

# Pennsylvania Charitable Exemptions

## Background

The Pennsylvania Constitution empowers the General Assembly to provide for exemptions from taxation. Article VIII, Section 2(a) of the Pennsylvania Constitution provides, among other things, that the General Assembly may exempt from taxation “[i]nstitutions of purely public charity. . . .”<sup>1</sup> The General Assembly implemented the provisions of Article VIII, Section 2(a)<sup>2</sup> through the enactment of the General County Assessment Law<sup>3</sup> and the Consolidated County Assessment Law.<sup>4</sup> The General Assembly is constitutionally constrained to exempt only those charitable organizations that are institutions of purely public charity.<sup>5</sup> The assessment laws extend real property tax exemptions to qualifying institutions of purely public charity.<sup>6</sup>

Although the Constitution and the assessment laws provide, generally, for real property tax exemptions for “institutions of purely public charity,” neither defines what constitutes this type of institution. Thus, since the term was first incorporated in the Pennsylvania Constitution of 1874,<sup>7</sup> the courts have had to delineate the features of what constitutes institutions of purely public charity.

The state Supreme Court in *Hospital Utilization Project v. Commonwealth*, 507 Pa. 1 (1985) (*HUP*) developed a five-part test based on over 100 years of judicial precedent<sup>8</sup> for the purpose of defining a purely public charity. The Court stated:

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<sup>1</sup> Section 2(v) states that real property tax exemptions granted for institutions of purely public charity may only be granted for that portion of real property that is actually and regularly used for the purpose of the institution.

<sup>2</sup> The Pennsylvania Supreme Court has noted, “The Constitution does not, of itself, exempt any property; it merely permits the legislature to do so within certain limits.” *Donohugh’s Appeal*, 86 Pa. 306, 309 (1878).

<sup>3</sup> General County Assessment Law, Act 155 of 1933 (72 P.S. §§ 5020-1 – 5020-602), generally. Section 204(a)(9) specifically addresses institutions of purely public charity.

<sup>4</sup> Consolidated County Assessment Law, 53 Pa.C.S. § 8801 et seq.; see § 8812, generally. Section 8812(a)(11) specifically addresses institutions of purely public charity.

<sup>5</sup> 27 *Summ. Pa. Jur.* 2d, Taxation § 18:1.

<sup>6</sup> In order to qualify for a property tax exemption, the real property owned by the institution of purely public charity must be “. . . necessary for the occupancy and enjoyment of such institutions so using it.” General County Assessment Law, § 204(a)(9); Consolidated County Assessment Law, § 8812(a)(11).

<sup>7</sup> Pa. Const. art. IX, § 1 (1874).

<sup>8</sup> In the *HUP* case, the Court reviewed decades of case law beginning with *Episcopal Academy v. Philadelphia*, 150 Pa. 565, 573 (1892). In this 1892 case, the Supreme Court reviewed prior law and held:

[It] may be safely said that whatever is gratuitously done or given in relief of the public burdens or for the advancement of the public good is a public charity. In every such case as the public is the beneficiary, the charity is a public charity. As no private or pecuniary return is reserved to the giver or any particular person, but all the benefit resulting from the gift or act goes to the public, it is a ‘purely public charity,’ the word ‘purely’ being equivalent to the word ‘wholly.’

Although the term “purely public charity” has not been defined with exactness under Pennsylvania law, case law has provided criteria by which we can set forth the parameters of a “purely public charity.”<sup>9</sup>

The five-part test established in *HUP* sets forth requirements that became the method of identifying institutions of purely public charity. The five factors are:

- Advances a charitable purpose.
- Donates or renders gratuitously a substantial portion of its services.
- Benefits a substantial and indefinite class of persons who are legitimate subjects of charity.
- Relieves the government of some of its burden.
- Operates entirely free from private profit motive.

Even with the creation of the five-part “test” by the Pennsylvania Supreme Court in *HUP*, varying court decisions followed due, in part, to difficulty in reconciling the various exemption provisions in the assessment laws.

