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

*Jillian A. Swogier\*\**

*This note discusses the context of state property tax exemption and the evolution of nonprofit hospitals. The note describes litigation and legislation through the lens of two states in the foreground: New Jersey and Illinois. The note further discusses successes and failures over the past decade with legislation, 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 has been a slow brew, evolving over decades throughout various states; however, the fight for the real property tax exemption has recently cast a bright spotlight on New Jersey, as 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 Corp. v. Township of Morristown*.<sup>1</sup>

A municipality challenging the nonprofit hospital property tax exemption is nothing new and has been occurring since the 1950s.<sup>2</sup> Current trends show, 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> As a solution to decades of uncertainty, states should enact a hospital contribution fee, as proposed by New Jersey in late 2015, or alternatively, they should enact an alternative fee structured for nonprofit hospitals to compensate municipalities. Either solution would provide more guidance for nonprofit hospitals than what currently is out there.

This note discusses the lack of clarity in the realm of the nonprofit hospital real property tax exemption that leads to broad judicial interpretations, depending on the judge. Part II of this note looks at the basics of tax exemption for nonprofit hospitals and explains how nonprofit hospitals become tax exempt, what the purpose of the nonprofit hospital tax exemption is, and how

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<sup>1</sup> Morristown Memorial Hospital is nationally ranked according to U.S. News Report. U.S. NEWS REPORT <http://health.usnews.com/best-hospitals/area/nj/northern-new-jersey> (last visited Feb. 29, 2016).

<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 that tax exemption rules must be strict, but reasonable).

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 Illinois. Parts III and IV of this note demonstrate the vulnerability of nonprofit hospitals, as well as the unclear system currently in place. Part V addresses a possible solution in light of the “lesson learned” from New Jersey and Illinois. Part V presents three challenges and solutions nonprofit hospitals and tax exemption laws face given current laws and interpretation: (1) that hospitals will never be a traditional donative entity (like a soup kitchen)—therefore the definition of charity care must be redefined; (2) 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—therefore, the use of nonprofit hospital must factor in modern healthcare policies; and (3) retaining revenues, or profits, is necessary for nonprofit hospitals to increase technology and their sophistication of modern healthcare. This note argues that nonprofit hospitals should be relieved of the current ambiguity in property tax exemption, judicial interpretation, and scrutiny. Outdated nonprofit property tax exemption laws no longer fit 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 story starts when hospitals were a new concept and primarily known as the place where the ailing poor would go to die.<sup>4</sup> The lengthy history of nonprofit hospitals demonstrates that nonprofit hospitals have evolved from “charitable alms houses” in the 18<sup>th</sup> century, aimed at providing medical care to the ailing impoverished, to the current model of sophisticated centers of

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<sup>4</sup> New Jersey Tax Court Judge Vito Bianco found the history of hospitals so important 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 that nonprofit hospitals have changed in structure and function since their evolution).

care which developed over the 19<sup>th</sup> and 20<sup>th</sup> centuries.<sup>5</sup> Nonprofit hospitals have changed from institutions providing 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' ability to pay.<sup>6</sup>

Stemming from the history of nonprofit hospitals, the purpose of allowing nonprofit hospitals to be tax exempt institutions is that they alleviate a burden from the government by providing care and serving a community benefit.<sup>7</sup> The landscape has changed for nonprofits hospitals as they try to compete for the same medical professionals, technology, and patients as their for-profit counterparts.<sup>8</sup> Nonprofit hospitals do not operate in the same manner as they once did because 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>9</sup> However, nonprofit hospitals still provide a community benefit and alleviate a government burden.<sup>10</sup>

**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>11</sup> Currently, sixty-eight percent of Medicare beds are located in nonprofit hospitals.<sup>12</sup>

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<sup>5</sup> *Id.* at 479.

<sup>6</sup> *Id.* at 465.

<sup>7</sup> Matt Nevisky, *The Value of Tax Breaks for Not-For-Profit Hospitals*, THE NATIONAL BUREAU OF ECONOMIC RESEARCH, <http://www.nber.org/digest/mar99/w6435.html>.

<sup>8</sup> *See* *Belmar v. Cipolla*, 96 N.J. 199, 207 (1984) (stating “a hospital is a complex business vitally affected with a public interest.”).

<sup>9</sup> *AHS Hosp. Corp. v. Town of Morristown*, 28 N.J. Tax at 465.

<sup>10</sup> *Id.*

<sup>11</sup> The National Health Law Program, or NHeLP, has put together an appendix with a checklist for nonprofit hospitals that include suggested requirements as NHeLP has identified from state legislation, and ACA requirements. *See* William N. Genrty & John R. Penrod, *The Tax Benefits of Not-for-Profit Hospitals*, NBER Working Paper No. 6435 (Feb. 1998), *available at* <http://www.nber.org/papers/w6435.pdf>.

<sup>12</sup> Corey Davis, *Nonprofit Hospitals and Community Benefit*, NATIONAL HEALTH LAW PROGRAM ISSUE BRIEF (Jul. 2011), *citing* U.S. Congressional Budget Office, PUB. NO. 2707, *Nonprofit Hospitals and the Provision of Community Benefit* at 3 (2006).

Approximately, seventy-seven percent of community hospitals are nonprofits.<sup>13</sup> Nonprofit hospitals aggregately receive local and state tax benefits of \$12.6 billion and account for fifty-one percent of the nation's hospitals.<sup>14</sup> With such a large nationwide footprint, nonprofit hospital mission statements which put caring for the indigent population above profit making should be taken at face value as the goals of the nonprofits' ideals and operations.<sup>15</sup> The mission statement, paired with meeting a percentage of charity care each year, should be sufficient for property tax exemption.<sup>16</sup>

Furthermore, an empirical study demonstrated that, of 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>17</sup> Two-thirds of all of the urban hospitals in the United States operate as a nonprofit, with the remainder split between for-profit and government ownership.<sup>18</sup> Meaning that the majority of nonprofit hospitals are in locations with the lowest income individuals.

Open-heart surgery is an example of a highly profitable service because insurance rates are higher and most heart-surgery patients are well insured or Medicare patients.<sup>19</sup> On the other hand, hospital-based psychiatric emergency services are generally unprofitable because these services are offered in the emergency room (which is a highly unprofitable department) and patients attracted to these services are usually poor and sick.<sup>20</sup> Open-heart surgery and hospital-based

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<sup>13</sup> *Id.*

<sup>14</sup> There are 5,686 hospitals in the nation and 2,887 are nonprofits. STATISTA.COM, *Statistics and facts about U.S. Hospitals* (last visited Apr. 16, 2016), <http://www.statista.com/topics/1074/hospitals/>.

