

**Real Estate and Sales Tax  
Exemption in Pennsylvania –  
10 P.S. §375 Defining  
"Purely Public Charities"**

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# Background

Pennsylvania's Constitution, at Article VIII, §2(a)(v), requires uniformity in taxation, but permits the legislature to enact statutes exempting institutions of purely public charity and that portion of the institution's real property actually and regularly used for its charitable purposes.

Pennsylvania's sales and use tax statute-exemption from sales tax on purchases of tangible personal property (and certain services which would otherwise be taxable) for use in their exempt activities.

Pennsylvania's real property taxation statute-exemption from real property tax if: (a) the institution is founded, endowed and maintained by charity; (b) revenues are applied to increase the efficiency and the facilities of the institution, and (c) the property is necessary to the purposes of the institution and not used in such a manner as to compete with commercial enterprise.

# Background

In Hospital Utilization Project ("HUP"), a 1985 sales tax case, the Pennsylvania Supreme Court summarized years of case law and determined that there are five requirements for being a "purely public charity." The institution must:

1. advance a charitable purpose;
2. render gratuitously a substantial portion of its services;
3. benefit a substantial and indefinite class of persons who are legitimate subjects of charity;
4. relieve the government of some of its burden; and
5. operate free from a private profit motive.

# Background

Following HUP, there was a period of extensive litigation by local jurisdictions attempting to apply HUP's requirements restrictively and thereby revoke real estate tax exemptions. The extent of the litigation and the strained interpretations the Commonwealth Court opinions gave the five HUP requirements, resulted in lobbying by Pennsylvania charities for a legislative solution to the uncertainties created by the developing case law. Effective November 26, 1997, Act 55, defining "purely public charities," was enacted.

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§375(a) An institution of purely public charity must meet the five tests set out in §§375(b)-5(f). If an institution meets the five tests, it is considered founded, endowed and maintained by charity. The deemed "founded, endowed and maintained by charity" provision is intended to assist the institution to meet the requirements of the real estate tax exemption statutes.

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§375(b) Charitable purposes. An institution of purely public charity must advance a charitable purpose, which it does if it is organized and operated primarily to fulfill any one or more of the following purposes:

1. relief of poverty;
2. advancement and provision of education (including post-secondary);
3. advancement of religion;
4. prevention and treatment of disease or injury, including mental retardation and mental disorders;
5. government or municipal purposes; or
6. accomplishment of a purpose which is recognized as important and beneficial to the public and which advances social, moral or physical objectives.

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§375(c) Private profit motive. The institution must operate entirely free from private profit motive, which it does if it meets all of the following:

1. Neither the institution's net earnings nor the donations it receives inure to the benefit of private individuals (using the federal 501(c)(3) standard);
2. The institution applies or reserves all revenue, including contributions, in excess of expenses in furtherance of its charitable purposes or to the funding of other institutions which meet the requirements of §§375(b) and (c);

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3. Compensation, including benefits, of any director, officer or employee, is not based primarily on the financial performance of the institution; and
4. As part of the institution's articles of incorporation (or, if it is unincorporated, its governing documents) its governing body has adopted a provision that expressly prohibits the use of any surplus funds for private inurement to any person in the event of a sale or dissolution of the institution.

See In re RHA Pennsylvania Nursing Homes Health and Rehabilitation Residence, 747 A.2d 1257 (Pa. Commw. 2000) for a holding that language prohibiting inurement and providing for the distribution of assets for charitable purposes on dissolution is sufficient to meet the requirements of §375(c)(4).



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## §375(d) Community service.

1. The institution must render gratuitously a substantial portion of its services. This requirement is satisfied if the institution actually provides any of the following:
  - a. goods or services to all who seek them without regard to their ability to pay if all the following apply: (i) the institution has a written policy to this effect; (ii) the institution has published this policy in a reasonable manner; and (iii) the institution provides uncompensated goods or services at least equal to 75% of its net operating income but not less than 3% of its total operating expenses;

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The act defines "net operating income" as the amount of funds remaining after all operating expenses related to the provision of goods or services associated with the institution's charitable purpose are deducted from payments received for providing these goods or services, as determined in accordance with generally accepted accounting principles applicable to the institution. It defines "total operating expenses" as the costs related to the provision of goods or services associated with the institution's charitable purpose, as determined in accordance with generally accepted accounting principles applicable to the institution.

