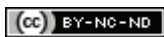


Journal of Law & Commerce

Vol. 32, No. 1 (2013) • ISSN: 2164-7984 (online)
DOI 10.5195/jlc.2013.57 • <http://jlc.law.pitt.edu>

REVISITING THE NONPROFIT PROPERTY-TAX EXEMPTION: AN EXAMINATION OF THE NEED TO CLARIFY ELIGIBILITY

Daniella Corcuera



This work is licensed under a Creative Commons Attribution-Noncommercial-No Derivative Works 3.0 United States License.



This site is published by the University Library System of the University of Pittsburgh as part of its D-Scribe Digital Publishing Program, and is cosponsored by the University of Pittsburgh Press.

REVISITING THE NONPROFIT PROPERTY-TAX EXEMPTION: AN
EXAMINATION OF THE NEED TO CLARIFY ELIGIBILITY

Daniella Corcuera^{*}

The City of Detroit's recent filing for bankruptcy has made the nation acutely aware of one uncomfortable fact: municipalities across the nation are struggling to make ends meet. As cities and towns attempt to find funding for services, previously quiet jurisdictions have begun to question charitable nonprofit tax exemptions. Of all the benefits received by nonprofit institutions, the property-tax exemption has become a notable source of contention. Local governments are now asking whether the institutions that have enjoyed the benefits of a property-tax exemption actually qualify for and/or deserve the financial benefit. As a result, cases challenging nonprofits have become common across the nation. Given that the number of nonprofits grew from 1,259,764 in 2010 to 1,574,674 in 2011, the legal effects of this brewing battle are sure to be noticeable both locally and nationwide.¹

Every state offers a charitable nonprofit property-tax exemption.² Depending on the state, the power to issue a property-tax exemption is typically either granted to the legislature by that state's constitution or mandated within the constitution itself.³ Until recently, this charitable tax exemption had gone relatively unquestioned because the benefits that these nonprofits provide to their local communities are numerous. Examples of charitable nonprofits include, among many others, universities and medical centers. These institutions are typically major employers for their regions,

^{*} J.D./M.B.A. candidate, University of Pittsburgh School of Law and Joseph M. Katz Graduate School of Business, 2014; B.A. 2011, Washington University in St. Louis.

¹ *Nonprofits*, URBAN INSTITUTE, <http://www.urban.org/nonprofits/index.cfm> (last visited Sept. 25, 2013).

² Evelyn Brody, *All Charities are Property-Tax Exempt, but Some Charities are More Exempt Than Others*, 44 NEW ENG. L. REV. 621, 625 (2010).

³ *Id.* at 624.

and are important to the local economy.⁴ Additionally, these types of institutions provide services that benefit the community while attracting visitors and potential future residents.⁵ However, as these local governments have become more pressed for funding, the charm of these institutions has worn off, leading to feelings of resentment. Many municipalities are now itching to challenge these exemptions.

This note will examine the implementation of, and issues related to, the property-tax exemption and compare various approaches to finding a satisfactory solution to the growing discontent without protracted litigation. Part I of this note will exemplify the changing treatment of the charitable nonprofit property-tax exemption by specifically examining the evolution of laws in Pennsylvania. Part II will compare solutions that have been suggested and implemented in cities across the nation. This section will explore the positive and negative aspects of each solution and discuss their relative levels of success. Part III will be a discussion of the branches responsible for solving the problem of how to consistently apply a nonprofit property tax exemption, and which branch should ultimately propose an answer: the courts, the legislature, the municipalities or the organizations themselves?

PART I

The charitable nonprofit property-tax exemption has recently made headlines in Pennsylvania. The origin of the Pennsylvania charitable exemption can be found in Article VII, § 2(a)(v) of the Constitution of the Commonwealth of Pennsylvania, which states that “(a) The General Assembly may by law exempt from taxation: . . . (v) institutions of purely public charity, but in the case of any real property-tax exemptions only that portion of real property . . . which is actually and regularly used for the purposes of the institution.”⁶ From this constitutional power, the legislature specifically excluded charitable organizations from the Sales and Use Tax

⁴ Daphne A. Kenyon & Adam H. Langley, *The Property-Tax Exemption for Nonprofits and Revenue Implications for Cities* (2011), URBAN INST. 6 (Nov. 30, 2011), <http://www.taxpolicycenter.org/UploadedPDF/412460-Property-Tax-Exemption-Nonprofits.pdf>.