<sup>15</sup> Mary Crossley, *Health Reform and the Mission of Nonprofit Hospitals*, THE HEALTHCAREBLOG.COM (Apr. 28, 2014), <http://thehealthcareblog.com/blog/2014/04/28/health-reform-and-the-mission-of-nonprofit-hospitals>.

<sup>16</sup> *Id.*

<sup>17</sup> Jill R. Horowitz, *Making Profits and Providing Care: Comparing Nonprofit, For-Profit, and Government Hospitals*, HEALTH AFFAIRS (May 2005), available at <http://content.healthaffairs.org/content/24/3/790.full>.

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

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

<sup>20</sup> *Id.*

psychiatric services show opposite ends of the spectrum, whereas acute care profitability has fluctuated greatly for decades.<sup>21</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 for post-acute care after being discharged.<sup>22</sup>

The empirical study examined the three areas discussed above with a sensitivity tests on population and region to compensate for bias. The study's purpose was to determine whether for-profit hospitals are more likely to engage in the higher profit reaping services.<sup>23</sup> The hypothesis was proven by the unlikelihood of for-profit hospitals to offer hospital-based emergency psychiatric services, and the increased likelihood of these hospitals to offer services like open-heart surgery and post-acute care, which they can charge more for and reap a greater profit.<sup>24</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.

#### **b. State Law Versus Federal Law.**

Every state has powers through its constitution to exempt certain entities from real property taxation, such as schools, churches, and hospitals.<sup>25</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>26</sup> Some states, such as Pennsylvania, have recently been looking at the possibility of amending their state constitution to determine which nonprofit entities will receive a tax

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

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

<sup>23</sup> Jill R. Horowitz, *Making Profits and Providing Care: Comparing Nonprofit, For-Profit, and Government Hospitals*, HEALTH AFFAIRS (May 2005), available at <http://content.healthaffairs.org/content/24/3/790.full>.

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

<sup>25</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*, [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, Section b (discussing challenges of constitutional powers in *Carle Foundation v. Cunningham Township*).

<sup>26</sup> *Id.*

exemption.<sup>27</sup> The modern operations of nonprofit entities, such as hospitals, may require a reworking of the state's constitution.<sup>28</sup> Other than reviewing a state constitution, state revenue services also provide guidelines, in their codes, for qualifying for real property tax exemption.<sup>29</sup> It is important to ensure before passing legislation that the state constitution is not violated to avoid problems (such as those in Illinois) in the future. In some circumstances, such as 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 provides federal benefits, such as possible lower interest rates in the public bond market.<sup>30</sup> The standards for granting these benefits at the state and federal levels differ as well.<sup>31</sup> States generally use a "charitable care standard," whereas the federal government uses "community benefit" to determine if an entity qualifies for §501(c)(3) tax benefits.<sup>32</sup> Therein lies the discrepancy. States have differing powers given to them by 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>33</sup> When discussing "tax exemption," this note focuses on state standards and real property tax exemption, unless specified otherwise.

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<sup>27</sup> Christian Anderson, *Constitutional amendment for nonprofit tax-exemptions passes the Pa. Senate, goes to House*, PENNLIVE.COM (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>28</sup> *Id.*

<sup>29</sup> See Minnesota Revenue Service, (*last visited* Feb. 24, 2016), [http://www.revenue.state.mn.us/businesses/sut/Pages/Nonprofit\\_ES.aspx](http://www.revenue.state.mn.us/businesses/sut/Pages/Nonprofit_ES.aspx) (detailing "who qualifies" section rules out the inclusion of hospitals. This stems from Minnesota's state constitution).

<sup>30</sup> Edward J. Bernert & Christopher J. Swift, *The "Charity Care" Requirement for Hospital Property Tax Exemptions*, (May 5, 2009) [http://www.bakerlaw.com/files/PublicDocs/News/Linked%20documents/ABA\\_Charity\\_Care.pdf](http://www.bakerlaw.com/files/PublicDocs/News/Linked%20documents/ABA_Charity_Care.pdf).

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

<sup>32</sup> Jeremy J. Schirra, *A Veil of Tax Exemption: A Proposal for the Continuation of Federal Tax-Exempt Status for "Nonprofit" Hospitals*, 21 HEALTH MATRIX 231, 250 (2011).

<sup>33</sup> *Id.* at 251.



### **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 in this case New Jersey, it is always the prudent course to look at the statute first. Under the Tax Act of 1913, an institution used for hospital purposes may qualify for property tax exemption only as long as it was not being conducted for profit.<sup>34</sup> During this period in 1913, New Jersey statute § 54:4-3.6 granted a property exemption for "hospital purposes" if no portion of them are solely used for profit making purposes:

The following 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>35</sup>

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

The central idea of New Jersey case law is that charities may not be used for profit making.<sup>36</sup> The most important interpretation of this statute was the New Jersey Tax Court's decision in *Paper Mill Playhouse v. Millburn Township*. *Paper Mill Playhouse*, which laid out a

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<sup>34</sup> L. 1913, c. 278, §4.

<sup>35</sup> N.J. STAT. ANN. §54:4-3.6 (2012).

<sup>36</sup> See *Trustees of the YMCA v. Paterson*, 61 N.J.L. 420 (Sup. Ct. 1898) (holding that the property was being used for eleemosynary purposes, to distribute charity, but not operating exclusively for a charitable purpose). See also *Cooper Hospital v. Camden*, 68 N.J.L. 691 (E. & A. 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.).

three-prong test which hospitals must meet to be eligible for a tax exemption under section 54:4-3.6.<sup>37</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>38</sup> Overall, the *Paper Mill Playhouse* test evaluates all components of an entity, requiring a demonstration that the operations, organization, and use of its property are not conducted for a profit.<sup>39</sup>

