



HAP

THE HOSPITAL & HEALTHSYSTEM
ASSOCIATION OF PENNSYLVANIA

Testimony
Submitted on behalf of The Hospital &
Healthsystem Association of Pennsylvania

Before the
House Finance Committee

Presented by
Scott A. Bishop
Senior Vice President, Legislative Services
The Hospital & Healthsystem Association of Pennsylvania

Harrisburg, Pennsylvania
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Chairman Benninghoff, Chairwoman Mundy, and members of the committee, HAP represents and advocates for nearly 240 acute and specialty care hospitals and health systems across the state and the patients they serve. We appreciate the opportunity to present the views of hospitals and health systems across the state on why we are seeking to amend the Pennsylvania Constitution to clarify that it is the exclusive role of the legislature to write laws providing for the qualifications of institutions of purely public charity. Further, this testimony will outline why HAP continues to support the clear, consistent, measurable and rigorous standards put forth in Act 55 of 1997 (The Institutions of Purely Public Charity Act).

Background and Key Provisions of Act 55 of 1997

Until Act 55 of 1997, Pennsylvania lacked a clear definition of "institutions of purely public charity," the term used in the Pennsylvania Constitution to describe entities eligible for exemption from state sales tax and real property taxes. In 1985, five criteria were adopted by the Pennsylvania Supreme Court (*Hospital Utilization Project (HUP) v. Commonwealth*, 507 Pa.1, 487 A.2d. 1306 (1985)) to determine whether an institution is an "institution of purely public charity." Under the *HUP* test, an institution qualifies as an "institution of purely public charity" if it advances a charitable purpose; operates entirely free from private profit motive; donates or renders gratuitously a substantial portion of its services; benefits a substantial and indefinite class of person who are legitimate objects of charity; and relieves the government of some its burden.

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 like hospitals and political subdivisions.

After receiving unanimous support by the General Assembly, Act 55 became law in November 1997. Given the uncertainty created by the *HUP* decision, the act was intended to bring clarity to the criteria to determine an institution's real property and

sales tax exemption status. Proponents of the act believed it would protect educational, health care, and other charitable institutions from unwarranted legal attacks by local governments and school districts. Indeed, this was landmark legislation because few, if any other states, had developed such comprehensive requirements for state tax exemption. Most states simply default to federal law which continues to be quite broad.

For nearly 15 years, Act 55 met its purpose. One reason HAP believes that Act 55 of 1997 has been so effective is because it uses the same five criteria established by the Supreme Court in 1985. However, it more clearly elaborates how an entity must demonstrate satisfaction of each criterion. Here are the key provisions of the act:

Charitable Purpose—There are six ways to meet this criterion:

- (1) Relief of poverty.
- (2) Advancement and provision of education.
- (3) Advancement of religion.
- (4) Prevention and treatment of disease or injury.
- (5) Government or municipal purposes.
- (6) A purpose, which is recognized as important and beneficial to the public and advances social, moral, or physical objectives.

No Private Profit Motive—The act puts to rest any suggestion that an institution with revenue exceeding necessary expenses operates with a private profit motive. Rather, to demonstrate the lack of profit motive, an institution must ensure the following:

- (1) Neither its net earnings, nor donations it receives, inure to the benefit of private shareholders or other individuals.
- (2) Any revenue in excess of expenses is used for the furtherance of its charitable purpose or to fund other charitable organizations.
- (3) Compensation and benefits of any director, officer, or employee shall not be based primarily on financial performance of the organization.
- (4) No surplus funds may be used for the private inurement to any person in the event of a sale or dissolution of an institution of purely public charity.

Community Service—The requirement that an institution donate a substantial portion of its services may be met under one of six alternative percentage tests. These quantifiable tests were designed to ensure that an institution provides some portion of its goods and services at no fee or reduced fees. The test that is used by most hospitals is the requirement that it must maintain an open admissions policy and provide uncompensated goods or services at least equal to 75 percent of net operating income, but not less than three (3) percent of total operating expenses.

Objects of Charity—The act clarifies the criterion, "legitimate object of charity," as individuals who cannot provide for themselves what the institution provides for them. The Act specifically declares that federally exempt labor organizations, agricultural organizations, business leagues, social clubs, and fraternal benefit societies qualify under this test.

Relief of Government Burden—The act clarifies the range of activities that can be deemed to relieve governmental burden. Thus, the act considers any of the following to be relief of a government burden:

- (1) Providing a service that government would otherwise be obligated to provide.
- (2) Providing services that are a government responsibility or have historically been performed by government.
- (3) Receiving on a regular basis payment for services rendered under a governmental program that are less than the full costs incurred by the institution.
- (4) Providing a service which reduces dependence on governmental programs.
- (5) Advancing or promoting religion by a religious ministry.
- (6) Voluntary agreement with local governments.

There are two unique and creative provisions in Act 55 of 1997—promotion of voluntary agreements with local governments, and prohibition of competition with small businesses.

Voluntary Agreements—Many charitable institutions, threatened by costly local government legal challenges to their tax exemption, opted to make payment, or provide services to local governments in-lieu-of-taxes ("PILOTS" and "SILOTS"). The Act supports these payments and offers incentives for continuing to make them.

