Non-Profit Hospital Ordered to Pay Property Taxes: A Shot Across the Bow

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BACKGROUND

Hospitals have long organized as non-profit corporations and received recognition as tax-exempt organizations by the IRS. More than two decades after for-profit hospitals entered the market, there are still twice as many non-profit hospitals as there are for-profits in the US. In Pennsylvania, the ratio is even higher: more than 75% of all hospitals are organized as non-profits. Generally speaking, the motivation for being a non-profit hospital is straight-forward: by avoiding cash-draining dividends and some (but not all) taxes, the non-profit has more money to devote to improving the delivery of healthcare.

THE *TOWER HEALTH* OPINION

The Chester County Court of Common Pleas ruled in a consolidated appeal of three local Tower Health hospitals – one of which (Jennersville Hospital) the parent company (or, in non-profit parlance, the sole corporate member) had previously announced will close at the end of 2021, and another of which (Brandywine Hospital) it wants to sell.[1] In a departure from over a century of non-profit hospital-tax decisions, Judge Jeffrey Sommer found that the Tower Health hospitals did not qualify as "charities" under the 1997 Institutions of Purely Public Charity Act (10 Pa. Stat. §371-385) (as influenced by prior Acts and judicial decisions). The court ruled that the hospitals failed to show that they provided "uncompensated" patient care. The court also frowned on the companies' administrative structure and executive compensation schemes which drained "huge sums … from the [hospitals and to Tower Health] which result in the hospital 'showing' a large net loss."

The court reached its decision after a two-week bench trial. The three Tower Health hospitals contended that provided charitable-care by providing services for which Medicare and others paid less than the hospitals wanted. The court disagreed, distinguishing between "undercompensated care" from truly "uncompensated" – or charitable–care. The court also found that the hospitals' reliance on a "master charge sheet" – a common feature in hospital finance offices – was misplaced, not only because the master charge sheet was not proffered into evidence, but also because the hospitals' own witness "testified [that] the master charge sheet has no meaning or value. … [T]he numbers, essentially, are pulled out of thin air and are created only because [the hospital] is required to have a charge sheet to satisfy federal requirements."

The three hospitals contended that they had each lost money, but the court noted that Tower Health had charged various fees to the three hospitals which amounted to $43 million in 2020 alone. The court emphasized that Tower Health executives were paid millions in annual compensation, well above the $1 million threshold for potential imposition of a 21.5% IRS excise tax. "Perhaps had each hospital not been required to pay exorbitant amounts to Tower Health for management fees and interest they would not have been 'failing businesses.'"

IMPORTANCE OF *TOWER HEALTH* FOR NON-PROFIT HEALTHCARE ORGANIZATIONS

The *Tower Health* court readily acknowledged that its decision will be appealed. It also implored the legislature for a long-overdue modernization of the tax-status statutes to fit the current world of healthcare reimbursements. Still, notwithstanding appellate review and/or an Act of the General Assembly, *Tower Health* sends a warning shot across the bow of non-profit healthcare organizations such as skilled nursing facilities, retirement communities, home healthcare enterprises, and others. While the *Tower Health* decision now stands alone – another county's court found that the organization was a tax-exempt "charity" – local townships, boroughs, and cities across the Commonwealth are examining how they can apply the decision to non-profit hospitals within their territories.

Non-profit organizations will want to pay close attention to the *Tower Health* decision. They will want to review:

- how and why revenue from a licensed healthcare enterprise is transferred to a parent company;
- the overall amount of local and parent company executive compensation (salary, bonuses, etc.); and
- billing and accounting practices with respect to genuinely uncompensated (as opposed to undercompensated) care.

Tower Health seems to 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. *Tower Health* cautions institutions to defend tax attacks with counsel with a deep commitment both to tax law and courtroom litigation. Fundamentally, the *Tower Health* message seems akin to the proverbial duck test: if your tax-exempt non-profit company looks, swims, and quacks like a for-profit duck, it may well be treated like a for-profit.

White and Williams works with non-profit healthcare systems, hospitals, physicians, and others who may need help maintaining non-profit, tax-exempt status, or navigating the effects of the *Tower Health* decision. If you have any questions or would like additional information, please contact Bill Kennedy (kennedyw@whiteandwilliams.com; 215.864.6816), or Jared Johnson (johnsonj@whiteandwilliams.com; 215.864.6290).

[1] *In re: Appeal of Brandywine, Jennersville, and Phoenixville Hospitals, et al.,* Chester County Nos. 17-11220, 17-11222, 17-11223, 17-11226, 17-11227, 18-11854, 18-11855, 18-11857, 18-11858, 18-11859.

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