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**PROPERTY TAX EXEMPTION FOR CHARITABLE  
NONPROFIT ORGANIZATIONS: A UNIFORM POSSIBILITY**

**Jaclyn Fabean Cherry<sup>†</sup>**

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<sup>†</sup> © 2017 Associate Dean for Academic Affairs & Associate Professor of Law, University of South Carolina School of Law. The author would like to thank Eleanor Bleecker and Emily Godwin for their research assistance and Vanessa McQuinn for her expertise.

[T]he very reason which makes direct taxation disagreeable makes it preferable. Under it every one knows how much he really pays.<sup>1</sup>

## I. INTRODUCTION

Under current property tax regimes in this country, charitable nonprofit organizations are treated differently not only from state to state and city to city, but also from municipality to municipality within each state. For example, in New Jersey, Princeton University was recently sued by citizens even after entering into an agreement with the local municipality to make payments in lieu of property taxes,<sup>2</sup> and hospitals now question what the property tax exemption law in their state requires since the Governor recently pocket-vetoed legislation that would have made a profound impact on charitable nonprofit organizations.<sup>3</sup> Additionally, Boston, Massachusetts and Pittsburgh, Pennsylvania ask charitable organizations to voluntarily enter into

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<sup>1</sup> JOHN STUART MILL, PRINCIPLES OF POLITICAL ECONOMY 864 (W.J. Ashley ed., Longmans, Green & Co. 1936).

<sup>2</sup> See *Fields v. Trs. of Princeton Univ.*, 28 N.J. Tax 574, 578 (N.J. Tax Ct. 2015); see also Elise Young, *Princeton Will Pay \$18 Million to Settle Residents' Tax Case*, BLOOMBERG (Oct. 14, 2016, 8:16 PM), <https://www.bloomberg.com/news/articles/2016-10-15/princeton-will-pay-18-million-to-settle-residents-tax-case>. After announcing its agreement with the local municipality to pay over \$21 million over a seven-year period as a payment in lieu of taxes, Princeton University found itself embroiled in a battle to maintain its property tax exemption when challenged by individual tax payers in its municipality. *Young, supra*; see Krystal Knapp, *Princeton University and Town Announce New Payment In Lieu of Taxes Deal*, PLANET PRINCETON (Apr. 24, 2014), <https://planetprinceton.com/2014/04/24/princeton-university-and-town-announce-new-payment-in-lieu-of-taxes-deal/>.

<sup>3</sup> All nonprofit hospitals in New Jersey, including Morristown Memorial Hospital, escaped legislation that was pocket-vetoed by Governor Christie in March 2016 that would have required all nonprofit hospitals in the state to pay fees to their municipalities to cover services. See Susan K. Livio, *Christie Rejects Requiring Nonprofit Hospitals to Pay 'Taxes,'* NJ.COM (Jan. 19, 2016, 7:12 PM), [http://www.nj.com/politics/index.ssf/2016/01/nonprofit\\_hospital\\_tax.html](http://www.nj.com/politics/index.ssf/2016/01/nonprofit_hospital_tax.html); see also Evelyn Brody, *The 21st Century Fight Over Who Sets the Terms of the Charity Property Tax Exemption*, 77 EXEMPT ORG. TAX REV. 259, 267 (2016) (“With 15 nonprofit hospitals appealing tax bills, on March 18, 2016 Governor Christie announced a two-year moratorium to give a newly appointed commission time to find a solution, but that controversial route requires legislative enactment.”); Susan K. Livio, *N.J. Non-profit Hospital 'Tax' Advances in Senate*, NJ.COM (Dec. 21, 2016, 7:10 PM), [http://www.nj.com/politics/index.ssf/2015/12/nj\\_non-profit\\_hospital\\_tax\\_advances\\_in\\_senate.html](http://www.nj.com/politics/index.ssf/2015/12/nj_non-profit_hospital_tax_advances_in_senate.html) [hereinafter Livio, *Non-profit Hospital Tax*].

payments in lieu of taxes (PILOTs)<sup>4</sup> regarding the property that they own, while other cities throughout the United States exempt charitable nonprofit organizations from property tax and do not require them to enter into PILOT agreements.<sup>5</sup>

While the policies and practices surrounding these laws are complex and multi-layered, it is past time for a resolution that provides a uniform approach to taxing the property owned by charitable nonprofit organizations.<sup>6</sup> While this issue has existed for some time, the sector has hit a tipping point as reports of conflicting court decisions occur weekly, providing little solace for charitable organizations.<sup>7</sup> If charitable nonprofits do not know what is expected, their ability to carry out their exempt missions for the benefit of our communities is at stake. The time charitable nonprofits spend defending themselves in court, arguing with municipal leaders, or creating strategies to avoid property tax, is time not spent on furthering their charitable missions and providing for unmet needs. Cases such as *Fields v. Trustees of Princeton University*, *AHS Hospital Corp. v. Town of Morristown*, and *Baruch SLS, Inc. v. Tittabawassee Township*, are just the most recent examples.<sup>8</sup>

A uniform solution has been difficult, given the various types and sizes of organizations in this sector. Many charitable nonprofit organizations have successfully morphed into large multi-corporate structures, such as hospitals and universities, or hybrid organizations, including benefit corporations, while local soup kitchens and other small after-school programs struggle to operate.<sup>9</sup> To date, there are no laws in this country differentiating charitable organizations by size (revenue) with regard to the property taxes being levied.<sup>10</sup> The legal, political, policy, and practical complexities of creating a uniform

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<sup>4</sup> Currently, 218 municipalities in twenty-eight states collect PILOTs from the charities located in their towns. See Fan Fei et al., *Are PILOTs Property Taxes for Nonprofits?*, 94 J. URB. ECON. 109, 111 (2016).

