

NONPROFIT

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A L E R T

POTENTIAL TAX CHANGES AHEAD FOR PENNSYLVANIA
NONPROFITS

By H. Lee Schwartzberg, Jr.

Pennsylvania charities that rely on exemptions from real property tax and sales and use tax may have good reason to be concerned. A recently released special report prepared by the Pennsylvania Auditor General quantifying potential tax revenues from currently exempt properties underscores the significance of an ongoing legislative initiative to give the General Assembly exclusive control over the rules that exempt certain Pennsylvania nonprofits from property tax and sales and use tax.

The Pennsylvania Constitution provides that the General Assembly may enact laws to exempt institutions of “purely public charity” from taxation, and many nonprofits do not pay property tax or sales and use tax under legislation now in effect. Certain efforts by the legislature to fine tune the applicability of the tax exemption have been thwarted, however, by the Pennsylvania Supreme Court’s ruling that it alone has the authority to define what constitutes “a purely public charity” under the Pennsylvania Constitution, and those Constitutional requirements must be satisfied before the scope of any tax exemptions under any statute passed by the General Assembly are considered. (*Mesivtah Eitz Chaim of Bobov, Inc. v. Pike County Board of Assessment Appeals* 615 Pa. 463, 473, 44 A.3d 3, 13 (2012)) In 1985 the Supreme Court identified five requirements for purely public charity status in *Hospital Utilization Project v. Commonwealth*¹ (507 Pa. 1, 487 A.2d 1306 (1985)), commonly referred to as the “HUP test.” As

recently as December 23, 2014, a unanimous three-judge panel of the Commonwealth Court ruled *Fayette Resources, Inc.*, a nonprofit that operates group homes in Western Pennsylvania, should not have been granted tax-exempt status because the second of the five HUP test requirements was not satisfied. (*Fayette Res., Inc. v. Fayette Cnty. Bd. of Assessment Appeals*, No. 405 C.D. 2014, 2014 Pa. Commw. LEXIS 589 (Pa. Commw. Ct. Dec. 23, 2014)) The Court highlighted how the evidence supported a determination Resources satisfied the requirements of The Purely Public Charity Act, 10 PS §375, but held that fact did not make Resources a purely public charity where the Constitutional requirements were not met.

The existence of two similar tests with potentially different outcomes has led to efforts underway in the Pennsylvania General Assembly to amend the Commonwealth’s Constitution² to give the General Assembly, rather than the Pennsylvania Supreme Court, exclusive control over what constitutes “a purely public charity” under the Constitution. This Constitutional amendment will require passage of the proposed joint resolution in two sessions of the General Assembly, followed by a voter referendum. The first passage occurred in June of 2013, and the Pennsylvania General Assembly’s current session started on January 6th.

Against this backdrop, the Pennsylvania Auditor General recently released a special report entitled “A Review of Potential Lost Revenue Due to Property Tax

Exemptions.”³ The report examines additional tax revenues that could be collected in ten Pennsylvania counties if all exempt properties were taxed. It also specifically examines the tax revenues that could be collected if medical facilities in those counties with purely public charity status were taxed. The report explains that “Medical facilities that are classified as institutions of purely public charity were reviewed due to reports of high revenues of some institutions in this category, growth and consolidation in the industry, and the fact that many for-profit medical facilities do exist and pay property taxes.”

While the Auditor General’s report focused on the impact of the property tax exemption, purely public charities can also obtain exemption from the Commonwealth’s sales and use tax. For some charities, the sales and use tax exemption is more important than the property tax exemption. The sales and use tax exemption does not appear to be the driving force behind the proposed Constitutional amendment, but the amendment would give the General Assembly exclusive control over which charities would qualify for the sales and use tax exemption as well.

Increased scrutiny of nonprofits, some of which have previously made payments in lieu of taxes (PILOTS) and provided services in lieu of taxes (SILOTS), is a predictable consequence of pervasive government deficits. At the same time, financial pressures on nonprofits create an incentive for them to work with their legislators to secure the maximum tax relief available. The proposed Constitutional amendment will mean nonprofits of all types should prepare themselves for increased political debate over which institutions should qualify as public charities entitled to exemption from property taxes as well as sales and use taxes. ◆

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¹ An entity qualifies as a purely public charity if it possesses the following characteristics: (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 (e) operates entirely free from private profit motive.

² SB 4 JR-2 of 2013, PN 347

³ http://www.auditorgen.state.pa.us/Media/Default/Reports/RPT_PropTaxExemptions_12182014_KGW2_Final2.pdf