

Pennsylvania Association of Nonprofit Organizations

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To: *Pennsylvania Joint Legislative Budget and Finance Committee*

From: *David A. Ross, J.D.*
PANO Public Policy Officer
On behalf of Pennsylvania Association of Nonprofit Organizations

Date: *May 6, 2009, 9:30am*

Subject: *Tax Exempt Property and Municipal Fiscal Status*

Location: *Hearing Room 1, North Office Building, Harrisburg, PA*

My name is David Ross. I am the Public Policy Officer of Pennsylvania Association of Nonprofit Organizations. PANO is the statewide membership organization serving and advancing the charitable nonprofit sector through leadership, advocacy, education and services in order to improve the quality of life in Pennsylvania. PANO is a 501(c)(3) charitable nonprofit organization representing over 800 member organizations. PANO helps charities become more effective. Thank you for providing this opportunity for us to share our views

PANO was instrumental in facilitating the Charities Build Communities coalition that led to the passage of Pennsylvania Act 55 of 1997, the "Institutions of Purely Public Charity Act". Since 1984, PANO has advocated in the public interest on behalf of 501(c)(3) charitable nonprofit organizations. Act 55 is a seminal piece of legislation that set Pennsylvania ahead of every other state in the country.

So many 501(c)(3) charitable nonprofit organizations are concerned that they will be asked (or asked again) to pay payments-in-lieu of taxes (PILOTs). Many charities face increasing demand for their services during a lean economic climate. At the same time municipalities are facing decreased revenue, charities also face funding cuts. When funding for social service programs are reduced, charities struggle to provide the same level of service with less money. If a state agency had to provide those services, costs would likely be higher. If those services were eliminated completely, the social impact would likely cost the entire community.

For Arts nonprofits there's a different dynamic. Nonprofit arts and cultural organizations are an economic engine for growth and development. For our blighted cities, the development of arts venues has helped stabilize real estate values and attracted a host of supporting businesses. For many Pennsylvania cities, nonprofit arts and cultural organizations have played an important role in their economic renaissance.

Scope of the Sector.

According to 2007 statistics from the National Center for Charitable Statistics (NCCS), Pennsylvania is home to conservatively 41,000 501(c)(3) public charities and foundations. [4].

From hospitals, colleges, daycare centers and clinics, to soup kitchens, social service providers, and foundations, Pennsylvania diverse and dynamic nonprofit sector is a major economic force in every region of the state.

Pennsylvania's nonprofit sector employs 1 out of every 9 full-time workers throughout the State (11.5% or 643,098 *FTE's*). This is 4.6% above the national average (6.9%) [5]. Together Pennsylvania's nonprofit *FTE's* earned over \$21.1 billion in wages in 2003, or 10.7% percent of total wages paid in Pennsylvania [5]. In addition, nonprofits account for almost as large a share of Pennsylvania's total private employment in rural areas as they do in urbanized areas.

Not all nonprofits are alike, or have the same resources. According to the Urban Institute, nation wide 81% of registered 501(c)(3) charities and foundations had annual revenues below \$1million, and 73% below \$500,000. In Pennsylvania, however, 90% had annual revenues below \$1million, and 86% below \$500,000. These 90% (nearly 36,000 charities and foundations) generated only 3.7% of the sector's total revenue, and held a mere 6.7% of its assets. In other words, the vast majority of Pennsylvania's nonprofits are operating on relatively small budgets, with little money to allocate beyond their mission. [4]

Since the recession began in 2007, Pennsylvania's nonprofits faced declining contributions, decreasing revenue, and losses of government and foundation funding. Resources are dwindling, but the community's need for nonprofit services is growing, and growing sharply. The recession is forcing many previously middle class tax-payers for the first time in their lives to need charitable services. Charities have become Pennsylvania's safety net. Yet, according to a noted nonprofit sector scholar, Pennsylvania could lose as many as 3,000 to 4,000 mission-driven, community-based nonprofits organizations over the next 18 months because of the recession.

These community-based, tax-exempt institutions are a major reason that Pennsylvania has a reputation for world-class hospitals, colleges, museums, philanthropies and even social services. They are also the source for some of Pennsylvania's most important and challenging jobs. But this is the same sector that on the average receives 9% lower wages and compensation for their services.

