the state of a portion of its duty to provide for the indigent sick.³⁵

Thus, until 1963, the phrase "institution of purely public charity" was not clearly defined in its constitutional sense. The *quid pro quo* idea was present in the law, but it had never been applied as the sole criterion in determining the tax status of an organization claiming exemption. Probably because of the strict requirement of exclusive use, the courts rarely had been confronted with cases that turned purely on the definition of charity.

IV. RIVER OAKS GARDEN CLUB V. CITY OF HOUSTON³⁶

River Oaks Garden Club brought suit to have its property declared exempt, under sections 14 and 20 of article 7150,³⁷ from ad valorem taxes assessed by the City of Houston. River Oaks Garden

³⁰ *City of Houston v. Scottish Rite Benevolent Ass'n*, 111 Tex. 191, 230 S.W. 978 (1921).

³¹ *Id.* at 981.

³² *Ibid.*

³³ *Santa Rosa Infirmary v. City of San Antonio*, 259 S.W. 926 (Tex. Comm. App. 1924).

³⁴ *Id.* at 935.

³⁵ *Ibid.*

³⁶ — Tex. —, 370 S.W.2d 851 (1963).

³⁷ Tex. Rev. Civ. Stat. Ann. art. 7150, §§ 14, 20 (1959).

Club is a nonprofit corporation whose declared purpose is to promote education in the field of gardening and related fine arts and to preserve a historical building known as the Old Smith County School. Other nonprofit organizations used the building without charge at various times³⁸ to hold meetings. The district court declared the property exempt. The court of civil appeals reversed because the property was not used exclusively by the owner.³⁹ In a five to four decision, the supreme court affirmed on other grounds, holding that the organization was not an institution of purely public charity within the constitutional meaning of that phrase because it did not assume to a material extent that which otherwise might become the obligation or duty of the community or state.⁴⁰ In accepting the *quid pro quo* standard of the *Scottish Rite* case, the majority pointed out that this definition did not arise from a statutory interpretation of the phrase "institution of purely public charity" in section 7 of article 7150, but rather was a definition of that phrase as it is used in the constitution.⁴¹

River Oaks contains language to the effect that River Oaks Garden Club came within section 14, which exempts societies of fine arts, and section 20, which exempts, among other things, organizations set up for the preservation of historical buildings.⁴² There is further language in the opinion to the effect that the activities carried on by River Oaks Garden Club were not activities which the state or community are under an obligation to finance.⁴³ Such findings would seem to require a holding that the legislature exceeded its authority in enacting sections 14 and 20, which exempt organizations carrying on such activities, and thus, that those sections are unconstitutional as applied to River Oaks Garden Club. The court, however, bypassed the constitutional question, apparently feeling that it was unnecessary to go this far.

Though the opinion does not specifically so state, the result of this case seems to have been reached through a factual determination

³⁸ Some of the organizations using the building without charge were, The Houston Symphony Society Women's Council, The Amarylis Society, The African Violet Society, and The Gulf Coast Botanic Research Society. 370 S.W.2d at 855.

³⁹ 360 S.W.2d 855 (Tex. Civ. App. 1962).

⁴⁰ 370 S.W.2d at 854.

⁴¹ *Ibid.*

⁴² "[P]etitioner has sought, in clear language, to bring its property within the exemptions of secs. 14 and 20. . . . For purposes of this opinion we may assume it has done so. However, if its exemption is not authorized by the Constitution, it has done so to no avail." *Id.* at 852, 853.

⁴³ "[Petitioner's] . . . activity may be one which the state or local government could finance from taxes, . . . but it is certainly not an activity which either the state or local government is under a duty or an obligation to finance in providing educational opportunities and benefits to its society." *Id.* at 855, 856.

that River Oaks Garden Club was benefitting primarily its membership rather than the public at large.⁴⁴ By placing emphasis here, and by refusing to determine the constitutionality of sections 14 and 20, the court may have been indicating that the nature of the activities contemplated by those sections might meet the *quid pro quo* standard if they benefit a sufficiently large number of the public. It is clear that benefit to a substantial segment of the public is required of a charitable institution no matter what activity the organization engages in. The distinction between membership and the public at large, however, is new. This is the first case in which a charity has been denied exemption because the benefits ran primarily to its members. Admittedly, the membership of the garden club reaped most of the benefits, but the opinion does not state that the membership attempted to frustrate public participation—the corporate charter showed an intent to benefit the public,⁴⁵ the public was invited to the club's meetings and those of other organizations using the premises, and the Old Smith County School was open to the public.⁴⁶ If in fact no public benefit was conferred it would seem to be because there was not a large following of the club's activities, not because the club intended to limit its benefits to the members. Under these facts a section 7 institution presumably would gain exemption.⁴⁷ Thus, there appear to be two factors which the court will examine in determining whether a particular organization attempting to qualify under sections 14 and 20 meets the *quid pro quo* standard: (1) whether the activity itself is one which the state or community has an obligation to support and (2) the extent to which the organization lessens that obligation. It would seem from *River Oaks* that if the class benefited is small, the court will require a clearer showing that the organization has assumed an important governmental obligation than if the

⁴⁴ Admittedly, its main activity is to educate and enlighten its members, and such other persons as care to attend its meetings or read its book, in the art of growing and arranging flowers. . . . If petitioner may claim tax exemption as a[n] . . . 'institution of purely public charity,' there can be no end of exemptions accorded clubhouses and meeting places owned by small groups of persons of common aesthetic interests who associate themselves to promote and enjoy their particular interests. *Id.* at 855.

