

Pennsylvania Association of Nonprofit Organizations

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To: Pennsylvania Senate Finance Committee

From: **Jack Owen, Esq.**
Rhoades & Wodarczyk, LLC
On behalf of Pennsylvania Association of Nonprofit Organizations

Date: August 30, 2007, 9am-12pm (11:00am)

Subject: **State charity law continues to promote quality of life in Pennsylvania
Public Hearing: Review of Pennsylvania Act 55 of 1997**

5th Floor City Council Chambers, 414 Grant Street, Pittsburgh, PA 15219

My name is Jack Owen. I am an attorney for Rhoades & Wodarczyk, LLC a Pittsburgh law firm specializing in nonprofits, tax and employee benefits. I am here today on behalf of PANO, the Pennsylvania Association of Nonprofit Organizations, of which I served on the Board of Directors for six (6) years. I am currently on the Advisory Board for PANO's Standards for Excellence Program and am a PANO member. I also serve as Secretary and Chair of Legislative Affairs for the Pittsburgh Planned Giving Council and am a member of the Greater Pittsburgh Nonprofit Partnership's Public Policy Committee. Today I am here representing PANO.

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 700 member charities and the broader charitable community. PANO helps Pennsylvania's charities become more effective. 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 charities. Act 55 is a seminal piece of legislation that set Pennsylvania ahead of every other state in the country. Potential changes to Act 55 are of great concern to the entire charitable community. This is the same community that receives lower wages, and markedly less compensation for their services, approximately 9% across the board.

For more than twenty years, I have represented charities, served on their boards, and volunteered. I started in this field 13 years before the enactment of Act 55 of 1997 and I can tell you that much has changed since that time, and much of it, for the better.

Scope of the Sector

Pennsylvania is home for over 61,000 public charities, as defined under Section 501(c)(3) of the Internal Revenue Code. Of these 61,000 charities, nearly ninety percent (90%) have budgets under \$500,000 (this includes PANO and the majority of PANO's members). The ten percent (10%) of charities with budgets over \$500,000, (less than 6,900 charities) generate nearly ninety-eight (98%) of the nonprofit sector's revenue in Pennsylvania. The smaller charities (the 90%) generate just over two percent (2%) of the nonprofit sector's total revenue, and hold an inconsequential 5.6% of the sector's total assets. Changes to Act 55 could make administration much more difficult for these smaller charitable organizations and could force resources to be diverted from their missions.

Background

November 26, 2007 marks the 10 year anniversary of the signing of Act 55 by the Governor of Pennsylvania. For Pennsylvania's 61,000 charities, the 650,000 full-time workers they employ, and the millions of Pennsylvanians they serve, Act 55 is responsible for improving the quality of life in Pennsylvania for everyone. This innovative law has served Pennsylvania, and has even served as a model for other states.

PANO was a major force in the creation of Act 55 as part of the *Charities Build Communities Coalition*. The *Charities Build Communities Coalition* was a coalition of approximately 175 organizations that monitored and lobbied the progress of Act 55 for nearly 10 years. The passage of Act 55 was a complex and lengthy process, but led to numerous compromises for the betterment of local governments, charities and the public alike.

Act 55 uses the same criterion for tax exemption established by the Pennsylvania Supreme Court in *Hospitalization Utilization Project v. Commonwealth*, 507 Pa. 1, 487 A.2d 1306 (1985) ("HUP") as the framework for defining an institution of public charity. Under Act 55, a purely public charity must (1) advance a charitable purpose, (2) donate or render gratuitously a substantial portion of its services to benefit the community, (3) benefit a substantial and indefinite class of persons who are legitimate subjects of charities, (4) relieve government of some of its burden, and (5) operate totally free from private profit motive. Unlike HUP, Act 55 provides rules for determining how a purely public charity satisfies each of the five criteria.

Act 55 Works!

