

## **Statement of The Hospital & Healthsystem Association of Pennsylvania**

Before Senate Finance Committee

Presented by

James M. Redmond  
Senior Vice President, Legislative Services  
The Hospital & Healthsystem Association of Pennsylvania (HAP)

Harrisburg, PA  
Wednesday, March 14, 2007

Chairman Browne, I am Jim Redmond, Senior Vice President, Legislative Services for The Hospital & Healthsystem Association of Pennsylvania (HAP). HAP represents and advocates for the nearly 250 acute and specialty care hospitals and health systems across the state and the patients they serve.

I appreciate the opportunity to present the views of hospitals and health systems across the state on Act 55 of 1997, the Institutions of Purely Public Charity Act.

### **Background**

On November 26, 1997, House Bill 55, the Institutions of Purely Public Charity Act, was signed by Governor Ridge and became Act 55 of 1997. The bill received unanimous support from the General Assembly. The Act was intended to bring clarity to the criteria to determine an institution's real property and sales tax exemption status. Proponents of the Act hoped that it would deliver educational, health care, and other charitable institutions from further unwarranted legal attacks by local governments and school districts. Ten years later, I can say that Act 55 of 1997 has met its purpose. Prior to Act 55 of 1997, there were at least 20-25 ongoing legal challenges between hospitals and political subdivisions. Currently, I am not aware of any such lawsuits.

Pennsylvania is unique among the states in this matter. No other state has developed such comprehensive requirements for state tax exemption. Most states rely on federal law that is quite broad.

Until Act 55 of 1997, Pennsylvania lacked a clear definition of "institutions of purely public charity," the term used in the Pennsylvania Constitution to describe entities eligible for exemption from state sales tax and real property taxes. In 1985, five criteria were adopted by the Pennsylvania Supreme Court (*Hospital Utilization Project v. Commonwealth*, 507 Pa.1, 487 A.2d. 1306 (1985)) to determine whether an institution is an "institution of purely public charity." Under this new test, an institution qualifies as an "institution of purely public charity" if it:

- Advances a charitable purpose.
- Operates entirely free from private profit motive.
- Donates or renders gratuitously a substantial portion of its services.
- Benefits a substantial and indefinite class of person who are legitimate objects of charity.
- Relieves the government of some its burden.

During the decade following the 1985 Supreme Court decision, there was a surge of litigation by local governments and school districts that believed the court had created new and quite narrow standards that would eliminate the exemption for certain previously exempt institutions. Instead of clarifying the situation, the litigation following the Supreme Court decision created confusion and costly confrontations between traditionally tax-exempt institutions and political subdivisions.

### **Key Components of Act 55 of 1997**

Act 55 of 1997 uses the same five criteria established by the Supreme Court in 1985 as the framework for defining an “institution of purely public charity,” but elaborates how an entity must demonstrate satisfaction of each criterion.

**Charitable Purpose**—There are six ways to meet this criterion:

- (1) Relief of poverty.
- (2) Advancement and provision of education.
- (3) Advancement of religion.
- (4) Prevention and treatment of disease or injury.
- (5) Government or municipal purposes.
- (6) A purpose, which is recognized as important and beneficial to the public and advances social, moral, or physical objectives.

**No Private Profit Motive**—The Act puts to rest any suggestion that an institution with revenue exceeding necessary expenses operates with a private profit motive. Rather, to demonstrate the lack of profit motive, an institution must ensure the following:

- (1) Neither its net earnings, nor donations it receives, inure to the benefit of private shareholders or other individuals.
- (2) Any revenue in excess of expenses is used for the furtherance of its charitable purpose or to fund other charitable organizations.
- (3) Compensation and benefits of any director, officer, or employee shall not be based primarily on financial performance of the organization.
- (4) No surplus funds may be used for the private inurement to any person in the event of a sale or dissolution of an institution of purely public charity.

**Community Service**—The requirement that an institution donate a substantial portion of its services may be met under one of six alternative percentage tests. These quantifiable tests were designed to ensure that an institution provides some portion of its goods and

services at no fee or reduced fees. The test that is used by most hospitals is the requirement that it must maintain an open admissions policy and provide uncompensated goods or services at least equal to 75 percent of net operating income, but not less than 3 percent of total operating expenses.

**Objects of Charity**—The Act clarifies the criterion, “legitimate object of charity,” as individuals who cannot provide for themselves what the institution provides for them. The Act specifically declares that federally exempt labor organizations, agricultural organizations, business leagues, social clubs, and fraternal benefit societies qualify under this test.

**Relief of Government Burden**—The Act clarifies the range of activities that can be deemed to relieve governmental burden. Thus, the Act considers any of the following to be relief of a government burden:

- (1) Providing a service that government would otherwise be obligated to provide.
- (2) Providing services that are a government responsibility or have historically been performed by government.
- (3) Receiving on a regular basis payment for services rendered under a governmental program that are less than the full costs incurred by the institution.
- (4) Providing a service which reduces dependence on governmental programs.
- (5) Advancing or promoting religion by a religious ministry.
- (6) Voluntary agreement with local governments.

There are two unique and creative provisions in Act 55 of 1997—promotion of voluntary agreements with local governments, and prohibition of competition with small businesses.

**Voluntary Agreements**—Many charitable institutions, threatened by costly local government legal challenges to their tax exemption, opted to make payment, or provide services to local governments in-lieu-of-taxes (“PILOTS” and “SILOTS”). The Act supports these payments and offers incentives for continuing to make them.

**Unfair Competition with Small Businesses**—The Act also prevents charities from using their tax-exempt status to compete unfairly with small businesses. Charities are not permitted to “fund, capitalize, guarantee the indebtedness of, lease obligations of, or subsidize a commercial business that is unrelated to the institution’s charitable purpose.

### **Conclusion**

Pennsylvanians count on health care being there when they or their family members need help. Pennsylvania hospitals and health systems provide care to patients 24 hours a day, seven days a week, and make every effort to treat all patients with dignity, respect, and compassion.

Each year, Pennsylvania hospitals and health systems provide care to 1.8 million inpatients, serve patients through 33 million outpatient visits, and provide care through 5 million emergency department visits. Pennsylvania is the only large state in this nation

without public hospitals, and therefore, Pennsylvania hospitals and health systems day in and day out, serve as the health care safety net for the poor and uninsured.

Tax exemption permits our hospitals to provide this critical service, which currently totals \$543 million in uncompensated care annually. In addition, we estimate that because of Medicare and Medicaid do not pay hospitals their actual costs, our hospitals face almost \$2 billion in underpayments from these government programs.

At the same time, our hospitals are also mindful that tax exemption is a privilege, not a right. They have a responsibility to the commonwealth to fulfill. Act 55 of 1997 has helped immensely to ensure that limited resources are not wasted on costly legal disputes, and the requirements for tax exemption are clear and precise.

Thank you for this opportunity to speak. I would be happy to answer any questions.

###

HAP  
3/07