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- b. goods or services for fees that are based on the recipient's ability to pay for them if all of the following apply: (i) the institution can demonstrate that it has implemented a written policy and a written schedule of fees based on individual or family income; (ii) at least 20% of the individuals receiving goods or services from the institution pay no fee or a fee which is lower than the cost of the goods or services provided; (iii) at least 10% of the individuals receiving goods or services from the institution receive a reduction in fees of at least 10% of their cost; and (iv) either no individual receiving goods or services from the institution pays a fee which is equal to or greater than the cost of the goods or services provided them, or the goods or services provided to the 20% receiving goods or services at a fee lower than cost are comparable in quality and quantity to the goods or services provided to those individuals who pay a fee which is equal to or greater than the cost of the goods or services provided to them;

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- c. wholly gratuitous goods or services to at least 5% of those receiving similar goods or services from the institution;
- d. financial assistance or uncompensated goods or services to at least 20% of those receiving similar goods or services from the institution if at least 10% of the individuals receiving goods or services from the institution either pay no fees or pay fees which are 90% or less of the cost of the goods or services provided to them;
- e. uncompensated goods or services which, in the aggregate, are equal to at least 5% of the institution's costs of providing goods or services;

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- f. goods or services at no fee or at reduced fees to government agencies or goods or services to individuals eligible for government programs if either one of the following applies: (i) the institution receives 75% or more of its gross operating revenue from grants or fee-for-service payments by government agencies and if the aggregate amount of fee-for-service payments from government agencies does not exceed 95% of the institution's costs of providing goods or services to the individuals for whom the fee-for-service payments are made; or (ii) the institution provides goods or services to individuals with mental retardation, to individuals who need mental health services, to members of an individual's family or a guardian in support of such goods or services or to individuals who are dependent, neglected or delinquent children, as long as the institution performs duties that would otherwise be the responsibility of government and the institution is restricted in its ability to retain revenue over expenses or voluntary contributions by one of the statutes listed in the act or by contractual limitations with county children and youth offices in Pennsylvania; or

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- g. fundraising on behalf of, or grants to, an institution of purely public charity, an entity similarly recognized by another state or foreign jurisdiction, a qualifying religious organization or a governmental agency and actual contribution of a substantial portion of the funds raised to such entity.

Certain of these formulas are designed to fit the operations of certain types of institutions. The most generally applicable is the 5% subsidy requirement of subsection (e). Under that provision, if the institution's costs of providing goods or services is \$20 million, it should satisfy the "render gratuitously" requirement if it provides a \$1 million subsidy ("uncompensated goods or services" – defined below - worth \$1 million).

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2. The institution may elect to average the applicable data for its five most recently completed fiscal years for the purposes of calculating any formula or meeting any quantitative standard in paragraph 1.
3. For the purposes of calculating the numbers of individuals for use in the percentage calculations in this subsection, educational institutions may use full-time equivalent students as defined by the Department of Education.

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4. "Uncompensated goods or services" are limited to any of the following:
  - a. The full cost of all goods or services provided by the institution for which the institution has not received monetary compensation or the difference between the full cost and any lesser fee received for the goods or services, including the cost of the goods or services provided to individuals unable to pay.

"Goods or services" are defined by the act as goods or services which promote any of the enumerated purposes under §375(b) and which are valued in accordance with generally accepted accounting principles applicable to the institution.



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- b. The difference between the full cost of education and research programs provided by or participated in by the institution and the payment made to the institution to support those programs.
- c. The difference between the full cost of providing goods or services and the payment made to the institution under any government program, including individuals covered by Medicare or Medicaid.
- d. The difference between the full cost of the community services which the institution provides or participates in and the payment made to the institution to support such community services.

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- e. The reasonable value of any money, property, goods or services donated by a primary donor to an institution of purely public charity or to a government agency or the reasonable value of the net donation made by a secondary donor to a primary donor. As used in this subparagraph, the following words and phrases have the following meanings:

"Net donation." In the case of a donation of money, property or identical goods and services made by a secondary donor, the difference between the value of the donation made by the secondary donor and the value of the donation made by the primary donor, provided such value is positive.

"Primary donor." An institution which makes a donation of any money, property, goods or services to an institution of purely public charity.

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"Secondary donor." An institution which receives a donation of any money, property, goods or services from a primary donor and then makes a donation back to that primary donor within three years of having received such donation.