In 1997, the General Assembly passed the Institutions of Purely Public Charity Act (IPPCA).<sup>10</sup> The General Assembly’s purpose in enacting this statute was to eliminate the inconsistent application of eligibility standards for charitable tax exemptions by creating specific legislative standards that would define the term institutions of purely public charity.<sup>11</sup> The General Assembly found:

...[there is] increasing confusion and confrontation among traditionally tax-exempt institutions and political subdivisions to the detriment of the public. There is increasing concern that the eligibility standards for charitable tax exemptions are being applied inconsistently, which may violate the uniformity provision of the Constitution of Pennsylvania.<sup>12</sup>

The IPPCA superficially incorporates the five-point *HUP* test, but significantly redefines the method by which each of the five tests is met and adds other requirements. The IPPCA states that an institution that meets the five criteria enumerated in the law shall be considered to be founded, endowed and maintained by public or private charity.<sup>13</sup>

The IPPCA also created new procedural provisions for challenging the tax-exempt status of an organization. Under the IPPCA, if a political subdivision challenges the tax-exempt status of an

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<sup>9</sup> *HUP*, 507 Pa. at 13

<sup>10</sup> Act 55 of 1997 (10 P.S. §§ 371-385).

<sup>11</sup> IPPCA, § 2.

<sup>12</sup> *Id.* §§ 2(a), (4), (5).

<sup>13</sup> IPPCA, § 5(a).

organization, and the organization possesses a valid sales and use tax exemption from the Pennsylvania Department of Revenue and has an annual program service revenue less than \$10 million, then the organization is entitled to assert a “rebuttable presumption” that it has satisfied all of the criteria for qualification as an institution of purely public charity. If the organization’s annual service revenue is equal to or exceeds \$10 million, the organization may assert the presumption only if it possesses a valid sales and use tax exemption and has a voluntary agreement<sup>14</sup> with the political subdivision in which it conducts substantial business operations.<sup>15</sup> If an organization asserts a presumption, then a political subdivision challenging that organization before a government agency or court will bear the burden of proving, by a preponderance of the evidence, that the organization does not comply with the requirements of the act.<sup>16</sup>

### *Purely Public Charity Status: Relationship of Constitutional Standard to Statutory Standard*

The Pennsylvania courts have considered the relationship of the constitutional requirements for establishing a purely public charity under Article VIII, Section 2 of the Pennsylvania Constitution and the requirements for establishing a purely public charity under the IPPCA. The Pennsylvania Supreme Court addressed the General Assembly’s statutory constraints in providing for charitable exemptions in *Alliance Home of Carlisle v. Board of Assessment Appeals*,<sup>17</sup> noting:

[The General Assembly] could elect to provide for charitable exemptions on a basis that was more limited than is constitutionally authorized . . . however, the constitutional command restrains the scope of exemption that may be legislatively authorized. . . . [T]he General Assembly cannot authorize an exemption that would go beyond what is permitted by the constitutional text and, if an exemption were deemed to exceed what is authorized, the courts would be duty-bound to strike it down.<sup>18</sup>

Since the codification of the IPPCA, the Pennsylvania courts have held that the General Assembly may enact legislation regarding that which is intended to be exempt from taxation, “but it cannot lessen the constitutional minimums by broadening the definition of “purely public charity” in the statute.”<sup>19</sup> In order to be deemed an institution of purely public charity and receive an exemption, an institution must first satisfy the judicially created *HUP* test. If it does so, then the institution

<sup>14</sup> An agreement in which the organization agrees to make contributions to the political subdivision for the purpose of defraying some of the cost of various local government services. *See* article section entitled “Payments in Lieu of Taxes (PILOTs).”

<sup>15</sup> IPPCA, § 6.

<sup>16</sup> *Id.*

<sup>17</sup> 591 Pa. 436 (2007).

<sup>18</sup> *Home of Carlisle*, 591 Pa. 436, 463 (2007).

