




PACHC Memo 12-05

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October 2, 2012

TO: Chief Executive Officers of Pennsylvania Community Health Centers  and Rural Health Clinics

FROM: Cheri Rinehart, President & CEO

SUBJECT: Local Challenges to Health Center Tax Exempt Status

SUMMARY: Two health center sites in Pennsylvania are responding to challenges to their tax exempt status by local taxing authorities and anticipate that the cases will go to trial. A recent Pennsylvania Supreme Court decision may spur additional challenges to the tax exempt status of health centers and other charitable organizations in the Commonwealth.

BACKGROUND: On February 13, 1985, the Pennsylvania Supreme Court issued an opinion in *Hospital Utilization Project (HUP), Appellant v. Commonwealth of Pennsylvania*, which remains in effect as the Court recently reaffirmed its applicability. In the HUP decision, the PA Supreme Court developed a five-part test to outline the method by which institutions of purely public charity are identified (“the HUP test”).

The five-pronged test includes:

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

During the decade following the 1985 Supreme Court decision, there was a surge of litigation by local governments and school districts that believed the court had created new and quite narrow standards that would eliminate the exemption for certain previously exempt institutions. Instead of clarifying the situation, the litigation following the Supreme Court decision created confusion and costly confrontations between traditionally tax-exempt institutions and political subdivisions.

In 1997, in response to the challenges many non-profit organizations faced, the Pennsylvania General Assembly unanimously passed the Institutions of Purely Public Charity Act (Act 55 of 1997) to eliminate the inconsistent application of eligibility standards for charitable tax

exemptions. The Act incorporates the five-part HUP test, and adds a series of quantitative tests which an entity needs to pass to achieve exemption. The Act enabled an entity and/or a taxing jurisdiction to apply these bright-line tests and to easily determine whether an organization was exempt or not.

With passage of Act 55 and the clarity to the criteria the law provided, challenges to tax-exempt status quieted for a number of years. However, a recent (April 25, 2012) Pennsylvania Supreme Court [decision](#) could change this as the Court denied public charity status to a religious summer camp in Pike County, even though it qualified as an institution of purely public charity under Act 55. The Court ruled that a charity will have to pass both the HUP criteria and Act 55; passing Act 55 will not be sufficient in and of itself. This was a close decision (5-4) and turned on the fact that the Act included among its criteria for satisfying the “relieves the government of a burden” prong, that an entity is exempt if it furthered a religious purpose. The majority in the decision reasoned that advancing a religious objective did not relieve the government of a burden and the Court had never identified this as doing so. The Court found that the Act’s inclusion of this standard was in conflict with the Court’s interpretation of this requirement and that the Legislature could not fundamentally alter or re-interpret the Court’s criteria; in other words, if there is a conflict between the Court’s interpretation and the Legislature’s law, the Court wins.

Importantly, the Court did not declare the entire Act unconstitutional. Unfortunately, it highlighted and reopened the ambiguity between correlating the Constitutional test (the five HUP) prongs) and Act 55. No one is quite sure how the two standards are to be read together going forward. There are numerous quantitative tests in the Act that a judge would likely accept as evidence of meeting both the HUP test and Act 55.

CURRENT STATUS: Two health center sites in Pennsylvania are among non-profits in the midst of challenges to their tax exempt status by local taxing jurisdictions. The challenges commenced *before* the Supreme Court’s camp decision. Both health centers are being challenged on the fourth prong of the HUP test: “relieves the government of some of its burden and all other requirements under the Act and applicable law.” According to Act 55, this criterion is satisfied if the institution... “receives on a regular basis payments for services rendered under a government program if the payments are less than the full costs incurred by the institution, as determined by generally accepted accounting principles.” (Act 55, §375(f)(3)). The taxing authorities are questioning how the health centers can both receive cost-based reimbursement and funding from the government and relieve government of some of its burden at the same time.

The April 12, 2012 Pennsylvania Supreme Court decision is being portrayed by some as a stunning rejection of Act 55, when in fact that cannot be said at this point. The reality is that the press coverage of the case as well as budget challenges have spiked a renewed interest among taxing jurisdictions and thus could result in challenges to the public charity status of other charitable organizations if taxing jurisdictions are motivated to take advantage of this decision.

In response to this new flurry of tax exempt challenges, Senator Mike Brubaker introduced Senate Bill 161. The bill is currently poised for a final vote in the House and has received wide support in the General Assembly and [business community](#). The bill amends the Pennsylvania Constitution to provide the General Assembly with the authority to establish standards for a purely public charity's qualifications. Currently, the Constitution only allows the General Assembly the authority to determine tax exemptions for institutions of purely public charity. This statutory change would allow the legislature to establish the criteria for purely public charity rather than have a court determine an organization's merits through the HUP Test.

Because Senate Bill 161 would amend the state constitution, the bill must pass the General Assembly in two consecutive sessions and be adopted by public referendum to be enacted into law. For example, as a best case scenario this means that an affirmative vote must be cast in the House before the legislature adjourns this October and then identical legislation must be reintroduced and adopted as early as possible in the 2013-14 legislative session to position a referendum vote in the spring of 2013 (municipal primaries).

MEMBER ACTION: Senate Bill 161 passed the Senate with only one negative vote and has support of Senate leaders. It now rests in the House, which does not seem poised to move it.

- 1- Thank your Senator for their support on the bill, emphasizing its importance to your organization and other community charitable organizations.
- 2- Please reach out to your state representative and encourage them to support the bill and help get it passed before the legislature adjourns on October 18. Explain how important it is for your organization and others to have clear guidance on the standards to qualify as a purely public charity, rather than each organization having to spend precious and limited time, energy and resources in responding to individual challenges and that these are resources that will be diverted from each organization's charitable mission.
- 3- Be prepared to articulate and quantify how your health center meets the HUP test.
- 4- Take any tax exempt challenge seriously.
- 5- Notify PACHC if your health center is facing a challenge.

This issue underscores the importance of grassroots advocacy, relationship building and ensuring decision makers in your community know your health center, the important role you play in access to quality health care for the most vulnerable, the economic impact you have and the challenges you face in meeting the requirement that your doors be open to all. You don't want to be in the position of having to make a friend when you need one; you want those relationships firmly in place.

PACHC ACTION: PACHC will continue to monitor this issue and work with legislators and partners on enactment of legislation to give the legislature the authority to define the criteria organizations must meet to qualify as purely public charities and restore clarity and stability on this issue.

FOR MORE INFORMATION: For more information, please contact Jim Willshier, Director of Policy & Partnership, at (717) 761-6443, ext. 206, jim@pachc.com.