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What's Going on With PA's Charitable Property Tax Exemption?

- The City of Pittsburgh has gone to court to seek revocation of UPMC's property tax exemption.
- Warren County revoked several charitable property tax exemptions, including those of Warren Hospital and its YMCA.
- Nonprofits throughout the state are being asked to negotiate PILOTs (voluntary payments in lieu of taxes) to avoid legal challenges to their exemptions.
- A Pennsylvania Supreme Court case that revoked the property tax exemption of a Jewish summer camp has dramatically changed the test used to determine whether a charity is eligible for property tax relief, triggering a legislative attempt to amend our state Constitution.

Here's a quick review of what has happened in recent years, and a summary of what you need to know about the current state of Pennsylvania's charitable property tax exemption:

The Test

As of today, a nonprofit must prove that it meets the Pennsylvania Constitution's definition of a "purely public charity" set forth in Article VIII, Section 2, using what are known as the "HUP" factors, based on the 1985 Pennsylvania Supreme Court case, *Hospital Utilization Project v. Commonwealth*.¹

The HUP factors are fairly strict, requiring that the organization:

- a. advances a charitable purpose;
- b. donates or renders gratuitously a substantial portion of its services;
- c. benefits a substantial and indefinite class of persons who are legitimate subjects of charity;
- d. relieves the government of some of its burden; and

¹ 487 A2d 1306 (Pa. 1985)

- e. operates entirely free from private profit motive.

If the charity fails this threshold determination, its property tax exemption may be revoked.

If it passes this constitutional scrutiny, it must then satisfy a second, more expansive statutory test under Act 55, the Institutions of Purely Public Charity Act (IPPCA)². This second step may be illusory, as the first test is far stricter. If you can pass the first test, you'll pass the second.

Why Do We Have a Two-Part Test if The First Step Matters More?

To understand, a little background on Act 55 is necessary.

Passed unanimously by both the House and Senate in 1997 after 21 months of negotiation between legislators and 175 stakeholders – including PANO – Act 55 was expected to alleviate what many thought was the inconsistent manner in which the HUP factors were being applied by courts across the state. Results were sometimes harsh, and treatment of charities could be unfair and disparate.

Critics of Act 55 had – and continue to have -- a different view. They think that its goal was to preserve the charitable exemptions granted to now-large-and-profitable health systems that should in principle be paying taxes, and to make it easier for charities to qualify for tax exemptions, thereby hurting local governments, school districts, and taxpayers.

This philosophical difference in opinion on the wisdom of Act 55 has come sharply into focus in the last few years, and has come to a head.

Now, an Explanation on *How We Got This Test*

This current, two-prong test was articulated by the Pennsylvania Supreme Court in a controversial 2011 decision, *Mesivtah Eitz Chaim of Bobov, Inc. v. Pike County Board of Assessment Appeals*³.

The majority opinion, although authored by Justice J. Michael Eakin – a Republican known for his conservative judicial temperament – was joined by the Court's three Democratic justices, Justice Max Baer, Justice Debra McCloskey Todd, and Justice Seamus P. McCaffery.

In *Mesivtah*, Justice Eakin throws down the constitutional gauntlet, saying that the relevant provision of the state Constitution does not grant but rather *limits* legislative authority to create tax exemptions, and that the General Assembly exceeded its constitutional authority in Act 55 by trying to establish itself as the sole arbiter of what is a "purely public charity." The Court emphatically retained the right to interpret the constitutional minimum requirements of tax exemption.

² 10 P.S. § 371

³ 13 A.3d 463 (2011)

While the Court did not find Act 55 unconstitutional or overrule it, it in effect made the Act redundant by re-instituting the *HUP* factors as the threshold test; as a practical matter, if an organization cannot meet the stringent *HUP* test, its exemption is a great risk, and the second, more-lenient Act 55 test doesn't come into play.

The *Mesivtah* dissent, however, written by the also traditionally conservative and Republican Justice Thomas G. Saylor (our next chief justice as of 2015), and joined in by his fellow Republicans, Chief Justice Ronald D. Castille and now-former Justice Joan Orié Melvin, disagreed. It argued that while the Supreme Court by right retains the power to interpret the Constitution, the Legislature's policy decisions such as those embodied in Act 55 give the Court the input it needs to perform its judicial review in light of the "ongoing, changeable nature of public policies." They would have deferred to the General Assembly's updated and more expansive Act 55 test to determine eligibility for property tax exemption.

What's Next?

In the wake of the *Mesivtah* decision, members of the Pennsylvania General Assembly, led by Senator Mike Brubaker, Chairman of the Senate Finance Committee and Senator Joe Scarnati, President Pro Tempore of the Senate, took action, introducing Senate Bill 4 in the current legislative session. This bill would amend the state Constitution to provide that only the Legislature has the right to determine the qualifications of institutions of "purely public charities." This would in essence restore Act 55 as the test of whether an organization merits its tax exemptions as a charity.

Senate Bill 4 passed both the House and the Senate in 2013, but the Constitution requires that constitutional amendments must be passed in two consecutive legislative sessions. Our next legislative session begins in January 2015.

One small wrinkle is that Senate Bill 4's prime sponsor, Senator Brubaker, who is a long-time advocate for Pennsylvania's charities, will retire at the end of this session; however, Senator Scarnati, the co-prime sponsor, is widely expected to champion this legislation again next session.

If the bill passes next session, it must then go to Pennsylvania voters for approval. If and when both of these things happened, the Pennsylvania Constitution would be amended, effectively overruling the *Mesivtah* case and reinstating the more relaxed Act 55 standards for tax exemption.

But even assuming that all the stars align and the State Constitution is amended, we have at least a year, and probably longer, to live with the current *Mesivtah* test that has put charities at greater risk of losing their property tax exemptions upon challenge by local taxing authorities.

What Does All of This Mean?

The sideshow here is that we're in the middle of an old-fashioned separation-of-powers fight. These happen. The Supreme Court flexed its muscle; now the General Assembly is moving to assert its predominance in determining tax exemption eligibility.

But don't be distracted by this. Under either scenario – (a) if nothing happens and the *Mesivtah* test remains in force or (b) if the Constitution is amended and we revert back to the more flexible Act 55 standard – the bottom line is that our local governments and school districts are in dire financial straits. Years of recession, dwindling revenues, shrinking tax bases, and the simultaneous escalation of costs on every front – pension, infrastructure, schools, and beyond – have been devastating to our municipal and school district budgets. Twenty six municipalities are in Act 47 – the official state program to help insolvent local governments. It has been estimated that two out of every five Pennsylvanians live in municipalities in financial distress.

Here are examples of just what's at stake in our two largest cities:

1. In its lawsuit, the City of Pittsburgh has alleged that UPMC's exemption from payroll and property taxes equal \$20 million in lost tax revenue annually; and
2. *The Philadelphia Inquirer* estimated based on last year's Actual Value Initiative in Philadelphia that the nonprofit sector holds 10% of the total real estate market for a value of about \$13 billion.

There are a growing number of very hungry taxing authorities out there. And they see possible revenue in the balance sheets many not-for-profits. There is no doubt that we'll be grappling with this issue in the months and years to come, no matter what happens in Harrisburg.

So What Should You Do?

- Stay focused on your charitable mission.
- Have good legal and financial advisors.
- Stay in touch with PANO; read the materials and alerts you get from them.
- Keep open lines of communication with your state legislators and local elected officials; tell them that your property tax exemption is critical to accomplishing your mission.

And by all means, keep up your good and important work!

