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Property Taxes

Hospital Settlement in Property Tax Case Holds Lessons for Nonprofit Health Systems

A nonprofit hospital's agreement to pay millions in back taxes to a New Jersey municipality should prompt similar entities to take steps to protect their property tax exemptions, attorneys who watched the case told Bloomberg BNA (*AHS Hosp. Corp. v. Town of Morristown*, N.J. Tax Ct., No. 010900-2007, settled, 11/10/15).

Nonprofit hospitals are exempt from real property taxes under state law, Michael A. Paff, a member of the commercial real estate and redevelopment team at Wilentz, Goldman & Spitzer in Newark, N.J., told Bloomberg BNA. In June, however, a state tax court stripped Morristown Medical Center (MMC) of its exemption, subjecting it to millions in back taxes and future assessments (24 HLR 917, 7/16/15).

In *AHS Hosp. Corp. v. Town of Morristown*, 2015 BL 206190 (N.J. Tax Ct. 2015), the court ruled that MMC was operating as a for-profit hospital, rather than as the nonprofit it claimed to be.

Paff said he wasn't surprised that MMC's parent corporation, Atlantic Hospital System, agreed to settle the case, because its liability to the town—already in excess of \$15.5 million—could have been far greater.

The issue isn't limited to New Jersey, Gary W. Herschman, of Epstein Becker Green in Newark, N.J., told Bloomberg BNA. There have been similar cases in other states, and with local governments facing budgetary concerns, "more and more states and municipalities will be revisiting whether nonprofit 501(c)(3) health-care facilities are entitled to state property tax exemptions," he said. A 501(c)(3) corporation is one that is exempt from taxation under federal tax law.

Nonprofit hospitals now must consider whether state and local authorities will be questioning their tax-exempt status, Herschman said.

Herschman, whose practice involves health-care transactional work, said acquiring corporations now must conduct due diligence on the extent to which their target might be exposed to property tax liability.

Both Paff and Herschman urged health-care attorneys to study the June tax court opinion, written by Judge Vito L. Bianco, for guidance on how to reduce a system's risk exposure.

Settlement Approved. The town council of Morristown, N.J., Nov. 10 approved the agreement between the town and AHS. The compromise ended a nearly decade-long fight over the town's assessment of real

property taxes against MMC by settling outstanding 2006 to 2015 property tax appeals and providing for future tax payments through 2025, according to a joint press release.

MMC will pay the town \$10 million in back taxes, along with \$5.5 million for interest and penalties, in annual installments over the next 10 years. Additionally, for the years 2016 through 2025, about 24 percent of the hospital's real property will be taxed at an assessed value of over \$40 million—an annual tax payment of \$1.05 million.

Morristown Mayor Timothy Dougherty said the agreement greatly benefits the town. "Taxpayers gain by having the hospital share a greater burden of the cost of providing municipal services, and the 10-year commitment provides a guaranteed revenue stream that allows the town to undertake plans for the future with confidence," Dougherty said.

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AHS's president and chief executive officer, Brian Gagnolati, said the agreement provides "clarity" for the hospital's financial obligations. "Additionally," he said, "Morristown Medical Center plans to have a greater presence in the lives of our community members by offering enhanced health and wellness programs that are reflective of their needs."

Dougherty said the hospital and town both "recognized the value in avoiding further litigation." The "spirit of collaboration" between the two "not only helped the two sides reach an equitable solution, it helped us cultivate a deeper relationship."

Gagnolati echoed Dougherty's remarks, saying that the settlement process led to an enhanced working relationship between the hospital and the town.

Closely Monitored. Hospitals throughout New Jersey were monitoring this dispute closely, Paff said. While 100 percent of the real property owned by a nonprofit system traditionally was treated by New Jersey as tax-exempt, the underlying tax court decision changed that, he said.

The tax court considered the administrative structure of both MMC and AHS. It found that MMC shared executives and board members with some of AHS's for-profit subsidiaries. MMC also allow its physician staff to bill patients directly for their services. Given these facts, the tax court said, it couldn't distinguish between the nonprofit portions of the facility and the portions that were used for profit-making purposes.

According to Paff, the court determined that only the visitor's parking garage, the auditorium and the fitness center were entitled to be excluded by the town when assessing MMC's property taxes.

The agreement in this case limited the assessable portion of the hospital's real property to about 24 percent, but other nonprofit hospitals now must determine what portion of their property might be considered taxable. That is "all up in the air," Paff said.

Limiting Liability. Hospitals that are trying to rein in their potential tax liability should identify the profit-making ventures within their facilities and make an effort to separate them from other services offered by the facility, Paff said. Money-making ventures, like offices that are leased to physicians, could be concentrated in one area of the facility, he said.

Also, nonprofit hospitals shouldn't have interlocking board members with for-profit corporations, Paff said, addressing the New Jersey Tax Court's concern over the hospital's administrative structure.

The effect of the tax court's decision, and the parties decision to settle, will be felt soon, because tax season is almost upon us, Paff said. Hospitals should be receiving notice of any assessments by the end of January 2016, he said.

Those assessments may be even larger than the ones imposed on MMC, since MMC is one of the smaller hospitals in New Jersey, Paff said. Additionally, he said, because New Jersey has the highest real property tax rates in the country, any assessment would be "a huge expense for a hospital," and "definitely" would have an impact on health-care costs.

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The New Jersey Tax Court's opinion is at http://www.bloomberglaw.com/public/document/AHS_Hosp_Corp_v_Town_of_Morristown_No_0109002007_2015_BL_206190_N.