

Appellate Court Upholds Denial of Property Tax Exemption to Non-Profit

By: William D. Kennedy

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Across the United States, public schools are primarily funded by property taxes based on assessments on both the land and buildings within the taxing district. Historically, however, non-profit hospitals, health centers, universities, and colleges – “meds and eds” – pay little, if any, property taxes. In 2021, however, White and Williams LLP warned of a trial court property tax case that acted as a shot across the bow, see *Non-Profit Hospital Ordered To Pay Property Taxes: A Shot Across the Bow and 'Non-Charitable' Nonprofit Hospital Ordered to Start Paying Property Taxes*. Recently, a mid-level appellate court upheld the trial court’s decision to deny property tax exemption to an ostensibly non-profit hospital that seemed to have been operated with a for-profit business model.

Background: “Meds and Eds” Property Tax Exemption

The vast majority of colleges, universities, hospitals and health centers are non-profit corporations. Non-profit hospitals make up 75% of the Pennsylvania market and more than two-thirds of the US market. Almost all such non-profits have received 501(c)(3) status, exempting them from federal income taxes. Likewise, under the guise of state “charity” statutes, most non-profit hospitals are exempt from paying property taxes. Those exemptions increase the burden of paying for local schools to all those without property tax exemptions.

Critics contend that the “local funding” concept of public schools leads to systemic inequality of educational opportunities. Schools in districts with rising property values fare substantially better in every metric than schools in areas of impoverished neighborhoods, vacant commercial parks, or abandoned industrial sites. The school funding property tax inequities cited by the Pennsylvania Commonwealth Court’s groundbreaking, 786-page decision in *William Penn School District v. Pennsylvania Department of Education*, 2023 Pa. Commw. Unpub. LEXIS 91 (Commw. Ct. Feb. 7, 2023) are compounded when local governments exempt “meds and eds” from having to pay property taxes.[1] Now, as Pennsylvania’s legislature grapples with how to provide all public students with a Constitutionally valid education, the property tax exemption enjoyed by non-profits faces new scrutiny.

The *Tower Health/Brandywine Hospital Decision*

Beginning in 1983, Brandywine Hospital operated as a stand-alone, non-profit, acute care hospital for an underserved population centered around Coatesville, Chester County, Pennsylvania, 40 miles west of Philadelphia. By mid-2001, after years of serving a largely uninsured population, the non-profit operation was sold to for-profit Community Health Services of Brentwood, Tennessee for \$82 million, \$40 million in cash and the rest in capital improvements. At one point, Community Health was the largest publicly traded hospital company in the nation, but in 2017 after several years of losses, it sold 12 of its 15 Pennsylvania hospitals. For \$423 million, Berks County-based non-profit Reading Health System – now known as Tower Health, LLC – bought five of the Community Health Philadelphia-area hospitals (Chestnut Hill Hospital, Brandywine Hospital, Jennersville Regional Hospital, Pottstown Memorial Hospital, and Phoenixville Hospital). Each facility was set up as a new LLC of which Tower Health became the sole member.[2]

For the tax years 2018 through 2021, the Chester County Board of Assessment Appeals denied Brandywine Hospital’s (Hospital) property tax exemption. On appeal, and after a *de novo* bench trial, the trial court also denied the exemption, finding that the Hospital did not qualify as a tax-exempt “charity” under the relevant statute. The trial court ruled that the Hospital failed to show that it provided gratuitous, “uncompensated” patient care. The trial court also focused on the Hospital’s executive compensation scheme which drained

"huge sums ...from the [hospital to Tower Health] which result in the hospital 'showing' a large net loss."

On appeal, the Commonwealth Court first dismissed the entire appeal due to the Hospital's egregious non-compliance with a mandatory court rule regarding an appellant's obligation to provide a "concise statement of the [trial court's] errors complained of..." In the name of "completeness," however, the Court then wrote that had it not dismissed the appeal, "we would affirm the trial court's decision on the merits."

The Commonwealth Court noted that under statutory and common law, a tax-exempt "charity" must advance a charitable purpose, relieve the government of a burden, donate a substantial portion of its services, and operate "entirely free from private profit motive." Under a series of common law appellate decisions, "the diversion of surplus monies into entities that have a profit motive" erodes a claim for tax-exempt "charitable" status. The Court noted that under Tower Health's compensation plan, 40% of the senior executives' compensation could be bonuses for the financial performance of Brandywine and other hospitals. Such a compensation plan belied Brandywine's claim that it operated without the forbidden "profit motive."

Like the trial court, the appellate court also emphasized the Hospital's failure to prove it had donated, or rendered gratuitously, its medical services to people who couldn't have afforded to pay. To qualify as the required "donated" or "gratuitous" care, a non-profit hospital has to demonstrate that it treated people who did not pay and could not afford to pay, as opposed to treating people whose governmental health insurance reimbursed the hospital at rates lower than the hospital wanted. Both the trial and appellate courts noted that Brandywine proffered no such evidence of the patients' inability to pay from lay or expert witnesses. In fact, the evidence pointed to the contrary conclusion: that Brandywine wrote off as "bad debt" unpaid fees for patients who actually had an ability to have paid such fees.

Impact of the *Tower Health/Brandywine Hospital Decision*

Both the trial and mid-level appellate court decisions in the Tower Health/Brandywine Hospital litigation highlight how disconnected Pennsylvania's antiquated law governing tax-exempt "charities" are from the modern reality of providing health care services. Still, that body of law is unlikely to change in favor of tax-exempt entities. Indeed, pursuant to *William Penn School District*, the Pennsylvania General Assembly is already considering how to revise the state's public school funding system; doing so requires more taxes from more taxpayers, not less from fewer.

The *Tower Health/Brandywine Hospital* decisions emphasize the importance for non-profit healthcare systems to work hard now if they want to maintain their property tax exemption. In light of the *Tower Health/Brandywine Hospital* decisions, non-profit healthcare systems will want to review:

- how and why revenue from a licensed healthcare enterprise is transferred from a subordinate, non-profit hospital to a parent non-profit company;
- the extent to which compensation incentives may fall outside of the definition of a "charity," and
- billing and accounting practices with respect to gratuitous care to people who cannot have afforded to pay.

The *Tower Health/Brandywine Hospital* cases seem provide a safe harbor for non-profit healthcare providers whose parent companies are paid commercially reasonable management fees, whose executives are not paid in excess of IRS guidelines, and who develop concrete evidence of uncompensated care. These court rulings caution institutions to defend tax attacks with counsel with a deep commitment to trial and appellate litigation.

White and Williams works with non-profit healthcare systems, hospitals and others who may need help maintaining non-profit, tax-exempt status, or navigating the effects of the *Tower Health/Brandywine Hospital* decisions. If you have any questions or would like additional information, please contact Bill Kennedy (kennedyw@whiteandwilliams.com; 215.864.6816).

[1] In *William Penn School District*, Pennsylvania's Commonwealth Court, sitting as a trial court, ruled that Pennsylvania's school funding system, as codified in legislation, violates the state Constitution and must be reformed to provide more funding to poorer school districts.

[2] Tower Health closed Brandywine Hospital in January 2023. In 2022, it sold Chestnut Hill Hospital for \$28 million to Philadelphia's Temple University Health System, and closed Jennersville Hospital, which has since been sold for \$8 million to Delaware-based ChristianaCare.

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