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NONPROFIT ORGANIZATIONS
ALERT
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The City of Philadelphia Passes Two Bills Affecting Taxes on Nonprofits

By Marla K. Conley and Jonathan R. Flora

The City of Philadelphia (the "City") recently adopted two bills related to the revenue the City generates from nonprofit organizations. In its summary statement on tax reform regarding nonprofits, the City states that these bills "put the world on notice that all activity of a charitable corporation is not necessarily exempt if it is outside of the defined charitable mission."

The New Bills

Bill #130009 (the "BIRT Amendment") impacts the City's Business Income and Receipts Tax (the "BIRT"). The BIRT historically provided an exception for any "business conducted by a nonprofit corporation or association organized for religious, charitable, or education purposes." The BIRT Amendment provides that this exception is not available for income and receipts from any "commercial activity that does not directly serve and is not directly connected with the corporation or association's religious, charitable, or education purposes." Although this language is similar to the federal income tax rules that impose a tax on unrelated business income, the bill does not utilize or reference any of the federal rules for determining the nature and type of income that is unrelated.

Bill #130123 (the "Property Tax Amendment") relates to property tax exemptions in the City. The bill provides that an entity holding a property tax exemption must file a sworn statement annually with the Chief Assessment Officer of the Office of Property Assessment:

- certifying that the organization continues to qualify as a purely public charity;
- certifying that the charity actually uses any exempt property to further the charity's purposes; and
- reporting the "portion of exempt property used for such purposes."

The City's position is that these bills do not change current tax law but clarify existing law and add a "sensible annual certification." The City also noted that Pennsylvania Supreme Court holdings in 2012 established a more stringent set of qualifications for a nonprofit to qualify for a property tax exemption in Pennsylvania. In light of these cases, the City stated that "charitable organizations in Pennsylvania need to strengthen their position so that they meet" these requirements.

Legislative Background

The Mayor signed both bills into law on Tuesday, June 25, 2013, after the City Council passed them unanimously on June 13. The bills received a unanimous recommendation from the City Council's Finance Committee on May 23.

At the Committee's hearing, Tilahun Afessa, the Director of Policy, Planning, and Outreach for the Department of Revenue, testified that the BIRT Amendment is intended to make the BIRT "clear by adding a clarifying provision which specifically states that this exclusion does not apply to commercial activity that does not directly serve and is not directly connected with the corporation or association's religious, charitable or education purposes." Mr. Afessa further stated that he believes the BIRT Amendment "shall help the Department of Revenue's compliance, enforcement, and outreach efforts and shall lead to a gradual increase" in the BIRT "revenue generated from for-profit activities of non-profit entities."

Mr. Afessa explained that the Property Tax Amendment is a companion to the BIRT Amendment. Pennsylvania statutes currently charge the City's Chief Assessment Officer with administering the City's property tax exemption system but fail to specify how it should be done. The Property Tax Amendment provides that the Officer shall grant an exemption only when the charity owns the property, occupies and uses it regularly, and does not derive income "other than from the recipients of the bounty of the exempt entity." The Property Tax Amendment also provides that every entity claiming a property tax exemption must file an annual certificate with the City, as described above. Mr. Afessa explained that the City believes the Property Tax Amendment will increase the real estate tax base and "lead

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to an eventual increase in real estate tax collection from properties owned by non-profit entities."

Steps Forward

Given continuing budgetary pressures and the City's current efforts to reform its tax assessment and collection systems, these bills are not a big surprise. Philadelphia has a large a number of properties owned by tax-exempt entities but a relatively small number of agreements for PILOTs ("Payments In Lieu of Taxes") and SILOTs ("Services In Lieu of Taxes"). Getting everyone to pay their "fair share" of the public burden has been a recurring theme in local civic discourse as well as nationally. Unfortunately, however, the City's effort to clarify its policies for collecting tax from exempt entities may result in some remaining confusion. For example, questions arise because the BIRT Amendment does not reference many of the traditional federal tax exemptions applicable to commercial activity, which would otherwise be taxed as unrelated business income, such as passive income, including interest income, rents, and royalties, or activities conducted irregularly or handled by volunteers. Perhaps recognizing the lack of clarity in the exemptions, Councilman Green confirmed with Mr. Afessa that the City intends to "write regulations to make very clear to the not-for-profit community what is business activity and what is not." Until such guidance is available, should charities rely on the corresponding federal tax-exempt provisions?

Another question raised by the annual certification requirement in the Property Tax Amendment is how charities should handle partial non-exempt uses of exempt property. With enormous economic stresses on charitable institutions, some charities have sought to leverage additional revenue streams by allowing third parties to use part of the charity's exempt property, and it is not clear from these bills how those uses will be treated. For example, a charity might periodically offer its space for weddings or other events or might lease a portion of its space to another nonprofit that pursues a different charitable mission. How will these partial uses affect exemptions in the new era of annual reporting?

In light of these questions and other trends impacting charitable organizations, now can be the right time for charities to inventory their revenue streams and property uses, analyzing the growth in certain activities and discussing how revenue streams and property uses should be reported and what the tax implications will be. This could be a time to consider whether a change in the nonprofit's strategic plan or charitable activities, a restructure, or other changes are advisable. We have significant experience in evaluating these issues and are available to assist with these kinds of reviews and considerations. ◆

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