

**FINDING A FIT FOR NONPROFIT HOSPITALS:  
A NATIONAL PERSPECTIVE OF STATE PROPERTY  
TAX EXEMPTION LAWS**

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\* J.D. Candidate, Seton Hall University School of Law Class of 2017. This Note discusses the context of state property tax exemption and the evolution of nonprofit hospitals. This Note describes litigation and legislation through the lens of two states in the foreground: New Jersey and Illinois. This Note further discusses legislative successes and failures over the past decade, and proposes a workable legislative solution. To support the proposal in this Note, policy concerns and reasoning are also discussed.

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#### I. INTRODUCTION: A NATIONAL PERSPECTIVE THROUGH THE LENS OF NEW JERSEY AND ILLINOIS

Nonprofit hospitals currently face an uphill battle filled with uncertainty and confusion regarding real property tax exemption. The issues facing nonprofit hospitals have been slowly brewing, evolving over decades throughout various states; however, the fight for the real property tax exemption has recently cast a bright spotlight on New Jersey. New Jersey came into national view when one of the state's largest and nationally ranked hospitals lost its tax-exempt status in the 2015 New Jersey Tax Court decision, *AHS Hospital Corporation v. Township of Morristown*.<sup>1</sup>

A municipality challenging the nonprofit hospital property tax exemption is nothing new: it has occurred since the 1950s.<sup>2</sup> Current trends show that when municipalities run low on capital they challenge nonprofit hospitals' real property tax exemption status in a "money grabbing" attempt to compensate for a lack in local tax revenues.<sup>3</sup> In order to solve decades of uncertainty, states should enact a hospital contribution fee as New Jersey attempted in late 2015. An alternative to states enacting a hospital contribution fee would be promulgating an alternative fee structure for nonprofit hospitals to compensate municipalities. Either solution would provide more guidance and taxation stability for nonprofit hospitals than the current system.<sup>4</sup>

<sup>1</sup> The health community was shocked when the tax appeal in favor of Morristown Township analyzed every function and operation of Morristown Memorial Hospital. See *AHS Hosp. Corp. v. Town of Morristown*, 28 N.J. Tax 456, 456 (2015).

<sup>2</sup> Lowell R. Mintz, Note, *The Rules of the Fight Must Be Fair: States Should Pass a Uniform Code for Nonprofit Hospital Tax Exemption of Real Property*, 26 J. L. & HEALTH 415, 417 (2013).

<sup>3</sup> See *Pasadena Hosp. Ass'n v. Cnty. of L.A.*, 221 P.2d 62, 62 (Cal. 1950) (arguing tax exemption rules must be strict but reasonable).

<sup>4</sup> "Without [a hospital contribution fee] the Tax Court ruling is likely to lead to a flurry of lawsuits involving lengthy and expensive litigation throughout the state." Betsy Ryan, *N.J.*

This Note discusses the lack of clarity in the realm of the nonprofit hospital real property tax exemption that often subsequently leads to broad judicial interpretations that are dependent upon the judge. Part II of this Note looks at the basics of tax exemption for nonprofit hospitals and discusses how nonprofit hospitals become tax exempt, the purpose of the nonprofit hospital tax exemption, and how state nonprofit law differs from federal nonprofit law. Part III examines recent legislation and litigation in New Jersey while Part IV analyzes recent legislation and litigation in the state of Illinois. Parts III and IV of this Note demonstrate the vulnerability of nonprofit hospitals, as well as the lack of clarity in the current system. Part V addresses a possible solution in light of “lessons learned” from New Jersey and Illinois. Specifically, this part presents three challenges and solutions that exist for nonprofit hospitals and tax exemption laws given current laws and interpretation: (1) that hospitals will never be a traditional donative entity (e.g., a soup kitchen)—therefore the definition of charity care must be redefined; (2) that the Affordable Care Act (“ACA”) has changed the landscape for nonprofit hospitals and their operations by encouraging integration, decreasing the pool of uninsured individuals, and requiring costlier programs—thus, the use of nonprofit hospitals must factor into modern healthcare policies; and (3) that retaining revenues, or profits, is necessary for nonprofit hospitals to increase technology and their sophistication of modern healthcare. This Note argues for a remedy for nonprofit hospitals to relieve them of the current ambiguity that exists in property tax exemption, judicial interpretation, and scrutiny. Outdated nonprofit property tax exemption laws can no longer be reconciled in the changing healthcare landscape and nonprofit hospitals are paying the price.

## II. HOW NONPROFIT HOSPITALS CAME TO BE TAX EXEMPT: THE BASICS

### A. *The History and Purpose of the Nonprofit Hospital Tax Exemption*

The narrative begins at the inception of hospitals when they were known as the place where the ailing poor would go to die.<sup>5</sup> The lengthy

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*Hospital Assn: Why We Support Community Service Fees for Nonprofit Hospitals* | Opinion, N.J.COM (Jan. 6, 2016), [http://www.nj.com/opinion/index.ssf/2016/01/nj\\_hospital\\_assn\\_why\\_we\\_support\\_community\\_service.html](http://www.nj.com/opinion/index.ssf/2016/01/nj_hospital_assn_why_we_support_community_service.html).

<sup>5</sup> New Jersey Tax Court Judge Vito Bianco found the history of hospitals so integral to the discussion of tax exemption that he reserved approximately seven pages of his opinion to it. See *AHS Hosp. Corp. v. Town of Morristown*, 28 N.J. Tax 456, 478 (2015) (arguing nonprofit hospitals have changed in structure and function since their evolution).

history of nonprofit hospitals demonstrates how nonprofit hospitals evolved from “charitable alms houses” in the eighteenth century, aimed at providing medical care to the ailing impoverished, to the current model of sophisticated centers of care that developed over the nineteenth and twentieth centuries.<sup>6</sup> Nonprofit hospitals have gone from being institutions that provide free basic medical attention to the terminally ill and poor, to state-of-the-art centers of innovation and education that can perform numerous procedures regardless of patients’ ultimate ability to pay.<sup>7</sup>

Stemming from their history, nonprofit hospitals should be allowed to be tax exempt institutions since they alleviate a burden from the government by providing care and serving a community benefit.<sup>8</sup> The landscape has changed for nonprofit hospitals as they try to compete for the same medical professionals, technology, and patients as their for-profit counterparts.<sup>9</sup> Nonprofit hospitals do not operate in the same manner as they once did; if they did, they would not survive in the private market—they would not be able to meet the technological and modern demands of the industry.<sup>10</sup> However, nonprofit hospitals still provide a community benefit and alleviate a government burden.<sup>11</sup> This demonstrates that nonprofit hospitals are generally not operationally constructed to make a profit.

i. Statistics Show Nonprofit Hospitals are Less Likely to Conduct Services for Profit

Nonprofit hospitals provide many societal benefits in exchange for receiving favorable tax treatment.<sup>12</sup> Currently, sixty-eight percent of Medicare beds are located in nonprofit hospitals.<sup>13</sup> Approximately

<sup>6</sup> *Id.* at 479.

<sup>7</sup> *Id.* at 465.

<sup>8</sup> Matt Nevisky, *The Value of Tax Breaks for Not-For-Profit Hospitals*, THE NAT’L BUREAU OF ECON. RESEARCH, <http://www.nber.org/digest/mar99/w6435.html> (last accessed Mar. 10, 2017).

<sup>9</sup> See *Belmar v. Cipolla*, 475 A.2d 533, 537 (N.J. 1984) (stating that “a hospital is a complex business vitally affected with a public interest”).

<sup>10</sup> *AHS Hosp. Corp.*, 28 N.J. Tax at 465.

<sup>11</sup> *Id.*

<sup>12</sup> The National Health Law Program (“NHeLP”) has put together an appendix with a checklist for nonprofit hospitals that includes suggested requirements NHeLP has identified from state legislation and ACA requirements. See William N. Gentry & John R. Penrod, *The Tax Benefits of Not-for-Profit Hospitals* (Nat’l Bureau of Econ. Research, Working Paper No. 6435, Feb. 1998), <http://www.nber.org/papers/w6435.pdf>.

<sup>13</sup> Corey Davis, *Nonprofit Hospitals and Community Benefit*, NAT’L HEALTH LAW PROGRAM ISSUE BRIEF (Jul. 2011), <http://www.healthlaw.org/issues/health-care-reform/nonprofit-hospitals-and-community-benefitpdf#.WMKoBPnys2w> (download full

seventy-seven percent of community hospitals are nonprofits.<sup>14</sup> On an aggregate basis, nonprofit hospitals received \$12.6 billion in local and state benefits in 2002 and \$24.6 billion in benefits in 2011, and these community hospitals account for fifty-one percent of the nation's hospitals.<sup>15</sup> Therefore, nonprofit hospitals have a large nationwide footprint.<sup>16</sup> Additionally, every nonprofit hospital has a mission statement, which generally puts caring for the indigent population above profit-making.<sup>17</sup> These statements of the nonprofits' ideals and operations should be taken at face value.<sup>18</sup> The mission statement, paired with meeting a percentage of charity care each year, should be sufficient for property tax exemption.<sup>19</sup>

In support of this point, an empirical study demonstrated that of the three types of hospital entities—nonprofit, for-profit, and government—for-profit hospitals have proven to make decisions based on profitability, such as offering open-heart surgery and home healthcare.<sup>20</sup> Two-thirds of the urban hospitals in the United States operate as a nonprofit, with the remainder split between for-profit and government ownership.<sup>21</sup> This indicates that the majority of nonprofit hospitals are in locations and neighborhoods where individuals with the lowest annual incomes reside.

Open-heart surgery is an example of a highly profitable service because insurance rates are high and most patients are either well-insured or receive Medicare coverage.<sup>22</sup> On the other hand, hospital-based psychiatric emergency services are generally unprofitable because these services are offered in the emergency room—a highly unprofitable department where patients who are high utilizers of these services are

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publication) (citing U.S. CONG. BUDGET OFFICE, Pub. No. 2707, *NONPROFIT HOSPITALS AND THE PROVISION OF COMMUNITY BENEFIT* 3 (2006)).