⁴⁵ *Id.* at 852.

⁴⁶ *Id.* at 855.

⁴⁷ Justification for this sliding scale approach to §§ 14 and 20 organizations may be found in the language of the exempting statutes. Though §§ 7, 14, and 20 do not specifically require that the activities of the organization be carried on for the public benefit, this is a constitutional requirement that has been superimposed on these sections by the courts. The legislature, however, has stated in § 7 that "members" may be the sole recipients of the benefit, and the supreme court has stated that the public is benefitted by a § 7 society even if it provides only for the welfare of its members. See note 28 *supra*. The word "members," however, is not present in §§ 14 and 20. This could well mean that the legislature did not intend to exempt section 14 and 20 institutions if the members receive the greatest share of the benefits. If so, the courts are powerless to do so.

benefits run to a large segment of the public. The converse of this test also may be true; viz., if the institution assumes a function which benefits the community, even though this activity is not clearly an obligation of the government, exemption may be given if the benefits provided by the organization reach a substantial portion of the public.

V. CONCLUSION

The *River Oaks* decision is significant in two respects. First, it avoids the issue of exclusive use. Silence on this question may indicate that a charitable institution will not lose its exemption if it allows other charities to use its facilities free of charge. Such a rule carries out the intent of the constitution and statutes to promote charitable activities better than does a rule which deprives an institution of its exemption simply because it aids other charitable institutions in carrying on their activities by allowing them free use of its premises. This interpretation of the court's silence, however, is purely conjectural. The court raised the element of exclusive use and stated that it is still a requirement.⁴⁸ Nevertheless, it refused to apply this standard, stating that the definitional aspect was more fundamental to the decision.

The second significant aspect of the decision is the adoption of the narrow *quid pro quo* standard of charitable exemptions, with its attendant ambiguities, as a constitutional criterion in determining whether an organization is an institution of purely public charity. *River Oaks* is unclear as to whether gardening, preservation of historical landmarks, and similar activities ever may be considered charitable under the *quid pro quo* standard. The most strict interpretation of the case is that many activities beneficial to the community, and normally considered to be "charitable," will be denied exemption because they do not assume an obligation that must otherwise be financed by tax dollars.⁴⁹ As discussed above, it is probable that the *quid pro quo* standard will not be applied in such a strict manner. Nevertheless, the decision stirs up an already murky area of law and until it is clarified, many organizations operating as valid charitable institu-

⁴⁸ 370 S.W.2d at 853.

⁴⁹ It is interesting to note that the budget for the City of Dallas includes an allocation for "Sundry Charges" described as "Expenses *legally or morally obligatory* upon the City as a public corporation." (Emphasis added.) Some expenses listed as Sundry Charges are the following: Historical Society, Dallas Art Museum, Health Museum, and Garden Center. City of Dallas General Budget for Fiscal Year 1963-1964, p. 229.

The budget for the City of New York for the same year shows allocations of approximately 4.5 million dollars for botanical gardens, zoological societies, and historical and art museums. New York Times, April 16, 1963, p. 26.

tions may find a harsher climate in future dealings with the tax assessor. *River Oaks* easily might be seen by the assessors as authority for cracking down on organizations which, though plainly altruistic, do not provide benefits in areas that fall within the traditional definition of public welfare. Such organizations probably will find it even more difficult to justify exemption if they benefit a comparatively small number of people.

The generally broadening areas of government assistance makes an enumeration of what is and what is not the obligation of the community or state difficult. In applying *River Oaks*, the assessor must be governed by his own opinion of what constitutes that obligation. He may find help, however, from language in the opinion which shows an apparent antipathy toward gardening, dramatics, and interior decorating.⁵⁰ Moreover, many organizations, presently claiming exemption, whose values lie in the fields of arts and sciences, and whose esoteric natures do not attract a wide following, might be met with similar antipathy. Under the present test these organizations face the prospect of harrassment and loss of tax exempt status which has previously been taken for granted.

The trend in other jurisdictions appears to be toward a broader definition of charity, exemption being based on public utility and social desirability rather than assumption of state or municipal duty to a massive extent. If *River Oaks* is applied literally, Texas will be rejecting that trend. Even if the courts interpret the *quid pro quo* standard liberally, the uncertainty which pervades the criteria for charitable exemptions in Texas will work a hardship on institutions in the fringe area. In most cases one should be able to look to the constitution and the exempting statutes to determine whether a particular organization qualifies for exemption. The present law, however, is so encumbered with small distinctions concerning exclusive use, the activities considered charitable, and the extent to which the public must be benefitted that, except in extreme cases, it is impossible to determine exemption status without the courts' help. It is hoped that this morass will be clarified when the court again is confronted with a charitable exemption case.

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⁵⁰ 370 S.W.2d at 856.