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- f. The reasonable value of volunteer assistance donated by individuals who are involved or assist in the provision of goods or services by the institution. The reasonable value of volunteer assistance, computed on an hourly basis, may not exceed the "statewide average weekly wage" as defined in §105.1 of the Act of June 2, 1915 (P.L. 736, No. 338), known as the Workers' Compensation Act, divided by 40.

The statewide average weekly wage is a fairly low figure. For most institutions many hours of volunteer services will be necessary in order for their value to be a material factor in meeting the subsidy requirement.

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- g. The cost of goods or services provided by an institution licensed by the Department of Health or the Department of Public Welfare to individuals who are unable to pay provided that reasonable and customary collection efforts have been made by the institution.

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- h. The value of any voluntary agreement as set forth in §377(c).

This last item may be very important in meeting the subsidy requirement and is a strong encouragement to voluntary agreements. Under the provisions of §377(c), \$1 paid under a voluntary agreement can be valued at as much as \$3.50 for purposes of the subsidy requirement. For example, if an institution needs to provide a \$1 million subsidy to meet the "render gratuitously" requirement, it can do so by paying \$285,715 to a political subdivision under a voluntary agreement (assuming that the \$285,715 payment is greater than .25% of its program service revenue).

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## §375(e) Charity to Persons.

1. The institution must benefit a substantial and indefinite class of persons who are legitimate subjects of charity.
2. "Legitimate subjects of charity" are those individuals who are unable to provide themselves with what the institution provides for them.

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A "substantial and indefinite class of persons" are persons not predetermined in number, provided that, where goods or services are received primarily by members of the institution, membership cannot be predetermined in number and cannot be arbitrarily denied by a vote of the existing members. The statute specifically recognizes that the use of admissions criteria and enrollment limitations by educational institutions does not constitute predetermined membership or arbitrary restrictions on membership so as to violate this requirement and recognizes that an institution may reasonably deny membership based on the types of services it provides so long as denial is not in violation of federal or state anti-discrimination laws.



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3. An institution is considered to benefit a substantial and indefinite class of persons who are legitimate subjects of charity if the institution is primarily engaged in fundraising on behalf of or making grants to an institution of purely public charity, an entity similarly recognized by another state or foreign jurisdiction, a qualifying religious organization or a government agency, and there is actual contribution of a substantial portion of the funds raised or contributions received to one of the foregoing.

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4. An institution which operates exclusively on a voluntary basis to provide emergency health and safety services to the community or an institution which provides funds and support exclusively to volunteer institutions which provide emergency health and safety services to the community is considered to benefit a substantial and indefinite class of persons who are legitimate subjects of charity.

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5. An institution is not considered to benefit a substantial and indefinite class of persons who are legitimate subjects of charity if: (A)(I) the institution is not a 501(c)(3) organization; and (A)(II) the institution is a 501(c)(4), (5), (6), (7), (8) or (9) organization and is an association of employees, the membership of which is limited to the employees of a designated person or persons; a labor organization; an agricultural or horticultural organization; a business league, chamber of commerce, real estate board, board of trade or professional sports league; a club organized for pleasure or recreation; or a fraternal beneficiary society, order or association.

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§375(f) Government service. The institution must relieve the government of some of its burden. This requirement is satisfied if the institution does any one of the following:

1. Provides a service to the public that the government would otherwise be obliged to fund or to provide directly or indirectly or to assure that a similar institution exists to provide the service;
2. Provides services in furtherance of its charitable purpose which are either the responsibility of the government by law or which historically have been assumed or offered or funded by the government;

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3. Receives on a regular basis payments for services rendered under a government program if the payments are less than the full costs incurred by the institution, as determined by generally accepted accounting principles;

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4. Provides a service to the public which directly lessens or indirectly reduces dependence on government programs or relieves or lessens the burden borne by government for the advancement of social, moral, educational or physical objectives;
5. Advances or promotes religion and is owned and operated by a corporation or other entity as a religious ministry and otherwise satisfies the five requirements set out in §375; or
6. Has a voluntary agreement with a political subdivision under §7.

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§375(g) Nonprofit groups. A nonprofit parent corporation, together with all of its subsidiary nonprofit corporations, may elect to be considered as a single institution in meeting the criteria set forth in §375 as long as all of the following are met: (1) each subsidiary: (I) is a nonstock corporation of which the nonprofit parent corporation is the only member; and (II) meets the requirements of §375; and (2) the parent: (I) is a nonstock corporation; (II) is a 501(c)(3) organization; (III) meets the requirements of §375(b) and (c) (charitable purpose and no private profit motive); and (IV) except for services that meet the requirements of §375, does not render services for a fee to an individual or entity that is not a subsidiary which meets the requirements of §375(g)(1) above.