<sup>14</sup> *Id.*

<sup>15</sup> There are 5,564 hospitals in the United States and 2,845 are nonprofits. AMERICAN HOSP. ASS'N, *Fast Facts on U.S. Hospitals*, <http://www.aha.org/research/rc/stat-studies/101207fastfacts%20with%20picture%202017.pdf> (last accessed Mar. 14, 2017). See also Julia James, *Nonprofit Hospitals' Community Benefit Requirements*, HEALTH AFFAIRS (Feb. 25, 2016), [http://healthaffairs.org/healthpolicybriefs/brief\\_pdfs/healthpolicybrief\\_153.pdf](http://healthaffairs.org/healthpolicybriefs/brief_pdfs/healthpolicybrief_153.pdf) (stating that bond financing in 2002 amounted to \$12.6 million).

<sup>16</sup> Mary Crossley, *Health Reform and the Mission of Nonprofit Hospitals*, THE HEALTH CARE BLOG (Apr. 28, 2014), <http://thehealthcareblog.com/blog/2014/04/28/health-reform-and-the-mission-of-nonprofit-hospitals>.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> Jill R. Horowitz, *Making Profits and Providing Care: Comparing Nonprofit, For-Profit, and Government Hospitals*, HEALTH AFFAIRS (May 2005), <http://content.healthaffairs.org/content/24/3/790.full>.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

usually poor and sick.<sup>23</sup> Open-heart surgery and hospital-based psychiatric services represent opposite ends of the fixed spectrum, whereas acute care profitability has fluctuated greatly for decades.<sup>24</sup> Hospitals in the mid-1990s began to realize that, unlike bundled diagnosis-related group payments for acute services, post-acute care could be highly profitable by transferring a patient to post-acute care after being discharged.<sup>25</sup>

The empirical study examined the three areas discussed above by performing sensitivity tests (accounting for disparities in the cities tested) on different populations and regions to compensate for bias.<sup>26</sup> The study was intended to determine whether for-profit hospitals are more likely to engage in services that reap a higher profit.<sup>27</sup> The results disproved the original hypothesis that for-profit hospitals are unlikely to offer hospital-based emergency psychiatric services.<sup>28</sup> Rather, they are more likely to offer services like open-heart surgery and post-acute care.<sup>29</sup> In turn, the hypothesis also stated that these for-profit hospitals can charge more for these services and reap a greater profit because these services are generally more expensive.<sup>30</sup> The statistics show that nonprofit hospitals do indeed follow their mission statements and operate in a manner that is not oriented towards profit-making.<sup>31</sup>

#### *B. State Law Versus Federal Law*

Every state has constitutional powers to exempt certain entities from real property taxation, such as schools, churches, and hospitals.<sup>32</sup> A state must ensure that the language presented in a bill regarding the tax exemption of nonprofit hospitals does not violate its state constitution.<sup>33</sup>

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<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> Jill R. Horowitz, *Making Profits and Providing Care: Comparing Nonprofit, For-Profit, and Government Hospitals*, HEALTH AFFAIRS (May 2005), <http://content.healthaffairs.org/content/24/3/790.full>.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

<sup>32</sup> Every state has its own Constitutional provisions on real property tax exemption. See Elizabeth Siegal & Scott Metcalf, *Property Tax Exemptions: An Overview of State Constitutional and Statutory Provisions* (2000), [https://www.civicfed.org/sites/default/files/civicfed\\_97.pdf](https://www.civicfed.org/sites/default/files/civicfed_97.pdf) (providing a compendium of state constitutions and provisions for real property tax exemption); see also *infra* Part IV.B (discussing challenges of constitutional powers in *Carle Foundation v. Cunningham Township*).

<sup>33</sup> See Siegal & Metcalf, *supra* note 32.

Some states, such as Pennsylvania, have recently considered the possibility of amending their state constitution in order to determine which nonprofit entities will receive a tax exemption.<sup>34</sup> Nonprofit entities are more complex than ever before, and thus the creation of state constitutional amendments may be necessary to take the conjecture out of the hands of the courts.<sup>35</sup> Other than reviewing a state constitution, state revenue services also provide guidelines in their codes for qualifying for real property tax exemption.<sup>36</sup> Before passing legislation, it is important to ensure that it does not violate the state constitution, which will avoid problems (such as those in Illinois) in the future. In some circumstances, such as in Pennsylvania, amendments or a reworking of the state constitution may be necessary.

State tax exemption may alleviate an entity of personal property and real property tax burdens, whereas the federal tax exemption may provide federal benefits.<sup>37</sup> The standards for granting these benefits at the state and federal levels also differ.<sup>38</sup> States generally use a “charitable care standard,” whereas the federal government uses a “community benefit standard” to determine if an entity qualifies for section 501(c)(3) tax benefits under the Internal Revenue Code (also called the federal tax code).<sup>39</sup> Therein lies the discrepancy: states have differing powers granted to them under their constitutions and differing real property tax exemption laws—so where a nonprofit hospital may pass the federal community benefit standard, a court’s narrow interpretation of the state charitable standard may preclude a nonprofit hospital from real property tax exemption.<sup>40</sup> When discussing “tax exemption,” this Note focuses on

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<sup>34</sup> Christian Anderson, *Constitutional Amendment for Nonprofit Tax-Exemptions Passes the Pa. Senate, Goes to House*, PENN LIVE (Feb. 17, 2015), [http://www.pennlive.com/politics/index.ssf/2015/02/constitutional\\_amendment\\_for\\_n.html](http://www.pennlive.com/politics/index.ssf/2015/02/constitutional_amendment_for_n.html).

<sup>35</sup> *Id.*

<sup>36</sup> See MINN. REVENUE SERV., *Sales Tax Exemption for Nonprofit Organizations*, [http://www.revenue.state.mn.us/businesses/sut/Pages/Nonprofit\\_ES.aspx](http://www.revenue.state.mn.us/businesses/sut/Pages/Nonprofit_ES.aspx) (last accessed Mar. 10, 2017) (noting that the “who qualifies” section rules out the inclusion of hospitals, which stems from Minnesota’s state constitution).

<sup>37</sup> Edward J. Bernert & Christopher J. Swift, *The “Charity Care” Requirement for Hospital Property Tax Exemptions*, AM. BAR ASS’N, SECTION OF TAXATION 1 (May 5, 2009), <https://www.yumpu.com/en/document/view/24998053/the-charity-care-requirement-for-hospital-property-tax-exemptions>.

<sup>38</sup> *Id.*

<sup>39</sup> See James, *supra* note 15 (“Nonprofit hospitals may qualify for favored tax treatment under federal—as well as a variety of state and local income, property, and sales—tax laws.”) (discussing the shift from the “charitable care standard” to the “community benefit” standard).

<sup>40</sup> Jeremy J. Schirra, Note, *A Veil of Tax Exemption: A Proposal for the Continuation of Federal Tax-Exempt Status for “Nonprofit” Hospitals*, 21 HEALTH MATRIX 231, 233 n.11 (2011) (stating that “state governments typically grant nonprofit status with the requirements varying by state”).

state standards and real property tax exemption, unless otherwise specified.

### III. AN EVALUATION OF NEW JERSEY PROPERTY TAX EXEMPTION FOR NONPROFIT HOSPITALS

#### A. *New Jersey Exemption Statute*

When analyzing a particular state's property tax exemption, such as New Jersey, it is always prudent to first look at the statute. Under the Federal Tax Act of 1913, an institution used for hospital purposes may qualify for property tax exemption only if it is not operating for profit.<sup>41</sup> During this period in 1913, New Jersey Statutes Annotated ("N.J.S.A") Section 54:4-3.6 granted a property exemption for "hospital purposes" if no portion of the hospital has the sole function of being conducted for a profit.

The following property shall be exempt from taxation under this chapter; . . . all buildings actually used in the work of associations and corporations organized for hospital purposes, provided that if any portion of a building used for hospital purposes is leased to profit-making organizations or otherwise used for purposes which are not themselves exempt from taxation, that portion shall be subject to taxation and the remaining portion only shall be exempt . . . provided, in case of all the foregoing, the buildings, or the lands on which they stand, or the associations, corporations, or institutions using and occupying them as aforesaid, are not conducted for profit . . . the foregoing exemption shall apply only where the association, corporation, or institution claiming the exemption owns the property in question and is incorporated or organized under the laws of this State and authorized to carry out the purposes on account of which the exemption is claimed . . . .<sup>42</sup>

#### B. *New Jersey Exemption Case Law*

The central idea of New Jersey case law is that charities may not be used for the purpose of making a profit.<sup>43</sup> The most important interpretation of this statute is the New Jersey Tax Court's decision in

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<sup>41</sup> Tax Act of 1913, ch. 278, § 4, 38 Stat. 114. This act modified and replaced the General Tax Act of 1903, ch. 394, § 4, which did not define what hospital purposes would constitute nonprofit tax exemption.

<sup>42</sup> N.J. STAT. ANN. § 54:4-3.6 (West 2012).

<sup>43</sup> See *Trustees of the YMCA v. Paterson*, 39 A. 655 (N.J. 1898) (holding that the property was being used for eleemosynary purposes, to distribute charity but was not operating exclusively for a charitable purpose. See also *Cooper Hospital v. Camden*, 54 A. 419 (N.J. 1903) (holding that a charitable institution owning a tract of land is not enough for tax exemption, but the use of the land must be for a charitable purpose to qualify for tax exemption).



*Paper Mill Playhouse v. Millburn Township*.<sup>44</sup> *Paper Mill Playhouse* laid out a three-pronged test that hospitals must meet in order to be eligible for a tax exemption under Section 54:4-3.6.<sup>45</sup> The hospital property must: (1) have ownership by an entity exclusively organized for an exempt purpose; (2) be actually and exclusively used for a tax-exempt purpose; and (3) not be operated or used to conduct a profit.<sup>46</sup> Overall, the *Paper Mill Playhouse* test evaluates all components of an entity and requires a hospital to demonstrate that the operations, organization, and use of its property are not making a profit as its primary purpose.<sup>47</sup>

Additionally, in *Kimberly School v. Montclair*, the New Jersey Supreme Court held that to test tax exemption status, courts should look at the dominant motive of the organization.<sup>48</sup> *Kimberly School* involved a small private school that appeared to be operating for a charitable purpose but was actually making a profit. The court stated that to properly invoke the test, the *dominant motive* of the organization would have to be a profit-generating one.<sup>49</sup> *Kimberly School* seemingly should apply to a similarly situated entity; however, the Tax Court in *AHS Hospital Corporation v. Morristown* recently rejected this dominant motive argument, stating that this is not the way that modern courts interpret tax exemption questions regarding N.J.S.A. Section 54:4-3.6.<sup>50</sup> While the *dominant motive* test is important, it is only a sole consideration in comparison to the three-pronged test set forth in *Paper Mill Playhouse v. Millburn*.<sup>51</sup>

The *Paper Mill Playhouse* test is crucial because a clear interpretation of it could resolve many uncertainties regarding nonprofit hospital tax exemptions in New Jersey. The first prong, or “organization test,” evaluates the entity’s structure, mission statement, and certificate of incorporation, and, as seen in *AHS Hospital Corporation v. Morristown*, the test evaluates third-party operations.<sup>52</sup> In *Hunterdon*

<sup>44</sup> *Paper Mill Playhouse v. Millburn Twp.*, 472 A.2d 517, 518 (N.J. 1984) (holding that in order for a nonprofit to secure tax exemption they must meet the following elements: (1) it must be organized exclusively for the moral and mental improvement of men, women and children; (2) its property must be actually and exclusively used for the tax-exempt purpose; and (3) its operation and use of its property must not be conducted for profit).

