

Putting The Charity Back In Purely Public Charities

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ABSTRACT

Pennsylvania's tax exemption for purely public charities has been the subject of significant litigation since at least the 1980s. When a Pennsylvania institution is granted purely public charity tax status, it becomes exempt from Pennsylvania sales tax, use tax, and real estate tax. The coveted tax treatment can make the difference in hundreds of thousands or even millions of dollars in sales, use and real estate taxes each year. In Pennsylvania, modern litigation on the issue of whether an institution qualifies as a purely public charity dates begins with the 1985 case of Hospital Utilization Project v. Commonwealth ("HUP" case).³

Examination of disputes about exempt status at the state level can reveal fundamental questions over what it means for an organization to self-identify as tax-exempt, nonprofit, or charitable in nature. Several recent cases focus on the impact of operating losses, especially for nursing homes and other senior living or care-related operations traditionally viewed as charitable in nature by both state and federal taxing authorities. This article is intended to provide useful advice for those seeking to understand—or benefit from—"purely charitable" tax exemptions.

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I. INTRODUCTION

There is a saying, “charity begins at home.” But, when it comes to modern versions of “homes for the aged,” charity clearly includes user fees.

The Pennsylvania Constitution permits the General Assembly to exempt certain types of institutions from certain taxes, and expressly includes institutions of purely public charity.⁴ However, the Pennsylvania Constitution does not define what constitutes a “purely public charity.” The HUP case laid out a test with five prongs that an institution must meet to be considered a purely public charity for Pennsylvania tax purposes. Twelve years later, in 1997, the legislature passed “The Institutions of Purely Public Charity Act,”⁵ also known as “Act 55,” which further defined what it means to be a “purely public charity” in Pennsylvania.

A number of cases dealing with whether an institution is a purely public charity have made their way through the Pennsylvania courts since 1997. Several notable cases⁶ provide background for an ongoing case, still pending following a 2021 decision by the Commonwealth Court. The Commonwealth Court’s decision in *Friends Boarding Home of Western Quarterly Meeting v. Commonwealth*⁷ examines a form of residential care for seniors to determine whether the Friends Boarding Home of Western Quarterly Meeting (“Friends Home”) should be exempted from Pennsylvania sales and use tax as a purely public charity.

While Pennsylvania has come a long way in defining a “purely public charity” since the decision in HUP, there still seems to be a significant amount of confusion and disagreement on whether certain institutions qualify as “purely public charities.” Despite the fact that “health care” has a traditional position as “charitable” for tax exemption purposes,⁸ the purely public charity status has proven to be particularly challenging for non-hospital enterprises, especially for organizations that serve the care needs of older adults, including nursing homes, continuing care re-

4. Article VIII, Section 2(a)(v) of the Pennsylvania Constitution provides that “[t]he General Assembly may by law exempt from taxation: (v) [i]nstitutions of purely public charity, but in the case of any real property of such institution only that portion or real property of such institution which is actually and regularly used for the purpose of the institution.”

5. The Institutions of Purely Public Charity Act, Nov. 26, P.L. 508, No. 55, §1, codified at 10 P.S. §§371-385 (1997).

6. *Mesivtah Eitz Chaim of Bobov, Inc. v. Pike County Board of Assessment Appeals*, 615 Pa. 463, 44 A.3d 3 (Pa. 2012); *In re Appeal of Dunwoody Village*, 52 A.3d 408, 419 (Pa. Commw. Ct. 2012).

7. *Friends Boarding Home of Western Quarterly Meeting v. Commonwealth*, 332 F.R. 2018, 260 A.3d 1064 (Pa. Commw. Ct. 2021).

8. James J. Fishman & Stephen Schwarz, *NONPROFIT ORGANIZATIONS* 333 (2010) (noting that when “[m]easured by assets and revenues, health care organizations are the largest component of the charitable sector.”).

tirement communities, and other types of senior living communities. Senior care operations play significant roles in an “aging” state such as Pennsylvania. They have a long history of receiving favorable tax-exempt status as “charitable” enterprises at the federal level under the Internal Revenue Code Section 501(c)(3); the IRS examines them through a historical lens as “homes for the aged.”⁹

In Pennsylvania, when a nonprofit organization qualifies for *income* tax exemption under Section 501(c)(3) of the federal tax code, it is usually also exempt from state *income* taxes.¹⁰ However, Pennsylvania enterprises asserting a charitable purpose may receive far closer scrutiny if they also seek to avoid state property, sales and use taxes. They should be organized as nonprofit in purpose, must be charitable from the perspective of income tax examiners, *and* must be able to satisfy the Pennsylvania courts’ interpretations of “purely charitable.” In increasingly revenue-hungry times, these distinctions should be carefully considered, and the distinctions may be important far beyond the borders of Pennsylvania.