<sup>5</sup> See *id.* at 109.

<sup>6</sup> See I.R.C. § 501(c)(3) (2012).

<sup>7</sup> See, e.g., John D. Colombo, *Commercial Activity and Charitable Tax Exemption*, 44 WM. & MARY L. REV. 487, 491 (2002); see also *infra* note 8.

<sup>8</sup> See *Baruch SLS, Inc. v. Tittabawassee Twp.*, 901 N.W.2d 843 (Mich. 2017); *Fields v. Trs. of Princeton Univ.*, 28 N.J. Tax 574 (2015); *AHS Hosp. Corp. v. Town of Morristown*, 28 N.J. Tax 456 (2015).

<sup>9</sup> See Christopher Lacovara, *Strange Creatures: A Hybrid Approach to Fiduciary Duty in Benefit Corporations*, 2011 COLUM. BUS. L. REV. 815, 823 (2011); see also Robert S. Kaplan & Allen S. Grossman, *The Emerging Capital Market for Nonprofits*, HARV. BUS. REV. (Oct. 2010), <https://hbr.org/2010/10/the-emerging-capital-market-for-nonprofits>.

<sup>10</sup> Indeed, classifying nonprofit organizations by revenue for tax purposes would run counter to the organizations' exemption from income taxation. See § 501(c)(3).

property tax system in this area have been considered for years.<sup>11</sup> Some states, cities, and municipalities have taken action to address this issue, but have not provided a uniform solution.<sup>12</sup> A solution may be found in British law, which follows a statutory scheme for taxing property owned by charities.<sup>13</sup> Additionally, the PILOT program that has been in place since 2012 in Boston, Massachusetts, might also be worth considering when creating a model.<sup>14</sup> However, one thing is evident: a solution is needed.

Charitable nonprofit organizations structured under Section 501(c)(3) of the Internal Revenue Code, by their very nature and the laws that govern them, are exempt from federal income and other taxes.<sup>15</sup> Traditionally, states have granted these organizations property tax exemption through their constitutions and local legislation.<sup>16</sup> But over the past fifteen years, in light of economic need, it has become increasingly common for local governments to threaten to revoke this exemption, thereby stimulating the rise in PILOTS and other tax schemes.<sup>17</sup>

In Parts I and II, this Article will discuss the need for a resolution in light of the applicable federal, state, and local laws. Part III will review the developing case law and seek to clarify and define the basis for this trend and all of its intended and unintended consequences. It will set forth the large differences among groups in this sector and ask whether the rise of new nonprofit corporate forms, such as the multi-corporate entities that are now our hospitals and universities, and hybrid organizations, have an effect on the latest push for ignoring

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<sup>11</sup> See Evelyn Brody et al., *The Charitable Property-Tax Exemption and PILOTS*, TAX POL'Y & CHARITIES 1 (Aug. 2012), <https://www.urban.org/sites/default/files/publication/25746/412640-The-Charitable-Property-Tax-Exemption-and-PILOTS.PDF>.

<sup>12</sup> See, e.g., cases cited in *supra* note 8.

<sup>13</sup> See *infra* notes 196–209 and accompanying text.

<sup>14</sup> See *Payment in Lieu of Tax (PILOT) Program*, CITY BOS. (Aug. 25, 2017), <https://www.boston.gov/finance/payment-lieu-tax-pilot-program>.

<sup>15</sup> I.R.C. § 501(c)(3); see Treas. Reg. § 1.501(c)(3)–1 (2012); see also *Nonprofit/Exempt Organizations*, TAXES CAL. GOV'T, <http://www.taxes.ca.gov/exemptbus.shtml> (last visited Oct. 9, 2017) (showing that charitable nonprofit organizations structured under § 501(c)(3) could also be exempt from state and local sales tax, occupancy tax, payroll tax, etc. depending on the state).

<sup>16</sup> See 10 PA. STAT. AND CONS. STAT. ANN. §§ 371–385 (West 2016); *Hosp. Utilization Project v. Commonwealth*, 487 A.2d 1306, 1312 (Pa. 1985), *superseded by statute*, 61 PA. CODE § 32.1 (2017), *as recognized in* *Betsy King LPGA Classic, Inc. v. Twp. of Richmond*, 739 A.2d 612, 615 (Pa. Commw. Ct. 1999).

<sup>17</sup> See Fei et al., *supra* note 4, at 109–12; see also *PILOT Programs—The Nonprofit Property Tax*, WAGENMAKER & OBERLY BLOG (July 15, 2015), <http://www.wagenmakerlaw.com/blog/pilot-programs—nonprofit-property-tax>.

property tax exemption, and will discuss whether an approach that acknowledges the differences among these organizations is more appropriate. Part IV will describe the British system for comparative purposes. Part V will discuss the policy issues surrounding this matter and ask whether there is a benefit to creating some consistency that would invoke a Model Act of sorts, which is discussed in Parts VI and VII.<sup>18</sup>

## II. PROPERTY TAX EXEMPTION AND THE CHARITABLE NONPROFIT ORGANIZATION

The first question one might ask is, while states are granted the power to tax property through their constitutions, what gives them the authority to tax organizations that have been granted tax-exempt status by the federal government? The second might be, even with this power, is it wise to tax their property? The following sections review the history in this area and provide some understanding of this complex issue. More than a federal versus state issue, political leaders as well as scholars are being called upon to contemplate whether charitable organizations hold value greater than their bottom line.