<sup>45</sup> *Id.* at 518.

<sup>46</sup> *Id.*

<sup>47</sup> See generally *Paper Mill Playhouse*, 472 A.2d 517.

<sup>48</sup> *Kimberly School v. Montclair*, 65 A.2d 500, 505 (N.J. 1949).

<sup>49</sup> *Id.* at 505.

<sup>50</sup> *AHS Hosp. Corp. v. Town of Morristown*, 28 N.J. Tax 456, 472 (2015).

<sup>51</sup> *Id.* at 496-500 (stating that the three-pronged test in *Paper Mill Playhouse v. Millburn* is the standard, as opposed to the *Kimberly School* dominant motive test).

<sup>52</sup> *Id.* at 528. See *Planned Parenthood of Bergen County, Inc. v. Hackensack City*, 12 N.J. Tax 598, 610 n.6 (1992) (holding that the *organized exclusively* provision refers to the

*Medical Center v. Township of Readington*, the court feared that allowing nonprofit hospitals to create elusive models would enable the nonprofit hospitals to self-define their mission, and in doing so, to determine the direction and extent of the definition of “hospital purposes” without limitation.<sup>53</sup> “Hospital purposes” includes any medical services patients require during their pre-admission, hospital stay, and post-admission.<sup>54</sup> The second prong, or “use test,” analyzes how the hospital uses its surrounding property and each section of its property.<sup>55</sup> The third prong is considered the “profit test.”<sup>56</sup> The “profit test” requires a pragmatic inquiry into profitability and a realistic common sense analysis of the actual operation of the taxpayer.<sup>57</sup> Under the “profit test,” mechanical centering on income and expenses of hospitals is to be avoided.<sup>58</sup> The New Jersey Supreme Court recognized in *International Schools, Inc. v. West Windsor Township* that the use and profit tests must be addressed in tandem.<sup>59</sup> The court in the case set forth in the next section, *AHS Hospital Corporation d/b/a Morristown Memorial Hospital v. Town of Morristown*, applied the three-pronged *Paper Mill Playhouse* test.<sup>60</sup>

*C. AHS Hospital Corporation d/b/a Morristown Memorial Hospital v. Town of Morristown*

*AHS Hospital Corporation v. Town of Morristown* is the case that brought New Jersey into the national spotlight for its nonprofit hospital tax exemption. In *AHS Hospital Corporation*, the Tax Court stripped Morristown Memorial Hospital (hereinafter “Morristown Memorial”) of its real property tax exemption.<sup>61</sup> This decision crowned the Township of Morristown the winner of an over five-year legal battle.<sup>62</sup> Judge Vito Bianco wrote a very detailed eighty-eight page opinion that applied the

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conduct of an organization and how it is actually run).

<sup>53</sup> *Hunterdon Med. Ctr. v. Twp. of Readington*, 918 A.2d 675, 679 (Super. Ct. App. Div. 2007).

<sup>54</sup> *Hunterdon Med. Ctr. v. Twp. of Readington*, 951 A.2d 931, 934 n.1 (N.J. 2008).

<sup>55</sup> *City of Long Branch v. Monmouth Medical Ctr.*, 351 A.2d 756, 764 (App. Div. 1976).

<sup>56</sup> *Paper Mill Playhouse*, 472 A.2d 517, 526.

<sup>57</sup> *Id.*

<sup>58</sup> *Id.*

<sup>59</sup> *AHS Hosp. Corp.*, 28 N.J. Tax at 499 (citing *International Schools, Inc. v. West Windsor Twp.*, 24 N.J. Tax 453, 455 (2009)).

<sup>60</sup> *Id.*

<sup>61</sup> *AHS Hosp. Corp.*, 28 N.J. Tax at 536 (“Clearly, the operation and function of modern non-profit hospitals do not meet the current criteria for property tax exemption under *N.J.S.A.* 54:4-3.6 and the applicable case law.”).

<sup>62</sup> See *AHS Hospital Corp. v. Town of Morristown*, 25 N.J. Tax 374, 469 (2010) (granting partial summary judgment in favor of Morristown, finding that the leased spaces in the Carol G. Simon Cancer Center, the Goryeb Children’s Hospital, and Au Bon Pain Café were operated for-profit during the tax years at issue).

aforementioned New Jersey law, perhaps suspecting that the opinion would not be well-received.<sup>63</sup> He prefaced his reasoning by stating that his decision “must *not* succumb to emotion, but rather, it must be based on the sufficiency of the evidence and sound legal reasoning.”<sup>64</sup>

Judge Bianco’s decision is not based on the comprehensive mission and operation of the hospital as one unit, but instead breaks down the hospital into each working part.<sup>65</sup> Despite Judge Bianco’s thorough analysis of Morristown Memorial’s inner-workings, some critics have expressed concern with Judge Bianco’s “under the hood” approach of microscopically analyzing the hospital’s nuts and bolts.<sup>66</sup> These same critics argue that the case’s holding threatens the overall mission of nonprofit hospitals.<sup>67</sup>

Judge Bianco dissects Morristown Memorial by analyzing the following components individually: (1) relationships with private for-profit physicians; (2) relationships with affiliated and non-affiliated for-profit entities; (3) executive salaries; (4) employed physicians’ contracts; (5) third-party agreements; (6) the gift shop; and (7) the auditorium, day care, fitness center, and cafeteria.<sup>68</sup> The Tax Court found that during 2006, 2007, and 2008, there were 1,200 private physicians that were granted privileges to the hospital, and these private physicians admitted approximately eighty-three percent of the patients who were admitted to the hospital.<sup>69</sup> Under the test in *International Schools v. West Windsor Township*, a tax-exempt organization can be used for exempt and non-exempt purposes, “so long as those purposes can be separately stated and accounted for and so long as the non-exempt use is never subject to the property exemption.”<sup>70</sup> Furthermore, the for-profit activities must be “evident, readily ascertainable, and separately accountable for taxing purposes,” and property exemptions may be denied where there is substantial comingling of for-profit and nonprofit activities.<sup>71</sup> In

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<sup>63</sup> *AHS Hosp. Corp.*, 28 N.J. Tax at 466.

<sup>64</sup> *Id.*

<sup>65</sup> See generally *AHS Hosp. Corp.*, 28 N.J. Tax at 525-535 (Section B of the opinion analyzes contracts and separate functions and transactions of Morristown Memorial Hospital.).

<sup>66</sup> Jacob Batchelor, *3 Takeaways from Hospital Tax Exemption Ruling*, LAW360 (July 7, 2015), <http://www.law360.com/articles/675747/3-takeaways-from-hospital-tax-exemption-ruling>.

<sup>67</sup> *Id.*

<sup>68</sup> *AHS Hosp. Corp.*, 28 N.J. Tax at 500-36.

<sup>69</sup> Kathy Butler Polvino et. al., *New Jersey Tax Court Eliminates Nonprofit Hospital’s Property Tax Exemption*, (July 31, 2015), <http://www.healthlawupdate.com/2015/07/new-jersey-tax-court-eliminates-non-profit-hospitals-property-tax-exemption/>.

<sup>70</sup> *AHS Hosp. Corp.*, 28 N.J. Tax at 500.

<sup>71</sup> *Id.*

*International Schools*, Judge Bianco found that the activities of for-profit physicians could not be isolated for taxation purposes.<sup>72</sup> However, in practice it is almost impossible to isolate for-profit physicians in one part of the hospital. Likewise, in the medical landscape of 2015, it is almost impossible for nonprofit hospitals to operate without for-profit physicians.

Over eighty pages into the decision, Judge Bianco sent a blazing warning to New Jersey nonprofit hospitals by stating:

If it is true that *all* nonprofit hospitals operate like the hospital in this case, as was the testimony here, then for purposes of the property tax exemption, modern nonprofit hospitals are essentially *legal fictions*; and it is long established that “fictions arise from the law and not from fictions.”<sup>73</sup>

Judge Bianco’s statement demonstrates the consistency between the Court’s holding and both the plain language of New Jersey’s common law and current statutes. He validated this point by referencing a need for state legislation to address the ever-changing position of nonprofit hospitals, explaining that “it is a function of the Legislature, not the courts, to promulgate what the terms and conditions will be.”<sup>74</sup> The New Jersey Legislature responded to Judge Bianco’s provocation by drafting a bill that would compensate municipalities while providing fiscal predictability for nonprofit hospitals.

#### *D. The Hospital Contribution Fee Bill*

New Jersey legislators responded to *AHS Hospital Corporation v. Town of Morristown* by introducing a bill (S.B. 3299 & A.B. 4903) on December 14, 2015 that would have required nonprofit tax-exempt hospitals, such as Morristown Memorial, to pay a community benefit contribution—known as a hospital service contribution.<sup>75</sup> The purpose of a hospital service contribution is to compensate municipalities where a nonprofit hospital employs—or allows its tax-exempt property to be used by—for-profit physicians for profitable activities.<sup>76</sup> The Bill was aimed at preventing litigation brought by municipalities against nonprofit hospitals in their jurisdiction.<sup>77</sup> The hospital service contribution provides municipalities with a formula that gives predictability to funding

<sup>72</sup> *Id.* at 501.

<sup>73</sup> *Id.* at 536.