<sup>19</sup> *Mesivtab Eitz Chaim of Bobov, Inc. v. Pike County Board of Assessment*, 615 Pa. 463, 465 (2012); *Fayette Res., Inc. v. Fayette Cty. Bd. of Assessment Appeals*, 107 A.3d 839 (Pa.Cwmth. 2014), *appeal denied*, 125 A.3d 778 (Pa. 2015).

may qualify for an exemption if it meets the requirements of the IPPCA. However, if an institution fails the *HUP* test, the statute is not applied.<sup>20</sup>

### *Use of the Property Affecting its Exempt Status*

Even if an entity qualifies as a purely public charity, the particular property in question (or part of the property) *might not qualify* for a real property tax exemption if the property is *not actually and regularly used for the purposes of the institution*. The Pennsylvania Constitution provides that the General Assembly may by law exempt from taxation: “[i]nstitutions of purely public charity, but in the case of any real property tax exemptions *only that portion of real property of such institution which is actually and regularly used for the purposes of the institution.*”<sup>21</sup>

Applicable provisions of the General County Assessment Law regard the use of the property in determining the taxability of a real property. Section 204 states:

(a) The following property shall be exempt from all county, city, borough, town, township, road, poor and school tax, to wit:

...

(9) All real property owned by one or more institutions of purely public charity, used and occupied partly by such owner or owners and partly by other institutions of purely public charity, and *necessary for the occupancy and enjoyment of such institutions so using it.*<sup>22</sup>

A similar provision exists in the Consolidated County Assessment Law.<sup>23</sup>

Ownership of property, then, is not the sole determiner of taxable status. The use of the property must be in support of the purpose/mission of the tax-exempt institution. Consequently, an institution of purely public charity, though itself tax exempt, may find certain property owned by it to be liable for real estate taxes if the property is not used to advance the purpose of the institution in question.

### *Payments in Lieu of Taxes (PILOTs)*

In addition to the above exemptions from taxation, real property can also be considered immune from taxation. Exempt properties are deemed to be taxable unless otherwise provided for by statute. Conversely, immune properties, such as state-owned property, are free from taxation unless

<sup>20</sup> See *Mesivtab, Fayette Res., Inc., supra*, note 19; *Alliance Home of Carlisle, and Community Options, Inc. v. Board of Property Assessment*, 571 Pa. 672 (2002).

<sup>21</sup> Pa. Const. art. VIII, § 2(v) (emphasis added).

<sup>22</sup> Emphasis added.

<sup>23</sup> 53 Pa.C.S. § 8812(a)(11).

otherwise authorized by statute.<sup>24</sup> Examples of immune properties include most federal, state or local government owned properties.

Exempt and immune properties can account for large proportions of a local municipality's real property, and thus can negatively affect the municipality's property tax revenue. To counteract this reduction in revenue, the IPPCA authorizes the implementation of voluntary agreements<sup>25</sup> between local government and institutions of purely public charity, commonly referred to as payments in lieu of taxes (PILOTs). The contributions collected from these voluntary agreements are able to be shared between multiple local governments, provided all parties agree to the sharing.<sup>26</sup> Institutions also have the option of forming public service foundations, which collect contributions from the institution and then provide funding to local governments. If an institution is involved in a public service foundation, the local government is not permitted to seek a voluntary agreement with the institution directly.<sup>27</sup> Both the voluntary agreements and the public service foundation contributions shall be used "to help ensure that essential governmental, public or community services will continue to be provided in a manner that will permit an institution to continue to fulfill its charitable mission."<sup>28</sup>

One of the criteria that the IPPCA requires for an institution of purely public charity is that the "institution must donate or render gratuitously a substantial portion of its services."<sup>29</sup> PILOTs are able to be credited toward that donation requirement as follows:

- If the contribution is less than or equal to 0.15% of the institution's revenue, then 150% of the value of the PILOT can be credited towards the community service criteria.
- If the contribution is greater than 0.15%, but less than 0.25%, of the institution's revenue, then 250% of the value of the PILOT can be credited towards the community service criteria.
- If the contribution is greater than or equal to 0.25% of the institution's revenue, then 350% of the value of the PILOT can be credited towards the community service criteria.<sup>30</sup>

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<sup>24</sup> See *Lehigh-Northampton Airport Authority v. Lehigh County Bd. Of Assessment Appeals*, 888 A.2d 1168 (Pa. 2005). As in the case of institutions of purely public charity, the ultimate exemption or immunity of property from taxation may depend on whether the actual use of the property is consistent with the public purpose of the exempt or immune entity. *Id.* at 1179.