II. PENNSYLVANIA’S CONSTITUTIONAL REQUIREMENT

The Pennsylvania Constitution specifically sets out under what circumstances the General Assembly may grant exemptions from taxation.¹¹ The institutions that may be granted tax exemptions include places of worship, certain types of “burial places,” public use properties, and properties owned and occupied by military service organizations for benevolent, charitable or patriotic purposes. The fifth category of potentially exempt organizations is where many of the disputes arise, providing exemptions for: **“Institutions 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 purpose of the institution.”**¹²

It seems apparent that the Pennsylvania Constitution intended to set strict limits on when tax exemptions may be granted by the General Assembly. The gray area in the Pennsylvania Constitution, over which a number of cases have been litigated, is what constitutes an institution of “purely public charity.” The Pennsylvania Constitution provides no definition of a “purely public charity.”¹³

Any statutory provision exempting persons or property from taxation will be strictly construed against the party seeking the exemption.¹⁴ While this may seem trivial, the effect is that the party seeking the tax exemption must affirmatively prove all aspects necessary for the tax exemption.¹⁵

9. See I.R.C. Section 501(c)(3) (2001); Rev. Rul. 61-72 (1961) providing that a “home for the aged which is dedicated to providing and does furnish care and housing for its residents at established rates which are substantially less than the costs of the services furnished, is exempt from Federal income tax. . . .”

10. Elizabeth Schmidt and Allen Madison, *NONPROFIT LAW: THE LIFE CYCLE OF A CHARITABLE ORGANIZATION*, 209-214 (3d Ed. 2021) (“States generally grant charitable exemptions from state income taxes to §501(c)(3) organizations.”) See 10 P.S. §162.5 (providing that for state registration of charitable organizations, federal tax exemption determination letters will be filed with the state). See also <https://www.dos.pa.gov/BusinessCharities/Charities/RegistrationForms/Pages/Exclusions-and-Exemptions-Chart.aspx>.

11. Pennsylvania Constitution Article 8, §2(a).

12. *Id.* (emphasis added).

13. *Id.*

14. 1 Pa.C.S. §1928(b)(5) states that “(b) all provisions of the classes hereafter enumerated shall be strictly construed: . . . (5) Provisions exempting persons or property from taxation.”

15. *Y.M.C.A. v. Reading*, 167 A.2d 469, 472 (Pa. 1961).

III. BACKGROUND: WHAT IT MEANS TO BE A “PURELY PUBLIC CHARITY”

In the days before the Pennsylvania Constitution was adopted in 1874, there was a practice of giving tax exemptions to alleged “purely public charities” by legislative grant.¹⁶ In 1878, the case of *Donohugh v. Library Co.* (better known as “*Appeal of Donohugh or Donohugh’s Appeal*”) made its way to the Pennsylvania Supreme Court.¹⁷ In *Donohugh’s Appeal*, the Philadelphia-based tax assessor, Donohugh, sought to assess real estate taxes against the Library Company of Philadelphia. The Library Company of Philadelphia sought an injunction claiming it was a “purely public charity” under the Pennsylvania Constitution and, therefore, exempt from such taxation.

Donohugh alleged unfairness in the practice of giving tax exemptions by legislative grant. The Pennsylvania Supreme Court observed that the practice of giving tax exemptions by legislative grant often gave tax exemptions to institutions that “. . . were, at best, private charities, and some of them . . . were not charities at all, but mere trading corporations for private individual profit.”¹⁸ Further, the Court observed that this type of favoritism by the General Assembly was just what the Pennsylvania Constitution intended to avoid by setting out the “purely public charity requirement.”¹⁹ The Court reasoned that to deserve the tax exemption, the alleged purely public charity must “feature public use” which “is not confined to privileged individuals, but is open to the indefinite public.”²⁰ The Court reasoned that the “purely” aspect means that the charity is entirely for public use, without some mix of private use or private individual gain.²¹

The Court ultimately granted the Library Company of Philadelphia its requested tax exemption and enjoined Donohugh from taxing it. The Court reasoned that, since the library allowed anyone to read its books within the library free of charge, it was a public charity. The Court further reasoned that since the library had no private profit motive and since it used all fees collected from book borrowers to operate the library, it was purely a charity. Thus, the Court held that the Library Company of Philadelphia met the Pennsylvania constitutional requirement of being a “purely public charity.”²²

IV. 1985: THE HOSPITAL UTILIZATION PROJECT CASE. THE PENNSYLVANIA SUPREME COURT TAKES A CLOSER LOOK AT THE “PURELY PUBLIC CHARITY REQUIREMENT”

In 1985, the case of *Hospital Utilization Project v. Commonwealth* (“HUP case” for short) was decided by the Pennsylvania Supreme Court.²³ The HUP test remains the primary way to determine if an institution will be regarded as a “purely public charity” for Pennsylvania tax purposes.

The Hospital Utilization Project (“HUP”) was a project funded by the Hospital Counsel from 1963 to 1966 with charitable contributions from the Allegheny County

16. *Appeal of Donohugh*, 86 Pa. 306 (Pa.1878).

17. *Id.*

18. *Id.* at 311.

19. *Id.*

20. *Id.* at 313.

21. *Id.* at 314.

22. *Id.* at 313-315.

23. *Hospital Utilization Project v. Com.*, 487 A.2d 1306 (Pa. 1985).