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Many groups of related Pennsylvania nonprofits are not set up as membership corporations with the parent as the sole member. Where the group does not fit the membership structure described in the statute, the parent organization may have difficulty meeting the requirements of serving legitimate subjects of charity, relieving the government of some of its burden and/or rendering gratuitously a substantial portion of its services. Parent corporations which provide management services to institutions outside of the group will also be ineligible for exemption based on the operations of their subsidiaries.



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§375(h) Parcel review. Nothing in the statute is to prevent a political subdivision from making determinations as to whether a parcel of property or a portion of a parcel of property is being used to advance the charitable purpose of an institution of purely public charity.

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§375(i) Lobbying/campaigning. No substantial part of the activities of a purely public charity shall consist of activities intended to influence legislation except as otherwise provided in Internal Revenue Code §501(h), or participating in or intervening in any political campaign on behalf of, or in opposition to, any candidate for public office as such limitations are interpreted under §501 of the Internal Revenue Code.

This language is not entirely clear, but the intent seems to be to prohibit campaigning and to permit an insubstantial amount of lobbying, following the federal rules for §501(c)(3) organizations.

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§376 Presumption process.

§376(a) Presumption determination.

1. If an institution of purely public charity possesses a valid sales tax exemption and has annual program service revenue less than \$10 million, for real estate tax exemption purposes it is entitled to assert a rebuttable presumption that it meets the five requirements of §375.
2. If an institution of purely public charity possesses a valid sales tax exemption and has annual program service revenue equal to or exceeding \$10 million, it is entitled to assert the presumption if the institution both possesses a valid sales tax exemption and has a §377 voluntary agreement with a political subdivision in which it conducts substantial business operations.

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3. A \$10 million or greater institution may assert the presumption only with regard to a challenge made by a political subdivision with which that institution has a §377 voluntary agreement.

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4. For purposes of calculating annual program service revenue under this section, an institution of purely public charity may elect to average its annual program service revenue for its two most recently completed fiscal years.

The act defines "program service revenue" as income earned from the provision of goods or services, including government fees and contracts associated with the institution's charitable purpose, which is reported on the annual return. "Annual return" is the federal Form 990 and for an institution not required by the federal government to file, the institution's annual financial statement.

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5. Beginning July 1, 1999 and every year thereafter, the Department of Revenue is to increase the \$10 million amount by 1%.

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§376(b) Burden of proof. If an institution of purely public charity asserts a presumption under §376(a), a political subdivision challenging that presumption before a government agency or a court bears the burden, by a preponderance of evidence, of proving that the institution does not meet the five requirements of §375.

§376(c) Department of Revenue order. The Department of Revenue must issue an order to any institution requesting sales tax exemption. An order denying an exemption must include specific information concerning the institution's failure to comply with at least one of the §375 requirements.

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## §377 Voluntary agreements.

§377(a) General rule. A political subdivision may execute a voluntary agreement with an institution that owns real property within the political subdivision. All contributions received from such voluntary agreements are to be used to help ensure that essential governmental services will continue to be provided in a manner that will permit the institution to continue to fulfill its charitable mission. A political subdivision may share with another political subdivision a portion of the proceeds from a voluntary agreement on the mutual agreement of all affected parties.



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§377(b) Public service foundations. Institutions of purely public charity may establish a public service foundation, on mutual agreement with a political subdivision, for the purpose of receiving, and distributing to a participating political subdivision, contributions from institutions of purely public charity.

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§377(c) Additional credit for voluntary agreements. An institution which has entered into a voluntary agreement may credit the following percentage of the reasonable value of its contribution for purposes of meeting the subsidy requirement of §375(d):

1. If the reasonable value of the institution's contribution is equal to or less than 0.15% of its program service revenue, the institution may credit the entire contribution at 150% of its value;
2. If the reasonable value of the institution's contribution is greater than 0.15% but less than 0.25% of its program service revenue, the institution may credit the entire contribution at 250% of its value;
3. If the reasonable value of the institution's contribution is greater than 0.25% of its program service revenue, the institution may credit the entire contribution at 350% of its value.

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Assume program service revenue is \$20 million: .15% of \$20 million is \$30,000 and .25% is \$50,000. Therefore, any payment under a voluntary agreement of more than \$50,000 would be valued at 350% of the amount paid for purposes of determining the amount of uncompensated goods or services provided by the institution in determining whether it meets the requirements of §375(d).