Act 55 expounds on each of these 5 HUP criteria originally established by the Pennsylvania Supreme Court. Two of the more pertinent requirements which demonstrate that Act 55 fulfills its intended purposes are as follows:

I. No Private Profit Motive Test

Act 55 requires that a purely public charity must operate without a private profit motive. Under the no private profit motive test, Act 55 provides that a purely public charity must ensure the following:

- (1) Neither a charity's net earnings, nor the donations it receives, may inure to the benefit of private shareholders or other individuals;
- (2) Any revenue in excess of expenses can only be 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; and
- (4) No surplus funds may be used for the private inurement of any person in the event of a sale or dissolution of an institution of purely public charity.

There has been much criticism of a few large charitable organizations for accumulating large surpluses, often referred to as "profits" in the public press. In the nonprofit sector, revenue that exceeds expenses is considered a surplus. For-profit business revenue that exceeds expenses is considered profit, which a for-profit business may use to pay dividends to shareholders. A nonprofit entity is prohibited from paying dividends or other distributions to shareholders under Act 55's "no private profit motive test." Nonprofit organizations generally do not have shareholders. In addition, compensation and benefits for employees of a purely-public charity are not based on the same criterion used by for profit businesses. For example, bonuses based on net revenue are not possible in a purely-public charity. Accordingly, the real question under the no private profit motive test is the second requirement, which provides that revenue in excess of expenses must be used for the furtherance of charitable purposes. Act 55 makes clear that a surplus is permissible (i.e., revenue in excess of expenses), as long as it is used in furtherance of charitable purposes. Thus, the question should not be whether a nonprofit may generate a surplus, but how is that surplus used? So long as the surplus is used to enhance the mission of the charity, and does not inure to the benefit of private individuals, then we must establish whether the charity meets the community service requirement.

II. Community Service Requirement Test

Under Act 55, a purely-public charity must donate or render gratuitously a substantial portion of its services, which is referred to as the community service requirement. There are six alternative percentage tests which can be met to demonstrate that a charity donates a substantial portion of services. These quantifiable tests were designed to ensure that a charity provides some portion of its goods and services at no fee or at a reduced fee. Act 55 was a carefully-crafted compromise; these tests under the community service requirement were designed to enable many different types of charities to demonstrate compliance with the Act.

The compromise of Act 55 sets forth strict tests for qualification. For example, the community service test insures that a charity provides a minimum level of benefits to the community. The integrity of Act 55 must be preserved and the impulse to amend it quickly or without significant study must be resisted.

Act 55 accomplishes many laudable objectives, but in PANO's view the most significant are as follows:

- (1) Surpluses in charities must be used solely to advance charitable purposes;
- (2) Excess funds of charities cannot be used for dividends, private benefit or inurements of any kind;
- (3) Unlike for-profits, compensation cannot reflect incentives for the financial performance of charities;
- (4) Charities should have open admission policies which are published in a reasonable manner and are made available to the public;
- (5) Voluntary agreements in lieu of taxes are important to the compromises inherent in Act 55 and should be continued; and
- (6) Act 55 should continue to reduce expensive and time-consuming litigation.

Conclusion

Act 55 works. The Act contains strict, measurable requirements that ensure that charities that serve the community, receive tax exemptions. In addition, Act 55 contains a mechanism for voluntary agreements whereby local governments and charities can arrive at a compromise for reasonable contributions to support essential government services.

As we mark the 10 year anniversary of Act 55 of 1997, it is worth remembering that charities are important, contributing members of our communities. From homeless shelters and symphonies, to food banks, hospitals and universities, charities do so much to promote the quality of life in our communities. Charities use their resources to help the poor and most unfortunate in our society. Charities relieve government of substantial burdens by performing much of the work that government cannot perform, or will no longer perform. I urge the Committee to resist the temptation to make tax exemption laws more burdensome and administratively complex for charities, particularly for the tens of thousands of smaller charities across Pennsylvania.

The vitality of Pennsylvania's charitable nonprofit sector depends on the preservation and uniform interpretation of Act 55, and its tax exemptions. Surpluses are the resource by which 501(c)(3) charitable nonprofit organizations build capacity to meet tomorrow's community needs. Changing Act 55 would likely result in financial and administrative burdens that thousands of Pennsylvania's charities can ill afford to bear.

On behalf of PANO, I thank the Committee for this opportunity to present comments. I would be happy to answer any questions.

Jack Owen, Esq.

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Pennsylvania Association of Nonprofit
Organizations

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