American charity law, including property tax exemption, is rooted in English law, where trusts created for charitable purposes were afforded special treatment.<sup>19</sup> While this tradition has long been carried on in the United States, it is an area that is causing great difficulty for municipalities, states, and the charitable tax-exempt organizations residing within them.<sup>20</sup> Until recently, legislatures and courts have been reluctant to tax these organizations unless it is clear that there is a lack of charitable mission, because under the Federal Tax Code these organizations have been granted tax exempt status and state constitutions and legislation have provided the same.<sup>21</sup> But as communities with large concentrations of tax-exempt properties pressure legislatures to impose user fees in lieu of taxes on these

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<sup>18</sup> See Cornell L. Sch. Legal Info. Inst., *Uniform Laws*, CORNELL L. SCH., <https://www.law.cornell.edu/uniform> (last visited Oct. 9, 2017) (explaining that Model Acts propose laws on topics where reform is the main goal, and therefore, state legislatures may make alterations or take the parts of the legislation that they like best, allowing the law to be tailored to the state).

<sup>19</sup> See NICHOLAS P. CAFARDI & JACLYN F. CHERRY, *TAX EXEMPT ORGANIZATIONS: CASES AND MATERIALS* 32 (Matthew Bender ed., 3d ed. 2014); Janne Gallagher, *The Legal Structure of Property-Tax Exemption*, in *PROPERTY-TAX EXEMPTION FOR CHARITIES: MAPPING THE BATTLEFIELD* 3–22 (Evelyn Brody ed., 2002).

<sup>20</sup> See Gallagher, *supra* note 19, at 3–22.

<sup>21</sup> *Id.* at 4–5.

organizations,<sup>22</sup> the landscape has continued to shift. Municipalities argue that they are providing police and fire protection, among other needed services, and deserve payments in lieu of taxes.<sup>23</sup> According to Joseph Cordes, a leading scholar in the area of property tax literature:

Unlike the charitable-contribution deduction under the income tax, the property-tax exemption has been somewhat controversial politically. Many local governments view the exemption as a costly drain on their local tax base, and some scholars argue that it is an unfair and inefficient subsidy, because it favors nonprofits that own real estate and may encourage some to invest more in real property than they would otherwise.<sup>24</sup>

Some for-profit entities claim that exemption creates an unfair advantage.<sup>25</sup> Interestingly, “exemptions and immunities for government-owned property, homestead allowances for owner-occupied residences, and the exemption of large amounts of agricultural land value through current use-assessment are not politically controversial, however much they may be criticized on economic or policy grounds.”<sup>26</sup> But because the definitions of charity, public welfare, and property value vary in state statutes and case law, property tax exemption for charitable tax-exempt organizations continues to be controversial.<sup>27</sup> Taxing bodies structure their property tax regimes based on these different definitions, so finding

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<sup>22</sup> *Id.* at 18.

<sup>23</sup> *Id.*

<sup>24</sup> Joseph J. Cordes et al., *What is the Property-Tax Exemption Worth?*, in PROPERTY-TAX EXEMPTION FOR CHARITIES: MAPPING THE BATTLEFIELD, *supra* note 19, at 81, 81. By the 1820s in the United States, states began to initiate reform in property taxation through a “general property” tax. *Auditor/Treasurer Manual*, MINN. DEP’T REVENUE §§ 1.01–4 (Jan. 2016), [http://www.revenue.state.mn.us/local\\_gov/prop\\_tax\\_admin/at\\_manual/atmanual.pdf](http://www.revenue.state.mn.us/local_gov/prop_tax_admin/at_manual/atmanual.pdf). This tax attempted to impose a uniform tax rate “on all forms of property . . . reflecting the Jacksonian belief that the actual value of property best represented tax-paying ability.” *Id.*

<sup>25</sup> See Estelle James, *Commercialism Among Nonprofits: Objectives, Opportunities and Constraints*, in TO PROFIT OR NOT TO PROFIT: THE COMMERCIAL TRANSFORMATION OF THE NONPROFIT SECTOR 282 (Burton A. Weisbrod ed., Cambridge Univ. Press 1998).

<sup>26</sup> Joan M. Youngman, *The Politics of the Property-Tax Debate*, in PROPERTY-TAX EXEMPTION FOR CHARITIES: MAPPING THE BATTLEFIELD, *supra* note 19, at 23, 23.

<sup>27</sup> See *id.* at 24.

commonalities to create a uniform approach across the states becomes difficult.

Historically, there is no clear statement of the nature and goal of the property tax.<sup>28</sup> “In the form of a general tax instrument, the tax incorporates many elements of a charge for property-related services, while its base of real property value suggests that this value serves as either an index of ability to pay or as a measure of benefits received.”<sup>29</sup> These rationales are inconsistent and create difficulty, especially when applied to charitable tax-exempt organizations.<sup>30</sup> However, assessing a fee, especially one for services, is easier to explain. An “exemption from property taxation does not necessarily imply an equivalent exemption from special assessments or fees.”<sup>31</sup> Therefore, “local governments often attempt to tax nonprofit institutions through fees.”<sup>32</sup>

These disputes reflect the tension between a fundamental consensus that charitable organizations should be tax-exempt, an equally basic belief that local governments should be reimbursed for the property related services they render, and a sense that property wealth indicates an ability to pay either taxes or some form of fees. This tension is greatest at the local level, where tax revenue is most likely to fund property-related services and where there may be resentment against state-mandated exemptions that reduce the local tax base.<sup>33</sup>

Therefore, PILOTs, which are considered fees, are ultimately regarded as taxes. However, they often run afoul of statutory and constitutional provisions governing taxes that require uniformity and equality.<sup>34</sup> Not only are there inconsistencies in whether termed a tax or a fee, but treatment is inconsistent as well.<sup>35</sup>

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<sup>28</sup> *See id.*

<sup>29</sup> *Id.*

<sup>30</sup> *See id.* at 24–25.

