Analysis – S-1306 (Vitale)

S-1306 (Vitale) is one of several bills introduced following last year’s Tax Court ruling against Morristown Medical Center. It was introduced on February 8, 2016, and is awaiting consideration by the Senate Community and Urban Affairs Committee. The bill would reaffirm the property tax exemption for non-profit hospitals and establish circumstances under which some hospitals would be required to enter into payment in lieu of taxes (PILOT) agreements with their host municipalities.

Background
The bill was introduced in the wake of the June 2015 ruling by Tax Court Judge Vito Bianco that held that Morristown Medical Center is not entitled to tax exemption on nearly all of its property in Morristown, primarily due to the commingling of non-profit and for-profit activities and what the judge deemed to be excess benefit to the for-profit entities as a result. In the ruling, Judge Vito Bianco, characterizing the concept of modern non-profit hospitals as “legal fictions,” stated that if all hospitals in their current form are structured like Morristown Medical then none are justified in receiving property tax exemption, and it’s up to the legislature to enact statutory changes that would change this framework.

Atlantic Health Systems (AHS), the parent of Morristown Medical Center, declined to appeal the decision and negotiated a settlement with the Town of Morristown, in which the hospital agreed to pay $15.5 million in back taxes and penalties, plus annual property taxes on 24 percent of the hospital's property from 2016 to 2025.

While the settlement resolved the dispute between AHS and Morristown, it essentially left unanswered all of the other questions raised by Judge Bianco’s decision. In the wake of the settlement announcement in the Morristown case, municipal officials in Newark, New Brunswick and elsewhere, in New Jersey and in other states, have moved swiftly to explore the possibility of challenging the tax exemptions or otherwise seeking payments from the hospitals within their borders. Currently, there are at least 26 hospitals in New Jersey whose tax exemptions have been formally challenged by their host municipalities.

Key Provisions
S-1306 establishes a formula for determining whether an “acute care hospital” 1 would be required to make payments in lieu of taxes. The formula is based on the percentage of total expenses devoted to community benefit expense and community building activities expenses as reported on Schedule H of the three most recent Form 990 information returns of a “qualified nonprofit acute care hospital” 2:

- If, over a 3-year period, the community benefit expense is 5% or more of its total expenses, or its combined community benefit expenses and community building activities percentage is 10% or more, the hospital will continue to be exempt from taxation. That hospital would be required to enter into a mandatory PILOT agreement with its host municipality if the average of its community benefit is between 5% - 8%, and the average combined community benefit expense and community building activities expense is less than 10% of its total expenses.

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1 “Acute care hospital” means a hospital which maintains and operates organized facilities and services as approved and licensed by the Department of Health for the diagnosis, treatment, or care of persons suffering from acute illness, injury, or deformity and in which all diagnosis, treatment, and care are administered by or performed under the direction of persons licensed to practice medicine or osteopathy in the State of New Jersey, and includes all land and buildings that are used in the delivery of health care services by such hospital and its medical providers or that are used for the management, maintenance, administration, and security of such hospital and its medical providers, and any licensed satellite emergency care facility of such hospital.

2 “Qualified nonprofit acute care hospital” means a nonprofit acute care hospital for which either an average of the community benefit expense percentages of total expense reported on its Internal Revenue Service Form 990, Schedule H, filed with the Internal Revenue Service for the three tax years prior to the pretax year is five percent or greater, or the average of the combined community benefit expense and community building activities percentages of total expense reported on those filings is 10 percent or greater.
• If the average community benefit expense is greater than 8% or the average of its combined community benefit expense and community building activities expense is 10% or more, the hospital may, but is not required to, enter into a PILOT agreement with its host municipality.
• If the community benefit expense is less than 5% and the average combined community benefit and community building activities expense is less than 10%, then the hospital is automatically subject to property taxation. The municipality in which such hospital is located may forego property tax collection and implement a PILOT agreement with the hospital instead.

Similar to other recent hospital property tax bills, S-1306 clarifies that non-profit hospitals may lease or permit the use of their facilities by for-profit medical providers for medical purposes without having such use jeopardize their exemption for that portion of their property. This specifically addresses one of the primary portions of Judge Bianco’s ruling against Atlantic Health Systems.

Questions
• Definition of “acute care hospital” – The bill provides separate definitions for an “acute care hospital” (definition on p. 1) and “hospital purposes”3 (e.g., nursing homes, residential care facilities, assisted living, etc.), when laying out the ownership or use requirements that might subject an entity to the bill’s requirements. The bill refers at various points to property owned by an acute care hospital, or “used as an acute care hospital” but owned by an organization organized for “hospital purposes.” Several legal experts have indicated that the definition of acute care hospital has been carefully drafted so that non-hospital organizations from being inadvertently or inappropriately subject to the bill’s requirements; however, non-hospital organizations involved in providing health or residential services should examine the definition carefully to determine whether they might be covered.
• Standing of third parties to bring property tax challenges – A separate but related issue in the context of recent property tax cases concerns the standing of individual residents and other third parties to challenge the determination of government officials regarding tax exemption. Amending the law to limit such standing (for all non-profit property tax cases, not just hospitals) would help to protect organizations from being arbitrarily forced to re-prove their exemptions repeatedly and from needlessly siphoning scarce resources away from charitable purposes. Such a provision is not part of the current bill.
• Constitutional questions – The NJ State League of Municipalities has opposed many of the property tax bills, claiming that they are unconstitutional because they alter the constitutional framework for who can grant property tax exemption and who receives it. Proponents say that they have satisfactorily addressed such concerns. (updated 4/17/2016)

3 In the bill, “Hospital purposes” includes qualified nonprofit acute care hospitals, health care facilities for the elderly, such as nursing homes; residential health care facilities; assisted living residences; facilities with a Class C license pursuant to P.L.1979, c.496 (C.55:13B-1 et al.), the "Rooming and Boarding House Act of 1979"; similar facilities that provide medical, nursing or personal care services to their residents; and that portion of the central administrative or service facility of a continuing care retirement community that is reasonably allocable as a health care facility for the elderly, but does not include acute care hospitals that do not meet the requirements of a qualified nonprofit acute care hospital, as that term is defined in [pending bill S-1306].