⁵ *Id.*

⁶ PA. CONST. art. VIII, § 2.

under 72 P.S. § 7204(10).⁷ Any nonprofit seeking an exemption must first establish itself as a “purely public charity” under the Pennsylvania constitution.⁸

The definition of a “purely public charity” has evolved over time. The Supreme Court of Pennsylvania first established that “[i]n every such case as the public is the beneficiary, the charity is a public charity. As no private or pecuniary return is reserved to the giver . . . but all the benefit resulting from the gift or act goes to the public, it is a ‘purely public charity,’ the word ‘purely’ being equivalent to the word ‘wholly.’”⁹ The Court further added to this definition by stating that “an institution claiming to be benevolent or charitable that it, or the portion of its property, in respect to which exemption is claimed, must possess an eleemosynary characteristic not possessed by institutions or property devoted to private gain or profit.”¹⁰ In *YMCA of Germantown v. Philadelphia*, the Court established a multi-faceted test to determine whether an institution is a “purely public charity.” “First, whatever it does for others is done free of charge, or at least . . . the charges [are] nominal or negligible; second, that those to whom it render help or services are those who are unable to provide themselves with that the institution provides for them.”¹¹

The Supreme Court of Pennsylvania further defined a “purely public charity” in *West Allegheny Hosp. v. Board of Prop. Assessment*.¹² The Court stated that being purely public required the institution to have an “open-admission policy.”¹³ That is, the services provided by the institution must be accessible to all members of the community. Additionally, the institution must have a recognized charitable purpose to be considered a charity.¹⁴ Clearly, the test for whether an organization qualified as a “purely public charity” according to the Pennsylvania constitution continued to evolve over time.

⁷ 72 PA. CONS. STAT. § 7204(10) (2000), as discussed in *Hosp. Utilization Project*, 487 A.2d at 1310–11.

⁸ *Hosp. Utilization Project*, 487 A.2d at 1312.

⁹ *Trs. of Acad. of Protestant Episcopal Church v. Taylor*, 25 A. 55, 56 (Pa. 1892).

¹⁰ *YMCA of Germantown v. Philadelphia*, 183 A. 204, 208 (Pa. 1936).

¹¹ *Id.* at 412.

¹² *W. Allegheny Hosp. v. Board of Property Assessment, Appeals and Review of Allegheny County*, 455 A.2d 1170 (Pa. 1982).

¹³ *Id.* at 1170.

¹⁴ *Id.*

In 1985, the Supreme Court of Pennsylvania established the *HUP* test in *Hospital Utilization Project v. Commonwealth*. In this case, the Court set forth a five-pronged test to be used in determining whether an institution seeking a tax exemption is a purely public charity under the Pennsylvania constitution. The five criteria set forth by *HUP* are that an entity:

- (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.¹⁵

The Court made it clear that “the mere fact that an organization is a non-profit corporation does not mandate that it should be exempt from taxation.”¹⁶ Once meeting the constitutional test set forth in the case, the institution would then have to meet the specific statutory criteria of the exemption they were seeking.

Of course, since 1985, cases from all levels of the Pennsylvania court system have set forth different criteria in determining whether an institution meets the *HUP* test. The subsequent cases were more confusing than clarifying, and the courts often contradicted themselves, making it difficult to have any level of certainty on the outcome of a case. The same case in two different jurisdictions within Pennsylvania might have been decided in completely opposite ways. The *HUP* test was not applied consistently, leading to uncertainty throughout the state.

In order to clarify the *HUP* test, the legislature passed the Institutions of Purely Public Charity Act in 1997, more commonly known as Act 55.¹⁷ Act 55 was meant to provide guidance in determining whether an institution met the five criteria of the *HUP* test, thereby leading to a more uniform application throughout the state. This act specifically listed the ways in which an institution might meet each prong of the *HUP* test, even detailing how an institution must distribute its revenue and compensate its directors in order to be considered free from a private profit motive.¹⁸ Due to the passage of Act 55, the amount of litigation related to charitable nonprofit

¹⁵ *Hosp. Utilization Project*, 487 A.2d 1306 (Pa. 1982).

¹⁶ *Id.* at 1316.

¹⁷ 10 PA. CONS. STAT. § 372(b) (1997).

¹⁸ 10 PA. CONS. STAT. § 375.

property-tax exemptions decreased.¹⁹ However, the legislation brought with it a critical discussion about whether an organization only needed to meet Act 55 to satisfy the *HUP* test, or if that organization still needed to satisfy the *HUP* test in order to meet the constitutional requirement, with Act 55 simply providing additional criteria.²⁰ Regardless of this debate, Act 55 was generally considered applicable until 2012.