Additionally, *Kimberly School v. Montclair*, a New Jersey Supreme Court case holding that the test for tax exemption is to look at the dominant motive of the organization.<sup>40</sup> *Kimberly School* involved a small private school and while it seemed to be operating for a charitable purpose the court stated that it was “not enough that a profit was made,” but that the *dominant motive* of the organization would have to be for a profit making purpose, in order to lose on the third-prong profit test of *Paper Mill Playhouse*.<sup>41</sup> *Kimberly School* seemingly should apply to a similarly situated entity; however, the Tax Court in *AHS Hospital Corp. v. Morristown* recently rejected this dominant motive argument, stating that this is not the way modern courts interpret tax exemption questions regarding N.J.S.A. §54:4-3.6.<sup>42</sup> While the *dominant motive* test is important it is only a consideration in comparison to the three-prong test in *Paper Mill Playhouse v. Millburn*.<sup>43</sup>

The *Paper Mill Playhouse* test is crucial to understand because a set interpretation of it could resolve many uncertainties of nonprofit hospital tax exemptions in New Jersey. The first prong, or “organization test,” evaluates the entity’s structure, mission statement, and certificate of

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<sup>37</sup> AHS Hosp. Corp. v. Town of Morristown, 28 N.J. Tax at 496.

<sup>38</sup> *Id.*; citing *Paper Mill Playhouse v. Millburn Twp.*, 95 N.J. 503, 506, 472 A.2d 517 (1984).

<sup>39</sup> *Id.*

<sup>40</sup> *Id.* at 497.; citing *Kimberly School v. Montclair*, 2 N.J. 28 (1949).

<sup>41</sup> *Kimberly School v. Montclair*, 2 N.J. 28, 38 (1949).

<sup>42</sup> AHS Hosp. Corp. v. Town of Morristown, 28 N.J. Tax at 472.

<sup>43</sup> *Id.* 496.

incorporation.<sup>44</sup> In *Hunterdon Med. Ctr. v. Township of Readington*, the court stated that to be organized exclusively for “hospital purposes,” the entity’s certificate of incorporation and mission must clearly state these purposes.<sup>45</sup> “Hospital purposes” includes any medical services patients require during their pre-admission, hospital stay, and post-admission services.<sup>46</sup> The second prong, or “use test,” analyzes how each portion of the hospital and its surrounding property are used.<sup>47</sup> The third prong, or “profit test,” is a “pragmatic inquiry into profitability [It is a] realistic common sense analysis of the actual operation of the taxpayer; mechanical centering on income and expense is to be avoided.”<sup>48</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>49</sup> The case in the next section, *AHS Hospital Corporation d/b/a Morristown Memorial Hospital v. Town of Morristown* applies the three-prong *Paper Mill Playhouse* test.

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

The case that brought New Jersey into the national spotlight for its nonprofit hospital tax exemption is *AHS Hospital Corporation v. Town of Morristown*. In *AHS Hosp. Corp.*, the Tax Court stripped Morristown Memorial Hospital (hereinafter “Morristown Memorial”) of its real property tax exemption. This decision crowned the Township of Morristown the winner of an over five-year legal battle.<sup>50</sup> Judge Vito Bianco wrote an eighty-eight page opinion applying the

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<sup>44</sup> *Id.* at 497. 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 conduct of an organization and how it is actually run).

<sup>45</sup> *Hunterdon Med. Ctr. v. Twp. of Readington*, 195 N.J. Tax 549, 557 (2008).

<sup>46</sup> *Id.* at n.1.

<sup>47</sup> *City of Long Branch v. Monmouth Medical Ctr.*, 138 N.J. Super. 524, 538 (App. Div. 1976).

<sup>48</sup> *Paper Mill Playhouse v. Millburn Twp.*, 95 N.J. 503.

<sup>49</sup> *AHS Hosp. Corp. v. Town of Morristown*, 28 N.J. Tax at 499; *citing* *International Schools, Inc. v. West Windsor Twp.*, 24 N.J. Tax 453, 455 (2009).

<sup>50</sup> See *AHS Hospital Corp. v. Town of Morristown*, 25 N.J. Tax 374 (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—and perhaps suspecting the opinion would not be well-received—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>51</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. 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>52</sup> These same critics argue that the holding is problematic for the overall mission of nonprofit hospitals.<sup>53</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>54</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 approximately eighty-three percent of the patients admitted to the hospital were admitted by these private physicians.<sup>55</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>56</sup>

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<sup>51</sup> AHS Hosp. Corp. v. Town of Morristown, 28 N.J. Tax at 466.

<sup>52</sup> Jacob Batchelor, *3 Takeaways from Hospital Tax Exemption Ruling*, LAW360 (Jul. 7, 2015 4:39 PM), <http://www.law360.com/articles/675747/3-takeaways-from-hospital-tax-exemption-ruling>.

<sup>53</sup> *Id.*

<sup>54</sup> AHS Hosp. Corp. v. Town of Morristown, 28 N.J. Tax at 465.

<sup>55</sup> Kathy Butler Polvino, et. al., *New Jersey Tax Court Eliminates Nonprofit Hospital’s Property Tax Exemption*, (Jul. 31, 2015), <http://www.healthlawupdate.com/2015/07/new-jersey-tax-court-eliminates-non-profit-hospitals-property-tax-exemption/>.

<sup>56</sup> AHS Hosp. Corp. v. Town of Morristown, 28 N.J. Tax at 455.

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>57</sup> Here, Judge Bianco found the activities of for-profit physicians could not be isolated for taxation purposes.<sup>58</sup> However, in practice, it is almost impossible to isolate and contain for-profit physicians in one part of the hospital. Likewise, it is almost impossible for nonprofit hospitals to operate without for-profit physicians in the medical landscape of 2015.

Over eighty pages into the decision, Judge Bianco sent a blazing warning message to New Jersey nonprofit hospitals when he stated:

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>59</sup>

Judge Bianco’s statement demonstrates the consistency of the court’s holding with the plain language of New Jersey’s common law and current statutes. He validates this point by referencing a need for state legislation to address the ever-changing position of nonprofit hospitals, stating that, “it is a function of the Legislature, not the courts, to promulgate what the terms and conditions will be.”<sup>60</sup> The New Jersey legislature did indeed take the provocation by Judge Bianco and began drafting a bill that would compensate municipalities, while providing fiscal predictability for nonprofit hospitals.

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

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

<sup>58</sup> *Id.* at 501.

<sup>59</sup> *Id.* at 536.

