Pennsylvania Association of School Business Officials

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SUBMITTED REMARKS REGARDING ACT 55

PREPARED BY THE

PENNSYLVANIA ASSOCIATION OF SCHOOL BUSINESS OFFICIALS

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Perspective of the Pennsylvania Association of School Business Officials (PASBO) Regarding Act 55 of 2007, the "Institutions of Purely Public Charity Act"

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I. Introduction

Mr. Chairman, and members of the House Finance Committee, on behalf of the Pennsylvania Association of School Business Officials (PASBO), thank you for the opportunity to present PASBO's perspective regarding Act 55 of 2007, the Institutions of Purely Public Charity Act, 10 P.S. §§ 371-385.

PASBO is an association of 3,000 members, two-thirds of which are K-12 non-instructional administrators who provide finance, accounting, operations, facilities, transportation, food service, technology, communication, human resources, purchasing and safety services to support classroom learning in schools in Pennsylvania.

PASBO is very pleased the Committee is taking a hard look at Act 55. The Pennsylvania Supreme Court's decision in *Mesivtah Eiz Chaim of Bobov, Inc. v. Pike County Board of Assessment Appeals,* 44 A.3d 3 (Pa. 2012), confirmed the Supreme Court's statement from ten years previous in *Community Options, Inc. v. Board of Property Assessment,* 813 A.2d 680 (Pa. 2002), that Act 55 did not replace the *HUP* test in establishing qualifications for a purely public charity, but instead added a legislative test that supplements the constitutional *HUP* test.

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As a result of the General Assembly's adoption of Senate Bill 4 earlier this year, with the possible result of a Constitutional amendment authorizing the General Assembly to establish the sole criteria for institutions of purely public charity, it is vitally important to closely evaluate Act 55.

Time constraints associated with this hearing preclude a thorough, comprehensive presentation on PASBO's views of Act 55. This testimony will provide a summary of PASBO's key perspectives regarding tax exemptions for purely public charities. PASBO would, of course, welcome further dialogue with the Committee on this critical issue.

II. Background

Before addressing Act 55, it is important to explain the fiscal context in which PASBO is providing this testimony.

A. Heavy Reliance on Real Estate Taxes – Thus, Impact of Exemptions is Acute

To appreciate the impact of tax exemptions for purely public charities on school districts' ability to fund educational programs, it is important to stress that the Commonwealth's funding scheme for public schools requires districts to rely heavily upon local real estate taxes.

Notably, the General Assembly's practice of requiring school districts to depend heavily upon local real estate taxes to fund educational programs is increasing and shows no sign of abating.

This trend is reflected through data from the website of the Pennsylvania Department of Education. During the 2003-04 school year, local real estate taxes comprised 39.4% of total school district revenues, and the state provided 42.3% of total school district revenues. In

contrast, in the 2011-12 school year (the most recent year for which PDE's website provides such data), local real estate taxes increased to 45.9% of total school district revenues, and state contributions decreased to 38.7% of total school district revenues.

In sum, as the state's percentage of contributions toward total school district revenues has decreased over time, local real estate taxes have replaced state funding as the leading source of school district revenues.

It is important to recognize that because reduced state contributions have increased the relative significance of real estate tax revenues to school districts, reductions in real estate taxes due to tax exemptions for purely public charities have had (and will continue to have) an increasingly severe impact on districts' ability to fund educational programs.

B. Act 1 of 2006 Amplifies Severe Impact of Real Estate Tax Exemptions

Act 1 of 2006, the Taxpayer Relief Act, 53 P.S. § 6926.101 *et seq.*, has increased even further the adverse financial impact of tax exemptions on school districts.

Before Act 1, a school district had somewhat of a "Hobson's Choice" in addressing a tax exemption granted to one of its taxpayers. The district could either assimilate the lost revenue from the new tax exemption by cutting educational expenditures in its next annual budget, or pass along the lost revenue to its other taxpayers through a real estate tax increase.

As a result of Act 1, though, school districts no longer have the former option. Any annual real estate tax increase is limited to the adjustment permitted by the Act 1 Index. A school district cannot increase its real estate tax rate beyond the Act 1 Index due to the loss of revenue resulting from a new tax exemption. As originally adopted in 2006, Act 1 had allowed an exception to the Act 1 Index for losses resulting from implementation of court orders –

including court orders granting real estate tax exemptions – but that Index exception was eliminated through 2011 amendments to Act 1.