<sup>31</sup> *Id.* at 25 (citing *Loyola Marymount Univ. v. L.A. Unified Sch. Dist.*, 53 Cal. Rptr. 2d 424 (Cal. Ct. App. 1996) and *State Highway Comm’n v. City of Topeka*, 393 P.2d 1008 (Kan. 1964)).

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> *See, e.g., Bolt v. City of Lansing*, 587 N.W.2d 264, 268 (Mich. 1998); *V-1 Oil Co. v. Utah State Tax Comm’n*, 942 P.2d 906, 913 (Utah 1996); Youngman, *supra* note 26, at 25.

<sup>35</sup> *See infra* Part V.

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### III. CHARITABLE NONPROFIT ORGANIZATIONS AND THE STATES

Charitable organizations that qualify for federal tax exemption under Section 501(c)(3) must be “organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition . . . or for the prevention of cruelty to children or animals . . . .”<sup>36</sup> These organizations are exempt from federal income tax once acquiring this designation.<sup>37</sup>

Whether or not a charitable nonprofit organization qualifies for other exemptions from tax, such as state sales, use, and/or property tax, depends on the mandate of the individual states through their constitutions, legislation, and case law.<sup>38</sup> This treatment varies widely and is now cause for concern.

Currently, seventeen state constitutions mandate exemption for charitable organizations, twenty-five grant the legislature authority to exempt these organizations, and eight are silent.<sup>39</sup> “Almost half of the state constitutions provide property tax exemption for classes of nonprofits—notably, churches, educational institutions, and ‘institutions of purely public charity’ (or some similar term).”<sup>40</sup> In other states, the state constitution grants to the legislature the authority to grant property tax exemption.<sup>41</sup> Even in these states the courts have become involved and created tests in keeping with their interpretation of the legislation.<sup>42</sup>

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<sup>36</sup> I.R.C. § 501(c)(3) (2012).

<sup>37</sup> § 501(a).

<sup>38</sup> See *infra* Part V.

<sup>39</sup> Brody, *supra* note 3, at 260 n.8.

<sup>40</sup> *Id.* at 260.

<sup>41</sup> See, e.g., PA. CONST. art. VIII, § 2 (“General Assembly may, by law, exempt from taxation: (i) Actual places of regularly stated religious worship; (ii) Actual places of burial, when used or held by a person or organization deriving no private or corporate profit therefrom and no substantial part of whose activity consists of selling personal property in connection therewith; (iii) That portion of public property which is actually and regularly used for public purposes; (iv) That portion of the property owned and occupied by any branch, post or camp of honorably discharged servicemen or servicewomen which is actually and regularly used for benevolent, charitable or patriotic purposes; and (v) Institutions of purely public charity, but in the case of any real property tax exemptions only that portion of real property of such institution which is actually and regularly used for the purposes of the institution.”).

<sup>42</sup> See *Carle Found. v. Cunningham Twp.*, 45 N.E.3d 1173, 1195–96 (Ill. App. Ct. 2016), *vacated for lack of appellate jurisdiction*, 2017 IL 120427, 2017 WL 1090961 (Ill. Mar. 23, 2017); see also *Hosp. Utilization Project v. Commonwealth*, 487 A.2d 1306, 1313 (Pa. 1985).

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### A. How the United States Treats Government-Owned Property

“Government-owned property is exempt from local taxes almost everywhere in the United States, but this situation is based less on logic than on now-outdated historical considerations.”<sup>43</sup> “Remarkably, there are no comprehensive estimates of the value of these exemptions.”<sup>44</sup> What is clear is that the amount of land owned by the government throughout the United States is greater than the property owned by nonprofits.<sup>45</sup> Interestingly, there are generally very little complaints about government-owned property being given exemption from taxes.<sup>46</sup>

Government-owned property traditionally has been exempt from taxation in order to avoid an empty ritual whereby the sovereign taxed itself. The implicit assumption of a single sovereign was quite reasonable in Elizabethan England, where the property tax first took root, but not so in the U.S. today. The myriad school districts and special districts that now compete with counties and municipalities for property tax revenues were virtually nonexistent in the nineteenth century. Today there is no economic reason to exclude all government property from the tax base.<sup>47</sup>

Providing tax exemption to nonprofit organizations’ property grew out of the government exemption tradition.<sup>48</sup> “In the seventeenth century, private parties did not always wait for the Crown to repair their bridges, causeways, seawalls or highways. They assumed this responsibility whenever self-interest required and the purse permitted.”<sup>49</sup> Because these activities relieved the government of a burden, governments provided these organizations support by exempting their property from tax.<sup>50</sup> Private nonprofit organizations were taking on government responsibilities, and therefore received the

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<sup>43</sup> H. Woods Bowman, *Reexamining the Property Tax Exemption*, 15 LAND LINES 5, 5 (2003), <http://www.lincolnst.edu/publications/articles/reexamining-property-tax-exemption>.

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

<sup>48</sup> See I.R.C. § 501(c)(3) (2012); see also *Baruch SLS, Inc. v. Tittabawassee Twp.*, 901 N.W.2d 843, 847 (Mich. 2017); see also *Hosp. Utilization Project v. Commonwealth*, 487 A.2d 1306, 1313–14 (Pa. 1985).

<sup>49</sup> Bowman, *supra* note 43, at 5.