Medical Society Foundation and thirty-three (33) private and corporate foundations.²⁴ By 1967, HUP was financially secure and the Hospital Counsel and the medical societies withdrew from the project. The hospitals involved then undertook to fund HUP through direct payment for its services. Accordingly, from 1967 forward, HUP has been financed by a fee-for-service arrangement.²⁵

The point of the HUP enterprise was to provide a uniform system of data collection and collation of statistical data on area-wide hospital utilization.²⁶ The statistical abstracts contained such information as admission and discharge data, medical diagnosis, treatment, length of stay, treating physician, etc. The information was collated and computerized, and reports were distributed to area hospitals so that each institution could compare its utilization statistics with those of other hospitals.²⁷

In 1969, HUP organized as a nonprofit corporation under Pennsylvania law. Its stated purpose was to promote the maintenance of high-quality patient care and effective use of hospital facilities. HUP used a state tax exemption number of its parent organizations until 1980, when it was directed to make an application for a separate exemption number. The Pennsylvania Department of Revenue then subsequently denied HUP an exemption number and litigation ensued.²⁸

In *HUP*, the Pennsylvania Supreme Court analyzed past case law and the Pennsylvania Constitution to set up a test to determine if an institution is a "purely public charity."²⁹ The *HUP* test directed that an entity qualifies as a purely public charity if it:

- (a) Advances a charitable purpose; (b) Donates or renders gratuitously a substantial portion of its services; (c) Benefits a substantial and indefinite class of persons who are legitimate subjects of charity; (d) Relieves the government of some of its burden; and (e) Operates entirely free from a private profit motive.³⁰

After announcing the test, the Court held that HUP as an enterprise failed to meet the necessary criteria.³¹ First, HUP's purpose of promoting and maintaining high quality medical records was laudable, but not charitable in a legal sense.³² Second, HUP did not donate or render gratuitously any of its services.³³ Third, HUP's beneficiaries were not a substantial or indefinite class who are legitimate objects of charity. Rather, they were hospitals.³⁴ Fourth, HUP did not relieve the government of any burden. While HUP's activities were laudable, they were not something the government would traditionally undertake. There was simply no evidence that HUP's activities would be provided by the government if HUP did not undertake them.³⁵ Finally, HUP did not operate entirely free from a private profit motive. Its directors were well paid, and it was difficult to distinguish HUP from any other commercial enterprise.³⁶

24. *Id.* at 1309.

25. *Id.*

26. *Id.*

27. *Id.*

28. *Id.*

29. *Id.* at 1312.

30. *Id.* at 1317.

31. *Id.*

32. *Id.*

33. *Id.*

34. *Id.*

35. *Id.*

36. *Id.* at 1317-8.

V. 1997: THE INSTITUTIONS OF PURELY PUBLIC CHARITY ACT. NEW RULES OR MERELY MORE CLARAFICATION?

On November 6, 1997, Pennsylvania enacted “Act 55,” The Institutions of Purely Public Charity Act.³⁷ The purpose of the Purely Public Charity Act was to set out more detailed and specific standards for determining whether institutions qualify as purely public charities.³⁸ Act 55 defined a number of terms relating to purely public charities, such as “Legitimate Subjects of Charity,”³⁹ “Private Profit Motive,”⁴⁰ “Community Service,”⁴¹ “Charity to Persons,”⁴² “Legitimate Subjects of Charity,”⁴³ “Substantial and Indefinite Class of Persons,”⁴⁴ and “Government Service.”⁴⁵

Although a primary purpose of the Institutions of Purely Public Charity Act was to provide clarification of the *HUP* standards, Act 55 also to some extent appeared to relax the *HUP* guidelines and expanded what may be considered a purely public charity. *HUP* required that an institution donate or render gratuitously a “substantial” portion of its services,⁴⁶ while Act 55 allowed institutions to merely offer some services at no charge or service some portion of the recipients free of charge.⁴⁷ Act 55 also gave more flexibility regarding the compensation of directors, officers, or employees of an institution. Under both Act 55 and *HUP*, the institution must operate entirely free of a private profit motive.⁴⁸ But, pursuant to Act 55, the limitation on compensation is more open, providing that compensation should not be based “primarily upon the financial performance of the institution.”⁴⁹

A review of Act 55 reveals that while it is not an entirely new set of rules regarding purely public charities, the Act, did, in fact, broaden and relax some of the *HUP* standards on what institutions may qualify as a purely public charity.⁵⁰

VI. WHAT CONTROLS? THE PURELY PUBLIC CHARITY ACT OR THE *HUP* TEST?

After the Purely Public Charity Act became law in 1997, it was not entirely clear if the *HUP* test was still relevant. In 2012, the Pennsylvania Supreme Court made it clear in deciding the case of *Mesivtah Eitz Chaim of Bobov, Inc. v. Pike County Board of Assessment Appeals*⁵¹ that the *HUP* test still would be applied when determining whether an institution is a purely public charity.

The *Mesivtah Eitz Chiam of Bobov, Inc.* (“*Mesivtah*”) applied for a tax exemption as a purely public charity and was denied by the Pike County Board of Assessment

37. The Institutions of Purely Public Charity Act, 10 P.S. §371-385 (1997).

38. *Id.* at §372(a)(1)-(5).

39. *Id.* at §375(b).

40. *Id.* at §375(c).

41. *Id.* at §375(d).

42. *Id.* at §375 (e).

43. *Id.* at §375(e)(2).

44. *Id.* at §375(e)(2).

45. *Id.* at §375(f).

46. *Hospital Utilization Project v. Com.*, 487 A.2d 1306, 1317 (Pa. 1985).

47. 10 P.S. §375(d)(1)(ii)(B)&(C). “(B) At least 20% of the individuals receiving services from the institution pay no fee or a fee which is lower than the cost of the goods and services provided by the institution.” and “(C) At least 10% of the individuals receiving goods or services from the institution receive a reduction in fees of at least 10% of the cost of the goods or services provided to them.”

