

CATALYST

Business EXPERTise

In this new Catalyst feature, recognized and respected issue experts from PA Chamber member companies answer businesses' most frequently asked questions about HR, Tax, Communications and Environmental concerns, compliance and best practices.

Finance/Tax

What is the impact of the PA Supreme Court's decision to require charities to meet the "constitutional" tax exemption test before considering the statutory test?

The Pennsylvania Supreme Court recently held that to qualify for property and sales tax exemptions, a charity must first meet the constitutional standard it established in 1985 ("HUP test") before and in addition to the statutory standard enacted in 1997 ("Act 55 test"). *Mesivtah Eitz Chaim of Bobov v. Pike Co Bd of Asmt Appeals*, 44 A.3d 3 (Pa. 2012), concerned real estate taxation of a religious summer camp, though it applies to sales and use taxation and every entity seeking status as an Institution of Purely Public Charity ("PPC") such as non-profit health care, education, senior living, social, recreational and arts organizations.

Under both tests a PPC must: advance a charitable purpose; donate or render gratuitously a substantial portion of its services; benefit a substantial and indefinite class of people who are legitimate subjects of charity; relieve some government burden; and operate entirely free from private profit motive. Act 55 provides more precise criteria and some relaxed definitions.

Property and sales tax exemption litigation fell sharply following enactment of Act 55, though many county courts and the Commonwealth Court continued to apply both the tests. The majority opinion in *Mesivtah* acknowledged the inherent uncertainty of its decision, noting that "our courts will apply the HUP test in light of evolving circumstances."

The Department of Revenue, which has relied solely on Act 55 for sales tax exemptions, is now "reviewing this situation." Several localities have indicated they will be scrutinizing property tax exemptions and increasingly seek payments-in-lieu-of-tax ("PILOT").

A proposed constitutional amendment overturning *Mesivtah* and supported by the PA Chamber failed to timely reach a final House vote following Senate approval (46-1) in the 2011-12 legislative session. Needing passage by two consecutive sessions, the earliest ballot appearance would be the 2016 General Election.

A PPC should take four steps to protect its property and sales tax exemptions. First, perform a self-assessment, applying both tests to each of its legal entities. Second, entity restructuring should be considered. Third, careful documentation is critical, as numerous



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cases have been lost by failing to prove one or more elements of the tests. Fourth, a PPC should consider entering into PILOT Agreements.

Reduced confrontation is a stated intent of Act 55 (Section 2(b)) to "ensure that charitable and public funds are not unnecessarily diverted from the public good to litigate eligibility for tax-exempt status." With *Mesivtah*, combined with increased financial pressure on both governments and nonprofits, the opposite result is expected. To manage this risk, PPCs need to be prepared under both tax-exemption tests for at least the next four years. ♦

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