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

New Jersey legislators responded to *AHS Hospital Corporation v. Town of Morristown* by introducing a bill (S3299/A4903) on December 7, 2015, that would have required nonprofit tax-exempt hospitals, such as Morristown Memorial, to pay a community benefit contribution or otherwise known as a hospital service contribution.<sup>61</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>62</sup> The bill aimed to prevent litigation brought by municipalities against nonprofit hospitals in their jurisdiction.<sup>63</sup> The hospital service contribution provides municipalities with a formula that gives predictability to funding and budgeting.<sup>64</sup>

The New Jersey bill provides solutions that could serve as an example to other states searching for ways to avoid long and expensive litigation.<sup>65</sup> Specifically, the hospital contribution fee amends N.J.S.A. § 54:4-3.6, calling for a fee of \$2.50 a day, per bed.<sup>66</sup> Accordingly, Morristown Memorial would pay approximately \$1,750 a day for its 700 beds, totaling \$638,740 for the year.<sup>67</sup> Furthermore, each hospital bed at a satellite emergency care facility would pay \$250 per day.<sup>68</sup> To cover inflation, the fees are set to rise two percent annually.<sup>69</sup> The New Jersey bill does many things that other state governments across the country could mimic to strike a compromise between modern nonprofit hospitals and the localities in which they are located.<sup>70</sup>

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<sup>61</sup> H.R. S3299, 216<sup>th</sup> Gen. Assemb., Reg. Sess. (N.J. 2015).

<sup>62</sup> *Id.*

<sup>63</sup> Susan K. Livio, *N.J. nonprofit hospital 'tax' wins final legislative approval*, NJ.COM (Jan. 11, 2016 11:06 PM), [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).

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

<sup>65</sup> H.R. S3299, 216<sup>th</sup> Gen. Assemb., Reg. Sess. (N.J. 2015).

<sup>66</sup> *Id.*

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

<sup>68</sup> *Id.*

<sup>69</sup> *Id.*

<sup>70</sup> *Id.*

First, the New Jersey Hospital Service Contribution does not require nonprofit hospitals to pay full property taxes, but rather a fixed fee per bed (\$2.50 per bed per day and \$250 per day per satellite emergency facility).<sup>71</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>72</sup> Likewise, the fee is not so sizable as to financially hinder nonprofits so much that they are forced to cut resources, layoff staff, or even close the hospital.<sup>73</sup> Presenting nonprofit hospitals with significant tax bills is a fear for many legislators, hospital workers, and the communities that rely on the quality and community care from hospitals.<sup>74</sup> For example, when drafting the New Jersey bill, Morristown Memorial was referenced as an “economic engine that employs approximately 140,000 workers.”<sup>75</sup>

Second, approximately 85% of New Jersey’s hospitals are nonprofit and are property tax exempt; however, nonprofit hospitals use community resources such as the local police, fire, and other public services.<sup>76</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 the hospital, such as Morristown Memorial.<sup>77</sup> Over time, analytics can be performed to show gains or losses for the hospital contributions.

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<sup>71</sup> Emily Rappleye, *NJ bill approved to ‘tax’ nonprofit hospitals: 5 things to know*, BECKER HOSPITAL REVIEW (Jan. 12, 2016), <http://www.beckershospitalreview.com/finance/nj-bill-approved-to-tax-nonprofit-hospitals-5-things-to-know.html>.

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

<sup>73</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>[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).

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

<sup>75</sup> *Id.*

<sup>76</sup> RAPPLEYE, *supra* note 71, at 2.

<sup>77</sup> *Id.*

On January 11, 2016 the bill went to New Jersey Governor Chris Christie's desk for approval.<sup>78</sup> At the end of the legislative session, on January, 19, 2016, Governor Christie made a decision to reject the pending Hospital Contribution Fee bill by using his constitutional power of silence to pocket veto the bill.<sup>79</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>80</sup> Moreover, the pocket veto should not be construed as an objection to the protection of nonprofit hospitals as currently, Governor Chris Christie has placed a moratorium until 2018 on all litigation commenced by municipalities against nonprofit hospitals.<sup>81</sup> Currently, there are fifteen pending suits that would be affected by the moratorium.<sup>82</sup>

**e. So, now what? The Future of the Hospital Contribution Fee.**

Some lawmakers argue that changing a system overnight is never effective. For example, New Jersey Spokeswomen Joelle Farrell addressed the New Jersey bill after Governor Christie's pocket veto stating 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>83</sup> Farrell raises a very important point: that there should be a well-thought out system that appeases both hospitals and municipalities, while safeguarding against potential

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<sup>78</sup> LIVIO, *supra* note 63, at 1.

<sup>79</sup> Susan K. Livio, *Christie rejects requiring nonprofit hospitals to pay 'taxes'*, NJ.COM (Jan. 19, 2016 7:12 PM), [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>80</sup> Beth Jones Sanborn, *NJ Governor Chris Christie vetoes bill to tax nonprofit hospitals*, Government Health IT, (Jan. 20, 2016), <http://www.govhealthit.com/news/nj-governor-chris-christie-vetoes-bill-tax-nonprofit-hospitals>.

<sup>81</sup> Ruth McCambridge, *Christie Would "Freeze" Suits Against Nonprofit Hospitals*, NONPROFITQUARTERLY.COM (Mar. 21, 2016), <https://nonprofitquarterly.org/2016/03/21/christies-bill-would-freeze-legal-challenges-to-tax-exemptions-of-nj-nonprofit-hospitals/>.

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

<sup>83</sup> Michael Booth, *Will Veto Spark Litigation Over Nonprofit Hospitals' Tax Status?*, NEW JERSEY LAW JOURNAL, Jan. 22, 2016.



constitutional issues.<sup>84</sup> Moreover, now is the time to address these concerns and lay out legislation. If not now, how many nonprofit hospitals need to be sued before action is taken? However, the concern regarding hasty decisions, as raised by the New Jersey Hospital Contribution bill, should be addressed.<sup>85</sup>

Another concern addressed regarding the New Jersey Hospital Contribution Fee bill is that the amount proposed would not be enough to compensate municipalities.<sup>86</sup> Some municipalities expressed that charging \$2.50 per bed a day is insufficient.<sup>87</sup> In regards to hastiness, the bill's opposition are in "fact finding" mode where they are looking to find how more about the operations of the nonprofit hospitals to assess whether the fee would short-change the municipalities.<sup>88</sup> Regardless, both sides of the bill agree that they do not want to impose such hefty fees as to put the hospitals out of business, but rather, want to create a methodology where both parties (the hospital and local governments) feel comfortable with the figure, as well as how legislators arrived at the figure.<sup>89</sup>

A final concern is 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>90</sup> The report analyzes the survey responses of more than five-hundred nonprofit hospitals.<sup>91</sup> The survey's questions were designed to look at the effectiveness of the community benefit standard, explaining

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

<sup>85</sup> *Id.*

<sup>86</sup> Linda Washburn, *Christie veto leaves hospitals open to lawsuits over property taxes*, NORTHJERSEY.COM (Jan. 20, 2016 1:21 AM), <http://www.northjersey.com/news/nj-state-news/veto-leaves-hospitals-open-to-lawsuits-1.1495249>.