Unfair Competition with Small Businesses—The act also prevents charities from using their tax-exempt status to compete unfairly with small businesses. Charities are not permitted to "fund, capitalize, guarantee the indebtedness of, lease obligations of, or subsidize a commercial business that is unrelated to the institution's charitable purpose.

Why a State Constitutional Amendment is Necessary

The language of Representative Benninghoff's House Bill 724 (reported in March by this committee) and Senate Bill 4, which passed both chambers of the General Assembly earlier this year, is necessary due to the Pennsylvania Supreme Court 2012 decision in *Mesivtah Eitz Chaim of Bobov, Inc. v. Pike County Board of Assessment Appeals*. In this case, the Court determined that it must rely first on the 1985 HUP test instead of applying the measurable and constitutional provisions of Act 55. In other words, the Court said that charitable organizations cannot receive public charity status unless they first satisfy a nearly 30-year-old judicially created test. One reason this is so troubling is that Act 55 uses the same five criteria established by the Court in the 1980s—it simply elaborates more clearly how an entity must demonstrate satisfaction of each criterion. Further, at no point has the Court said that Act 55 or any provision of the act is unconstitutional. That is why we believe the Court should first apply the provisions of Act 55 when determining the status of an institution of purely public charity.

HAP is very concerned that the *Mesivtah* decision has set the commonwealth back decades in a key area of the law for Pennsylvania's health care, educational, and other charitable organizations. In fact, this decision could return the state to a time of confusion, inefficiency, and conflicting decisions, and likely will result in a surge of costly litigation that hospitals and other charitable providers can ill afford. Because the Court

has decided that they will continue to apply the *HUP* test prior to Act 55, charitable organizations now will need to litigate in different courtrooms facing different interpretations by different judges in order to prove their tax-exempt status.

Finally, we do believe it is important to note that this exercise should not be about inserting new substantive language into the State Constitution (i.e. placing the provisions of Act 55 into the Constitution) or about using this process as a means to further specific political agendas. The most appropriate constitutional change is to make certain the General Assembly's role as the sole determiner of the criteria necessary to define an institution of purely public charity. Then, the courts should apply those criteria in the cases they consider.

Why Reversing the Impact of the *Mesivtah* Decision is Important

Amending the Pennsylvania Constitution to reverse the impact of the *Mesivtah* decision will enable the legislature to maintain certainty and uniformity across the state in a key area of the law. Otherwise, the commonwealth risks allowing the standards necessary to determine an institution of purely public charity to be established one court decision at a time.

Each year, Pennsylvania hospitals and health systems provide care to nearly two million inpatients, serve patients through almost 40 million outpatient visits, and provide care through six million emergency department visits. We are the **only** state of our size in this nation that does not have public hospitals—as a result, **all** Pennsylvania hospitals and health systems serve as the health care safety net for the poor, the uninsured and the commonwealth's most vulnerable citizens. And, hospitals treat patients regardless of their ability to pay. What this means is that, in addition to the hundreds of millions of dollars in state and federal spending cuts levied against hospitals, they must also absorb more than \$1 billion in uncompensated care each year.

But, Pennsylvania hospitals do not just impact the physical health of the patients they serve. Each year these facilities provide billions of dollars in charitable benefits in their communities. Hospital and health system services reach down country roads and city streets in the form of neighborhood clinics, mobile health units, and social service networks. Across the commonwealth, hospitals invest millions in local improvement and revitalization projects. They work on environmental health issues, offer mentoring programs, train and develop community leaders, and ensure disaster readiness. These community-building activities extend beyond direct health care, by clearly addressing many of the root causes of health problems, such as poverty, crime, and environmental issues.

While a hospital or health system's complete financial structure is a complex one, tax exemption is essential in helping these facilities achieve their core mission in health care, manage increasingly difficult payment challenges, and build their communities by providing all of the additional activities and services discussed above.

Conclusion

Before closing, we want to note that, in addition to HAP, the language of House Bill 724 and Senate Bill 4 is supported by the Association of Independent Colleges & Universities of Pennsylvania, LeadingAge PA, the Pennsylvania Association of Community Health Centers, the Pennsylvania Association of Independent Schools, The Pennsylvania Association of Nonprofit Organizations, the Pennsylvania Association of Rehabilitation Facilities, the Pennsylvania Bar Association, the Pennsylvania Catholic Conference, the Pennsylvania Catholic Health Association, the Pennsylvania Chamber of Business and Industry; the Pennsylvania Community Providers Association, the Pennsylvania Institute of Certified Public Accountants, the Pennsylvania Jewish Coalition, the Pennsylvania Alliance of State YMCAs, and the United Way of Pennsylvania.

Thank you for the opportunity to present HAP's and the hospital community's support for Act 55 of 1997 and to share why we are advocating to amend the Pennsylvania Constitution. Hospitals do understand that tax exemption is a privilege, not a right. They recognize they have a responsibility to their patients, their communities, and to this commonwealth that goes beyond the daily business operations of their facilities. The clear, consistent, measurable, and rigorous provisions of Act 55 have helped them fulfill this responsibility by ensuring that limited resources are not wasted on costly and unnecessary legal disputes.

HAP looks forward to working with the General Assembly to restore clarity to how the state and local governments determine the real property and sales tax exemption status of a charitable institution. I am happy to respond to any questions you or the members of the committee may have.

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