In April 2012, the Supreme Court of Pennsylvania answered the question of the relevance of Act 55 in *Mesivtah Eitz Chaim of Bobov, Inc. v. Pike County Bd. of Assessment Appeals*.²¹ In this case, the Court stated that “the General Assembly cannot displace our interpretation because ‘the ultimate power and authority to interpret the Pennsylvania Constitution rests with the judiciary, and in particular with this Court.’”²² Ultimately, “to receive an exemption without violating the Constitution, the party must meet the definition of ‘purely public charity’ as measured by the test in *HUP*. If it does so, it may qualify for exemption if it meets the statute’s requirements. Act 55, however, cannot excuse the constitutional minimum—if you do not qualify under the *HUP* test, you never get to the statute.”²³ The majority unequivocally stated that Act 55 does not provide any sense of security in meeting the constitutional minimum. The *HUP* test is the test that will determine the outcome of cases.

Given that the *HUP* test was so inconsistently applied throughout jurisdictions in the state, the *Bobov* case has generated concern from institutions. From 1997 to 2012, many organizations were given unquestioned property-tax exemptions under Act 55. Now, these previously exempt institutions will have to prove their qualification for exemptions under the *HUP* test. Due to the economic difficulty that plagues municipalities across the state, it is extremely likely that the exemptions of many charitable nonprofits will be questioned in the next coming years. Already, in the state’s two major cities, Philadelphia and Pittsburgh, city

¹⁹ Richard T. Frazier & Stanley J. Kull, “Purely Public Charities” in *Pennsylvania. Back to the Future-Again* (May 2012), <http://www.saul.com/publications-alerts-833.html>.

²⁰ *Id.*

²¹ *Mesivtah Eitz Chaim of Bobov, Inc. v. Pike County Bd. of Assessment Appeals*, 44 A.3d 3 (Pa. 2012).

²² *Mesivtah Eitz Chaim of Bobov*, 44 A.3d at 7 (citing *Stilp v. Pennsylvania*, 905 A.2d 918, 948 (2006)).

²³ *Id.* at 9.

councils and county officials have called for hearings to explore whether or not certain institutions should receive property-tax exemptions.²⁴ The focus has been largely on nonprofits that resemble a typical corporation—those that earn significant revenues have been particularly targeted. The success of this initial questioning remains to be seen.

PART II

The legislative and judicial evolution of Pennsylvania charitable nonprofit property-tax exemption laws is a representative example of the difficulty of establishing a consistently applicable definition that all parties will recognize, even in financially-strapped times. Nationwide, organizations in many local jurisdictions are dealing with successful challenges to their own state's exemption. For example, the Illinois Supreme Court recently decided that a nonprofit hospital's charitable use of property did not constitute a charitable use, and therefore that hospital did not qualify for a property-tax exemption.²⁵ Minnesota, a state which was experiencing similar difficulties in defining charitable nonprofit status, passed a statute that aimed to provide clarity to the Minnesota Supreme Court's established test.²⁶ However, this statute has not stopped cities from challenging the exemption status of big and small nonprofits alike.²⁷ In the absence of a satisfactory answer regarding a state's specific criteria for determining this property-tax exemption, municipalities have begun to look for alternative methods of taxing or receiving payment from charitable nonprofits. This has led to a few different proposals, which will be examined below.

²⁴ See *Heard on the Hill/In City Hall: Clarke says AVI Needs More to Make it Work* (Jan. 31, 2013), <http://www.phillyrecord.com/2013/01/heard-on-the-hill-in-city-hall-clarke-says-avi-needs-more-to-make-it-work>; Tony LaRussa, *Fitzgerald tells Allegheny County Nonprofits to Justify Tax-Exempt Statuses*, TRIBLIVE (Jan. 23, 2013), <http://triblive.com/news/allegheny/3342710-74/county-fitzgerald-exempt#axzz2JegonrHn>.

²⁵ Antonio Senagore, *Are Nonprofit Hospitals Charitable Institutions?*, 99 ILL. B.J. 96 (2011).

²⁶ Minnesota Council of Nonprofits, *Charitable Property-Tax Exemption Redefined*, <http://www.minnesotanonprofits.org/mcn-at-the-capitol/past-successes/charitable-property-tax-exemption-redefined>.