<sup>87</sup> *Id.*

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

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

<sup>90</sup> IRS, *IRS Exempt Organizations Hospital Study Executive Summary of Final Report* (Feb. 2009), [https://www.irs.gov/pub/irs-tege/execsum\\_hospprojrept.pdf](https://www.irs.gov/pub/irs-tege/execsum_hospprojrept.pdf).

<sup>91</sup> *Id.*

such issues 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>92</sup> The problem with making a determination regarding the effectiveness of the community benefits in nonprofit hospitals is usually the administrative procedures and their accuracy.<sup>93</sup> The same concern has been raised with regards to imposing a Hospital Contribution Fee: that the administrative task in assessing the cost-benefit would be over-burdensome.<sup>94</sup>

However, the Hospital Contribution Fee proposed by New Jersey is reflective of what needs to be enacted in order 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>95</sup> Moreover, the Hospital Contribution Fee will vary 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 alike, and in equal proportions.<sup>96</sup>

Nonprofit hospitals do not have shareholders. They are run by a board of community volunteers who determined that to preserve the amount of money retained for operations, but still offset services provided by local resources, such as police and fire, \$2.50 would result in a fair and reasonable total by the year end.<sup>97</sup> A recent study shows that New Jersey's nonprofit hospitals contribute more than \$2.4 billion annually on community benefits.<sup>98</sup> Furthermore, nonprofit hospitals employ a large portion of the community, employing nearly 144,000 people who then

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<sup>92</sup> *Id.*

<sup>93</sup> *Id.*

<sup>94</sup> NEW JERSEY HOSPITAL ASSOCIATION, *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>95</sup> *Id.*

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

<sup>97</sup> *Id.*

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

provide tax and wage contributions throughout their communities.<sup>99</sup> A Hospital Contribution Fee, such as the one proposed in New Jersey, gives a needed balance between placing undue financial burdens on hospitals and reimbursing 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>100</sup> The Illinois Supreme Court took a different approach than the New Jersey Tax Court in *AHS Hospital Corp.* because the Illinois Supreme Court did not break down each individual operation at Provena Covenant Medical Center. Rather, the *Provena* court strictly applied the Illinois Property Tax Code (§15-65 and §15-86), which focuses on whether a nonprofit hospital has met the definitional standards of ‘charity care’ and being an ‘institution of public charity’.<sup>101</sup> The court defined charity care by the number of uninsured patients who received free or discounted care.<sup>102</sup> The total of Provena’s revenues from providing healthcare services were .7%, or 302 out of 110,000 patients, and found to be *de minimus* in comparison with the hospital’s total revenues.<sup>103</sup> Moreover, the *Provena* court removed Medicare and Medicaid losses from the definition of charity care because opting into Medicare and Medicaid provides an additional revenue stream for hospitals.<sup>104</sup> The court also did not consider bad debts and unfavorable business decisions to constitute charity care.<sup>105</sup>

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

<sup>100</sup> *Provena Covenant Med. Ctr. v. Dep’t of Revenue*, 236 Ill. 2d. 368 (2010).

<sup>101</sup> *Id.* at 380.

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

<sup>103</sup> *Id.* at 399.

<sup>104</sup> *Id.* at 377.

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

The Illinois Supreme Court applied the factors *Methodist Old Peoples Home v. Korzen*, which examine whether a charitable institution: (1) has no capital, stock, or shareholders; (2) earns no profits or dividends, but engages in private and public charity; (3) dispenses charity 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 charitable benefits the institution offers.<sup>106</sup> The second factor provides that the charity provided by the hospital must help “relieve the burdens on the government.”<sup>107</sup> The governmental burden is on the local government because the property taxes in question are payable to the town, city, borough, etc.<sup>108</sup> Relief of the government’s burden justifies the reward of property tax exemption for the hospital. Illinois, like New Jersey, did 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>109</sup> The nonprofit hospital must be able to show that they alleviated some local government burden by providing charity care.<sup>110</sup>

Comparable to events in New Jersey after the *AHS Hosp. Corp.* 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>111</sup> The law essentially gives all hospitals, for-profit and nonprofit, the opportunity for a tax break based on the charity they provide.<sup>112</sup> Nonprofit hospitals are expected to provide

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<sup>106</sup> *Provena Covenant Med. Ctr. v. Dep’t of Revenue*, 236 Ill. 2d. at 390.

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

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

<sup>109</sup> *Id.* at 391.

<sup>110</sup> *Id.*

<sup>111</sup> AMEND. S.B. 2194 (2012), available at <http://www.ilga.gov/legislation/97/SB/PDF/09700SB2194ham003.pdf>. (the bill was signed by former Illinois Governor Patrick Quinn in response to the Provena ruling).

<sup>112</sup> *Id.*

charity care in an amount equal to the property tax they would have had to pay; likewise, for-profit hospitals are given a tax credit for charitable care that they provide.<sup>113</sup>

If a hospital is not tax exempt through the federal tax code, it still may receive tax credits equal to the lesser of: (1) the local property taxes paid on real property used for hospital purposes; or (2) the total cost of free or qualified charitable services or activities provided.<sup>114</sup> The property tax exemption and tax credit is available through “qualified services or activities.”<sup>115</sup> In assessing the amount of “qualified services or activities,” the hospital may choose to use one of the following two 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>116</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>117</sup> Health services provided to low-income or indigent individuals will be counted if the hospital provides or reimburses for physician services, clinics, or programs for these populations.<sup>118</sup> Moreover, hospitals may also choose to financially support or subsidize unaffiliated hospitals, affiliated hospitals, community clinics, or educational services for needy populations.<sup>119</sup> Hospitals may also add direct or indirect financial support or subsidies to state or local governments.<sup>120</sup> Subsidies provided for support of state healthcare programs are calculated

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<sup>113</sup> Nonprofit Blogger, *Illinois Enacts Hospital Property Tax Exemption Standards*, (Jun. 4, 2012), <http://lawprofessors.typepad.com/nonprofit/2012/06/illinois-enacts-hospital-property-tax-exemption-standards.html>.