<sup>74</sup> *Id.*

<sup>75</sup> S.B. 3299, 216<sup>th</sup> Gen. Assemb., Reg. Sess. (N.J. 2015); A.B. 4903, 216<sup>th</sup> Leg., Reg. Sess. (N.J. 2015).

<sup>76</sup> S.B. 3299, 216<sup>th</sup> Gen. Assemb., Reg. Sess. (N.J. 2015).

<sup>77</sup> Susan K. Livio, *N.J. Nonprofit Hospital ‘Tax’ Wins Final Legislative Approval*, NJ.COM (Jan. 11, 2016), [http://www.nj.com/politics/index.ssf/2016/01/nonprofit\\_hospital\\_tax\\_wins\\_final\\_legislative\\_appr.html](http://www.nj.com/politics/index.ssf/2016/01/nonprofit_hospital_tax_wins_final_legislative_appr.html).

and budgeting.<sup>78</sup>

The New Jersey bill provides solutions that could serve as an example for other states that are searching for ways to avoid long and expensive litigation.<sup>79</sup> Specifically, the hospital contribution fee amends N.J.S.A. Section 54:4-3.6, calling for a daily fee of \$2.50 per bed.<sup>80</sup> Accordingly, Morristown Memorial would pay approximately \$1,750 per day for its 700 beds, totaling \$638,740 for the year.<sup>81</sup> Furthermore, each hospital bed at a satellite emergency care facility would pay \$250 per day.<sup>82</sup> To cover inflation, the fees are set to rise two percent annually.<sup>83</sup> The New Jersey bill does many things that other state governments across the country could mimic to allow them to find a compromise between modern nonprofit hospitals and the localities in which they are located.<sup>84</sup>

First, the New Jersey Hospital Service Contribution Fee Bill does not require nonprofit hospitals to pay full property taxes, but rather a fixed fee per bed (\$2.50 daily per bed and \$250 daily per satellite emergency facility).<sup>85</sup> This is beneficial because it allows municipalities and hospitals alike to know how much they will pay out or receive annually in fees and income.<sup>86</sup> Likewise, the fee is not so dramatic as to financially hinder nonprofits in a manner that would force them to cut resources, layoff staff, or even close the hospital.<sup>87</sup> Presenting nonprofit hospitals with significant tax bills is a fear of many legislators, hospital workers, and the communities that rely on hospitals' quality and community care.<sup>88</sup> For example, when drafting the New Jersey bill, Morristown Memorial was referred to as an "economic engine that employs approximately 140,000 workers."<sup>89</sup>

Second, approximately eighty-five percent of New Jersey's hospitals are nonprofit and property tax exempt; however, nonprofit hospitals use community resources, such as the local police, fire, and

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<sup>78</sup> *Id.*

<sup>79</sup> S.B. 3299, 216<sup>th</sup> Gen. Assemb., Reg. Sess. (N.J. 2015).

<sup>80</sup> *Id.*

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

<sup>83</sup> *Id.*

<sup>84</sup> *Id.*

<sup>85</sup> Emily Rappleye, *NJ Bill Approved to 'Tax' Nonprofit Hospitals: 5 Things to Know*, BECKER HOSP. REV. (Jan. 12, 2016), <http://www.beckershospitalreview.com/finance/nj-bill-approved-to-tax-nonprofit-hospitals-5-things-to-know.html>.

<sup>86</sup> *Id.*

<sup>87</sup> Sen. Robert Ocean, *Singer Hospital Community Payment Bill Advances* (Dec. 21, 2015), <http://www.senatenj.com/index.php/singer/singer-hospital-community-payment-bill-advances/24981>.

<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

other public services.<sup>90</sup> The hospital service contribution fee allows these public utilities to knowingly measure the amount of services provided in comparison with the fixed fees paid by a hospital, such as Morristown Memorial.<sup>91</sup> Over time, analytics can be utilized to show gains or losses for the hospital contributions.

On January 11, 2016 the Bill arrived on New Jersey Governor Chris Christie's desk for approval.<sup>92</sup> At the end of the legislative session, on January, 19, 2016, Governor Christie made the decision to reject the pending Hospital Contribution Fee Bill by using his constitutional power of silence to pocket veto the Bill.<sup>93</sup> The main parties to this legislation in New Jersey include the Governor's Office, Department of Community Affairs, Department of Taxation, the New Jersey Hospital Association, League of Municipalities, and the Attorney General's Office.<sup>94</sup> Moreover, Governor Christie has placed a moratorium until 2018 on all litigation commenced by municipalities against nonprofit hospitals; therefore, Governor Christie's pocket veto should not be construed as an objection to the protection of nonprofit hospitals.<sup>95</sup> Currently, there are fifteen pending suits that have been affected by the moratorium.<sup>96</sup>

#### *E. So, Now What? The Future of the Hospital Contribution Fee*

Some lawmakers argue that changing a system overnight is never effective.<sup>97</sup> For example, New Jersey Spokeswomen Joelle Farrell addressed the New Jersey bill after Governor Christie's pocket veto, and stated that "[h]aving the Legislature pass more than 100 bills in such a hasty and scrambled way, praying for them to be rubber stamped, is never a good formula for effectively doing public business."<sup>98</sup> Farrell raises a very important point—that a well-thought out system would be a

<sup>90</sup> Rappleye, *supra* note 85, at 2.

<sup>91</sup> Rappleye, *supra* note 85, at 2.

<sup>92</sup> Livio, *supra* note 77, at 1.

<sup>93</sup> Susan K. Livio, *Christie Rejects Requiring Nonprofit Hospitals to Pay 'Taxes'*, NJ.COM (Jan. 19, 2016), [http://www.nj.com/politics/index.ssf/2016/01/nonprofit\\_hospital\\_tax.html](http://www.nj.com/politics/index.ssf/2016/01/nonprofit_hospital_tax.html).

<sup>94</sup> Beth Jones Sanborn, *NJ Governor Chris Christie Vetoes Bill to Tax Nonprofit Hospitals*, HEALTH IT NEWS (Jan. 20, 2016), <http://www.govhealthit.com/news/nj-governor-chris-christie-vetoes-bill-tax-nonprofit-hospitals>.

<sup>95</sup> Ruth McCambridge, *Christie Would "Freeze" Suits Against Nonprofit Hospitals*, NONPROFIT QUARTERLY (Mar. 21, 2016), <https://nonprofitquarterly.org/2016/03/21/christies-bill-would-freeze-legal-challenges-to-tax-exemptions-of-nj-nonprofit-hospitals/>.

<sup>96</sup> *Id.*

<sup>97</sup> Michael Booth, *Will Veto Spark Litigation over Nonprofit Hospitals' Tax Status?*, N.J. L.J. (Jan. 22, 2016), <http://www.njlawjournal.com/id=1202747728347/Will-Veto-Spark-Litigation-Over-Nonprofit-Hospitals-Tax-Status?slreturn=20170210092744>.

<sup>98</sup> *Id.*

compromise between hospitals and municipalities, which safeguards against potential state constitutional issues.<sup>99</sup> Moreover, now is the time to address these concerns and lay out legislation. If action is not taken now, then when is the proper time: how many nonprofit hospitals need to be sued before implementing legislation? However, the concern regarding hasty decisions, as raised by the New Jersey Hospital Contribution Fee Bill, should be addressed.<sup>100</sup>

Another concern regarding the New Jersey Hospital Contribution Fee Bill is that the amount proposed would not be enough to compensate municipalities.<sup>101</sup> Some municipalities expressed that charging \$2.50 daily per bed is insufficient.<sup>102</sup> In regards to hastiness, the opposition of the Bill is in “fact-finding” mode where municipalities are skeptically digging into the operations of the nonprofit hospitals to assess whether the contribution fee would end up short-changing the municipalities.<sup>103</sup> Regardless, both sides of the Bill agree that they do not want to impose fees so hefty that they would put the hospitals out of business.<sup>104</sup> Rather, they want to create a methodology where both parties—the hospitals and local governments—feel comfortable with the fee and how legislators arrived at that number.<sup>105</sup>

A final concern is the administrative difficulties imposed by legislation, such as the Hospital Contribution Fee Bill. The Internal Revenue Service (“IRS”) conducted a study regarding the nonprofit hospital tax exemption in 2006 and published its final report in 2009.<sup>106</sup> The report analyzed the survey responses of more than five hundred nonprofit hospitals.<sup>107</sup> The survey was designed to assess whether a hospital is exempt or taxable in accordance with the community benefit standard, requesting information, such as the hospitals’ patient mix, emergency room, board of directors, medical staff privileges, community programs, professional education and training, medical research, and uncompensated care.<sup>108</sup> The primary problem with making a

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<sup>99</sup> *Id.*

<sup>100</sup> *Id.*

<sup>101</sup> Linda Washburn, *Christie Veto Leaves Hospitals Open to Lawsuits over Property Taxes*, NORTHJERSEY.COM (Jan. 20, 2016), <http://www.northjersey.com/news/nj-state-news/veto-leaves-hospitals-open-to-lawsuits-1.1495249>.

<sup>102</sup> *Id.*

<sup>103</sup> *Id.*

<sup>104</sup> *Id.*

<sup>105</sup> *Id.*

<sup>106</sup> I.R.S., IRS EXEMPT ORGANIZATIONS HOSPITAL STUDY EXECUTIVE SUMMARY OF FINAL REPORT (Feb. 2009), [http://www.lawrenceassociates.com/pdfs/IRS%20Exempt%20Orgs%20Hospital%20Study%20Exec%20Summ%20\(Feb%202008\).pdf](http://www.lawrenceassociates.com/pdfs/IRS%20Exempt%20Orgs%20Hospital%20Study%20Exec%20Summ%20(Feb%202008).pdf).