²⁷ Jean Hopfensperger, *Cities Ask Tax-Exempt Groups to Pay for Services*, STARTRIBUNE (Jan. 27, 2013), <http://www.startribune.com/local/188619381.html?refer=y>.

The policy responses that have emerged in response to this problem are varied. The most common answer to the question of collecting revenue from nonprofits is the PILOT program. A PILOT is a “payment in lieu of taxes.” Rather than paying a property tax, organizations can choose to enter into voluntary agreements in which they agree to pay some amount (typically a percentage of the tax they would have to pay if they weren’t exempt) to the local municipality. The sum may be designated for a particular purpose or just given to the local government for general distribution.²⁸ PILOT agreements may vary from a one-time payment to a long-term contract.²⁹ The idea behind PILOTs is that, since property tax revenues are lost, the charitable institution helps to ease the burden on the local government, without having to pay the full amount of tax on their property. PILOT programs are voluntary.³⁰

The city of Boston currently has one of the most widely recognized PILOT programs. Though data on PILOTs is not consistently tracked, it is estimated that, in fiscal year 2010, Boston received \$34,048,428 in PILOT revenue.³¹ This program generates more funds than any other PILOT program in the United States.³² Around 52% of the land area in Boston is considered to be property-tax exempt.³³ Owners of this land include governmental bodies as well as charities such as churches, synagogues, educational institutions, and health care organizations.³⁴

Even though the city of Boston has enjoyed significant success with its PILOT program, it has still attempted to evolve its program over time. PILOTs became a seriously considered solution in Boston due to the creation of the Boston PILOT task force in 2009. The task force was created “with the objectives of making PILOT contributions more consistent across institutions, and increasing revenue from PILOTs.”³⁵ The

²⁸ Eric A. Lustig, *The Boston City Pilot Task Force: An Emerging Best Practice?*, 44 NEW ENG. L. REV. 601, 602 (2010).

²⁹ Kenyon & Langley, *supra* note 4, at 6.

³⁰ Lustig, *supra* note 28, at 602.

³¹ *Mayor’s PILOT Task Force: Final Report & Recommendations*, City of Boston 7 (Dec. 2010), http://www.cityofboston.gov/Images_Documents/PILOT_%20Task%20Force%20Final%20Report_WEB%20_tcm3-21904.pdf.

³² *Id.*

³³ Lustig, *supra* note 28, at 606.

³⁴ *Id.*

³⁵ Kenyon & Langley, *supra* note 4, at 7.

city used this task force to set the basis for amounts of PILOT agreements and determined an appropriate standard of payment at the level of 25%.³⁶ A deduction for “extraordinary community services” allowed a deduction of up to 50% of the PILOT for community benefits.³⁷ These community benefits must, among other things, be quantifiable and directly benefit the city of Boston’s residents.

The recommendations of this task force were set out as an attempt to remedy the “uneven nature” of PILOT payments, which meant that certain institutions were “carrying the weight of many at a time when the City need[ed] a fair and consistently executed PILOT program to maintain its fiscal health.”³⁸ The lack of consistent agreements between charitable nonprofits and local governments is one downside to PILOT programs nationwide. Since the programs are voluntary (due to the fact that they are not statutorily regulated), they are incredibly inconsistent and do not necessarily correlate with the amount of tax-exempt property owned and used by an institution.³⁹ Additionally, there are limits on how much leverage a municipality can exert on the nonprofits that it hosts.⁴⁰ Negotiations for PILOT programs can often become tense, especially in lean economic times. Ultimately, every state provides for a charitable nonprofit property-tax exemption, and no institution wants that right to be entirely infringed. Some institutions may even resent the idea of having to negotiate a PILOT, since this may be taken as an admission of lack of charitable exemption status.

Finally, depending on the reach of certain nonprofits, a PILOT program may not fully discourage judicial challenges to that organization’s exemption status. Although a nonprofit may agree to pay a percentage of its would-be tax in a PILOT, depending on the terms, their exemption may still be challenged by an organization that was not privy to the PILOT agreement. Since one of the supposed benefits of entering into a PILOT program is the security of knowing that your charitable exempt status is

³⁶ *Mayor’s PILOT Task Force: Final Report & Recommendations*, *supra* note 31, at 11.

³⁷ *Id.* at 12.

³⁸ *Id.* at 7.

³⁹ *Id.*

⁴⁰ Lustig, *supra* note 28, at 619.

recognized by the local government, the fact that you may still be drawn into litigation is an obvious downside to PILOTs.

