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HealthCare Appraisers' Industry Insight

NONPROFIT STATUS CHALLENGES

SYDNEY HILZENRATH, CEP, CECP, FRED LARA, CFA, ASA, CVA AND WILLIAM KAUFMANN, JD/MBA

An article in Medical Economics calls on patients to “demand that the nonprofit hospitals that profess to be charitable institutions stop paying their executives outsized compensation packages, and start giving back to the communities they take from.”¹ Within the last year, Senator Chuck Grassley of Iowa wrote the IRS requesting to increase its scrutiny of 990 Schedule H reports with aim at verifying the legitimacy of nonprofit hospitals’ tax exempt status.² Litigation between municipalities and nonprofit hospitals continues to develop nearly five years after the New Jersey Tax Court’s seminal decision that denied Morristown Medical Center’s nonprofit property tax exemption for its main campus. Given these litigation, legislative, and public actions, the trend in nonprofit hospitals facing challenges to tax exemption appears to continue to build momentum. Hospitals and health systems account for nearly two-thirds of the 5,000 nonprofit organizations in the United States and now may be facing substantial unforeseen financial burdens as a result of this trend.

Morristown Medical Center was the first nonprofit hospital to be denied its tax benefits by a court of law, which based the ruling on two key findings: (1) entanglement of nonprofit activities with for-profit entities; and (2) that the hospital failed to meet the burden of reasonable compensation for its staff (*i.e.*, its employed physicians and non-physician executives). Ultimately, the New Jersey Tax Court ruled that Morristown Medical Center failed the profit test and that “for-profit activity [was] carried out by private physicians.” The outcome of the ruling included a \$15.5 million penalty for the nonprofit hospital, along with commencement of annual taxes of approximately \$1 million.

Following the Morristown case, over 40 New Jersey municipalities challenged the property tax exemption for various nonprofit hospitals, many of which are still working through the legal process, including:³

- Ridgewood and The Valley Hospital, alleging \$4.5 million in back taxes
- Paterson and St. Joseph’s Regional Medical Center, alleging \$5.7 million in back taxes
- Vineland and Inspira Health Network, alleging \$3.1 million in back taxes for 2018 alone

¹ “How nonprofit hospitals get away with the biggest rip off in America,” Marni Jameson Carey, Medical Economics, Published January 17, 2020. <https://www.medicaleconomics.com/news/how-nonprofit-hospitals-get-away-biggest-rip-america>

² “Grassley back at it, ramping up scrutiny of tax-exempt hospitals,” Susannah Luthi, Modern Healthcare, Published March 9, 2019. <https://www.modernhealthcare.com/government/grassley-back-it-ramping-up-scrutiny-tax-exempt-hospitals>

³ “These NJ towns still have pending lawsuits to tax hospitals.” Keith Ortiz, New Jersey Record, Published May 22, 2019. <https://www.northjersey.com/story/news/local/2019/05/22/nj-towns-still-have-pending-lawsuits-tax-hospitals-hackensack-university-medical-center/3754167002/>



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In addition to New Jersey cases, Pennsylvania municipalities have followed the trend in challenging hospital tax-exemptions, with litigation arising in Pittsburgh and Upper Moreland Township. The Pennsylvania Attorney General has taken the position that the University of Pittsburgh Medical Center owes \$40 million in 2018 back taxes.⁴ Upper Moreland Township, on the other hand, is focusing on the future, alleging that Asplundh Cancer Center, an affiliate of Abington Memorial Hospital and Jefferson Health System, should pay \$500,000 per year in property taxes. Notably, Upper Moreland Township specifically alleged that “[c]ontrary to state law, the Abington/Jefferson health network conducts its far-reaching business enterprises as profit-making businesses – including paying its top executives millions of dollars – while avoiding payment of their fair share of property taxes.”⁵

Challenges regarding nonprofit hospital property taxes have also extended into the legislative realm in Montana, New Jersey, and Georgia. Senators in Montana have repeatedly proposed a bill to revoke the property tax exemption for nonprofit organizations that pay executives excessive compensation over \$250,000 per year.⁶ Georgia has embarked on more strict scrutiny through the 2019 law that passed mandating that nonprofit hospitals disclose all key financial data directly to the state, specifically include the level of executive compensation and benefits.⁷ The New Jersey legislature is weighing whether to create a “contribution fee” of \$2.50 per bed, per day, to be paid by nonprofit hospitals in order to offset municipal services generally provided by the towns.

In preparation for impending nonprofit tax exempt status challenges, preemptively establishing the reasonableness of compensation amounts may be a key arrow in the defense quiver. HealthCare Appraisers has expertise in executive compensation design, benchmarking, governance and fair market value analysis to help support nonprofit hospitals’ compliance and risk mitigation. Please contact Sydney Hilzenrath (Executive Compensation & Governance) or Fred Lara (Compensation Valuation) with any questions or to discuss your organization’s needs.

⁴ “Giant hospital system’s charity status challenged,” Carolyn Y. Johnson, The Washington Post, Published February 7, 2019. <https://www.washingtonpost.com/health/2019/02/07/giant-hospital-systems-charity-status-challenged/>

⁵ “UPPER MORELAND TOWNSHIP SCHOOL DISTRICT FILES CHALLENGE TO ABINGTON HOSPITAL’S LUCRATIVE LOCAL PROPERTY TAX-EXEMPTION,” Freiwald Law, Published January 16, 2019. <https://www.freiwaldlaw.com/wp-content/uploads/2019/01/UPPER-MORELAND-RELEASE.pdf>

⁶ “Public Policy Issues,” Montana Nonprofit Association, Last Visited January 27, 2020. <https://www.mtnonprofit.org/public-policy/public-policy-issues/>

⁷ “No Delay: Georgia Nonprofit Hospitals Must Disclose Financial Data Soon,” Andy Miller, Georgia Health News, Published September 18, 2019. <https://www.wabe.org/no-delay-georgia-nonprofit-hospitals-must-disclose-financial-data-soon/>

