

## New Philadelphia Tax Ordinances Will Impact Charities

*Law360, New York (August 15, 2013, 11:50 AM ET)* -- In June 2013, the mayor of the city of Philadelphia signed into law two ordinances that "clarify" the business income and receipts tax (formerly known as the business privilege tax) and the property assessment provisions of the Philadelphia Code. These ordinances will impact charities.

### Property Assessment

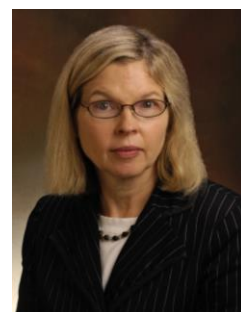
**Annual Statement.** A charity with real estate that is exempt from real estate tax will now have to file each year a sworn statement certifying:

1. that the charity continues to be a "purely public charity,"
2. the uses to which the exempt real estate is put and how those uses further the charity's exempt purposes, and
3. the portion of the exempt property used for the charity's exempt purposes.

The ordinance does not state when the annual statement is due, or for what year the first annual statement is due. Presumably, the Office of Property Assessment will publish the information necessary for charities to comply with the requirement.

**Requirements for Exemption.** The ordinance inserts a new provision into the code that permits the chief assessment officer to grant an exemption for a purely public charity under the General County Assessment Law only with respect to real property:

1. in which the exempt entity has legal or equitable title,
2. from which the exempt entity derives no income other than from the recipients of the bounty of the exempt entity, and
3. that is occupied, and actually and regularly used, for the purpose or purposes that entitled the exempt entity to such exemption, and only with respect to such portion of the real property that is used for such purposes.



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In its summary of the ordinances published by the city, the city gives the following explanation of the requirement that the charity not derive income other than from the recipients of its bounty: "i.e., that it does not sublease the property to for-profit entities ('lobby Starbucks,' offices, etc.)." This explanation leaves open the possibility that certain uses of a portion of the real estate by other nonprofit entities might permit the property to remain exempt.

### **Business Income and Receipts Tax**

**Activity Not Connected With Charitable Purposes.** The ordinance adds language to the portion of the code that excludes business conducted by a charity from the definition of "business" subject to the business income and receipts tax. According to the summary, the ordinance clarifies that a nonprofit receiving income from activity outside of its charitable mission will be subject to the business income and receipts tax.

With the inclusion of the new language, taxable "business" excludes "[a]ny business conducted by a nonprofit ... organized for religious, charity or education purposes, other than commercial activity that does not directly serve and is not directly connected with the ... religious, charitable or education purposes ...."

**Examples.** The summary gives as examples of activity subject to tax, the subleasing of property to for-profit entities ("lobby Starbucks," offices, etc.) and ongoing commercial storefront enterprises. The subleasing example highlights an issue that will be confusing for charities.

The city's concept of "commercial activity not directly serving and connected to charitable purposes," is similar to the federal income tax concept of "unrelated trade or business" activity. An entity that is exempt from federal income tax is nevertheless subject to tax on its net income from unrelated trades and businesses.

**Comparison to Federal UBIT.** The federal unrelated business income tax does not apply to investment income, royalties and income from the rental of real property (unless the investment or real property producing the income is debt-financed).

It is not clear what position the city will take with respect to whether the business income and receipts tax applies to investment income and royalties. It may be, and hopefully will be, that the city will accept the position that the activity producing investment income is not "commercial," and will make it clear that investment income is not subject to the tax.

The example in the summary takes the position that leasing real property to a for-profit is a commercial activity subject to tax. If the city continues to maintain this position, it will try to subject income from such leasing to tax, even though income from leasing real property is not subject to federal unrelated business income tax.

This will be an administrative burden for charities, even if deductions for depreciation and other expenses result in little net income from leasing. And for some charities, there could be substantial tax if net income from leasing is subject to tax.

In the summary, the city refers to *Mesivtah Eitz Chaim of Bobov Inc. v. Pike County Board of Assessment Appeals*, decided by the Pennsylvania Supreme Court in 2012. In *Bobov*, the nonprofit argued that because it met one of the requirements for being a purely public charity under Pennsylvania's

Institutions of Purely Public Charity Act (Act 55), it also met that requirement under the HUP test (the test for being a purely public charity as set forth in the Pennsylvania Supreme Court's 1985 decision in the Hospital Utilization Project case).

But the Supreme Court in Bobov determined that exemption requires a charity to meet the requirements for being a purely public charity under the HUP test as well as Act 55. The summary refers to the requirements of the HUP test being "more stringent" than those of Act 55. The city has taken the recent Supreme Court decision as an opportunity to clarify its position with respect to the taxation of income from noncharitable activity and real estate used in noncharitable activity.

The summary makes clear that the city thinks that the "clarifying" amendments to the Pennsylvania Code and the new annual statement will result in additional tax revenues for the city.

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