Similar issues exist with the SILOT, a relative of the PILOT. A SILOT is an agreement of “services in lieu of taxes.” Such an agreement means that nonprofits would provide valuable services to local residents rather than making a payment to a municipality.⁴¹ SILOTs and PILOTs can often be merged, with an organization pledging a certain amount in payment as well as a certain amount of services to be provided to local residents. This may even involve forming a partnership with the municipality to “foster economic growth, which can increase a city’s tax base.”⁴² An example of this is the relationship between the city of New Haven and Yale University.⁴³ However, as previously discussed, such agreements can be contentious to negotiate. A SILOT may make it especially difficult to reach any consistent agreement considering that it is typically more difficult to quantify services over payment. PILOT programs are already deemed to be somewhat inadequate in ensuring that every nonprofit pays its fair share—the additional issues associated with trying to calculate the worth of general services provided by a specific organization may complicate the establishment of a SILOT.

Logically, there is also a significant issue of continuity with PILOT and SILOT programs. Since these agreements are voluntary, there is no guarantee that they will create a continuous stream of revenue for a city. At any time, an institution may decide that it no longer wishes to participate in a PILOT or SILOT program, and simply choose to renege on its agreement. Such is the case in the City of Philadelphia. In 1994, Philadelphia implemented a PILOT and SILOT program calling on all nonprofit charities located in the city to “contribute some portion of their assessed property tax burden to the city.”⁴⁴ The city-wide PILOT/SILOT program was adopted by Executive Order.⁴⁵ The specific program details included:

⁴¹ Kenyon & Langley, *supra* note 4, at 7.

⁴² *Id.* at 8.

⁴³ *Id.*

⁴⁴ Pamela J. Leland, *Property-Tax Exemption and Municipal Revenue: Philadelphia’s Efforts to Solicit Payments-in-Lieu-of-Taxes from Charitable Nonprofit Organizations*, INT’L J. NOT-FOR-PROFIT L., June 1999, available at http://www.icnl.org/research/journal/vol1iss4/art_1.htm.

⁴⁵ *Id.*

1. A PILOT/SILOT payment equal to 40% of the annual property tax it would owe if not tax-exempt.
2. An incentive program whereby those organizations with agreements in place by December 1, 1994, would have a reduced rate of 33% of the annual property tax.
3. The calculation of the annual property tax would be based on assessed values held by the Board of Revision of Taxes and the City's millage rate.
4. The School District would be a full participant in the process (receiving 55% of any moneys received).
5. Up to 33% (one-third) of the PILOT obligations could be replaced with SILOTs.
6. All PILOT/SILOT agreements would be overseen by a PILOTs/SILOTs Advisory Board and formalized by a contract between the nonprofit, the City, the School District, the Center City District and any other special service districts which may be created.
7. Special provisions would be made for any nonprofit organization found to meet the 5 criteria in the *HUP* test.⁴⁶

There were, of course, exceptions to the above provisions. For example, the City agreed to include a "hardship" status, by which an organization could prove financial hardship and only have to contribute a minimum payment.⁴⁷ Additionally, if an organization was granted "home free" status by the Advisory Board, meaning that they met the requirements of the *HUP* test,⁴⁸ they would not be expected to participate in the Voluntary Contribution Program.⁴⁹ By July 1, 1996, the City had negotiated agreements with 42 institutions.⁵⁰ These institutions consisted of healthcare organizations, educational institutions, and professional or scientific societies.⁵¹ All the agreements were for a period of five years.⁵²

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ *Hosp. Utilization Project*, 487 A.2d at 1312.

⁴⁹ Leland, *supra* note 44.

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Id.*

The City quickly ran into trouble with this program. One significant issue was that, in initial reports, the city expected to receive around \$24 million annually from the healthcare and educational community alone. In reality, Philadelphia only received around \$9.4 million.⁵³ This reduced revenue can be attributed to the amount of organizations that were granted hardship status, and also multiple reassessments of the values of properties which they owned. These reassessments significantly lowered the value of their properties, which lowered actual revenues.⁵⁴

Another factor that may have contributed to lower revenues is that of Philadelphia's approach in negotiating with institutions. The City was weary of alienating nonprofits with this program, and so negotiations were carried out in a "kind and gentle" manner.⁵⁵ The City of Philadelphia did not want the program to come across as harsh, and it was willing to work with organizations in order to make agreements seem less one sided.⁵⁶ However, in doing so, it ultimately came to varying terms with each organization, meaning that the program was not implemented uniformly.⁵⁷ As long as the City of Philadelphia felt that it was receiving an appropriate benefit from the deal, there was no need to ensure that each agreement was uniformly proportional to the size and value of each individual organization.⁵⁸

