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TAX - NEW JERSEY

AHS Hospital Corp. v. Town of Morristown

Tax Court of New Jersey - June 25, 2015 - N.J.Tax - 2015 WL 3956132

Hospital, as taxpayer, sought review of town's denial of property tax exemption under statute granting exemption for nonprofit organizations.

As matters of first impression, the New Jersey Tax Court held that:

- For-profit activities of physicians and nonprofit activities carried out by hospital were unable to be separately stated and accounted for;
- Operation and use of hospital property was for benefit of affiliated and non-affiliated for-profit entities;
- Contracts for physicians employed directly by hospital had profit-making purpose; but
- Management agreement between hospital and contractor related to parking garage was not entered into with profit-making purpose;
- Hospital's agreement with company to provide services including food and nutrition and laundry distribution demonstrated profit-making purpose;
- Gift shop was not reasonably necessary for hospital purpose; and
- Hospital auditorium and fitness center were not operated or used for profit.

For-profit activities of voluntary physicians and exclusive contract physicians and nonprofit activities carried out by hospital were unable to be separately stated and accounted for, such that areas in hospital in which physicians practiced were not exempt from property tax under statute granting exemption for nonprofit entities. For-profit voluntary and exclusive contract physicians were subject to taxation, and voluntary and exclusive contract physicians worked throughout hospital and were not contained within any particular area.

Hospital operated and used its property for profit-making purpose by entangling its activities with affiliated and non-affiliated for-profit entities, such that hospital did not qualify for property tax exemption for nonprofit organizations, since commingling of effort and activities with for-profit entities was significant and substantial benefit was conferred on for-profit entities as a result. Hospital provided substantial subsidies to affiliated and unaffiliated for-profit entities in form of working capital loans, capital loans, and recruitments loans, hospital employees worked at affiliated for-profit entity, and hospital executives also served affiliated entities in executive capacities, making arm's-length transactions impossible.

Compensation hospital paid its executives was not reasonable, as factor weighing in favor of determination that hospital's operation and use of its property was conducted for profit, rendering hospital ineligible for property tax exemption for nonprofit organization, absent evidence of salaries paid for similar positions by similar institutions.

Contracts for physicians employed directly by hospital had profit-making purpose, in violation of requirement under statute granting property tax exemption for nonprofit organizations that property must not be used for profit. Employed physicians were given incentive component in addition to

their base compensation, incentive pools were derived from departmental expenses, and profit was split between hospital and physicians, indicating that revenue-sharing operation was conducted for profit-making purpose.

Management agreement between hospital and private, for-profit contractor to provide services related to visitors' parking garage on hospital property was not entered into with profit-making purpose, such that agreement satisfied requirement that property not be used for profit under statute granting property tax exemption for nonprofit organizations. Hospital paid fixed management fee and bore expenses of operating parking garage, such that fee arrangement with contractor was no different from compensation paid to hospital employees, and hospital operated parking garage at a loss.

Hospital's arrangement with company to provide food and nutrition services, environmental services, laundry and linen distribution, patient transportation, and plant operations maintenance demonstrated profit-making purpose, in violation of requirement that hospital property not be used for profit under statute granting property tax exemption for nonprofit organizations, such that areas of hospital in which company operated were subject to taxation. Hospital's agreement with company demonstrated that both parties contemplated generation of additional revenue in form of reduced expenses, and additional revenue was split between hospital and company.

Gift shop was not reasonably necessary for hospital purpose, but rather served as form of competition to commercially-owned facilities, such that gift shop was not actually and exclusively used for tax-exempt purpose of hospital, as required for gift shop to be exempt from taxation under statute granting property tax exemption for nonprofit organizations. Gift shop did not provide any medical service required by hospital patient, but rather gift shop simply sold items that visitor might bring to patient or use for his or her own purposes, and gift shop was merely a convenience for hospital visitors.

Hospital auditorium was not used for profit, as required for area of hospital in which auditorium was located to be exempt from property taxes under statute granting exemption for nonprofit organizations. Payments were not collected by hospital for use of auditorium.

Hospital fitness center was not used or operated for profit, as required for fitness center to be exempt from property tax under statute granting exemption for nonprofit organizations. Although small amount of hospital employees who used fitness center paid a minor fee, there was not considerable business activity involving fitness center, and no profit was made from fitness center.

Hospital day care center was not exempt from property taxes under statute granting exemption for nonprofit organizations, absent demonstration that day care center was not used or operated for profit.

"If it is true that all non-profit hospitals operate like the Hospital in this case, as was the testimony here, then for purposes of the property tax exemption, modern non-profit hospitals are essentially *legal fictions*; and it is long established that "fictions arise from the law, and not law from fictions." Accordingly, if the property tax exemption for modern non-profit hospitals is to exist at all in New Jersey going forward, then it is a function of the Legislature and not the courts to promulgate what the terms and conditions will be. Clearly, the operation and function of modern non-profit hospitals do not meet the current criteria for property tax exemption under N.J.S.A. 54:4-3.6 and the applicable case law."