48. *Hospital Utilization Project v. Com.*, 487 A.2d 1306, 1317 (Pa. 1985).

49. 10 P.S. §375(c)(3).

50. See also Loren D. Prescott, Jr., *Pennsylvania Charities, Tax Exemption, and the Institutions of Purely Public Charity Act*, 73 TEMPLE L. R. 951 (2000).

51. 44 A.3d 3 (Pa. 2012).

Appeals.⁵² In the appeal, the Commonwealth Court applied the *HUP* test and denied Mesivtah the purely public charity exemption.⁵³ Mesivtah then appealed to the Pennsylvania Supreme Court claiming, in part, that the *HUP* test should not have been applied and that it only needed to meet the criteria of the Purely Public Charity Act.⁵⁴

Mesivtah was a non-profit religious entity related to the Bobov Orthodox Jewish community in Brooklyn, New York. It ran a summer camp in Pike County, Pennsylvania, that gave classes on the Jewish faith and provided food and recreational activities to students. The camp was funded by donations, rental income from a building in Brooklyn, and by tuition from students. The camp provided financial assistance to some students, all of whom came from outside of Pike County.⁵⁵

The Pennsylvania Supreme Court determined that the *HUP* test would be applied to Mesivtah to determine whether it qualified as a purely public charity.⁵⁶ The Court reasoned that while the Purely Public Charities Act was enacted with good intentions, such as reducing confusion, the Act's good intentions do not excuse non-compliance with the Pennsylvania Constitution.⁵⁷ The Supreme Court went on to explain that a long line of prior case law has required that for an institution to be deemed a "purely public charity," it must relieve the government of some of its burden.⁵⁸ While Mesivtah's activities were laudable, the Supreme Court agreed with the Commonwealth Court that Mesivtah's activities did not relieve the government of some of its burden and, therefore, it could not be considered a purely public charity since it did not meet that constitutional requirement.⁵⁹

VII. ARE NET OPERATING LOSSES PROOF THAT AN INSTITUTION DONATES OR RENDERS GRATUITOUSLY A SUBSTANTIAL PORTION OF ITS SERVICES?

The Pennsylvania Supreme Court also addressed the "relief of public burden" question in 1996 in the case of *In re St. Margaret Seneca Place v. Board of Property Assessments Appeals and Review, County of Allegheny*.⁶⁰ First, the Court held that Seneca Place was a nursing home providing medical care and shelter to "the aged in need," and thus bears a substantial burden that would otherwise fall on the government. The County then argued that a significant percentage of the enterprise's operating losses were offset by government payments under programs such as Medicaid or Medicare, thus proving it was not offering significant services "gratuitously." The Court nonetheless found that Seneca Place had demonstrated it was "funding" one-third of the costs of care for half of its residents, satisfying the "gratuitous service" requirement and thus was entitled to a tax-exempt status.⁶¹

52. *Mesivtah Eitz Chiam of Bobov, Inc. v. Pike County Board of Assessment Appeals*, 44 A.3d 3, 5 (Pa 2012).

53. *Id.*

54. *Id.* at 6.

55. *Id.* at 5.

56. *Id.* at 8.

57. *Id.*

58. *Id.* at 9.

59. *Id.*

60. *In re St. Margaret Seneca Place v. Board of Property Assessments Appeals and Review, County of Allegheny*, 640 A.2d 380 (Pa. 1994).

61. See also *In re Tax Appeals of United Presbyterian Homes*, 236 A.2d 776 (Pa. 1968), where the Pennsylvania Supreme Court held that even though many residents of a home for the aged paid their way completely, the home had never in any year realized a profit, and any profit did not go to an individual or for-profit corporation, therefore it was entitled to a tax exemption as a charity. "Moreover, it is a

But what about *other* organizations claiming real property, use or sales tax exemptions at the state level by arguing, at least in part, that they are operating at a loss? Act 55 provides a quantitative test for “community services,” by providing “[u]ncompensated goods or services which in the aggregate are equal to at least 5% of the institution’s costs of providing goods or services.”⁶²

In 2012, the Commonwealth Court decided the case of the *Appeal of Dunwoody Village*.⁶³ Dunwoody Village (DVI) operated and described itself as a “Non-Denominational, Not-for-Profit” Continuing Care Retirement Community (“CCRC”) in Newtown Township, with three levels of residential options, including assisted living and skilled care.⁶⁴ The Commonwealth Court affirmed administrative and lower court rulings, rejecting Dunwoody’s requested exemptions, and concluding that DVI failed to satisfy every prong of the HUP test.⁶⁵ Key to the ruling was the finding that even though DVI had a net operating loss each year from 2003 through 2009⁶⁶ that averaged greater than 5% of the total cost of services per year, DVI still was unable to satisfy HUP requirement that it prove it donates or renders gratuitously a substantial portion of its services.⁶⁷ DVI was unable to show that it offered services to those who could not afford to pay fees. Rather, the court concluded the community rarely admitted residents who would be unable to pay hefty entrance fees for admission to its independent living or assisted living units and it had no Medicaid patients in its skilled care unit.⁶⁸ Thus, mere “losses” were not deemed the equivalent of “charity,” nor did a record of losses appear to document a clear charitable plan to operate “entirely free from private profit motive.”⁶⁹

