

•Focus on Finance•

Answers to your Accounting and Tax Questions

Non-profit Hospitals Under Fire for Exemption from Property Taxes

There has been some recent press about the government seeking not-for-profit hospitals to pay property taxes. How do we defend ourselves against such scrutiny?

Hospitals should properly and completely identify and quantify their charity care costs and all other community benefit costs provided to the community on an annual basis. Hospital personnel should be aware of these costs for purposes of disclosing and discussing with the general public.

On April 4, 2008, the Wall Street Journal's Health Blog posted an article called, "On Top of Tax Breaks, Nonprofit Hospitals Reap Big Profits." Outlined below are a few highlights:

"Take a look at Northwestern Memorial Hospital in Chicago, which has rebuilt its entire campus in the last few years, including a new women's hospital with marble in the lobby and flat-screen TVs in birthing rooms. The hospital's former CEO received a \$16.4 million payout in 2006, the WSJ says.

The same year, the hospital spent \$20.8 million (less than 2% of its revenue) on charity care. Northwestern Memorial receives tax breaks of \$50 million, one foundation calculates.... Hospital officials say the facility provides community benefits beyond charity care. Taking into account educational and other expenses, such as bad debt and unreimbursed Medicaid costs, Northwestern Memorial values its total community-benefit contribution at \$230 million for fiscal 2006."

The Center for Tax and Budget Accountability, a Chicago nonprofit organization, estimates the value of the hospital's annual property-tax exemption at \$37.5 million. Northwestern Memorial is also exempt from \$12.5 million in sales tax for a total of \$50 million in annual tax exemptions, not counting the taxes it doesn't pay on its investment gains, the center estimates."

In the July/August 2007 FOCUS on Finance column, we discussed how not-for-profit hospitals need to be proactive in offering, identifying and quantifying community benefit programs within its community in conjunction with maintaining its tax-exempt status.

In this economy, the pressure from cash-strapped state, local and municipal governments is greater than ever. They are taking a closer look at whether not-for-profit hospitals are doing their part to benefit public interest by providing chari-



Anthony Panico



Scott Mariani

ty care and other community benefit services to their local communities, or whether it is in the best interest of the public if the government were to impose property taxes in order to lessen the tax burden on citizens with regards to costs related to infrastructure and education within their community.

According to the American Hospital Directory, not for-profit hospitals account for about 60 percent of the more than 3,400 hospitals in the U.S. In a report issued in December 2006, the Congressional Budget Office estimated nonprofit hospitals receive \$12.6 billion in annual tax exemptions, on top of the \$32 billion in federal, state and local subsidies the hospital industry as a whole receives each year.

There is a popular theory that all hospitals should pay appropriate property taxes and report their profits and losses and pay taxes accordingly. If hospitals are providing a large amount of charitable care, those services would be quantified and exempt from taxes as a business loss. If not, and the hospital is generating excess revenue, then income should be taxable. Of course, only a small percentage of these hospitals can boast such excess; a large percentage of not-for-profits are struggling just to keep their doors open.

Q Does the new Form 990 address the community benefit issues?

A Yes, the newly revised Form 990, Schedule H, due to take full effect in 2009, requires a not-for-profit hospital to demonstrate specifics of their respective community-benefit contributions. It is important to note that a not-for-profit hospital must effectively plan and organize its community benefit programs in accordance with IRS rulings, as well as disclose its community

benefits to the general public. Quality indicators need to be built into the community benefit program, allowing the ability for a quantifiable evaluation. Establishing specific objectives is fundamental in order to assess the effectiveness of services and activities in improving health within the community.

Boards or Board committees can also play a role in this process by continually overseeing and reviewing existing charity care policies; community benefit reports and the methods of disclosing this information to the general public, and an internal assessment of how that organization is meeting its community's health care needs.

Has New Jersey been actively reviewing property tax-exemption issues?

Yes, there is a state statute applicable to property tax-exemption, N.J.S.A. 54:4-3.6 relating to property tax exemption. In addition, recently the issue of property tax-exemption was raised by a municipality with respect to certain premises owned and operated by Hunterdon Medical Center. Important to point out is that this property was not directly on the hospital grounds, but a number of miles away. Factors that were reviewed in this matter included the following:

- Integration of the facilities (including distance);
- Supervision by hospital medical staff;
- Service to hospital patients versus the general public; and
- Competition with commercial businesses.

In addition while not necessarily a property tax per se, a state, local or municipality may also attempt to seek payment from the tax-exempt hospital in the form of a "PILOT"; a payment in lieu of tax. Lastly, it should be pointed out that a hospital could also end up paying property taxes on some of its properties while continuing to enjoy exemption from property taxes on other of its properties.

Summary

Tax-exempt hospitals enjoy many benefits as a result of their exempt status, including but not limited to, being exempt from Federal corporate income tax; being exempt from Federal unemployment tax; having access to tax-exempt financing and related costs and maintaining exemption from state, local and municipal property taxes. A hospital reduces the possibility of Federal, state, local and municipal scrutiny of the organization by completely disclosing, identifying and quantifying their charity care costs and all other community benefit costs it provides to the community on an annual basis.

About the Authors

Scott J. Mariani, JD, is a Partner and Anthony Panico is a Senior Manager at WithumSmith+Brown, Certified Public Accountants and Consultants. Both Scott and Anthony are based in the firm's Morristown, NJ, office, and can be reached at 973-898-9494.

If you have a question related to accounting or tax that you would like answered in the next issue of Garden State Focus, please e-mail it to elitten@foxrothschild.com. Your questions are greatly encouraged!