<sup>107</sup> *Id.*

<sup>108</sup> *Id.*

determination regarding the effectiveness of the community benefits in nonprofit hospitals is the administrative procedures and their accuracy.<sup>109</sup>

However, the hospital contribution fee proposed by New Jersey is reflective of what needs to be enacted to create clarity for our currently vulnerable nonprofit hospitals who, in any given period, can be challenged by their local governments for real property taxes. The first upside to the Hospital Contribution Fee Bill is that it removes the uncertainty hospitals face in their tax treatment.<sup>110</sup> Moreover, the hospital contribution fee will fluctuate by the size of the hospital because it is determined by the number of beds on site; therefore, it is not a fixed rate that would affect small and large hospitals in the same way.<sup>111</sup>

Nonprofit hospitals do not have shareholders.<sup>112</sup> Nonprofits are generally run by a board of community volunteers who determine the budget, including the amount of money retained for operations, the amount of money retained on reserve, the amount of money that should go to support local municipalities (i.e., supporting local police and fire houses), and what should be included in such support.<sup>113</sup> A recent study showed that New Jersey's nonprofit hospitals contribute more than \$2.4 billion annually on community benefits.<sup>114</sup> Furthermore, nonprofit hospitals employ a large portion of the community. The same study showed New Jersey nonprofit hospitals employ nearly 144,000 people—that is 144,000 people in the workforce who then pay taxes and whose wages are spent throughout their communities.<sup>115</sup> A hospital contribution fee, such as the one proposed in New Jersey, balances the need to avoid placing undue financial burdens on hospitals with the need to reimburse

<sup>109</sup> *Id.* at 4 (“Both the community benefit and reasonable compensation standards have proved difficult for the IRS to administer. Both involve application of imprecise legal standards to complex, varied and evolving fact patterns. Some have suggested that these standards need to be revised. As these discussions occur, and despite the limitations described above, the study provides important information.”).

<sup>110</sup> See Linda Stamato, *Tax Law and Policy: A Shifting Landscape for Not-for-Profits*, NJ.COM (Sept. 15, 2016), [http://www.nj.com/opinion/index.ssf/2015/09/tax\\_law\\_and\\_policy\\_a\\_shifting\\_landscape\\_for\\_not-fo.html](http://www.nj.com/opinion/index.ssf/2015/09/tax_law_and_policy_a_shifting_landscape_for_not-fo.html). (“Congress may need to close obvious loopholes in law, moreover, to provide a clear avenue for enhanced IRS enforcement.”).

<sup>111</sup> See S.B. 3299, 216th Gen. Assemb., Reg. Sess. (N.J. 2015) (noting that the fee is \$2.50 a day for each licensed bed).

<sup>112</sup> JOHN F. HORTY & DANIEL M. MULHOLLAND III, *Legal Differences Between Investor-Owned and Nonprofit Health Care Institutions*, in INSTITUTE OF MEDICINE 17 (1983), [https://www.ncbi.nlm.nih.gov/books/NBK216761/pdf/Bookshelf\\_NBK216761.pdf](https://www.ncbi.nlm.nih.gov/books/NBK216761/pdf/Bookshelf_NBK216761.pdf).

<sup>113</sup> Jane Masaoka, *Boards of All-Volunteer Organizations*, BLUE AVOCADO, <http://www.blueavocado.org/content/boards-all-volunteer-organizations> (last accessed Mar. 10, 2017).

<sup>114</sup> N.J. HOSP. ASS'N, *Why We Support Community Contribution Fee for Hospitals* (Jan. 11, 2016), <http://www.njha.com/posts/2016/why-we-support-community-contribution-fee-for-hospitals>.

<sup>115</sup> *Id.*



municipalities for services provided to nonprofit hospitals.

#### IV. ILLINOIS

##### *A. Provena Covenant Medical Center v. Department of Revenue*

In 2010, the Illinois Supreme Court, in *Provena Covenant Medical Center v. Department of Revenue*, upheld a decision to remove the property tax exemption of Provena Covenant Hospital in Urbana, Illinois.<sup>116</sup> The Illinois Supreme Court took a different approach than the New Jersey Tax Court in *AHS Hospital Corporation* because the Illinois Supreme Court did not break down each individual operation at Provena Covenant Medical Center.<sup>117</sup> Rather, the *Provena* court strictly applied the Illinois Property Tax Code Sections 15-65 and 15-86, which focus on whether a nonprofit hospital meets the definitions of “charity care” and “institution of public charity.”<sup>118</sup> “Charity care” includes the number of uninsured patients who receive free or discounted care.<sup>119</sup> The total amount of Provena’s revenue from providing healthcare services was 0.7%, or 302 out of 110,000 patients, and was found to be *de minimus* in comparison with the hospital’s total revenue.<sup>120</sup> Moreover, Medicare and Medicaid losses were removed from the definition of “charity care” because opting into Medicare and Medicaid provides an additional revenue stream for hospitals.<sup>121</sup> The court also did not consider bad debts and unfavorable business decisions in determining whether Provena met the definition of “charity care.”<sup>122</sup>

The Illinois Supreme Court applied the factors noted in *Methodist Old Peoples Home v. Korzen*, which examines whether a charitable institution (1) lacks capital, stock, or shareholders; (2) does not earn profits or dividends but engages in private and public charity; (3) allocates charitable benefits to all those who need and apply for it; (4) does not generate a private gain or profit to any person connected with the institution; and (5) does not appear to place obstacles or undue burdens in the way of those who need and avail themselves of the

<sup>116</sup> *Provena Covenant Med. Ctr. v. Dep’t of Revenue*, 925 N.E.2d. 1131, 1136 (Ill. 2010).

<sup>117</sup> *Id.*

<sup>118</sup> *Id.* at 1139.

<sup>119</sup> *Charity Care*, WIKIPEDIA, [https://en.wikipedia.org/wiki/Charity\\_care](https://en.wikipedia.org/wiki/Charity_care) (last accessed Mar. 10, 2017).

<sup>120</sup> *Provena*, 925 N.E.2d. at 1150.

<sup>121</sup> *Id.* at 1138.

<sup>122</sup> *Id.*; see also Mark Roller, *Tax Exemption Challenges Facing Hospitals*, LINKEDIN, <https://www.linkedin.com/pulse/tax-exemption-challenges-facing-nonprofit-hospitals-mark-roller> (last accessed Mar. 6, 2017) (detailing the shortcomings of Schedule H for Medicare under the community benefit standard).

charitable benefits the institution offers.<sup>123</sup> The second factor requires that the charitable benefits provided by the hospital help “relieve the burdens on the government.”<sup>124</sup> Relief of the government’s burden justifies the reward of property tax exemption for the hospital.<sup>125</sup> Illinois, like New Jersey, does not require a dollar-for-dollar correlation between the amount spent on charity care and tax exemptions; however, there is a *sine qua non* that a hospital must demonstrate.<sup>126</sup> The nonprofit hospital must show that it alleviated some local government burden by providing charity care.<sup>127</sup>

Similar to events in New Jersey after the *AHS Hospital Corporation* decision, the Illinois legislature was prompted to pass a law in 2012, which made nonprofit hospitals permanently tax exempt by establishing minimal financial standards for providing community benefits to qualify for exemptions.<sup>128</sup> The law essentially gives all hospitals, both for-profit and nonprofit, the opportunity to acquire a tax break based on the charity they provide.<sup>129</sup> Nonprofit hospitals are expected to provide charitable

<sup>123</sup> *Methodist Old Peoples Home v. Korzen*, 233 N.E.2d 537, 541-42 (Ill. 1968); *Provena*, 925 N.E.2d. at 1145.

<sup>124</sup> *Provena*, 925 N.E.2d. at 1145.

<sup>125</sup> Patrick Manders, *Problems and Developments in the Tax-Exemption of Health Care Providers*, 4 HEALTH L. & POL’Y 9 (Jan. 7, 2014), <http://digitalcommons.wcl.american.edu/cgi/viewcontent.cgi?article=1125&context=hlp>.

<sup>126</sup> *Provena*, 925 N.E.2d. at 1145. But see Salvatore Risso & Nicholas Pugliese, *Christie Unveils \$35.5 Billion State Budget Plan, His Last* (Feb. 28, 2017), <http://www.northjersey.com/story/news/new-jersey/2017/02/28/christie-unveils-355-billion-state-budget-his-last/98531222/> (stating that it would be a change for the government to match charity care dollar-for-dollar).

<sup>127</sup> *Provena*, 925 N.E.2d. at 1145 (applying within the criteria of charity as “a gift to be applied \*\*\* for the benefit of an indefinite number of persons, persuading them to an educational or religious conviction, for their general welfare—or in some way reducing the burdens of government”).

<sup>128</sup> See AMEND. S.B. 2194, 97th Gen. Assemb. (Ill. 2012). The bill was signed by former Illinois Governor Patrick Quinn in response to the *Provena* ruling to address a standard and place a “dollar amount” on the criteria for nonprofit tax exemption. The bill established that Illinois nonprofit hospitals may qualify for property tax exemption if the value of certain “qualified services or activities” that the nonprofit hospital provides is equal to or exceeds the estimated value of the hospital’s property tax liability. *Id.*; see also AMEND. S.B. 3261, 97th Gen. Assemb. (Ill. 2012) (increasing requirements for hospitals to provide charity care to uninsured persons for medically necessary treatment).

<sup>129</sup> See AMEND. S.B. 2194, 97th Gen. Assemb. (Ill. 2012) (noting that according to S.B. 2194, hospitals that are not exempt under the federal income tax code may receive a credit against state income taxes equal to the lesser of: (a) the amount of property taxes paid on real property used for hospital purposes, or (b) the cost of free or discounted services provided pursuant to the hospital financial assistance policy, measured at cost). See also AMEND. S.B. 3261, 97th Gen. Assemb. (Ill. 2012) (noting that according to S.B. 3261, hospital charity care obligations are strengthened by requiring hospitals to provide a charitable discount of 100% of its charges for all medically necessary health care services exceeding \$300 to uninsured individuals that apply for such a discount and who have a family income of not more than

care in an amount equal to the property tax they would have had to pay.<sup>130</sup> Likewise, for-profit hospitals are given a tax credit for the charitable care they provide.<sup>131</sup>

If a hospital is not tax exempt through the federal tax code, it still may receive tax credits equal to the lesser of the local property taxes paid on real property used for hospital purposes or the total cost of free or qualified charitable services or activities provided.<sup>132</sup> The property tax exemption and tax credit is available through “qualified services or activities.”<sup>133</sup> In assessing the amount of “qualified services or activities,” the hospital may choose to use one of the following annual calculations: “(1) the value of the services or activities for the hospital year; or (2) the average value of those services or activities for the three fiscal years ending with the hospital year.”<sup>134</sup>

The Illinois law requires hospitals to keep a record of the charity care provided through the hospital’s discount program or various discounts provided under the Hospital Uninsured Patient Discount Act.<sup>135</sup> Health services provided to low-income or indigent individuals are included if the hospital provides or reimburses the physicians, clinics, or programs that service these populations.<sup>136</sup> Moreover, hospitals may choose to financially support or subsidize unaffiliated hospitals, affiliated hospitals, community clinics, or educational services for needy

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200% of the federal poverty guidelines (not more than 125% of the federal poverty guidelines for rural and critical access hospitals)).