<sup>50</sup> See *id.*

exemption that the government would have received.<sup>51</sup>

In early colonial times in the United States, much like in England, the crown or the government could not take on all of the needs of the people, so nonprofit groups began providing the needed services.<sup>52</sup> By assuming these responsibilities, the organizations relieved the government of some of its burden and oftentimes qualified for tax relief in the form of property tax exemption.<sup>53</sup> Eventually, part of relieving the government of some of its burden became providing charitable care and mitigating poverty.<sup>54</sup> Since government-owned property has traditionally not been taxed, in keeping with the practice that the government (or the crown) should not tax itself, the nonprofits providing these services were not taxed either, since these organizations were acting *sua sponte* as independent government agencies.<sup>55</sup>

Exemptions for property owned by charitable, nonprofit organizations remain in place today because the government still does not tax itself.<sup>56</sup> *Hospitalization Utilization Project v. Commonwealth*,<sup>57</sup> a noted case from Pennsylvania in this area, has been cited in the decisions of other states, and these influences have pushed this issue to the forefront in New Jersey, Illinois, and Michigan.<sup>58</sup>

The following discussion of case law, that set forth and expanded the tests used in this area, provides a framework for structuring a uniform system. While each example is unique, all bear resemblances

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<sup>51</sup> *See id.*

<sup>52</sup> *See* Peter Dobkin Hall, *A Historical Overview of Philanthropy, Voluntary Associations, and Nonprofit Organizations in the United States, 1600-2000*, in *THE NONPROFIT SECTOR: A RESEARCH HANDBOOK* 36 (Walter W. Powell & Richard Steinberg eds., Yale Univ. Press 2d ed. 2006).

<sup>53</sup> *See* Stephanie A. Bruch, *Politicking From the Pulpit: An Analysis of the IRS's Current Section 501(c)(3) Enforcement Efforts and How it is Costing America*, 53 *ST. LOUIS L.J.* 1253, 1259 (2009).

<sup>54</sup> *See id.*; *see also* Bowman, *supra* note 43, at 5.

<sup>55</sup> Bowman, *supra* note 43, at 6.

<sup>56</sup> *See* I.R.C. § 501(c)(3) (2012); *see also* Bowman, *supra* note 43, at 6 (explaining that charitable exemptions grew out of the government exemption because charities took on roles of the government to alleviate poverty, thus relieving the government of a burden).

<sup>57</sup> *See* *Hosp. Utilization Project v. Commonwealth*, 487 A.2d 1306 (Pa. 1985) *superseded by statute*, 61 PA. CODE § 32.1 (2017), *as recognized in* *Betsy King LPGA Classic, Inc. v. Twp. of Richmond*, 739 A.2d 612, 615 (Pa. Commw. Ct. 1999).

<sup>58</sup> *See, e.g.,* *Carle Found. v. Cunningham Twp.*, 45 N.E.3d 1173 (Ill. App. Ct. 2016), *vacated for lack of appellate jurisdiction*, 2017 IL 120427, 2017 WL 1090961 (Ill. Mar. 23, 2017); *Baruch SLS, Inc. v. Tittabawassee Twp.*, 901 N.W.2d 843 (Mich. 2017); *Fields v. Trs. of Princeton Univ.*, 28 N.J. Tax 574 (2015).

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that are worth considering in order to reach a uniform solution.

## **B. State Legislation and Case Law Examples**

### *1. Pennsylvania*

In *Hospitalization Utilization Project*,<sup>59</sup> the Pennsylvania Supreme Court determined the method for taxing property owned by charitable nonprofit organizations by interpreting the legislative intent of Act 55.<sup>60</sup> The test, now known as the HUP test, caused great controversy between the courts and the legislature when local municipalities began to use the test to determine whether organizations qualified for exemption from property tax.<sup>61</sup> Local legislatures believed that only they could create this test, based on whether an organization was a “purely public charity.”<sup>62</sup>

In this case, the Hospital Utilization Project (HUP), was originally funded by the Hospital Council to form a uniform system for the collection and collation of statistical data on area-wide hospital utilization.<sup>63</sup> From 1963 to 1966, HUP’s funding came from charitable organizations.<sup>64</sup> However, in 1967, HUP had become financially secure and its contributors withdrew from the project, causing the participating hospitals to fund HUP through direct payment for its services.<sup>65</sup> Thus, from 1967 to the date of the action, HUP had been solely financed through a fee-for-services arrangement.<sup>66</sup> Specifically, each participating hospital was charged a set fee for each patient abstract it submitted to HUP.<sup>67</sup> HUP would then charge everyone for its services and did not provide regular and continual financial aid to its individual customers that were unable to pay for services.<sup>68</sup>

Under Pennsylvania law, the legislature is constitutionally limited and can only exempt from tax those charitable organizations that are institutions of “purely public charity.”<sup>69</sup> Therefore, before the court

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<sup>59</sup> See *Hosp. Utilization Project*, 487 A.2d at 1312–14.

<sup>60</sup> See 10 PA. STAT. AND CONS. STAT. ANN. §§ 371–385 (West 2016).

<sup>61</sup> See Daniella Corcuera, *Revisiting the Nonprofit Property-Tax Exemption: An Examination of the Need to Clarify Eligibility*, 32 J.L. & COM. 155, 158–59 (2013).

<sup>62</sup> See *Hosp. Utilization Project*, 487 A.2d at 1312.

<sup>63</sup> See *id.* at 1309.

<sup>64</sup> See *id.*

<sup>65</sup> See *id.*

<sup>66</sup> See *id.*

<sup>67</sup> See *id.*

<sup>68</sup> See *id.* at 1309–10.