The DVI case demonstrated the Commonwealth Court’s willingness to make a careful examination of the financing structure for all phases of a continuing care community’s operations. The Commonwealth Court distinguished its rejection of Dunwoody’s exempt status from other CCRC-related decisions, including a Pennsylvania Supreme Court decision in 2007 that confirmed the exempt status for parcels of property used for independent living units in a continuing care community in *Alliance Homes of Carlisle, PA v. Bd of Assessment Appeals*.⁷⁰

In modern iterations, virtually all forms of nonprofit senior care facilities operate on some type of fee-for-service basis; CCRCs or Life Plan communities use various types of contracts to set entrance fees and monthly service fees, sometimes supplemented by donations or foundations that supplement or cover operating expenses.⁷¹ In 2014, another continuing care retirement company was successful in responding to a County assessor’s challenge to its status as a purely charitable

matter of wide common knowledge in which we gladly participate that the public or general welfare policy of Pennsylvania has been increasingly broadened to include greater and greater concern and care for the aged . . . and consequently the words ‘charity’ and ‘public charity’ must be given a liberal interpretation.” *Id.*, at 779.

62. 10 P.S. §375(d)(1)(v).

63. *Appeal of Dunwoody Village*, 52 A.3d 408 (Pa. Commw. 2012).

64. See <https://www.dunwoody.org/why-dunwoody/>.

65. *Dunwoody Village*, *supra* note 63, at 425.

66. *Id.*, at 419.

67. *Id.*, at 419.

68. *Id.*, at 418-420.

69. *Id.*, at 424.

70. *Alliance Home of Carlisle, PA v. Bd of Assessment Appeals*, 919 A.2d 206 (Pa. 2007). Compare *Menno Haven, Inc. v. Franklin County Bd of Assessment*, 919 A.2d 333 (Commw. PA 2007) (holding CCRC company was not operating in a way that made its skilled nursing facilities eligible for real estate tax exemptions).

71. Katherine C. Pearson & David Sarcone, *Ongoing Challenges for Pennsylvania Continuing Care and Life Plan Communities*, 90 PA Bar Q. 1 (January 2019).

organization. In *Albright Care Services v. Union County Bd. of Assessment*,⁷² the Commonwealth Court compared Albright's two CCRC operations to the Dunwoody CCRC, noting that Albright did admit Medicaid patients, who by definition would be unable to fully pay for their own care and it did not require its residents to pledge to pay privately via "life care contracts." Further, the independent living facilities were shown to be a part of a comprehensive care scheme, and thus the real estate parcels on which those units were located were deemed exempt from real estate taxes.⁷³ Although the *Albright* opinion is unreported, it demonstrates the level of scrutiny used by county tax assessors and the court, especially when considering tax exemptions for "homes for the aged" in the modern age of senior living and care operations.

Pennsylvania is not alone in scrutinizing state property tax exemptions for senior care facilities, with states such as Minnesota,⁷⁴ Illinois,⁷⁵ and New Jersey⁷⁶ recently reconsidering exemptions under their state laws. In other states, also, operating losses have been argued in response to challenges by state tax authorities. In New York, for example, a long-standing tax exempt operation that became known as the "Osborn" evolved from its 1880 mission to provide a home for "respectable aged women in needy circumstances," to a mid-1980s focus on providing a range of increasing services for both older women and men, using a variety of residential contract options.⁷⁷ "By the late 1980s, [however,] the Osborn's financial condition had seriously deteriorated."⁷⁸ The buildings were in substantial need of repairs, and it was difficult to attract new residents. With inadequate paying residents, "the Osborn had to spend its endowment principal in order to pay its operating losses. . . ." ⁷⁹ This history demonstrates a practical challenge for nonprofit organizations providing "care" or similar user services. A charitable endowment may not be enough over time to cover operating losses, and therefore a restructuring of resident fees (a type of user fee) may be seen as necessary for financial survival of the care-giving entity. This requires careful thought about the balance between solvency and charitable mission.

Relying on guidance from outside consultants in 2000, the Osborn reorganized, rebuilt, expanded, and refinanced as a CCRC, still with a goal of providing long-term living, including assisted living and skilled care, to older persons. "In 2001 the Osborn convened a Charity Task Force to develop a charity policy that would allow it to pursue the Osborn's historical mission while sustaining the financial viability of its operations. . . The Task Force recommended that the total funds budgeted for

72. *Albright Care Services v. Union County Bd of Assessment*, unreported decision, available at 2014 WL 316588 (Pa. Commw. 2014).

73. *Id.*, at *15, and remanding the case for further consideration on the tax exempt status of parcels related to a museum and flood plain.

74. *Croixdale Inc. v. County of Washington*, 726 N.W. 2d 483 (Minn. 2007) (denying an assisted living center a property tax exemption as an institution of "purely public charity").

75. *Franciscan Communities, Inc. v. Hamer*, 975 N.E. 2d 733 (Ill. Ct. App. 2012) (denying property tax exemption to CCRC owned and operated by religious organization).

76. *Presbyterian Home at Pennington, Inc. v. Borough of Pennington*, 25 N.J. Tax 249 (Sup. Ct. of N.J., App. Div., 2009) (reversing state tax court's denial of exemption, concluding that assisted living facility was entitled to hospital purposes real estate tax exemption, regardless of whether it provided charitable care).