<sup>130</sup> Lisa Schencker, *Should Illinois Hospitals Have to Pay Property Taxes? Court Will Weigh Question*, CHI. TRIB. (Jan. 8, 2017), <http://www.chicagotribune.com/business/ct-hospital-tax-exemptions-0108-biz-20170106-story.html> (stating that “an Illinois not-for-profit hospital can be considered tax-exempt if the value of its charitable services is equal to or greater than its estimated tax liability”).

<sup>131</sup> Nonprofit Blogger, *Illinois Enacts Hospital Property Tax Exemption Standards*, LAW PROFESSOR BLOGS NETWORK (June 4, 2012), <http://lawprofessors.typepad.com/nonprofit/2012/06/illinois-enacts-hospital-property-tax-exemption-standards.html>.

<sup>132</sup> AMEND. S.B. 2194, 97th Gen. Assemb. (Ill. 2012).

<sup>133</sup> *Id.*

<sup>134</sup> Jordan M. Goodman, *New Legislation Seeks to Clarify Property Tax Exemption for Nonprofit Health Care Institutions*, 23 J. MULTISTATE TAX AND INCENTIVES 6 (Sept. 2013), <http://www.hmblaw.com/media/77954/goodman-illlegisrehospitalpptytaxexempt-sept2013jmt-copyforweb.pdf>.

<sup>135</sup> Hospital Uninsured Patient Discount Act, 210 ILL. COMP. STAT. ANN. 89/1 (LexisNexis 2016).

<sup>136</sup> See Memorandum from the Ill. Hosp. Ass’n to Chief Exec. Officers, Member Hosps. & Health Sys. et al. (June 10, 2008), <http://web.law.columbia.edu/sites/default/files/microsites/attorneys-general/files/Illinois%20Hospital%20Association's%20memorandum%20on%20the%20new%20legislation.pdf> (providing a summary of discounts under the bill and stating which “[c]harges are to be discounted to 135% of cost. In addition, a hospital will not be able to collect more than 25% of an uninsured patient’s family’s gross income (‘the cap’) in any one-year period.”).

populations.<sup>137</sup> Hospitals may also add direct or indirect financial support or subsidies to state or local governments.<sup>138</sup> Subsidies provided for support of state healthcare programs are calculated at the beginning of each applicable year by choosing either (1) ten percent of the payments to the hospital entity or any of the hospital's affiliates for Medicaid or other programs, such as the State Children's Health Insurance Program ("SCHIP"), or (2) the amount of subsidy granted to the state or local government Medicaid recipients as calculated in Schedule H of IRS Form 990.<sup>139</sup>

The Illinois legislature allows hospitals to include unreimbursed services that relieve the burden of the local government in the formula for "qualified services or activities" so long as these services are not accounted for in another category of the hospital's calculation.<sup>140</sup> These services include, but are not limited to, providing emergency care, neonatal, trauma, burn, rehabilitation, or other special services.<sup>141</sup> The portion of reimbursed costs for low-income individuals is calculated in a ratio that divides the costs attributable to "charitable care" by the hospital's annual total costs.<sup>142</sup> For emergency services, the ratio will use gross charges multiplied by the cost to charge ratio.<sup>143</sup>

Furthermore, in Illinois, the purpose of Illinois Property Tax Code Section 15-86 is to add onto the provision in Section 15-65, which states, "All property of the following is exempt when actually and exclusively used for charitable or beneficent purposes, and not leased or otherwise used with a view to profit . . . ."<sup>144</sup> In order to dissipate any confusion or uncertainty for nonprofit hospitals and municipalities as to whether they meet a "charitable or beneficent purpose," the legislation established a "quantifiable standard for the issuance of charitable considerations of exemptions for such property," especially in regards to a quantitative or monetary threshold.<sup>145</sup>

Section 15-86 does not have ownership requirements, such as being an "institute of public charity," to qualify for a charitable exemption.<sup>146</sup>

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<sup>137</sup> 35 ILL. COMP. STAT. ANN. 200/15-86 (LexisNexis 2016).

<sup>138</sup> *Id.*

<sup>139</sup> *Id.*

<sup>140</sup> *Id.* (stating, in Section (b), that a "hospital owner or hospital affiliate satisfies the conditions for an exemption under this Section if the value of qualified services or activities . . .").

<sup>141</sup> *Id.*

<sup>142</sup> *Id.*

<sup>143</sup> 35 ILL. COMP. STAT. ANN. 200/15-86 (LexisNexis 2016).

<sup>144</sup> 35 ILL. COMP. STAT. 200/15-65 (LexisNexis 2016).

<sup>145</sup> *Carle Found. v. Cunningham Twp.*, 45 N.E.3d 1173, 1183 (Ill. 2016).

<sup>146</sup> 35 ILL. COMP. STAT. ANN. 200/15-86 (LexisNexis 2016).

The only requirement of Section 15-86 is that the property be used “exclusively for charitable purposes.”<sup>147</sup> Section 15-65 also requires charitable ownership.<sup>148</sup> Section 15-86(c) demonstrates the legislature’s intent in creating section 15-86:

A hospital applicant satisfies the conditions for an exemption under this Section with respect to the subject property, and shall be issued a charitable exemption for that property, if the value of services or activities listed in subsection (e) for the hospital year exceeds the relevant hospital entity’s estimated property tax liability, as determined under subsection (g) for the year which exemption is sought.<sup>149</sup>

In other words, the legislation contemplates contributing “services and activities” as charitable exemptions.<sup>150</sup> The exemption contribution comes about in two forms: (1) the *actual dollar* amount used to provide for the healthcare needs of low-income or underserved individuals and which alleviates a burden of the government; and (2) the *estimated amount* that a hospital would owe in property tax liability in the given year.<sup>151</sup>

Overall, Section 15-86 aims to clarify the real property tax exemption of nonprofit hospitals by allowing all qualified hospitals to obtain property tax exemption based on charitable purpose and annual contribution regardless of ownership.<sup>152</sup> This is a necessary provision for the Illinois legislation that resulted from the *Provena* case because it gets hospitals, regardless of ownership, over the initial burden of proving their charitable mission when challenged.

#### *B. Carle Foundation Hospital v. Cunningham Township*

After the Illinois legislature waded through the muddy waters of the nonprofit hospital real property tax exemption and the definition of “charitable purpose,” nonprofit hospitals hit another wall.<sup>153</sup> On January

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<sup>147</sup> *Id.*

<sup>148</sup> *Id.*

<sup>149</sup> *Id.*

<sup>150</sup> *Id.*

<sup>151</sup> *Carle Found.*, 45 N.E.3d at 1184.

<sup>152</sup> *Id.*

<sup>153</sup> *See id.* at 1199 (finding that Section 15-86 is unconstitutionality premised on language in the Constitution of the State of Illinois requiring that the “exclusive” use of property be for charitable purposes in order for a property tax exemption to be granted); *see also* Ares G. Dalianis & Scott R. Metcalf, *Additional Analysis of Illinois Appellate Court Decision Finding Hospital Property Tax Exemption Unconstitutional*, FRANCZEK RADELET ATTORNEYS & COUNSELORS, [http://www.franczek.com/frontcenter-Additional\\_Analysis\\_Illinois.html](http://www.franczek.com/frontcenter-Additional_Analysis_Illinois.html) (last accessed Mar. 7, 2017) (“Article IX, Section 6 of the Constitution states that the General Assembly may provide an exemption from taxation only for “property used exclusively for . . . charitable purposes.”). According to the Court, Section 15-86 contains no such limitation on eligibility for the hospital exemption, and a hospital not used exclusively for

5, 2016, the Illinois Fourth District Appeals Court decided *Carle Foundation v. Cunningham Township*, holding Section 15-86 of the Illinois Tax Code unconstitutional.<sup>154</sup>

The Illinois Appeals Court held that Section 15-86 was facially unconstitutional on the grounds that it grants a charitable exemption on the basis of unconstitutional criteria, in violation of the Illinois Constitution.<sup>155</sup> The *Carle Foundation* decision stated that Section 15-86 aims to give hospitals a charitable tax exemption for providing “services or subsidies equal in value to the estimated property tax liability, without requiring the subject property to be used exclusively for charitable purposes.”<sup>156</sup>

Article IX, Section 6, of the Illinois Constitution allows an exemption of property taxes to be granted to “units of local government and school districts and properties *used exclusively* for agricultural and horticultural societies.”<sup>157</sup> The Illinois Constitution also carves out exemptions for schools, religion, cemeteries, and other charitable purposes.<sup>158</sup> The *Carle Foundation* court looked closely at the language “used exclusively,” and stated Section 15-86 exceeds the scope of the Illinois Constitution, not only because nonprofit hospitals are not used exclusively for charitable purposes, but because Section 15-86 broadens the authority given to the State to exempt hospitals.<sup>159</sup>

The *Carle Foundation* decision suggested that Section 15-86 settles for much less than *exclusive use* by not requiring the property to be used for a charitable use at all.<sup>160</sup> The Illinois Appellate Court suggested the legislature use language, such as, “*even though* property is used exclusively for charitable purposes,” because the property would only qualify for such exemption if the value of services provided equals or exceeds the real property tax liability.<sup>161</sup> This suggestion would effectively meet the legislative intent of Section 15-86 because the state must evaluate whether a nonprofit hospital seeking property tax

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charitable purposes would still be entitled to an exemption under the language of Section 15-86 if the value of its charitable services exceeds the estimated amount of its property taxes. Because the Illinois General Assembly did not require hospitals receiving the exemption to be used exclusively for charitable purposes, the Court concluded that Section 15-86 is unconstitutional. *Id.*

<sup>154</sup> *Carle Found.*, 45 N.E.3d at 1199.

<sup>155</sup> *Id.*

<sup>156</sup> *Id.*

<sup>157</sup> Ill. Const. art. IX, § 6 (Lexis, LexisNexis through 2016 Reg. Leg. Sess.) (emphasis added).

<sup>158</sup> *Id.*

<sup>159</sup> *Carle Found.*, 45 N.E.3d at 1199.