<sup>69</sup> See *id.* at 1312.

could even question if HUP qualified for property tax exemption, it had to determine if HUP qualified under the Pennsylvania Constitution as a “purely public charity.”<sup>70</sup>

The court looked to the landmark case *YMCA of Germantown v. City of Philadelphia* for guidance, where it expanded on the early concept of a “purely public charity” by setting forth the following analysis:

First, whatever it does for others is done free of charge, or at least so nearly free of charge as to make the charges nominal or negligible; second, that those to whom it renders help or services are those who are unable to provide themselves with what the institution provides for them, that is, they are legitimate subjects of charity.<sup>71</sup>

In the instant case, HUP offered no free service, and the organization operated at a profit from 1979 until 1982.<sup>72</sup> Furthermore, the cash reserve was not used to aid the underprivileged, sick, or infirm—instead, it was used to enhance business operations.<sup>73</sup> Although case law supported HUP’s assertion that receiving some payment for services did not conclude the “purely public charity” analysis, HUP’s facts were distinguishable from established case law.<sup>74</sup> HUP provided no financial aid, and there was nothing in the record that supported a finding that HUP provided its services without regard to the health care facility’s ability to pay.<sup>75</sup>

After reviewing the established case law, the court determined that an entity would qualify as a “purely public charity” if it: (a) advanced a charitable purpose; (b) donated or rendered gratuitously a substantial portion of its services; (c) benefited a substantial and indefinite class of persons who are legitimate subjects of charity; (d) relieved the government of some of its burden; and (e) operated entirely free from private profit motive.<sup>76</sup> Based on these characteristics, HUP did not qualify as a “purely public charity” and did not qualify for exemption from property tax.<sup>77</sup>

After determining that the Plaintiff was not entitled to exemption,

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<sup>70</sup> *Id.*

<sup>71</sup> *Id.* at 1313 (citing *YMCA of Germantown v. City of Philadelphia*, 187 A.2d 204, 209 (Pa. 1936)).

<sup>72</sup> *See id.* at 1315.

<sup>73</sup> *See id.*

<sup>74</sup> *See id.* at 1316.

<sup>75</sup> *See id.*

<sup>76</sup> *See id.* at 1317.

<sup>77</sup> *See id.* at 1319.

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the court stated: “[T]he origin of the charitable exemption under Section 204, 72 P.S. § 7204, is Article VIII, section 2(a)(v) of the Pennsylvania Constitution of 1968 which states: ‘(a) *The General Assembly may by law exempt from taxation: . . . (v) Institutions of purely public charity . . .*’”<sup>78</sup>

Through the years, courts have applied the HUP test in varying degrees, and some grant more deference to the legislature than others.<sup>79</sup> As recently as 2015, the Pennsylvania legislature attempted to amend the Pennsylvania Constitution to allow for legislative control of the definitions contained in Act 55, specifically, what qualifies as a “purely public charity,”<sup>80</sup> for property tax exemption purposes.

## 2. *New Jersey*

Though certainly distinct from HUP, a review of two recent New Jersey cases provides a strikingly similar struggle between legislation and case law interpretation when navigating this area.

The outcome of *Fields v. Trustees of Princeton University*,<sup>81</sup> a case decided in 2015, provides long-term ramifications for all charitable nonprofits in the state by setting out not only legal criteria that the courts intend to follow but by providing an example of a resolution reached in spite of the court’s decision. In *Fields*, taxpayers filed a complaint challenging the property tax exemptions that had been granted by the Municipal Tax Assessor (Assessor) for twenty-one individual parcels owned by Princeton University.<sup>82</sup> After the Assessor continued to grant the exemptions in 2012, 2013, and 2014 for these and other parcels owned by Princeton, four of the original taxpayers filed complaints in 2014 and 2015 challenging Princeton’s exemption *in toto*.<sup>83</sup>

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<sup>78</sup> *Id.* (emphasis added).

<sup>79</sup> *Id.* at 1319.

<sup>80</sup> PA. CONST. art. VIII, § 2(b); S.B. 4, 2015–2016 Reg. Sess. (Pa. 2015). The proposed amendment would add a clause to Section 2(b) of Article VIII, reading: “Section 2. Exemptions and special provisions. (b) The General Assembly may, by law: (vii) Establish uniform standards and qualifications which shall be the criteria to determine qualification as institutions of purely public charity under clause (v) of subsection (a) of this section.” *Id.*

<sup>81</sup> See *Fields v. Trs. of Princeton Univ.*, 28 N.J. Tax 574 (2015).

<sup>82</sup> *Id.* at 578.

<sup>83</sup> *Id.* (“In the 2011 matter, the Tax Court refused to dismiss the suit on motion for partial summary judgment; no appeal was taken. Princeton then moved to dismiss both the 2014 and 2015 complaints before this court, which motion was also denied. This time, Princeton appealed for interlocutory relief to the Appellate Division; the higher court denied Princeton’s motion for leave to appeal on the 2014 and 2015 matters. On July 14, 2015, Princeton moved for a determination as to

The court stated in its decision<sup>84</sup> that the determination of an exemption was more properly one of statutory and case law interpretation than one requiring any special expertise possessed of an assessor.<sup>85</sup> Further stating that by analogy, the court had previously determined that “[i]n a proceeding in the Tax Court there is a presumption of correctness in favor of the county board judgment [with regard to value determinations] . . . . Statutory interpretation, however, is a question of law . . . and ‘statutory construction is ultimately a judicial function.’”<sup>86</sup> The court found no justification for why the same reasoning would not apply equally to an assessor, as it does to a county board of taxation.<sup>87</sup> Accordingly, Princeton’s argument that the presumption of validity extended to the exemption determinations made by the Assessor was unpersuasive and unsupported by case law and statute.<sup>88</sup> The Court was satisfied that the presumption of validity afforded the Assessor’s original tax assessments did not extend to tax exemptions.<sup>89</sup>

In October 2016, the case was settled to include a \$2 million payment in 2017 and \$1.6 million in the following five years to fund Princeton residents receiving a homestead benefit under the New Jersey Homestead Property Tax Credit Act.<sup>90</sup> Additionally, the Witherspoon Jackson Development Corporation, “which helps fund housing for economically disadvantaged residents” will receive \$416,700 each year from 2017 to 2019, and the town of Princeton will

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which party has the burden of proof in these matters, and submitted a brief supporting a court order placing that burden on the Taxpayers. In response, the Taxpayers submitted a memorandum in opposition. The Municipality did not submit a brief either in support of, or in opposition to, Princeton’s motion. At argument, however, the Municipality’s counsel argued in support of the motion.”).