<sup>114</sup> AMEND. S.B. 3261 (2012), *available at* <http://www.ilga.gov/legislation/97/SB/PDF/09700SB3261lv.pdf>.

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

<sup>116</sup> Jordan M. Goodman, *New Legislation Seeks to Clarify Property Tax Exemption for Nonprofit Health Care Institutions*, J. Multistate Tax and Incentives, Vol. 23 No.6 (Sep. 2013), *available at* <http://www.hmblaw.com/media/77954/goodman-illlegisrehospitalpptytaxexempt-sept2013jmt-copyforweb.pdf>.

<sup>117</sup> AMEND. S.B. 3261 (2012), *available at* <http://www.ilga.gov/legislation/97/SB/PDF/09700SB3261lv.pdf>.

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

<sup>119</sup> *Id.*

<sup>120</sup> *Id.*

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 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>121</sup>

The Illinois legislature allows hospitals to include unreimbursed services that relieve burden to the local government to be taken into account in the formula for “qualified services or activities,” as long as these services are not taken into account in another category of the hospital's calculation.<sup>122</sup> These services include but are not limited to providing emergency care, neonatal, trauma, burn, rehabilitation, or other special services.<sup>123</sup> The portion of reimbursed costs for low-income individuals is calculated in a ratio that adds the costs attributable to “charitable care” as the numerator, divided by the hospital's annual total costs as the denominator.<sup>124</sup> For emergency service, the ratio will use gross charges multiplied by the cost to charge ratio.<sup>125</sup>

Furthermore, in Illinois, the purpose of §15-86 is to add onto the provision in §15-65, which states: “Charitable Purposes. All property of the following is exempt when actually and exclusively used for charitable or beneficent purposes, and not leaser or otherwise used with a view to profit.”<sup>126</sup> In order to dissipate any confusion or uncertainty for nonprofit hospitals and municipalities as to whether it meets 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>127</sup>

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

<sup>122</sup> *Id.*

<sup>123</sup> AMEND. S.B. 3261 (2012), available at <http://www.ilga.gov/legislation/97/SB/PDF/09700SB3261lv.pdf>.

<sup>124</sup> *Id.*

<sup>125</sup> *Id.*

<sup>126</sup> *Id.*

<sup>127</sup> *Carle Found. v. Cunningham Twp.*, 2016 IL. App (4<sup>th</sup>) 140795, \*P71; 2016 Ill. App. LEXIS 1, \*\*19.

Section 15-86 does not have ownership requirements, such as being an “institute of public charity,” in order to qualify for a charitable exemption.<sup>128</sup> The only requirement of §15-86 is that the property be used “exclusively for charitable purposes;” §15-65 also requires charitable ownership.<sup>129</sup> Section 15-86(c) demonstrates the legislature’s intent in creating §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>130</sup>

In other words, the legislation contemplates contributing “services and activities” by hospitals to be charitable exemptions. This contribution comes about in two forms: (1) the actual dollar amount that addresses the healthcare needs of low-income or undeserved individuals, and alleviates a burden from the government; and (2) the estimated amount that hospital would owe in property tax liability in the given year.<sup>131</sup>

Overall, §15-86 aims to open the door to clarity for 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>132</sup> This is a necessary provision for the Illinois legislation that resulted from the *Provena* case because it gets hospitals over the initial burden when challenged—regardless of ownership.

**b. Carle Foundation Hospital v. Cunningham Township.**

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<sup>128</sup> 35 ILL. COMP. STAT. ANN. 200/15-86 (LexisNexis 2016).

<sup>129</sup> *Id.*

<sup>130</sup> *Id.*

<sup>131</sup> *Carle Found. v. Cunningham Twp.*, 2016 IL. App (4<sup>th</sup>) 140795, at \*\*18.

<sup>132</sup> *Id.*

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. On January 5, 2016, the Illinois Fourth District Appeals Court decided the *Carle Foundation v. Cunningham Township*, holding §15-86 of the Illinois Tax Code unconstitutional.<sup>133</sup>

The Illinois Appeals Court held § 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>134</sup> The *Carle Foundation* decision states that §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>135</sup>

Article IX, section 6, of the Illinois Constitution of 1970 allows an exemption of property taxes to be granted to “units of local government and school districts and propertied *used exclusively* for agricultural and horticultural societies.”<sup>136</sup> The Illinois Constitution also carves out exemptions for schools, religious, cemeteries, and other charitable purposes.<sup>137</sup> The *Carle Foundation* court looked closely at the *used exclusively* language, and also stated that §15-86 exceeds the scope of the Illinois Constitution because, not only are nonprofit hospitals not used exclusively for charitable purposes, but §15-86 broadens the authority given to the State to exempt hospitals.<sup>138</sup>

The *Carle Foundation* decision suggests that §15-86 settles for much less than *exclusive use* by not requiring the property to be used for a charitable use at all.<sup>139</sup> The Illinois Appellate

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<sup>133</sup> *Carle Found. v. Cunningham Twp.*, 2016 IL. App (4<sup>th</sup>) 140795, at \*\*19.

<sup>134</sup> *Id.*

<sup>135</sup> *Id.* at \*\*17.

<sup>136</sup> Ill. Const. 1970, art. IX. §6.

<sup>137</sup> *Id.*

<sup>138</sup> *Carle Found. v. Cunningham Twp.*, 2016 IL. App (4<sup>th</sup>) 140795, at \*\*20.

<sup>139</sup> *Id.* at \*\*24.



Court suggests language to the legislature such as, “*even though* property is used exclusively for charitable purposes,” the property would only qualify for such exemption if the value of services provided equals or exceeds the real property tax liability.<sup>140</sup> This suggestion would effectively meet the legislative intent of §15-86 because the question of whether the nonprofit hospital was exclusively organized for a charitable purpose would still remain. 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 exemptions stem from the following factors: (1) the definition of “charity”; (2) the use and purpose of the entity; and (3) 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 the legislature struggle with defining “charity.” According to the dictionary, a charity is an “organization that helps people who are poor, sick, etc.”<sup>141</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>142</sup> One generally accepted concept that the dictionary leaves out is that a traditional charity is primarily funded by gifts, donations, and grants.<sup>143</sup>

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<sup>140</sup> *Id.* at \*\*26.