<sup>160</sup> *Id.* at 1195.

<sup>161</sup> *Id.* at 1197.

exemption was exclusively organized for charitable purposes. Arguably, implementing such a suggestion would put nonprofit hospitals back at square one when it comes to clarity.

#### V. FINDING A SOLUTION: USING LESSONS LEARNED FROM NEW JERSEY AND ILLINOIS

As discussed above, the continuous problems for nonprofit hospital property tax exemptions stem from the definition of “charity,” the use and purpose of the entity, and profits generated from nonprofit hospitals. The factors align with New Jersey’s *Paper Mill Playhouse* test and the legal dicta in *Provena* and *Carle Foundation*. States should redefine the aforementioned factors with the following considerations and solutions.

##### A. Factor #1: Defining Charity—Nonprofit Hospitals Are Not Donative Entities

As seen in Illinois and New Jersey, courts and state legislatures struggle with defining “charity” in terms of property tax exemption for nonprofit hospitals.<sup>162</sup> According to the Merriam-Webster Dictionary, a charity is an “organization that helps people who are poor, sick, etc.”<sup>163</sup> The dictionary also defines the act of “charity” as “the act of giving money, food, or other kinds of help to people who are poor, sick, etc.”<sup>164</sup> One generally accepted concept the dictionary leaves out is that a traditional charity is primarily funded by gifts, donations, and grants.<sup>165</sup>

Although a soup kitchen and a nonprofit hospital are both charitable organizations aimed at helping the community, they could not be more different in their operations. A soup kitchen offers food to the homeless or needy at no charge or at a very low cost.<sup>166</sup> A nonprofit hospital does not have the ability to give free care purely from donations and gifts in today’s modern healthcare economy because it is simply too expensive.<sup>167</sup> In order to administer care and operate as a sophisticated healthcare provider, hospitals must charge patients.<sup>168</sup>

Under the federal tax code’s Section 501(c)(3) community benefit

<sup>162</sup> See *supra* Parts III.C & IV.A (discussing *AHS Hospital* and *Provena*, which demonstrate each state’s struggle through the cases in New Jersey and Illinois, respectively).

<sup>163</sup> *Charity*, MERRIAM-WEBSTER, <http://www.merriam-webster.com/dictionary/charity> (last accessed Mar. 10, 2017).

<sup>164</sup> *Id.*

<sup>165</sup> Mintz, *supra* note 2, at 434-35.

<sup>166</sup> *Soup Kitchens*, ENCYCLOPEDIA.COM, <http://www.encyclopedia.com/doc/1G2-3403400542.html> (last accessed Mar. 10, 2017).

<sup>167</sup> Mintz, *supra* note 2, at 435.

<sup>168</sup> Mintz, *supra* note 2, at 435.

standard, nonprofit hospitals must have a charity care policy that provides financial assistance for those who cannot pay.<sup>169</sup> One may wonder why hospitals must operate so differently from traditional charities like a soup kitchen. The answer is that it is much simpler for a soup kitchen to replenish food once it has begun depleting its supply; nonprofit hospitals, on the other hand, must continue to use any surplus in revenues to further their charitable mission by acquiring new equipment, hiring staff, constructing new facilities, maintaining administrative costs, engaging in new programs, and providing care.<sup>170</sup> Nonprofit hospitals are not able to function as a zero-sum charity, and they are not able to rely on donations as a primary source of funding like traditional charities do because of cost and society's reliance on hospital services.

Because nonprofit hospitals will never be purely donative entities, states should define "charity" as the IRS does for Section 501(c)(3) federal nonprofit tax exemptions. Section 501(c)(3) requires that nonprofit entities be organized and operated exclusively for a charitable purpose.<sup>171</sup> Furthermore, Section 501(r) imposes new requirements on nonprofit hospitals by requiring that they (1) establish a financial assistance and emergency medical care policy; (2) limit the amount charged for emergency or other medically necessary care to patients who qualify for financial assistance; (3) take reasonable steps to determine whether a patient is eligible for financial assistance before asserting extraordinary collections actions; and (4) conduct a Community Health Needs Assessment ("CHNA") and strategy at least once every three years.<sup>172</sup> If a nonprofit hospital meets the strict criteria of Sections 501(c)(3) and 501(r), then states should recognize the nonprofit hospital as a charitable organization.

*B. Factor #2: ACA Mandates Have Changed Nonprofit Hospital*

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<sup>169</sup> See MAYO CLINIC, *Charity Care Policy – Administration of Financial Assistance* (June 2012), <http://www.mayoclinic.org/documents/charitable-care-and-financial-assistance-policy/doc-20079439> (providing the criteria for patients seeking financial assistance).

<sup>170</sup> Mintz, *supra* note 2, at 435.

<sup>171</sup> 26 U.S.C. § 501(c)(3) (2017).

<sup>172</sup> Bob Herman, *10 Ways for Hospitals and Health Systems to Increase Profitability in 2012*, BECKERS HOSP. REV. (Nov. 29, 2011), <http://www.beckershospitalreview.com/finance/10-ways-for-hospitals-and-health-systems-to-increase-profitability-in-2012.html> (stating in 2012, two years after the enactment of the Affordable Care Act, that "approaching physicians and working together to create a more cost-conscious supply plan for every department can help foster a better working relationship with physicians in addition to supply savings").



*Property Use*

## i. ACA Encourages Integration

Physician groups and hospitals working together promote increased quality of care and lower costs.<sup>173</sup> This goal of the ACA, however, conflicts with the “use test” of real property tax exemption law, which resists the comingling of for-profit and nonprofit physicians and entities.<sup>174</sup> It is imperative to consider the progression of healthcare reform when looking at a nonprofit hospital’s property use.

The healthcare market has evolved into an industry where all players, insurance companies, hospitals, private physicians, etc., are encouraged to coordinate patient care and work together.<sup>175</sup> Horizon Healthcare Innovations, a subsidiary of parent company Horizon Blue Cross Blue Shield of New Jersey, is one example of a healthcare player that has led New Jersey’s changing healthcare landscape by initiating the contracting of healthcare reform models (such as patient-centered medical homes, accountable care organizations, and episode of care).<sup>176</sup> For example, an Accountable Care Organization (“ACO”) is a coalition of hospitals, physicians, and other healthcare providers that work together to coordinate an individual’s healthcare.<sup>177</sup> Precluding nonprofit and for-profit healthcare providers from sharing space and entering into agreements to provide care is antithetical to an ACO’s purpose of providing collaborative care.

Another reason nonprofit and for-profit arrangements should be sustained is to allow nonprofit hospitals to remain competitive in acquiring new talent and equipment. The New Jersey Board of Medical

<sup>173</sup> See MARY WITT ET AL., CAL. HEALTHCARE FOUND., PHYSICIAN-HOSPITAL INTEGRATION IN THE ERA OF HEALTH REFORM 2 (2010), <http://www.chcf.org/~media/MEDIA%20LIBRARY%20Files/PDF/PDF%20P/PDF%20PhysicianHospitalIntegrationEraHealthReform.pdf>.

<sup>174</sup> See *AHS Hosp. Corp.*, 28 N.J. Tax 456, 455 (2015) (noting Judge Vito Bianco’s scrutiny over the comingling of for-profit physicians on Morristown Memorial’s property).

<sup>175</sup> See *Healthcare Reform Working Together*, BLUE CROSS & BLUE SHIELD OF LA. (Jan. 2010), <https://www.bcbsla.com/Docs/BN-1-19-10.pdf> (last accessed Mar. 7, 2017) (stating that to reduce costs and improve quality healthcare, providers and the industry as a whole must work together).

<sup>176</sup> See *Patient-Centered Programs*, HORIZON BLUE CROSS & BLUE SHIELD OF N.J., <https://www.horizonblue.com/providers/products-programs/horizon-healthcare-innovations> (last accessed Mar. 10, 2017) (detailing various healthcare reform models, such as Accountable Care Organizations (“ACOs”) and Patient-Centered Medical Homes (“PCMHs”), which are encouraged by the ACA to promote efficacy in the new marketplace).

<sup>177</sup> See *Accountable Care Organizations (ACO)*, CTRS. FOR MEDICARE & MEDICAID SERVS., <https://www.cms.gov/Medicare/Medicare-Fee-for-Service-Payment/ACO/index.html?redirect=/Aco> (last updated Jan. 6, 2015) (explaining what an ACO is).

Examiners sets high standards for hospital licensing. Facilities must retain certain physician groups and provide specific types of care and services for “hospital purposes.”<sup>178</sup> Failure to retain a certain number of physicians, staff, and services will put a hospital out of business because it will lose its license.<sup>179</sup> It will be very difficult for nonprofit hospitals to operate under New Jersey’s regulations in the modern marketplace without having the ability to enter into relationships with outside, for-profit facilities and for-profit physicians.<sup>180</sup>

ii. Smaller Pool of Uninsured Under ACA

In redrafting the qualifications and standards for nonprofit hospitals to receive a property tax exemption, state legislatures must consider the impact of the ACA on uninsured individuals. The ACA has provided the means for thirty million Americans to obtain health insurance. Having so many Americans insured has had a large impact on nonprofit hospitals’ satisfaction of providing “charity care”—the quota for hospitals to meet in serving underserved or needy patients. If nonprofit hospitals were arguably not taking care of enough uninsured individuals prior to the enactment of the ACA, they would have had an even smaller uninsured pool without the ACA and, instead, a heightened Medicaid and Children’s Health Insurance Program (“CHIP”) pool, which had over 4.5 million new enrollees as of 2014.<sup>181</sup> Because a large number of uninsured individuals have and will become insured, the legislature must consider that some nonprofit hospitals will be forced to convert to for-profit entities because the pool of uninsured individuals to whom they provide charity care will be too small in comparison to a nonprofit hospital’s annual revenues.<sup>182</sup>

Some states have already begun factoring in the effects of the ACA. These states include: Texas, which requires a hospital to spend at least four percent of its revenue on charity care to maintain its nonprofit status; California, which sets its state standard at five percent of revenues on charity care; and Illinois, which requires an eight percent threshold to

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<sup>178</sup> See N.J.A.C. § 8:43G *et seq.* (West 2016) (detailing the licensing requirements for hospitals in the State of New Jersey, which includes the specialties and number of physicians a hospital must maintain); see also Eric J. Santos, *Property Tax Exemptions for Hospitals: A Blunt Instrument Where a Scalpel is Needed*, 8 COLUM. J. TAX L. 113 (2017).