<sup>84</sup> *Id.* at 583–84.

<sup>85</sup> *See, e.g.,* Fountain House of N.J., Inc. v. Montague Twp., 13 N.J. Tax 387, 399–400 (1993) (stating that “[t]o examine merely the formalities of organization without examining the actual conduct (activities) of the corporation thereafter, would result in the elevation of form over substance” which could not have been “the legislature’s intent” in enacting section 54:4–3.6).

<sup>86</sup> *Fields*, 28 N.J. Tax at 584 (alteration in original) (citing *O’Rourke v. Twp. of Fredon*, 25 N.J. Tax 443, 450 (2010) and *MacDonald v. Shaker Heights Bd. of Income Tax Review*, 41 N.E.3d 376, 380 (2015) (stating that “[t]he appellate decisions in tax cases do not indicate that any deference is owed to the municipal tax board on issues of law.”).

<sup>87</sup> *See O’Rourke*, 25 N.J. Tax at 451.

<sup>88</sup> *See id.* at 451–52.

<sup>89</sup> *See id.*

<sup>90</sup> Anna Merriman, *Princeton U., Residents Reach Agreement in Tax Exemption Lawsuit*, NJ.COM (Oct. 14, 2016, 7:53 PM), [http://www.nj.com/mercer/index.ssf/2016/10/princeton\\_u\\_residents\\_reach\\_agreement\\_in\\_tax\\_exemp.html](http://www.nj.com/mercer/index.ssf/2016/10/princeton_u_residents_reach_agreement_in_tax_exemp.html).

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receive a \$3.5 million annual contribution in 2021 and 2022.<sup>91</sup>

In another example, *AHS Hospital Corp. v. Town of Morristown*,<sup>92</sup> the Hospital, as taxpayer, sought review of the town's denial of property tax exemption under a statute granting exemption for nonprofit organizations. Following trial, the Tax Court held that: the for-profit activities of physicians who worked for the hospital were not separately accounted for; the nonprofit activities carried out by the hospital were not listed separately in the financial sheets; some hospital property was used for the benefit of for-profit entities; and several contracts entered into with physicians were for profit-making purposes.<sup>93</sup> Further, the court stated that the food and laundry service contracts were entered into for profit making purposes and the gift shop did not serve the hospital's charitable purpose.<sup>94</sup> The court did distinguish that the parking garage management agreement between the hospital and contractor did not have a profit-making purpose and the auditorium and fitness center were not operated for profit.<sup>95</sup> The court stated:

[T]o secure an exemption under *N.J.S.A.* 54:4–3.6, the following three criteria must be met: “(1) [the owner of the property] must be organized exclusively for the [exempt purpose]; (2) its property must be actually and exclusively used for the tax-exempt purpose; and (3) its operation and use of its property must not be conducted for profit.”<sup>96</sup>

In January 2016, the New Jersey Assembly Appropriations Committee approved a bill that would have required New Jersey hospitals to pay fees to communities to provide public safety and other local services.<sup>97</sup> The statute, titled “The Hospital Community Service Contribution Bill,” was based on the *AHS Hospital Corp.* decision that found Morristown Medical Center operated largely as a for-profit hospital, making it subject to property tax.<sup>98</sup> The two sides settled on

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<sup>91</sup> *Id.*

<sup>92</sup> *See AHS Hosp. Corp. v. Town of Morristown*, 28 N.J. Tax 456, 463 (2015).

<sup>93</sup> *See id.* at 501–02, 513.

<sup>94</sup> *See id.* at 528–30, 533.

<sup>95</sup> *See id.* at 535.

<sup>96</sup> *Id.* at 496 (alteration in original) (quoting *Hunterdon Med. Ctr. v. Twp. of Readington*, 951 A.2d 931, 937 (N.J. 2008) (quoting *Paper Mill Playhouse v. Millburn Twp.*, 472 A.2d 517, 518 (N.J. 1984)).

<sup>97</sup> ASSEMB. APPROPRIATIONS COMM., S. 4093, 216th Leg., Reg. Sess. (N.J. 2016), [http://www.njleg.state.nj.us/2014/Bills/A5000/4903\\_S1.PDF](http://www.njleg.state.nj.us/2014/Bills/A5000/4903_S1.PDF).

<sup>98</sup> *See Tax Court Rules Against Hospital in Morristown Property Tax Case*, CTR. FOR NON-PROFITS,

an agreement that the hospital pay more than \$15.5 million over the next ten years.<sup>99</sup> According to the bill, hospitals with for-profit operations would have paid the municipality that hosts them \$2.50 per day for each hospital bed and \$250 per day for each satellite emergency care facility.<sup>100</sup> In March 2016, Governor Christie announced a two-year moratorium of the bill to give a newly appointed commission time to find a solution.<sup>101</sup>

### 3. *Illinois*

Several property tax cases have been decided in Illinois recently, and again, involve multi-corporate hospital systems.<sup>102</sup> In *Provena Covenant Medical Center v. Department of Revenue*, the taxpayer, Provena Hospitals, applied to the Champaign County board of review to exempt all of the forty-three parcels of land in its complex from property taxes for 2002.<sup>103</sup> Provena Hospitals made this request on the grounds that the parcels were owned by an institution of public charity and that the property was “actually and exclusively used for charitable or beneficent purposes, and not leased or otherwise used with a view to profit.”<sup>104</sup> The board of review recommended that the request be denied and the Illinois Department of Revenue agreed.<sup>105</sup> To determine if the parcels qualified for exemption the court considered distinctive characteristics of a charitable institution, which included:

- (1) it has no capital, capital stock, or shareholders;
- (2) it earns no profits or dividends but rather derives its funds mainly from private and public charity and held them in trust for the purposes expressed in the charter;
- (3) it

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[http://www.njnonprofits.org/PropertyTax\\_MorristownMedical.html](http://www.njnonprofits.org/PropertyTax_MorristownMedical.html) (last updated Feb. 27, 2017).