<sup>141</sup> *Charity Definition*, MERRIAM-WEBSTER.COM, <http://www.merriam-webster.com/dictionary/charity> (last visited Jan. 19, 2016).

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

<sup>143</sup> LOWELL, *supra* note 2, at 4-6,8.

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>144</sup> Soup kitchens are able to do this because they are usually associated with communities or religious organizations that donate money and goods, such as food and common toiletries.<sup>145</sup> A nonprofit hospital does not have the ability to give free care from pure donations and gifts in today's modern healthcare world because it is simply too expensive.<sup>146</sup> In order to administer care and operate as a sophisticated healthcare provider, hospitals must charge patients.<sup>147</sup>

Under federal tax law §501(c)(3) community benefit standard, nonprofit hospitals must have a charity care policy that provides financial assistance for those who cannot pay.<sup>148</sup> Hospitals are not able to provide free care or financial assistance to those who are insured or can afford to pay their medical bills.<sup>149</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, but nonprofit hospitals 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>150</sup> Nonprofit hospitals are not able to function as a zero-sum charity, and they are

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<sup>144</sup> *Soup Kitchens*, ENCYCLOPEDIA.COM, <http://www.encyclopedia.com/doc/1G2-3403400542.html> (last visited Jan. 19, 2016).

<sup>145</sup> *Id.*

<sup>146</sup> LOWELL, *supra* note 2, at 5.

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

<sup>148</sup> See Mayo Clinic, *Charity Care Policy – Administration of Financial Assistance*, <http://www.mayoclinic.org/documents/charitable-care-and-financial-assistance-policy/doc-20079439> (providing the criteria for patients seeking financial assistance), (last visited Feb. 15, 2016).

<sup>149</sup> LOWELL, *supra* note 2, at 12-16.

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

not able to rely on donations as a primary source of funding like a traditional charity does because of cost and society's reliance on services.

Because nonprofit hospitals will never be purely donative entities, states should define "charity" as the IRS does for §501(c)(3) federal nonprofit tax exemptions. The requirement under §501(c)(3) of the federal tax code requires nonprofit entities to be organized and operated exclusively for a charitable purpose.<sup>151</sup> Furthermore, §501(r) imposes new requirements on nonprofit hospitals by requiring them to provide the four additional requirements: (1) establishing a financial assistance and emergency medical care policy; (2) limiting the amount charged for emergency or other medically necessary care to patients who qualify for financial assistance; (3) taking 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>152</sup> If a nonprofit hospital meets the strict criteria for §501(c)(3) eligibility and §501(r) requirements, states should recognize the nonprofit hospital as a charitable organization.

**b. Factor #2: ACA Mandates Have Changed Nonprofit Hospital Property Use.**

**i. ACA Encourages Integration.**

Physician groups and hospitals working together promote increased quality and lower costs.<sup>153</sup> This a goal of ACA; however, this goal conflicts with the "use test" of real property tax exemption law, which resists the comingling of for-profit and nonprofit physicians and entities.<sup>154</sup>

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<sup>151</sup> 26 U.S.C. § 501(C)(3) (2014).

<sup>152</sup> 26 U.S.C. § 501(r) (2012).

<sup>153</sup> Laura Summer, *Integration, Concentration, and Competition in the Provider Marketplace*, Academy Health, available at [https://www.academyhealth.org/files/publications/AH\\_R\\_Integration%20FINAL2.pdf](https://www.academyhealth.org/files/publications/AH_R_Integration%20FINAL2.pdf).

<sup>154</sup> AHS Hosp. Corp. v. Town of Morristown, 28 N.J. Tax at 455 (recall Judge Vito Bianco's scrutiny over the comingling of for-profit physicians on Morristown Memorial's property).

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. Horizon Healthcare Innovations, a subsidiary of parent company Horizon Blue Cross Blue Shield of New Jersey, is one example of a healthcare player that is leading New Jersey's changing landscape by initiating the contracting of healthcare reform models such as: patient-centered medical homes, accountable care organizations, and episode of care.<sup>155</sup> For example, an accountable care organization ("ACO") is a group of hospitals, physicians, and other healthcare providers that work together to coordinate individuals' care.<sup>156</sup> It would be non-progressive in a collaborative healthcare entity, such as an ACO, to preclude nonprofit and for-profit healthcare providers from working on one another's property, and to enter into agreements with one another, when all players in the arrangement are providing care.

Another reason not to discourage the nonprofit and for-profit arrangements is to allow nonprofit hospitals to stay competitive in acquiring new talent and equipment. As an example, the New Jersey Board of Medical Examiners sets high standards for hospital licensing; including providing various types of care, physicians, and services for 'hospital purposes.'<sup>157</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>158</sup> It will be very difficult for nonprofit hospitals to operate under New

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<sup>155</sup> See Horizon Healthcare Innovations, *Products & Programs*, available at <https://www.horizonblue.com/providers/products-programs/horizon-healthcare-innovations> (detailing various healthcare reform models such as ACOs and PCMHs, which are encouraged by the ACA to promote efficacy in the new marketplace).

<sup>156</sup> See Centers for Medicare & Medicaid Services, *Accountable Care Organizations*, <https://www.cms.gov/Medicare/Medicare-Fee-for-Service-Payment/ACO/index.html?redirect=/Aco> (explaining "What's an ACO?").

<sup>157</sup> N.J. STAT. ANN. §8:43G (West 2016).

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

Jersey state regulation in the modern marketplace without having the ability to enter into relationships with outside for-profit facilities and for-profit physicians.<sup>159</sup>

## ii. Smaller Pool of Uninsured Under ACA.

Since the enactment of the ACA, thirty million more Americans have health insurance.<sup>160</sup> One may ask how this pertains to property tax exemption. Recall the definition of “charity care” that requires a quota for hospitals to meet in serving undeserved or needy patients. If nonprofit hospitals were arguably not taking care of enough uninsured individuals prior to the enactment of the ACA, they will have even less of an uninsured pool and a heightened Medicaid and CHIP pool, with over 4.5 million new enrollees as of 2014.<sup>161</sup>

In redrafting the qualifications and standards for nonprofit hospitals to receive a property tax exemption, the state legislatures must consider the impact of uninsured individuals from the ACA. Failure to take into consideration the large number of those who will be insured will likely result in hospitals having 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>162</sup>

Some states have already begun factoring in the effect from 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; Pennsylvania, which sets its state standard at three percent of revenues on charity care; and as discussed as a response to the *Provena* case, Illinois, which

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<sup>159</sup> LOWELL, *supra* note 2, at 6.