<sup>179</sup> Non-compliance with New Jersey’s Administrative Code and regulations for hospital licensing carries civil penalties, including fines and injunctive relief. See N.J.A.C. § 8:43G *et seq.* (West 2016).

<sup>180</sup> Mintz, *supra* note 2, at 6.

<sup>181</sup> Vikki Wachino, et. al., *How is the ACA Impacting Medicaid Enrollment*, HENRY J. KAISER FAMILY FOUND. (May 5, 2014), <http://kff.org/medicaid/issue-brief/how-is-the-aca-impacting-medicaid-enrollment/>.

<sup>182</sup> See Mintz, *supra* note 2, at 441-42.

maintain a hospital's nonprofit status.<sup>183</sup> Thresholds of revenue spent on charity care shift the argument to whether hospitals are providing *enough* charity care. This is a much more reasonable and logical question to ask nonprofit hospitals rather than denying the property tax exemption based on outdated rules that, when applied, are too stringent. The applicability of the stringent common law is demonstrated in *Provena* and, more recently, in *AHS Hospital Corporation*. The ACA creates a new landscape that will cause New Jersey to consider how much qualifying charity care is worthy of a property tax exemption and how to redefine "community benefit" to encompass a more widespread population rather than just the decreasing uninsured population.

### iii. More Programs to Fund

The ACA requires hospitals to fund and take part in additional programs. For example, hospitals must follow more stringent readmission standards under the ACA, increasing pressures for some of New Jersey's top hospitals.<sup>184</sup> This year, New Jersey led the country in the most penalized hospitals.<sup>185</sup> Complicating the process, New Jersey hospitals have fallen within the lowest operating margin costs, working within three percent.<sup>186</sup> Hospitals have many programs and responsibilities and large tax bills may decrease the amount of resources they can spend elsewhere.<sup>187</sup> In light of the increasing pressures on

<sup>183</sup> See Jill Horowitz, *The ACA's Hospital Tax-Exemption Rules and the Practice of Medicine*, HEALTH AFFAIRS BLOG (Mar. 3, 2015), <http://healthaffairs.org/blog/2015/03/03/the-acas-hospital-tax-exemption-rules-and-the-practice-of-medicine/> ("Texas conditions state tax-exemption on the provision of charity care and community benefits. The state allows nonprofit hospitals to meet their obligations by, among other methods, providing free care and community benefits equal to at least five percent of the hospital's net patient revenues (with at least the equivalent of four percent of net patient revenue going to charity care and government-sponsored care for indigents)."); see also A.G. File No. 2015-102, LEGISLATIVE ANALYST'S OFFICE (Dec. 18, 2015), <http://www.lao.ca.gov/BallotAnalysis/Initiative/2015-102> (stating that current law "requires nonprofit hospitals, unless exempted by the measure, to provide an amount of charity care (as defined by the measure) equal to at least 5 percent of their net patient revenues").

<sup>184</sup> See Susan K. Livio, *N.J. Leads Nation for Number of Hospitals Penalized for High Readmissions*, NJ.COM (Aug. 4, 2015), [http://www.nj.com/politics/index.ssf/2015/08/nearly\\_every\\_nj\\_hospital\\_to\\_be\\_penalized\\_for\\_high.html](http://www.nj.com/politics/index.ssf/2015/08/nearly_every_nj_hospital_to_be_penalized_for_high.html).

<sup>185</sup> *Id.* Coincidentally, New Jersey is also home to some of the highest performing hospitals, giving rise to an interesting debate about the ACA's readmission formulas.

<sup>186</sup> Anthony Birritteri, *Hospitals in Transition: How Executives from Some of the State's Leading Healthcare Institutions are Implementing New Cures to Keep Their Industry and Communities Healthy*, N.J. BUS. MAG. (Aug. 11, 2014), [http://njbmagazine.com/monthly\\_articles/hospitals-transition](http://njbmagazine.com/monthly_articles/hospitals-transition).

<sup>187</sup> See Jack E. Karns, *Justifying the Nonprofit Hospital Tax Exemption in a Competitive Market*, 13 WIDENER L.J. 383, 386 (2004) (discussing the rationale for nonprofit hospitals to maintain tax exemption in the changing healthcare landscape).

hospitals, nonprofit hospitals are struggling to adapt to new government mandates and the modern healthcare landscape, such as a different pool of uninsured individuals, pressures of model integration, and funding of additional programs and assessments. Post-ACA nonprofit hospital use is very different than that contemplated by the New Jersey Supreme Court in 1961 in *Paper Mill Playhouse*. Deference must be given to hospitals so they can meet their charitable aims while maintaining competitiveness in the sophisticated and complex market of healthcare reform.

*C. Factor #3: Nonprofit Hospitals Need Money on Reserve*

Nonprofit hospitals need money on reserve to operate—a reserve does not mean that nonprofit hospitals should be operating for a profit in contrast to Section 501(c)(3) of the federal tax code, but, rather, that additional revenues can be used to further the sophistication of the hospital and overall community benefit. In a June 2004 Senate Committee on Finance hearing, the Assembly met to discuss ways to protect nonprofit hospitals from being harmed by the societal view that the hospitals no longer meet their intended missions.<sup>188</sup> The Committee specifically addressed the concern that some tax-exempt organizations are set up primarily to receive tax breaks and evade taxes.<sup>189</sup>

United States Senator Max Burns released a statement emphasizing the good that comes from charitable institutions but asserted that a balance should be struck between charities that aim to do good and those that engage in “sloppy, unethical, and criminal behavior.”<sup>190</sup> He further encouraged alignment between the federal and state governments to monitor this behavior.<sup>191</sup> The importance here is the distinction between the acceptable behaviors proffered by the government for a hospital to receive a property tax exemption and the reasons nonprofit hospitals, such as Morristown Memorial, are losing their tax exemptions. Examples presented by Senator Burns include “charities engaging in abusive tax shelters, salaries paid to trustees, and insider deals with insufficient transparency.”<sup>192</sup> These acts are undoubtedly unsupported by taxpayers because they are generally illegal criminal acts. They stand in contrast to nonprofit hospitals that operate as a business and passively generate

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<sup>188</sup> See Statement of U.S. Senator Max Baucus, Ranking Member of the Senate Comm. on Finance, on Charity Oversight and Reform: Keeping Bad Things from Happening to Good Charities (June 22, 2004) available at <http://www.finance.senate.gov/imo/media/doc/062204mb1.pdf>.

<sup>189</sup> *Id.*

<sup>190</sup> *Id.*

<sup>191</sup> *Id.*

<sup>192</sup> *Id.*

income to meet the expectations of society; however, such acts are distinguishable from having cash reserves for operations.

In contrast to the concerns about illicit behavior by nonprofits, the various findings in *AHS Hospital Corporation v. Town of Morristown* only serve to invite more litigation from local governments and third parties looking for a payday.<sup>193</sup> Furthermore, third parties may be encouraged to challenge nonprofit hospitals. Local taxpayers in Princeton, New Jersey, have brought a tax assessment challenge against Princeton University, claiming that the university bears the burden of proving that it meets the requirements for property tax exemption.<sup>194</sup> In April 2016, twenty-four more Princeton residents joined the suit claiming that local taxpayers should not have to absorb the unpaid property tax.<sup>195</sup>

Third party suits have questioned not only tax assessments, but also the collection practices of nonprofit hospitals. For example, a famous plaintiffs' attorney, Richard Scruggs, filed a series of class action lawsuits against nonprofit hospitals who were attempting to collect payments from indigent and uninsured patients.<sup>196</sup> Over six hundred nonprofit hospitals across the country were named in the litigation in state and federal courts.<sup>197</sup> Within months of the filings, nearly all of the cases were dismissed.<sup>198</sup> Disgruntled patients proved that nonprofit hospitals need modern-day expectations laid out and updated because of the high financial stakes nonprofits face in these lawsuits. This fiasco was brought about by years of negative media and societal disapproval of nonprofit hospitals not meeting their charitable care obligations.<sup>199</sup> However, property tax exemption is not additional income or profit for nonprofit hospitals, but rather, it is simply one less expense that nonprofit hospitals incur.<sup>200</sup> Nonprofit hospitals should be given flexibility to retain revenue and should be shielded from litigation that claims they are after a profit. Additional revenue enables nonprofit hospitals to maintain operations and develop the technologies and sophistication society has come to know and expect. Allowing nonprofits to have revenue without jumping

<sup>193</sup> *AHS Hosp. Corp.*, 28 N.J. Tax at 472. See *supra* Part III.D (stating that fifteen municipalities have filed tax assessment challenges against nonprofit hospitals in their municipalities).

<sup>194</sup> See Anna Merriman, *24 More Residents Challenge Princeton U.'s Tax Exempt Status*, NJ.COM (Apr. 6, 2016), [http://www.nj.com/mercer/index.ssf/2016/04/24\\_more\\_residents\\_challenge\\_princeton\\_us\\_tax\\_exemp.html](http://www.nj.com/mercer/index.ssf/2016/04/24_more_residents_challenge_princeton_us_tax_exemp.html).

<sup>195</sup> *Id.*

<sup>196</sup> Lisa Kinney Helvin, *Caring for the Uninsured: Are Not-for-Profit Hospitals Doing Their Share?*, 8 YALE J. HEALTH POL'Y L. & ETHICS 425 (2013).

<sup>197</sup> *Id.*

<sup>198</sup> *Id.*

<sup>199</sup> Mintz, *supra* note 2, at 441.

<sup>200</sup> Mintz, *supra* note 2, at 431.

to call it “profit” makes good business sense—and even nonprofits need good business sense to remain in existence.

#### VI. CONCLUSION

Nonprofit hospitals have undoubtedly evolved since their early beginnings. This evolution is a positive one since nonprofit hospitals have become sophisticated centers of care. The definitions of “charity,” “use,” and “profit” warranting property tax exemption should be redefined by state legislatures to avoid arbitrary tax assessment challenges brought by municipalities and third parties. The heavy burden of federal and state mandates, such as the ACA, and the burden of societal expectations, such as providing state-of-the art advancements, must be considered to ensure nonprofit hospitals are protected in the modern healthcare industry.