<sup>25</sup> IPPCA § 3: "Voluntary agreement." An agreement, contract or other arrangement for the purpose of receiving contributions pursuant to section 7 between a political subdivision and an institution seeking or possessing an exemption as an institution of purely public charity. These contributions are for the purpose of defraying some of the cost of various local government services. The term includes the establishment of public service foundations by institutions of purely public charity.

<sup>26</sup> IPPCA § 7(a).

<sup>27</sup> IPPCA § 7(b).

<sup>28</sup> *Id.*

<sup>29</sup> IPPCA § 5(d)(1).

<sup>30</sup> IPPCA § 7(c).

Determining the revenue that a local municipality gains from a PILOT is problematic, because these contributions are not always clearly labelled as PILOTs. This becomes particularly difficult in attempting to compare revenue streams of different municipalities.

Analysis of several cities nationwide shows the variance in revenue streams from PILOTs. Research by the Lincoln Institute of Land Policy looked at PILOT revenue in eleven cities nationwide, and found that the PILOT revenue generated, as a share of the city's total budget, ranged from a low of 0.01% in Minneapolis, MN, to a high of 4.77% in Bristol, RI. The median share of these cities was 0.66% of the total municipal budget.

<b>PILOT Contributions to Municipal Revenues<sup>31</sup></b>				
<b>City</b>	<b>Revenue Generated (\$)</b>	<b>City Budget (\$)</b>	<b>Year</b>	<b>Revenue Generated as Share of Total Budget (%)</b>
Baltimore, MD	5,000,000	1,493,018,000	FY2001	0.33
Boston, MA	15,685,743	2,380,000,000	FY2009	0.66
Bristol, RI	2,100,000	44,017,031	FY2009	4.77
Butler, PA	15,000	8,442,098	FY2010	0.18
Cambridge, MA	4,508,000	466,749,012	FY2008	0.97
Detroit, MI	4,160,000	2,460,000,000	FY1998	0.17
Lebanon, NH	1,280,085	42,312,510	FY2010	3.03
Minneapolis, MN	158,962	1,400,000,000	FY2009	0.01
New Haven, CT	7,500,000	648,585,765	FY2010	1.16
Pittsburgh, PA	4,416,667	496,611,848	FY2007	0.89
Providence, RI	2,500,000	444,544,123	FY2010	0.56

In addition to voluntary agreements and public service foundations as set forth in the IPPCA, there are PILOTs established in other laws to enable the federal and state government to defray the revenue loss to local governments from immune properties. Per the Pennsylvania Fiscal Code, the state will make PILOTs to local municipalities for land owned by the Department of Conservation and Natural Resources (DCNR), Pennsylvania Game Commission (PGC), and the Pennsylvania Fish and Boat Commission (PFBC). DCNR makes payments of \$2.00 per acre to each county, school district, and township where real property is owned, while PGC and PFBC make payments of \$1.20 per acre.<sup>32</sup> Similar payments are made at the federal level for property owned by the Department of the Interior.<sup>33</sup>

<sup>31</sup> Kenyon, Daphne A. and Adam H. Langley. *Payments in Lieu of Taxes: Balancing Municipal and Nonprofit Interests*. Lincoln Institute of Land Policy, Cambridge, MA, 2010, p. 22.

<sup>32</sup> 72 P.S. § 1798.1-E(b).

<sup>33</sup> 31 U.S.C.A. Ch 69.