Thus, under Act 1, new tax exemptions for a purely public charity impose a direct dollar-to-dollar reduction on school district revenues, and thus can have a striking, adverse impact on the financial ability of districts to provide educational programs.

III. Concerns with Act 55

There is no doubt that many non-profit organizations play instrumental and positive roles in Pennsylvania's local communities. Certainly, PASBO applauds the efforts of staff and volunteers associated with all non-profit organizations that enhance our society.

At the same time, though, it is important to recognize Pennsylvania law has never awarded exemptions from real estate taxes to all beneficial, non-profit organizations. To the contrary, the Pennsylvania Constitution has reserved real estate tax exempt status for a very select group, such as non-profit institutions that qualify as "purely public charities."

PASBO's chief concern with Act 55 is that it substantially liberalizes the test to qualify as a purely public charity. It would allow tax exemptions to institutions that actually donate relatively little charitable care. Thus, if the constitutional test is removed as contemplated by the adoption of Senate Bill 4, and Act 55 becomes the only test necessary to qualify as a purely public charity, already scarce funding for public education will likely be further reduced.

A. Constitutional Law on Purely Public Charities

The Pennsylvania Constitution provides generally for "uniformity" in the treatment of Pennsylvania taxpayers. Pa. Const., Article VIII § 1. As an exception to this general mandate of

uniformity, the Pennsylvania Constitution permits the General Assembly the option to adopt laws allowing tax exemptions for certain types of real estate, including property owned by and utilized by "institutions of purely public charity." Pa. Const., Article VIII, § 2(a)(v). In turn, the General Assembly has accepted this constitutional invitation and adopted laws providing for certain real estate tax exemptions, including for real estate owned and occupied by "institutions of purely public charity" that is "necessary for the occupancy and enjoyment of such institutions so using it." Consolidated County Assessment Law, 53 P.S. § 8812(a)(11).

In deciding whether institutions qualify for a real estate tax exemption as a "purely public charity," the Pennsylvania Supreme Court has developed and applied the *HUP* test, which provides that an institution is not a purely public charity unless it meets all of the following five criteria:

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

Hospital Utilization Project v. Commonwealth, 487 A.2d 1306 (Pa. 1985).

Although all five of these criteria have been subject to judicial evaluation – and further acknowledging that these five criteria are all somewhat interrelated – as a practical matter, whether an institution qualifies under the *HUP* test often comes down to whether the institution "donates or renders gratuitously a substantial portion of its services."

With regard to this "substantial donated care" component of the *HUP* test, Pennsylvania courts have refused to adopt a precise, objective formula on how much donated care is required to meet the test. Rather, as the Supreme Court stated as follows in *HUP.* there is no bright-line

test for what constitutes "substantial" donated care, and such evaluation must consider all circumstances relevant to whether a particular institution truly provides services to those in need:

> Whether or not the portion donated or rendered gratuitously is "substantial" is a determination to be made based on the totality of circumstances surrounding the organization. The word "substantial" does not imply a magical percentage. It must appear from the facts that the organization makes a bona fide effort to service primarily those who cannot afford the usual fee.

HUP, 487 A.2d at 1316 n. 9.

Pennsylvania courts have recognized the difficulty in establishing objective criteria that will fit a wide variety of institutions over a continuum of time, even by comparing facts of a case to prior court decisions, "because of the continually changing nature of the concept of charity and the variable circumstances of time, place, and purpose." *American Law Institute v. Commonwealth,* 882 A.2d 1088, 1091 (Pa. Cmwlth. 2005).

Among the leading Supreme Court decisions on the constitutional standard for purely public charities is *St. Margaret Seneca Place v. Board of Property Assessment, Appeals and Review,* 640 A.2d 380 (Pa. 1994). In *St. Margaret*, the Court held that accepting Medicare and Medicaid payments that do not cover the full cost of care for nursing home residents can satisfy the *HUP* requirement of donating a substantial portion of the nursing home's services. Specifically, 48% of the nursing home's residents in *St. Margaret* paid for services through Medicaid. The Medicaid payments only covered two-thirds of the cost of care. The Court held the remaining one-third of the cost of care constituted donated services for purposes of the *HUP* test, and concluded the nursing home was a purely public charity.

