RECENT NJ PROPERTY TAX SETTLEMENT: WHAT IT MEANS FOR NONPROFIT HOSPITALS…AND WHAT IT DOES NOT

UPDATE – January 19, 2016: Although both houses of the New Jersey legislature passed the measure mentioned in this post, New Jersey Governor Chris Christie subsequently pocket vetoed the measure. Legislators at the state and local levels are reportedly continuing their efforts to craft a legislative solution to clarify hospital property tax exemptions in New Jersey.

Many national publications have recently focused upon a decision from the New Jersey Tax Court stripping Morristown Memorial Hospital of its property tax exemption, the subsequent settlement of the hospital's appeal and a legislative push to tax New Jersey nonprofit hospitals. While hospitals and other health care organizations in New Jersey must pay close attention to how these developments might affect their property tax exemption, hospitals in most other states can breathe more comfortably. Hospital leaders should understand what the Morristown settlement means for tax-exempt hospitals nationally and what actions hospitals should take in response.

BACKGROUND

AHS Hospital Corp., d/b/a Morristown Memorial Hospital ("Morristown Hospital") settled a property tax dispute last month with the Town of Morristown, a Municipal Corporation of the State of New Jersey ("Morristown"), for $26 million. The settlement was in lieu of an appeal by Morristown Hospital of an earlier New Jersey Tax Court decision in which nearly all of the hospital's 1.1 million square foot campus would have been subject to property tax due to the tax court's finding that many aspects of the hospital were being operated in a for-profit manner. Under the settlement, Morristown and Morristown Hospital agreed that about 24 percent of the hospital's current property should have been taxable and will be taxable going forward - an adverse result, but one that averted the much greater magnitude of the tax court's decision. Since then, a bill has been proposed in the New Jersey legislature that would charge New Jersey nonprofit hospitals a fee of $2.50 per day for each hospital bed in the prior year, as well as $750 per day for each "satellite emergency care" facility, with certain exemptions available.

A NATIONAL PERSPECTIVE

Much of the commentary in the weeks since the Morristown settlement was announced featured sweeping statements warning that the court decision and settlement signal a growing national trend. In fact, property tax is a state law issue, and while some states have recently placed increased scrutiny on property tax exemptions for nonprofit hospitals, the trend has largely failed to materialize on a nationwide scale. Moreover, property tax exemption status typically does not affect a hospital's exemption from other taxes.

Before New Jersey, the most notable challenge to a hospital's property tax exemption was the 2010 Provena Covenant decision in Illinois, in response to which the legislature enacted clearer rules in 2012. These rules broadly require Illinois nonprofit hospitals to provide uncompensated care in an amount at least equal to the property tax that would have been assessed on the hospital's property in order to maintain exemption from property tax. Certain municipalities in Pennsylvania have also revoked property tax exemptions for nonprofit hospitals in recent years, but legislative efforts in Maine, Connecticut and Ohio have yet to gain enough support to become law.

Hospital leaders nationwide should also remember that, depending on their locality, their hospitals may seek exemption from a variety of tax types, including federal income tax, state income tax, state and local real and personal property tax and occasionally state sales tax. A hospital's loss or partial loss of tax-exempt status in one area or in one jurisdiction does not necessarily affect its exemption in other areas or other jurisdictions. In Morristown Hospital's case, for example, partial loss of property tax exemption in Morristown, New Jersey will have no impact on the hospital's exemption from federal income tax.

HOW TAX-EXEMPT HOSPITALS SHOULD RESPOND

Tax-exempt hospitals should be aware that certain states are increasing scrutiny of hospital property tax exemption and reexamining the standards required to maintain such exemptions. Of course, the best way to avoid property taxation is compliance with state property tax exemption laws. But, to the extent these laws are vague or unfriendly to nonprofit hospitals, tax-exempt hospitals should ensure strict compliance with the standards of Internal Revenue Code Section 501(r), which Hall Render has written about extensively. By adhering to the 501(r) statute and regulations, especially periodic review of a community health needs assessment and maintaining a robust financial

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assistance policy, tax-exempt hospitals will naturally give more attention to the level of charity care they are providing (the issue in the Provena case) and thus avoid the appearance of being operated for profit (the issue in the Morristown case). The 501(r) requirements for the financial assistance policy are relatively minimal, so hospitals should strive to exceed these basic guidelines in order to avoid scrutiny at both the federal and state levels.

If a tax-exempt hospital includes for-profit entities in its organizational structure, the hospital should ensure that accurate records are kept for each entity and that property and other resources are strictly segregated between the nonprofit and for-profit arms.

Finally, tax-exempt hospitals should contact their local hospital associations to look for ways to demonstrate to the legislature and the community the unique and vital benefits these hospitals provide - benefits that would not be possible, or at least not to the same degree, if the hospitals were required to pay taxes.

For further questions about property tax exemption or 501(r) compliance, please contact:

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