77. *Miriam Osborn Memorial Home Ass'n v. Assessor of City of Rye*, 909 N.Y.S. 2d 493 (NY Supreme Ct., App. Div., 2010).

78. *Id.*, at 496-7.

79. *Id.*

charity expenditures annually not exceed 5% of the estimated principal balance of the endowment fund as of the beginning of any given year.”⁸⁰

The Charity Task Force concluded that restructuring permitted the Osborn to continue to provide long-term living, while saving itself from “certain financial ruin.”⁸¹ But, in *Miriam Osborn Memorial Home Ass’n v. Assessor of City of Rye*, the appellate division of the New York Supreme Court carefully considered the local tax assessor’s challenge to the changed operations, and compared the Osborn’s history with the impact of its revised financial structure. The court observed that “[t]he overwhelming evidence established that admission to the Osborn is [now] restricted to wealthy and relatively healthy senior citizens. . . .”⁸² The court concluded: “In short, the Osborn is largely limited to wealthy seniors, and the number of residents who do rely on the Osborn’s charity are too few to support the conclusion that the Osborn’s property is being used principally or primarily for a charitable purpose. Therefore, the Osborn is not entitled to a charitable use tax exemption [under New York law].”⁸³

There is an old saying, “charity begins at home.” But, when it comes to modern versions of “homes for the aged,” charity clearly includes user fees.

VIII. ARE “PILOT” AGREEMENTS A VIABLE ALTERNATIVE FOR INSTITUTIONS?

Payment in lieu of tax (“PILOT”) agreements are contracts between nonprofit organizations and taxing entities.⁸⁴ There has been a limited amount of litigation on PILOTS in Pennsylvania. Typically, the payment made to the taxing authority is a percentage the institution would pay if it were not exempt from property taxes.⁸⁵ These agreements are often requested by the taxing entities and may come with a real or implied threat to assess real estate taxes against the nonprofit institution if the nonprofit institution does not agree to enter into an agreement. In addition, it seems possible that in the absence of specific standards, PILOTS could lead to arbitrary results.

PILOT agreements are authorized by statute in Pennsylvania⁸⁶ and came into wide use in the 1990s.⁸⁷ In the early 1990s, Erie revoked all exemptions for charities, and the charities were required to prove their tax-exempt status. In roughly 1993-1994, Allegheny Hospital in Pittsburgh agreed to a substantial PILOT payment with the local taxing authority. Around that same time, the Board of Revision in Philadelphia asked institutions such as nursing homes and colleges to complete a questionnaire, which the board examined for evidence of ineligibility for tax-exempt status.

80. *Id.*, at 500. The Osborn, operating in New York, of course was not subject to Pennsylvania’s suggested “minimum” of 5%. But these single digit percentages demonstrate the narrow margin for financial survival for nonprofits and thus show a close relationship between solvency and funding from user fees or other funding sources in residential or care-related operations.

81. *Id.*

82. *Id.* at 504.

83. *Id.*, at 507. The court also concluded the skilled care unit was not entitled to a partial exemption as a charitable hospital as it principally catered to wealthy senior citizens. *Id.*, at 509.

84. *E.g.*, *In re Appeal of City of Portsmouth*, 855 A.2d 483 (N.H. 2004).

85. Alan Zimmet, Ellie Neiberger, Nichole Nate, *Pilot Agreements Have Liftoff: City of Largo v. AHF Bay Fund, LLC*, 47 STETSON L. R. 405 (2018).

86. See 53 Pa.C.S. §8812(c) and 10 P.S. §372(a)(7), discussed at Appeal of Springfield Hosp., 179 A.3d 632 (Pa. Cmhw. 2018). See also 10 P.S. §377 (1997) (referring to “Voluntary Agreements”).

87. George S. Forde Jr. & Christopher E. Cummings, *Payment in Lieu of Taxes: The Philadelphia Experience*, 37 THE CATHOLIC LAWYER 133, at 141 (No. 2 1996).

In the mid-1990s, the *Philadelphia Inquirer* published articles highlighting the large number of tax-exempt institutions in Philadelphia and the corresponding loss of tax revenue. Challenges and fights over tax exemptions have led increasing numbers of Pennsylvania charitable institutions to agree “voluntarily” to PILOT agreements.⁸⁸

In the case of *Appeal of Springfield Hosp.*,⁸⁹ the Pennsylvania Commonwealth Court rendered a decision granting a petition to enforce a PILOT agreement, thus validating such agreements as an acceptable way for an institution to settle a real estate tax assessment appeal.⁹⁰

The background of the case is important; the events highlight the significance of PILOT terms. The hospital was expanding its health campus, starting in 1992. The expansion prompted the Delaware County Board of Assessment Appeals (Board) to issue a notice removing the property’s tax-exempt status and fixing the real estate tax assessment at \$500,000. Springfield Hospital appealed to the Court of Common Pleas of Delaware County contending that the property remained wholly exempt because the entire tract of land was a necessary part of an institution of purely public charity.⁹¹ The parties resolved the tax assessment appeal by a PILOT agreement, which the trial court approved by order dated May 31, 1994.⁹² The trial court’s PILOT Order provided in pertinent part that:

[a]fter the final Certificate of Occupancy is granted by Springfield Township to Springfield Hospital for the new medical campus, Springfield Hospital, its successors and assigned, shall not be subject to real estate tax on the existing hospital building so long as the existing hospital building is used solely for hospital purposes by Springfield Hospital or is used solely for hospital purposes by an entity which is tax exempt from federal tax under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended.⁹³

The PILOT Order also stated that it is “binding on the successors and assigns of Springfield Hospital.”⁹⁴

Springfield Hospital was later sold to Crozer-Keystone Health System (CKHS), an exempt entity under §501(c)(3) of the Internal Revenue Code.⁹⁵ On January 8, 2016, CKHS sold Springfield Hospital to Prospect with the transfer effective July 1, 2016. Prospect is a for-profit entity but takes the position it continues to use the hospital building solely for hospital purposes.⁹⁶

Since the hospital was sold to a for-profit entity, the Taxing Authorities believed that the property no longer qualified as tax exempt, and the Springfield School District issued a tax bill dated July 1, 2016, in the amount of \$433,956.15 based on the property’s real estate tax assessed value.⁹⁷ Prospect disputed the Taxing Authorities’ interpretation of the PILOT Order and the property’s tax status. The Assessment Office initially declined to change the property’s tax status.⁹⁸ However, the Taxing Authorities continued to press the exemption issue because of the for-profit nature of the latest owner, Prospect. Eventually Prospect was forced to appeal adverse rulings to the Commonwealth Court.⁹⁹

88. *Id.* at 141-147.

89. *Appeal of Springfield Hosp.*, 179 A.3d 632 (Pa. Commw. 2018).

90. *Id.*

91. *Id.* at 634.

92. *Id.* at 634-635.

93. *Id.* at 635.

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.*

98. *Id.*

99. *Id.* at 634.

The Commonwealth Court, confirming a lower court's ruling, concluded that the Springfield Hospital property was taxable pursuant to terms of the PILOT agreement and set the date the property lost its tax exempt status as July 1, 2016.¹⁰⁰ The Commonwealth Court reasoned that the language of the 1994 PILOT Order was clear that the property would only remain tax exempt so long as the entity that operated the hospital was exempt from federal taxation.¹⁰¹ Furthermore, the Commonwealth Court reasoned that the 1994 PILOT Order did not violate the tax day assessment rule¹⁰² because the parties agreed to that order to settle the tax status of the property, as well as when the property would become subject to property tax.¹⁰³

Based on the Commonwealth Court's decision in *Appeal of Springfield Hosp*, Pennsylvania courts are likely to uphold PILOT agreements; such agreements save the courts the tough challenge of analyzing often complicated financial structures, particularly in health care and residential care for the aged. There is little guidance, beyond statutory language authorizing "voluntary agreements,"¹⁰⁴ as to what rules govern so-called "voluntary" PILOT agreements; it is hoped the increasing use of PILOTs will not give rise to renewed concerns about arbitrary, privately negotiated grants of exemptions, such as seemed to have occurred with legislative grants in the 1800s, discussed in *Donohugh's Appeal*.¹⁰⁵ Nonetheless, a presumptively valid purpose for voluntary agreements is described by Act 55: "It is the intent of this act to encourage financially secure institutions of purely public charity to enter into voluntary agreements or maintain existing or continuing agreements for the purpose of defraying some of the cost of various local government services."¹⁰⁶ Indeed, greater transparency about PILOTs may help both the public and the courts to understand what it takes to keep nonprofits both solvent and charitable.¹⁰⁷

In essence, PILOT agreements are simply negotiated agreements between taxing authorities and institutions that permit both sides some predictability about tax consequences for the future. PILOT agreements may be advantageous for institutions that do not want to gamble on decisions by courts about whether their operations and activities will satisfy Pennsylvania's statutory and Constitutional requirements to qualify for fully exempt status as a purely public charity.

IX. THE ONGOING FRIENDS BOARDING HOME OF WESTERN QUARTERLY MEETING LITIGATION

At this writing (June 2022), another residential senior care-related case is pending in the Pennsylvania Commonwealth Court, the case of *Friends Boarding Home of Western Quarterly Meeting v. Commonwealth*.¹⁰⁸

100. *Id.* at 641.

101. *Id.* at 639.

102. The "Tax Day Assessment Rule" is a common law rule where if a parcel of real estate is exempt from taxation on January 1st of a given year, then the real estate is exempt from taxation for the entire year. Accordingly, the tax status of the real estate under common law could not change until January 1st of the following year. The Commonwealth Court held in *Appeal of Springfield Hosp.* that the Tax Day Assessment Rule treatment of real estate could be negotiated away via a PILOT agreement. *Id.* at 639-640.

103. *Id.* at 639.

104. 10 P.S. §372(a)(7) and §377 (1997).

105. *Appeal of Donohugh*, 86 Pa. 306 (Pa. 1878), discussed *supra*.

106. 10 P.S. §372 (a)(7).

107. See generally Evelyn Brody, *All Charities are Propety-Tax Exempt, But Some Charities Are More Exempt Than Others*, 44 NEW ENGLAND L. REV. 621 (2010) (advocating for nonprofit organizations to utilize greater transparency for PILOTs).

108. *Friends Boarding Home of Western Quarterly Meeting v. Commonwealth*, 332 F.R. 2018, 260 A.3d 1064 (Pa. Commw. Ct. 2021).