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§377(d) and (e) Existing and new agreements. Nothing in Act 55 impacts any existing agreement between an institution and a political subdivision which provides for payments of taxes or of payments in lieu of taxes or inhibits the execution of voluntary agreements after Act 55's November 26, 1997 effective date.

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§378 Unfair competition with small business.

§378(b) General rule. An institution of purely public charity may not fund, capitalize, guarantee the indebtedness of or lease obligations of, or subsidize a commercial business that is unrelated to the institution's charitable purpose as stated in the institution's charter or governing legal documents.

The act defines "commercial business" as the sale of products or services that are principally the same as those offered by an existing small business in the same community. It defines a "small business" as any self-employed individual, sole proprietorship, firm, corporation, partnership, association or other entity that: (1) has fewer than 101 full-time employees; and (2) is subject to income taxation by Pennsylvania.

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This is the most onerous provision of Act 55 and can cause difficulties for institutions which, faced with falling or restrictive funding, turn to unrelated activities in an attempt to subsidize their charitable activities. The act can prohibit use of an institution's assets to capitalize new for-profit activities. The statute applies to unrelated "commercial businesses" (defined as the sale of goods or services that are principally the same as those offered by an existing small business in the same community) whether in a separate subsidiary or not. One of the provision's oddities is that it is stated as an absolute prohibition. On the face of the statutory language there is no ability of a purely public charity to forego tax exemption in exchange for the right to subsidize commercial businesses.

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In some instances, an institution may be able to amend its articles of incorporation to broaden its charitable purposes and thereby cause otherwise "commercial business" activities to become related to its charitable purposes. As outlined below, there is an important exception to the prohibition for existing commercial activities, but only to the extent they are not expanded beyond their scope on Act 55's effective date.

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§378(i) Remedies. The Department of State is to establish a system of mandatory arbitration for the purpose of receiving complaints from aggrieved small businesses that an institution has violated §378. If the arbitrator finds that the institution violated §378, he or she may issue an injunction as part of his or her order, but no damages may be assessed against the institution. Either party may appeal the arbitrator's decision. The cost of the arbitration is to be borne by the complainant, unless the arbitrator directs otherwise, but each party is responsible for its own attorney's fees and other costs.

The Attorney General is apparently not able to enforce the prohibition. Based on the statutory language, only an "aggrieved small business" may enforce the provision.



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§378(c) Exceptions. The prohibition on unrelated commercial business activities does not apply if:

1. the commercial business is intended only for the use of the institution's employees, staff, alumni, faculty, members, students, clients, volunteers, patients or residents; or
2. the commercial business results in sales to the general public that are incidental or periodic rather than permanent and ongoing.

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§378(d)-(g) The prohibition does not prohibit: subsidization of another institution of purely public charity; investments; use of facilities to host groups for educational purposes; or the conduct of commercial business if the institution is formally requested to conduct it by the Commonwealth or a political subdivision.

§378(h) Existing business arrangements. Where the institution conducted or subsidized a commercial activity prior to the act's effective date, it may continue to do so without violating §378, as long as it does not substantially expand the scope of the commercial business.

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## §379 Accountability and disclosure.

§379(a) Reporting. An institution of purely public charity that does not register under the Charitable Solicitations Act must file an annual report with the Bureau of Charitable Organizations within 135 days after the close of its fiscal year. The report must include a copy of the institution's annual report filed with the IRS (the Form 990 or 990-PF) and information on each affiliate of the institution. The act defines an "affiliate" as a domestic or foreign corporation, association, trust or other organization which owns a 10% or greater interest in an institution of purely public charity and as a domestic or foreign corporation, association, trust or other organization in which an institution of purely public charity owns a 10% or greater interest. Because the act provides that the reports are to be available for public inspection, the inclusion of information with respect to affiliates is one means for a small business to try to determine whether an institution has violated §378.

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§379(d) Exemption from filing. The following are exempt from reporting:

1. a bona fide duly constituted religious institution and such separate groups or corporations which form an integral part of a religious institution and are exempt from filing an annual return to the IRS; and
2. an institution of purely public charity which receives contributions of less than \$25,000 per year provided that the institution's program service revenue does not equal or exceed \$5 million.

A private foundation, which is required to file its Forms 990-PF with the Attorney General, must also file them with the Bureau of Charitable Organizations if it is a purely public charity.