Finally, the political circumstances surrounding the PILOT/SILOT program contributed to an overall feeling of distrust. Out of the 300 nonprofits that were examined, only 45 entered into PILOT agreements.⁵⁹ As mentioned above, these organizations consisted of healthcare, educational, and professional associations. There was a noticeable lack of older and wealthier arts and culture organizations.⁶⁰ Such organizations were granted "home free" status.⁶¹ Although it is possible that these organizations did meet the *HUP* test and should have been considered to be

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ *Id.*

exempt from the program, the fact that the mayor of Philadelphia had designated arts and culture as a crucial aspect of his academic development plan meant that many looked at the absence of these organizations with skepticism.⁶² In fact, representatives of the nonprofit community felt that the purpose of the program had been to target participating organizations from the beginning, and was merely devised to look equal on its face.⁶³

Due to the issues plaguing the Philadelphia PILOT/SILOT program, many of the originally participating organizations chose not to renew their agreements. Some agreements were re-negotiated for significantly lower sums. In 2009, Philadelphia had PILOT agreements with 17 institutions that brought in \$686,922.⁶⁴ The most significant contribution was \$275,000 from a retirement community.⁶⁵ The largest nonprofit organizations, such as the University of Pennsylvania, Drexel University, Temple University, and the Children's Hospital of Pennsylvania, did not have PILOT agreements.⁶⁶ After the initial five-year agreements expired, most of these larger institutions declined to renew their PILOT agreements. As such, the PILOT program is generally recognized to have been a very short-term success.

It is worth noting that, aside from its initially shaky ground, the Philadelphia PILOT/SILOT program may have also been negatively impacted by the passage of Act 55.⁶⁷ Part of the initial leverage that the City had in negotiating contracts was that cases surrounding the *HUP* test had left determination of exempt status muddled. Once Act 55 was passed, the requirements became much clearer, and it was generally considered easier to prove an exempt status. The legislative measure essentially eliminated the fear that an organization's status would be challenged successfully.⁶⁸ Therefore, many nonprofits decided that the minimized risk provided no incentive to enter into PILOT programs, since their general purpose was to provide some protection against threats of litigation. Philadelphia's

⁶² *Id.*

⁶³ *Id.*

⁶⁴ Anthony Campisi, *City Has Seen Its PILOT Light Go Out*, PHILLY.COM (Mar. 5, 2010), http://articles.philly.com/2010-03-05/news/25215390_1_nonprofits-pilot-program-agreements.

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ *Hosp. Utilization Project*, 487 A.2d at 1316–17; 10 P.S. §§ 371–385 (1997).

⁶⁸ Campisi, *supra* note 64.

PILOT/SILOT program simply could not withstand the test of legislative change.

Although PILOTs and SILOTs are the most popular type of agreement between municipalities and nonprofits, they are not a universal panacea. Depending on the community, local governments that do not heavily rely on income tax revenue and cities in which nonprofits do not own substantial real estate would not see any significant benefit from establishing a PILOT/SILOT programs with their local nonprofits.⁶⁹ Instead, municipalities may look to charge exempt organizations user fees, special assessments, and municipal services fees.⁷⁰ User fees involve payment “for services like garbage collection, water, and sewer.”⁷¹ A municipal service fee is related to the user fee. An organization is charged a fee for use of services, though the fee may not necessarily be related to how much of a local service that property uses.⁷² Examples of this fee include street-light and drainage fees.⁷³ A special assessment may be used to pay for municipal improvements that benefit the piece of property that is tax exempt.⁷⁴ Additionally, municipalities may choose to levy “special tariffs, such as tuition taxes, on groups that use nonprofit services.”⁷⁵ Some states may also choose to reimburse cities for lost revenue due to property-tax exemptions.⁷⁶ This is currently the case in Connecticut and Rhode Island.⁷⁷ However, given that most states are experiencing budget issues, it is unlikely that this type of plan will become widespread.

PART III

Given the varying degrees of efficacy that PILOTs, SILOTs, and municipal and other fees have had in easing the strain caused by the issue of

⁶⁹ Karin Fischer, *As Cities Seek Payments in Lieu of Taxes, Colleges Are Urged to Work Out Deals*, CHRON. HIGHER EDUC. (Nov. 29, 2010), <http://chronicle.com/article/article-content/125558/>.