Since *St. Margaret,* courts have continued to look closely at the percentage of hospital patients or nursing home residents served on Medicaid or Medicare, and have analyzed the actual cost of care not covered by these government sources. Again, the courts have not developed any

objective, bright line test to achieve the "substantial donated care" requirement under *HUP*, but have continued to apply a subjective evaluation of the overall circumstances involving the level of donated care:

> In order to satisfy its burden of establishing that the Hospital donates or renders gratuitously a substantial portion of its services, the Hospital must demonstrate that it makes a bona fide effort to service those persons who are unable to afford the usual fee or medical care. . . . [T]he determination as to whether the services donated by the organization are 'substantial' is to be made based on the ***totality of the circumstances***; there is ***no bright line test***, based on a certain percentage of donated services, for resolving this question.

Lehighton Area School District v. Carbon County Board of Assessment, 708 A.2d 1297, 1309 (Pa. Cmwlth. 1998) (emphasis added).

B. <u>Act 55 Lowers the Bar to Qualify as a Purely Public Charity</u>

Act 55 maintained the same five basic criteria from the *HUP* test for determining whether an institution qualifies as a purely public charity. A major difference, though, involves the donated care component of the test. Instead of the subjective evaluation of donated care under *HUP,* as defined through *St. Margaret* and other court decisions, Act 55 uses objective measurements on whether donated care is "substantial" enough to qualify as a purely public charity. 10 P.S. § 375(d)(1).

Act 55 lists seven different ways an institution can meet the donated care requirement. Notably, an institution needs to meet only one of the seven financial criteria to achieve the legislative test to "donate or render gratuitously a substantial portion of its services."

Among the seven different ways an institution can meet the "substantial donation" test under 10 P.S. § 375(d)(1), one stands out as a particularly low threshold:

> (iv) Financial assistance or uncompensated goods or services to at least 20% of those receiving similar goods or services from the institution if at least 10% of the

> individuals receiving goods or services from the institution either paid no fees or fees which were 90% or less of the cost of the goods or services provided to them, after consideration of any financial assistance provided to them by the institution.

Under this approach, an institution can meet the "substantial donation" component of the Act 55 test by accepting 99% of its costs of care for 10% of the institution's customers, and accepting 90% of its costs of care for another 10% of the institution's customers.

For instance, if a Continuing Care Retirement Community ("CCRC") operates an independent living facility with 80 residents, an assisted living facility with 10 residents and a skilled nursing facility with 10 residents, the entire 100-resident complex would enjoy a complete real estate tax exemption under Act 55 by accepting 99% of the CCRC's actual cost of care for the 10 assisted living residents, and 90% of the CCRC's actual cost of care for the 10 skilled nursing residents. This scarcely sounds like a "purely public charity" – particularly if the residents ultimately receiving either 1% or 10% donated care in the assisted living and skilled nursing facilities entered the CCRC by first paying a hefty "up front admission fee," of tens or even hundreds of thousands of dollars, to reside initially in the independent living facility.

The foregoing scenario is essentially reflected in the case of *Menno Haven v. Franklin County Board of Assessment and Revision of Taxes,* 919 A.2d 333 (Pa. Cmwlth. 2007), *appeal pet. den.,* 596 Pa. 711, 940 A.2d 367 (2007). In *Menno Haven*, the Commonwealth Court of Pennsylvania held that a skilled nursing component of a CCRC was not exempt under the *HUP* test, regardless of whether it met the objective "substantial donation" test under Act 55, because the overall framework of the CCRC reflected very little charitable care.

The basic facts of *Menno Haven* are as follows:

- Menno Haven charged substantial entrance fees to residents for admission to its independent living facility. The entrance fee (in 2004 dollars) ranged between $45,000 and $329,500, depending on the type of residence selected.

- Menno Haven had a financial assets test for admission to its independent living facility, to ensure that after residents paid their entrance fee they could likely continue paying monthly fees, and could also ultimately pay for increased health care services in the assisted living and nursing home facilities.

- However, Menno Haven recognized that some of its residents would run out of money and become eligible for Medicaid. Menno Haven had a practice of allowing such residents to remain in the skilled nursing facility as Medicaid patients, with Menno Haven picking up the difference as "donated care."

- Menno Haven did not have a contractual obligation to provide donated care when patients ran out of money – indeed, such a contract would render the residents ineligible for Medicaid – but provided such donated care as a matter of its routine practice, which was explained to residents during the CCRC's admissions process.

- The court ruled that providing donated care for 30% of skilled nursing residents at Menno Haven did ***not*** meet the *HUP* test for a purely public charity. The court recognized that most of the residents receiving donated care had initially been independent living residents at Menno Haven; thus, they had paid substantial entrance fees to the CCRC, as part of an overall understanding that donated skilled nursing care would later be available if a resident ran out of money.

