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NONPROFIT ORGANIZATIONS

ALERT

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THE CHANGING LANDSCAPE OF CHARITABLE TAX EXEMPTION IN PENNSYLVANIA

By Noel A. Fleming

Introduction

On February 17, 2015, the Pennsylvania Senate passed a bill that could have far reaching implications for all Pennsylvania nonprofit charitable organizations. The bill, S.B. 4, is a proposal to amend the Pennsylvania Constitution to give the General Assembly the authority to determine the qualification standards for so-called "institutions of purely public charity." To effect such an amendment, the bill must be passed in two consecutive legislative sessions before being approved by Pennsylvania voters in a general referendum. Prior to this most recent passage by the Senate, the bill was passed in the last legislative session of the General Assembly in June 2013. As such, it will now move to the House of Representatives for its second review and consideration. If approved by the House, the bill will likely be placed on Pennsylvania ballots in this November's general election.

S.B. 4 Back Story – What is an "Institution of Purely Public Charity" Anyway?

"Well, I never heard it before, but it sounds uncommon nonsense."
— Lewis Carroll, *Alice in Wonderland*

Although the Pennsylvania Constitution does not directly exempt any organization from taxation, it authorizes the General Assembly to enact laws to grant to "institutions of purely public charity" an exemption from state taxation. Thus, to be eligible for real estate or sales and use tax exemption under Pennsylvania law, a charitable nonprofit organization must first qualify as an "institution of purely public charity" within the meaning of the Pennsylvania Constitution. However, the Pennsylvania Constitution does not define the term "institution of purely public charity" nor does it currently give the General Assembly the authority to do so.

This lack of a clear definitional standard has spurred much litigation over the years. To help address the definitional void, in 1985 the Supreme Court established a multifactor test designed to identify organizations that qualified as institutions of purely public charity. The test, as announced in *Hospital Utilization Project v. Commonwealth,* 487 A.2d 1306, 1317 (Pa. 1985) (the HUP Test), requires nonprofit organizations to satisfy five criteria to be recognized as institutions of purely public charity. They must: (1) advance a charitable purpose; (2) donate or render gratuitously a substantial portion of their services; (3) benefit a substantial and indefinite class of persons who are legitimate subjects of charity; (4) relieve the government of some of its burden; and (5) operate entirely free from private profit motive. While the HUP Test has been helpful in establishing reliable written standards for nonprofits, the interpretation of those standards

by local municipalities and state courts has proven to be inconsistent and haphazard at best. One might say this lack of consistency has led to "uncommon nonsense."

In an attempt to make the qualification standards more consistent and accessible, in 1997, the General Assembly enacted the Institutions of Purely Public Charity Act (Act 55) prescribing a five-part qualification test similar to the HUP Test, but with objective criteria for satisfying each part of the Act 55 test. Although Act 55 was a laudable effort at clarifying the inconsistent interpretation and application of the HUP Test, in many cases its adoption led to further confusion and even more unpredictable results. One of the most recent and highly publicized of these unpredictable results was the Supreme Court's 2012 decision in *Mesivtah Eitz Chaim of Bobov, Inc., v. Pike County Board of Assessment Appeals*, 44 A.3d 3 (Pa. 2012). There, the Court found that because it alone had the authority to interpret the state's Constitution, charitable organizations seeking tax exemption must first satisfy the Supreme Court's HUP Test standards before demonstrating that they also meet Act 55's requirements. While it is debatable whether the *Mesivtah* decision stated anything new, *Mesivtah* had the effect of galvanizing many legislators who thought the judiciary had overstepped its boundaries by ignoring and not giving proper deference to Act 55.

Thus, the General Assembly introduced and passed S.B. 4 in 2013 as the first step to amending the Pennsylvania Constitution. S.B. 4 would add a new provision to the Constitution that would permit the legislature to *"[e]stablish uniform standards and qualifications which shall be the criteria to determine qualification as an institution of purely public charity under clause (v) of subsection (a) of this section.*"

Public Hearing – February 4, 2015

On February 4, 2015, the Senate's Finance Committee heard testimony from various parties with an interest in state nonprofit tax exemption matters. Pennsylvania's Auditor General, Eugene A. DePasquale, reminded the Committee that many local municipalities are facing a severe financial deficit while simultaneously dealing with a dwindling tax base and ever increasing operational costs. He referred the Committee to his December 2014 report which found that more than $1.5 billion in potential property tax revenue was not being realized because of tax exemptions that have been granted to Pennsylvania nonprofit organizations. (A previous Alert explores the Auditor General's December 2014 report in greater detail.) It is evident that the Auditor General's office does not favor any efforts that would make it easier for nonprofit organizations to qualify for property tax exemption.

The Finance Committee also heard testimony from two academics each of whom specializes in nonprofit law – Nicholas P. Cafardi, Professor of Law at Duquesne University School of Law, and Katherine C. Pearson, Professor of Law at Dickenson School of Law.

Interestingly, both Professor Cafardi and Professor Pearson believe that because the proposed amendment would not expressly give the General Assembly the right to "define" what constitutes an institution of purely public charity, but would merely allow it to set qualifying standards, the amendment would not grant to the General Assembly any power that it does not currently possess. Essentially, it is each professor's opinion that passage of the amendment would do nothing to change the status quo.

Conclusion

Requiring a nonprofit charitable organization to satisfy two separate five-part tests to qualify as an "institution of purely public charity" is an unnecessarily complicated procedure that has led to increasing confusion and confrontation among traditionally tax-exempt institutions and political subdivisions. S.B. 4 appears to be an attempt by the General Assembly to simplify and clarify the current complex and arcane procedure. Whether these efforts will achieve the desired result remains to be seen. Nevertheless, the ultimate outcome will have an impact on all Pennsylvania nonprofit charitable organizations.

The Schnader Nonprofit Group will continue to monitor this evolving issue and will provide additional reports as new developments occur. ◆

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