As your study indicates, nonprofits are already contributing to their communities in many ways. While most nonprofits, do not own property, for those that do, some are paying real estate taxes on the property they own, others have employed their own police and sanitation services, and still others are pay PILOTs. Those that do own property rely on that property to provide services to the community. Charitable tax exemptions demonstrate that as a society we value charity and community service.

Act 55 of 1997.

Pennsylvania Act 55 of 1997 the "Institutions of Purely Public Charity Act" is the seminal law that governs how charities operate, and qualify for State tax exemptions.[2] While charitable tax exemptions are expressly provided for in Pennsylvania's Constitution, Act 55 provides clear standards and thresholds for charitable behavior, and reduces the threat of court

challenges.[1] The Act clarified the definition of a "purely public charity" as articulated in the HUP test.[3] "An entity qualifies as a purely public charity if it possesses the following characteristics:"

- (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 private profit motive.

All 5 criteria must be met to qualify for tax exemptions. Act 55 reduced costly and unnecessary litigation by providing some clarity and uniformity.

PILOT Agreements.

Act 55 also provides for voluntary contributions, or payments in-lieu-of taxes (PILOT), agreements between municipalities and their local nonprofit organizations. The voluntary aspect of these agreements is core to the compromises inherent in Act 55.

PILOTs can adversely affect charities' ability to provide programming and serve the needy in the community. Furthermore, PILOTs deplete critical charitable resources that the charity uses to build capacity to meet future community needs.

The Nonprofit Community holds divergent views on the paying of PILOTs. Some charities pay PILOTs to be 'good citizens' which may even advance their charitable mission. Other nonprofits may consider PILOTs to be a form of extortion. The history of PILOTs in Pennsylvania is equally vexing.

Whatever the rationale is for PILOTs, charities across Pennsylvania are paying them. Some agreements are made public, others are not. There is no single method applied, or database compiling this information. Nor is there any measurement of the effectiveness of charities paying PILOTs.

Although property tax revenue is important to local governments, most local governments grant property tax exemptions to nonprofits in order to facilitate economically and socially valuable public services. As for the economic benefit, nonprofits provide substantial public benefits that are underprovided by the private sector. Our 501(c)(3) universities provide a number of public services, from education and research, to health care and commerce in the surrounding community which benefits the public as a whole.

As for the social benefit, most nonprofits provide public benefits that, in their absence, would have to be provided by the government and financed through taxes. If your local nonprofit hospitals did not exist, the local government would have to pay for the medical care for those who can not afford to pay. So with respect to nonprofit hospitals, their exemptions can be viewed as revenue neutral, or even a more effective way to provide those services. Forgoing taxes to pay for those services is usually more efficient than taxing the public to pay for those services.

Conclusion.

We acknowledge the efforts of the Legislative Budget and Finance Committee researchers. Gathering and analyzing this information was a daunting task.

While finding a solution for Pennsylvania's distressed municipalities is a legitimate priority, any effective solution must address the root cause. The problem is not that charities are receiving too many tax exemptions. Charities earn their tax exemptions by providing services that government is no longer willing or able to provide. Charities contribute significantly more in service to their communities than they receive in tax exemptions. The problem is that our urban communities are blighted, our population has left these communities, and 2600 local government entities are too expensive to operate. There are just too many administrators duplicating too many services.

Whether through services, payments, contributions, or taxes, nonprofits' are already contributing resources directly to their municipalities. At the same time, municipalities are relying on their nonprofits to provide services that improve the quality of life in the community. These PILOTs deplete charitable resources and prevent charities from investing in the capacity that they will need to be able to meet the needs of tomorrow. Thank you for providing the opportunity for our comments.

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Endnotes:

[1] See Pa. Const. Art viii Section 2(a)(v)

[2] Institutions of Purely Public Charity Act of 1997, Act of November 26, 1997 (P.L. 508, No.55) 10 P.S. §§ 371 - 385.

[3] Hospital Utilization Project v. Commonwealth, 507 Pa. 1, 487 A.2d 1306 (1985)

[4] The Urban Institute, National Center for Charitable Statistics, <http://nccsdataweb.urban.org/PubApps/profile1.php?state=PA> (Pennsylvania profile). Based organizations that filed Form 990 (including 990EZ and 990PF) within 24 months of the 2008, Jan BMF release date, as reported in NCCS Core Files and IRS Business Master Files.

[5] Pennsylvania Nonprofit Employment, Johns Hopkins Nonprofit Employment Data Project, (2005) http://www.pano.org/documents/PA_Nonprofit_Employment_Report.pdf