- Indeed, only 8% of residents entering the skilled nursing facility from outside of Menno Haven were immediately eligible for Medicaid – all others had to demonstrate they met the financial asset test for admission to the CCRC.

- The Court held this low percentage of donated care to residents entering Menno Haven directly into its skilled nursing facility (who had not paid a large entrance fee to reside in the independent living facility) demonstrated the motivating factor behind most of Menno Haven's donated care was not charitable intent, but rather an obligation to continue providing care to its former independent living residents.

- Therefore, the Court found that Menno Haven "primarily caters to well-to-do elderly and to those already within the community," and held it did not qualify as a tax-exempt purely public charity.

Thus, even though Menno Haven provided 30% of its skilled nursing residents with donated care – well above the 20% requirement in Act 55 that is addressed above – the court properly recognized under *HUP* that no more than 8% of the residents received donated care that was truly motivated by charity. The other 22% of skilled nursing residents received donated care as a result of the overall arrangement, whereby they had paid a large up-front fee to enter the

CCRC through its independent living facility, in recognition that the CCRC would later provide some degree of gratuitous skilled nursing care if the residents ran out of assets. Simply because the CCRC lived up to its end of the overall bargain with its residents did not make such donated care "charitable" under *HUP,* regardless of whether the overall quantity of donated care met the objective Act 55 test.

The *Menno Haven* test is a good example of why the objective financial criteria for donated care in Act 55 are ill-suited to address the question of purely public charities – and in particular, where an institution need only meet one of the seven objective financial criteria of Act 55, and one of the seven (as noted above) is relatively easy to meet.

In a similar case, *In re Appeal of Dunwoody Village,* 52 A.3d 408 (Pa. Cmwlth. 2012), the Commonwealth Court held that a CCRC was not a purely public charity under *HUP,* even though it met one of the seven objective financial criteria in Act 55 – donating care to residents equal to 5% or more of its cost of providing services, 10 P.S. § 375(d)(1)(v) – because the donated care went almost exclusively to nursing home residents who had initially paid large up-front fees to enter the CCRC through its independent living facility: "It does not appear from the facts that DVI makes a bona fide effort to service primarily those who cannot afford the usual fee." *Id.* at 418.

According to information on the Pennsylvania Department of Insurance's website, there are 273 CCRCs in the Commonwealth. PASBO is concerned that many CCRCs share common characteristics with the situation in *Menno Haven* and *Dunwoody Village,* and could become fully tax exempt under Act 55, if the constitutional considerations of providing substantial charity are not considered as they were in *Menno Haven* and *Dunwoody Village.*

In this regard, it is also notable that since the enactment of Act 55, the Pennsylvania Supreme Court has ruled that whether a CCRC qualifies as a purely public charity must take into account the combined operations of the CCRC, and separate facilities within a CCRC providing independent living, assisted living and skill nursing care cannot be considered separately for tax exempt treatment. *Alliance Home of Carlisle v. Board of Assessment Appeals,* 919 A.2d 206 (Pa. 2007).

There are various other concerns with the financial criteria in Act 55 – for instance, in quantifying its "donated services" to customers, an institution can include financial donations it has received from others and the financial value of volunteer hours contributed to the institution. 10 P.S. § 375(d)(4)(v). It makes no sense, though, to include financial donations and volunteers received by the institution in calculating the amount of donated services the institution is providing to others. This is just another example of how Act 55 is too liberal in its qualifications for what constitutes a purely public charity.

The bottom line is Act 55 allows institutions that do not provide much true charitable care to qualify for a real estate tax exemption as a purely public charity. Should Act 55 as currently adopted become the sole test for determining tax exemptions for purely public charities, as a result of a constitutional amendment contemplated by Senate Bill 4, institutions that are clearly not "purely" charitable would qualify under the objective, lenient financial standards of Act 55.

PASBO urges this Committee to take a hard look at Act 55, and to make appropriate changes to ensure the General Assembly does not open the floodgates to providing tax exemptions to non-profit institutions that are not "purely" public charities.

IV. CONCLUSION

PASBO appreciates this opportunity to share some of its concerns with Act 55. Although time available for this hearing does not permit a full discussion of all significant issues, PASBO would be very pleased to engage in more extensive dialogue with the Committee as it addresses Act 55 – including providing more detailed input on specific ways to fix shortcomings in the Act 55 criteria for purely public charities. PASBO urges the Committee to look very closely at this vitally important issue. Thank you.