⁷⁰ Kenyon & Langley, *supra* note 4, at 5.

⁷¹ *Id.*

⁷² *Id.*

⁷³ Ianthe Jeanne Dugan, *Strapped Cities Hit Nonprofits With Fees*, WALL ST. J. (Dec. 27, 2010), <http://online.wsj.com/article/SB10001424052748703548604576038080723678202.html>.

⁷⁴ Kenyon & Langley, *supra* note 4.

⁷⁵ Fischer, *supra* note 69.

⁷⁶ *Id.*

⁷⁷ *Id.*

nonprofit tax exemptions, it is clear that there has been no singular approach that has uniformly shown a level of success. The effectiveness of each solution depends greatly on the structure of each municipality and the way they collect revenue. It is important to the longevity of any program that a state or local solution be applied consistently, predictably, and uniformly. Any discussion of a uniform solution must address the issue of who should establish the solution: the legislature, the courts, the municipalities, or the organizations?

Every state has a charitable tax exemption.⁷⁸ Though the requirements vary from state to state, each state's exemption has generally been specified in a state statute or state court.⁷⁹ In about half of the states, the state constitution includes a mandate exemption for charities.⁸⁰ Given the example in Part I, it is not unusual for an exemption to be defined by both the courts and the legislature over time. Therefore, one way to create a more uniformly applicable solution to a definition may be through either of these channels. For example, state legislatures may choose to narrow the scope of the property-tax exemption.⁸¹ The legislature may choose to pass a stricter definition of what is required of a nonprofit organization in order to qualify for a charitable property-tax exemption.⁸² However, in many states, any measure passed by the legislature, particularly one that is related to an interpretation of a constitutional mandate, may ultimately be interpreted by the courts. Consider the history of the *HUP* test and Act 55 discussed in Part I.⁸³ Although the legislature passed Act 55 with the intent to clarify any ambiguities introduced throughout the court's interpretations, the Supreme Court of Pennsylvania ultimately decided that the Act simply could not be given greater weight than the court established test. In some states, such as Illinois, a supreme court may decide that the legislature has no place in defining any constitutional terms, thereby restricting legislative powers.⁸⁴

⁷⁸ DAPHNE A. KENYON & ADAM H. LANGLEY, LINCOLN INST. OF LAND POLICY, PAYMENTS IN LIEU OF TAXES: BALANCING MUNICIPAL AND NONPROFIT INTERESTS 12 (2010), available at https://www.lincolninst.edu/pubs/dl/1853_1174_PILOTS%20PFR%20final.pdf.

⁷⁹ *Id.*

⁸⁰ Brody, *supra* note 2, at 624.

⁸¹ Kenyon & Langley, *supra* note 4, at 8.

⁸² *Id.* at 9.

⁸³ See 10 PA. CONS. STAT. §§ 371–385 (1997); Hospital Utilization Project v. Com., 487 A.2d at 1316–17.

⁸⁴ Brody, *supra* note 2, at 629.

Another drawback to putting the responsibility of unambiguously defining qualifications for property-tax exemption on the state legislature is the issue of time. Any dramatic overhaul will, realistically, not occur quickly.⁸⁵ Indeed, passing any law (particularly laws on such a contentious issue) requires, at a minimum, navigating a political maze, listening to commentary from the public and interested parties, and voting to pass the measure. Any major change in state law will, most likely, not be easy. The complexity of this issue makes it even more unlikely that any proposed legislation would pass quickly. Considering the amount of money at stake for both the organizations and the municipalities, it is safe to bet that neither party will let any adverse change in law occur without a fight.

Another potential option is to leave the task of clearly and uniformly defining charitable property-tax exemptions to the state court system. Of course, any challenge to an organization's property-tax exemption status is brought in the court system, and nonprofit entities have had success in defending their status in state supreme courts.⁸⁶ Therefore, it does make sense that courts are best situated to finally clarify each state's requirements. However, there are drawbacks to this approach. Most significantly, different local courts can often interpret very similar fact patterns in a variety of ways. While some counties may view actions such as charging fees for services or high executive compensation as deal breakers in determining an organization's property-tax exemption status, other counties may not be so quick to judge.⁸⁷ In this way, courts have actually increased ambiguity with regard to the common factors that are raised in challenging an institution's exemption status.⁸⁸ There may also be issues in the way different levels of state courts apply their analyses. Again, using the example of Pennsylvania, prior to the decision of the *Bobov* case, lower courts were willing to apply both *HUP* and Act 55 more strictly, while the Supreme Court of Pennsylvania accepted a broader definition.⁸⁹ Additionally, most court systems do not have the reputation of moving along quickly, meaning that any definitive answer may take a long time to

⁸⁵ Kenyon & Langley, *supra* note 4, at 9.