<sup>160</sup> David Whelan, *ObamaCare Could Cause Nonprofit Hospitals to Lose Their Tax-Exempt Status: Here’s How*, FORBES (Sep. 17, 2012 10:43 PM), <http://www.forbes.com/sites/davidwhelan/2012/09/17/obamacare-could-cause-nonprofit-hospitals-to-lose-their-tax-exempt-status-heres-how>.

<sup>161</sup> Vikki Wachino, et. al., *How is the ACA Impacting Medicaid Enrollment*, THE HENRY J. KAISER FAMILY FOUNDATION (May 5, 2014), <http://kff.org/medicaid/issue-brief/how-is-the-aca-impacting-medicaid-enrollment/>

<sup>162</sup> LOWELL, *supra* note 2, at 6.

requires an eight percent threshold to maintain a hospital's nonprofit status.<sup>163</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 of non profit 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 the case at hand, *AHS Hospital Corp.* The ACA provides 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 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 readmission standards under the ACA, which currently has increased pressures for some of New Jersey's top hospitals.<sup>164</sup> This year New Jersey led the country in the most penalized hospitals.<sup>165</sup> In 2012, New Jersey hospitals fell within the lowest operating margin costs, working within three percent.<sup>166</sup> Hospitals have many programs and responsibilities and large tax bills may decrease the amount of resources they can spend elsewhere.<sup>167</sup> In light of the increasing pressures on hospitals, the use of nonprofit hospitals has and continues to change as

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<sup>163</sup> *Id.*

<sup>164</sup> Susan K. Livio, *N.J. leads nation for number of hospitals penalized for high readmissions*, NJ.COM (Aug. 04, 2015 2:08 PM), [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>165</sup> *Id.* Coincidentally New Jersey is also home to some of the highest performing hospitals, but the debate on the readmissions formula is another debate, set for another time.

<sup>166</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. BUSINESS MAGAZINE (Aug. 11, 2014), [http://njbmagazine.com/monthly\\_articles/hospitals-transition](http://njbmagazine.com/monthly_articles/hospitals-transition).

<sup>167</sup> 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 a tax exemption in the changing healthcare landscape).

they must meet government mandates and the modern healthcare landscape—such as a different pool of uninsured, pressures of model integration, and funding additional programs and assessments. The use of nonprofit hospital campuses in 1961 when the *Paper Mill Playhouse* decision was handed down versus the use of nonprofit hospital campuses post-ACA enactment in 2010 is very different. Deference must be given to hospitals so they can meet their charitable aims, as well as compete 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 doesn't mean that nonprofit hospitals should be operating for a profit in contrast to the federal §501(c)(3) statute, but 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>168</sup> The concerns addressed were that some tax-exempt organizations are sometimes set up primarily to receive tax breaks and evade taxes.<sup>169</sup> Taxpayer expectations of not filling the pockets of individuals, while not disciplining institutions, such as nonprofit hospitals, from modernization were weighed at this hearing.

United States Senator Max Burns released a statement emphasizing the good that comes from charitable institutions, but argued that a balance should be met between charities who are aimed at doing good and those that engage in “sloppy, unethical, and criminal behavior.” He further encouraged alignment between the federal government and states to monitor this

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<sup>168</sup> Senate Finance Committee, “Staff Discussion Draft,” Senate Finance Committee Hearing—Charity Oversight and Reform: Keeping Bad Things from Happening to Good Charities (Jun. 22 2004), *available at* <http://www.finance.senate.gov/imo/media/doc/062204mb1.pdf>.

<sup>169</sup> *Id.*

behavior.<sup>170</sup> What is important 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>171</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 income to meet the expectations of society, however such acts are distinguishable from having cash reserves for operations.

However, rulings such as that in *AHS Hospital Corp. v. Town of Morristown* only serve to entice more litigation from local governments and third parties looking for a payday. See *infra* Part III section d where fifteen municipalities have filed tax assessment challenges against nonprofit hospitals in their municipalities. 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 to prove their property tax exemption case.<sup>172</sup> In April 2016, twenty-four more Princeton residents joined the suit claiming that the unpaid property tax must be absorbed by local taxpayers.<sup>173</sup>

Third party suits have not only questioned tax assessments, but collection actions by 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

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<sup>170</sup> *Id.*

<sup>171</sup> *Id.*

<sup>172</sup> *Fields v. Trustees of Princeton University* is an ongoing case where twenty-four more residents in Princeton, NJ recently joined the suit in April 2016. Anna Merriman, *24 More Residents Challenge Princeton U.’s tax exemption 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>173</sup> *Id.*



indigent and uninsured patients.<sup>174</sup> Over six hundred nonprofit hospitals across the country were named in the litigation in state and federal courts.<sup>175</sup> Within months of the filings, nearly all of the cases were dismissed.<sup>176</sup> Disgruntled patients proved that nonprofit hospitals need modern day expectations laid out and updated, because of the lack of defense 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>177</sup> However, property tax exemption is nontangible and is not retained revenue, but simply one less expense for nonprofit hospitals.<sup>178</sup> Nonprofit hospitals should be given flexibility in being able to retain revenues, and not be challenged under the argument that they are after profit. Additional revenues enable nonprofit hospitals to maintain operations and to develop the technologies and sophistication of the hospital that society has come to know and expect. Allowing nonprofits to have revenues without jumping 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 burdens of federal and state mandates, such as the ACA, and society expectations, such as providing state-of-the art advancements must be considered to ensure nonprofit hospitals are protected in the modern healthcare industry.

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<sup>174</sup> Lisa Kinney Helvin, *Caring for the Uninsured: Are Not-for-Profit Hospitals Doing Their Share?*, 8 YALE J. HEALTH POL'Y L. & ETHICS (2013).

<sup>175</sup> *Id.*

<sup>176</sup> *Id.*

<sup>177</sup> LOWELL, *supra* note 2, at 21-24.

<sup>178</sup> *Id.*