The entity's casename reflects the history of the facility, which dates back to 1898 when it was founded by a group of Quakers in Chester County; the name now used is Friends Home in Kennett.¹⁰⁹ In its brief filed with the Commonwealth Court, Friends Home refers to its Chartered mission to provide "aged or infirm persons of limited means . . . a permanent abiding place" where they can "obtain at a moderate cost all of the comforts needed for their declining years."¹¹⁰ The website describes progressive alternatives for care: Independent Living, Supportive Independent Living, Personal Care, and Skilled Nursing Care.

It is perhaps significant that Friends Home in Kennett is not one of the thirteen CCRCs in Chester County described by the Pennsylvania Insurance Department¹¹¹ as licensed to provide "continuing care," although its mission certainly seems similar.¹¹² Thus, after analyzing the tax-exempt status of nursing homes and CCRCs, the Pennsylvania courts have been called upon to examine another type of "organizational structure" for long-term services.

In an opinion published on September 7, 2021, the Commonwealth Court concluded that the "totality of the circumstances" failed to indicate that Friends Home donated a substantial portion of its services.¹¹³ In addition, the court ruled that the facility failed to show it benefits a "substantial and indefinite class of persons" who were subjects of charity." The court found:

If a resident cannot pay, Friends may either decline admission or require the resident to leave. . . . Friends only provides financial assistance to those in need who have resided at the activity for more than two years. . . . Friends limits the amount of assistance to \$2,000 per month or \$40,000 for a lifetime. . . . In other words, a qualifying resident that received \$2,000 per month in aid will only be able to receive assistance for a maximum of 20 months. Friends continues to care for a resident only if he or she can afford services with the limited financial assistance it provides at its discretion. Those who cannot afford to stay have had to leave. . . . Between 2016 and 2019, seven residents left due to lack of funds.¹¹⁴

What appears to be Friends' plan to ensure financial survival for the "entity," especially in the face of rising costs of care in virtually all sectors of health care, is thus challenged as being insufficiently supported by charity.

Of additional potential significance, state challenges to exemptions for organizations traditionally deemed to be charitable, such as the latest challenge of a long-standing, nonprofit "home for the aged," may have implications for federal income tax exemptions, for as analysts have predicted:

Despite the differences between federal income tax exemption and state property tax exemption, pressure exists at both levels of government to find more tax revenue and to resolve tensions that arise when nonprofit organizations engage in commercial activity without aiding the poor or lessening the burdens of govern-

109. See Friends Home in Kennett, "About Us," at <https://fhkennett.org/about-us/>.

110. Brief of Petitioner, Friends Boarding Home of Western Quarterly Meeting, filed January 20, 2021, available on Westlaw.

111. See the website maintained by the Insurance Department for both nonprofit and for-profit CCRCs licensed in Pennsylvania at <http://www.insurance.state.pa.us/scripts/ccfsearch?level=1&item=County15>.

112. See e.g., Katherine C. Pearson, *Continuing Care Retirement Communities, State Regulation and the Growing Importance of Counsel for Residents and their Families*, 77 PA Bar Q. 172 (No.4, 2006); Katherine C. Pearson & Joshua Wilkins, *Will Continuing Care Retirement Communities Continue? A Pennsylvania Law Update*, 82 PA. Bar Q. 89 (April 2011); Katherine C. Pearson & David Sarcone, *Ongoing Challenges for Pennsylvania Continuing Care and Life Plan Communities*, 90 PA Bar Q. 1 (January 2019).

113. Friends Boarding Home of Western Quarterly Meeting v. Commonwealth, 260 A.3d 1064, at 1074.

114. *Id.* at 1073-1074 (omitting citations to the record).

ment. The IRS and Congress will undoubtedly be watching developments at the state level, just as state policymakers will watch the IRS and Congress. Whether the standards for tax exemptions at the state and federal levels will ultimately be uniform remains an open question.¹¹⁵

Friends Home has filed exceptions to the Commonwealth Court ruling which are pending before that court. An appeal to the Pennsylvania Supreme Court is also possible.

X. CONCLUSION

Taken as a whole, it seems clear that state challenges will continue for facilities historically permitted to avoid both income taxes and state real estate, sales and use taxes. Mere “operating” losses, even at a threshold level identified by Act 55, may not be enough to prove a purely charitable status under Pennsylvania law. Especially for senior care facilities, regardless of the form of the enterprise, the need to survive financially may require careful, intentional consideration of who they are serving and how they raise and allocate funds, in fulfilling any charitable mission as a tax-exempt operation.

115. Elizabeth Schmidt and Allen Madison, *NONPROFIT LAW: THE LIFE CYCLE OF A CHARITABLE ORGANIZATION* 213-214 (3d Ed. 2021). Sometimes identified as “commercial doctrine” related concerns, questions are often raised about nonprofit organizations’ involvement in commercial activities, especially in fields such as healthcare where it may be hard to distinguish the fees charged by for-profit and nonprofit entities. Significantly, in 2019, “almost three-quarter of the revenues” reported by all Section 501(c)(3) charities on their annual 990 statements came from “fees for goods and services.” *Id.*, at 349-350. As one offset, specific IRS rules can result in income taxes for nonprofits on “unrelated business income.” *Id.*, at 373-404.