⁸⁶ KENYON & LANGLEY, *supra* note 78, at 13.

⁸⁷ *Id.* at 13–14.

⁸⁸ See Kenyon & Langley, *supra* note 4, at 4; *supra* notes 13–17.

⁸⁹ See Brody, *supra* note 2, at 627; *supra* notes 14–16.

develop. Ultimately, the courts may not be the best channel to rapidly lead to a more uniform approach in determining property-tax exemption.

The argument can also be made that each municipality should be allowed to determine which property-owning nonprofits are eligible for an exemption.⁹⁰ This would be particularly effective in remedying the geographic mismatch between the services and benefits provided by a particular nonprofit and the actual lost property tax revenue.⁹¹ Oftentimes, the services offered by an organization can be spread throughout a particular region, while the bulk of the lost revenue may be concentrated within the specific host municipality.⁹² In this circumstance, it seems reasonable to give the power of deciding whether that organization should be given a property-tax exemption to the municipality which will be most greatly affected by that decision. Only one state, Virginia, has used this approach, so it is difficult to gauge whether this would be an effective way of remedying existing issues.⁹³ Additionally, some municipalities may be uncomfortable with drastically changing their approach to property tax, particularly in those instances where such changes would affect all property owners.⁹⁴

One of the most widely implemented solutions has been for organizations to come to individual agreements with their municipalities, giving both the municipality and the organization some say in the outcome. It is true that PILOT and SILOT programs can be contentious to negotiate and may be an unreliable source of revenue.⁹⁵ Tense negotiations could ultimately lead to an organization's decision to raise its fees or cut services and benefits to a community. Nonprofit organizations that are large regional employers could also choose to cut back on their employee counts in order to make up the difference in net profits after paying large amounts of taxes.⁹⁶ However, PILOTs/SILOTs are ways to ensure that nonprofits pay for the use of services and contribute necessary revenue to their host

⁹⁰ Kenyon & Langley, *supra* note 4, at 8.

⁹¹ KENYON & LANGLEY, *supra* note 78, at 11.

⁹² *Id.*

⁹³ Kenyon & Langley, *supra* note 4, at 8.

⁹⁴ *Id.* at 9.

⁹⁵ KENYON & LANGLEY, *supra* note 78, at 32–33.

⁹⁶ *Id.* at 33–34.

municipality.⁹⁷ These programs can also help to relieve some of the tension felt between a large nonprofit and its community, particularly during lean economic times.

Ultimately, different municipalities have different needs. While some local governments might greatly benefit from a systematic PILOT/SILOT program, others would see little increase in revenue. A true solution must be a collaborative approach between all the levels of state leadership.⁹⁸ While “[m]any of the flaws of PILOTs can be addressed by adopting a systematic program,” the voluntary and temporary nature would have to be addressed by the legislature and the courts.⁹⁹ Alternatively, while the legislature and the state court system may seek to specify qualifying criteria, unavoidable ambiguity may mean that only an agreement between the local government and the organization would give either a chance of avoiding litigation. What makes sense in theory may not be practically successful, and so no one approach can be designated as the best approach. Rather, each state must be responsible for determining the most beneficial path for its cities and counties.

CONCLUSION

The charitable property-tax exemption has been a source of contention between nonprofits and their host municipalities for years. Due to the economic slowdown, financially strapped cities and counties are more aware of lost tax revenue as a result of this exemption. Pennsylvania is just one example of the continually evolving definition of different criteria set forth by both the state legislature and the court system in determining exemption status. Many different solutions, such as PILOT/SILOT programs and municipal service fees, have been proposed and implemented, but their relative successes have been varied. A resolution of the negative feelings between local residents, local governments and nonprofit organizations must be achieved through collaboration between the state legislature, the state court system, the local municipalities, and the organizations themselves. Any systematic and permanent solution must be

⁹⁷ *Id.* at 29–32.

⁹⁸ Kenyon & Langley, *supra* note 4, at 9.

⁹⁹ *Id.*

cognizant of the services a host municipality provides to a nonprofit and the benefits that the municipality receives from the nonprofit.