<sup>99</sup> See Tim Darragh, *Atlantic Health To Pay Morristown \$15.5M To Settle Tax Case*, NJ.COM (Nov. 10, 2015, 11:36 PM),

[http://www.nj.com/morris/index.ssf/2015/11/atlantic\\_health\\_to\\_pay\\_morristown\\_155m\\_to\\_settle\\_t.html](http://www.nj.com/morris/index.ssf/2015/11/atlantic_health_to_pay_morristown_155m_to_settle_t.html).

<sup>100</sup> See Livio, *Non-profit Hospital Tax*, *supra* note 3.

<sup>101</sup> John Reitmeyer, *Christie Proposes Two-Year Moratorium on Hospital Property Tax Plan*, NJ SPOTLIGHT (Mar. 21, 2016),

<http://www.njspotlight.com/stories/16/03/20/governor-proposes-two-year-moratorium-on-hospital-property-tax-plan/>.

<sup>102</sup> See, e.g., *Provena Covenant Med. Ctr. v. Dep’t of Revenue*, 925 N.E.2d 1131 (Ill. 2010); see also *Carle Found. v. Cunningham Twp.*, 45 N.E.3d 1173 (Ill. App. Ct. 2016), *vacated for lack of appellate jurisdiction*, 2017 IL 120427, 2017 WL 1090961 (Ill. Mar. 23, 2017).

<sup>103</sup> *Provena*, 925 N.E.2d at 1131.

<sup>104</sup> *Id.* at 1141.

<sup>105</sup> See *id.*

dispenses charity to all who need it and apply for it; (4) it does not provide gain or profit in a private sense to any person connected with it; and (5) it does not appear to place any obstacles in the way of those who need and would avail themselves of the charitable benefits it dispenses.<sup>106</sup>

The court determined that Provena Hospitals met the first and fourth factors because the organization had no capital, capital stock, or shareholders, and that it did not provide gain or profit in the private sense to any person connected with it.<sup>107</sup> However, Provena Hospitals failed to meet the remaining factors.<sup>108</sup> Regarding the second factor, Provena Hospitals' funds were not derived mainly from private and public charity and held in trust for the purposes expressed in the charter.<sup>109</sup> "They [were] generated, overwhelmingly, by providing medical services for a fee."<sup>110</sup> In addition:

Provena Hospitals likewise failed to show by clear and convincing evidence that it satisfied factors three or five, namely, that it dispensed charity to all who needed it and applied for it and did not appear to place any obstacles in the way of those who needed and would have availed themselves of the charitable benefits it dispenses.<sup>111</sup>

Even if these factors were not an issue, Provena Hospitals would still have to show that the parcels were to be used exclusively for charitable purposes.<sup>112</sup> "Of the 43 real estate parcels involved . . . the four utilized by the Crisis Nursery [likely had] the strongest claim on being used exclusively for charitable purposes."<sup>113</sup> However, "[c]haritable use of these four parcels would not, under any legal theory, be sufficient to also confer a charitable exemption on the remaining thirty-nine parcels comprising the [medical center] complex."<sup>114</sup>

Therefore, the court concluded that the Department of Revenue was correct in denying Provena Hospitals' request for charitable

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<sup>106</sup> *Id.* at 1145 (citing *Methodist Old Peoples Home v. Korzen*, 233 N.E.2d 537, 539 (Ill. 1968)).

<sup>107</sup> *See id.*

<sup>108</sup> *See id.* at 1146.

<sup>109</sup> *See id.*

<sup>110</sup> *Id.* (alteration in original).

<sup>111</sup> *Id.*

<sup>112</sup> *See id.* at 1149.

<sup>113</sup> *Id.* at 1154 (alteration in original).

<sup>114</sup> *Id.* at 1154 (alteration in original).

exemption as to any of the forty-three parcels.<sup>115</sup> The court went on to state that had the legislature wished, it could have provided that even though property is used exclusively for charitable purposes, the property shall be exempt from taxation only if, additionally, the value of the charitable services equals or exceeds the estimated property tax liability—because, again, the legislature is free to make the terms of an exemption more restrictive than the terms in article IX, section 6.<sup>116</sup>

The Illinois court discussed this issue again, several years later in the *Carle Foundation v. Cunningham Township* decision,<sup>117</sup> where the plaintiff foundation owned four parcels of land, which prior to 2004, were exempt because of charitable use.<sup>118</sup> In the case, the foundation claimed “that the four parcels should be exempt from real estate taxes during the assessment years 2004 to 2011 on the ground of charitable use.”<sup>119</sup> Specifically, the court granted summary judgment on Count II of the foundation’s complaint, which sought a declaratory judgment “that Section 15 – 86 applies to any determination of [the foundation’s] entitlement to exemptions for the Four Parcels for tax assessment years 2004 through 2011.”<sup>120</sup> The township defendants appealed, asserting that the amended statute was unconstitutional.<sup>121</sup> Subsection (c) of the amended statute stated:

A hospital applicant satisfies the conditions for an exemption under this Section with respect to the subject property, and shall be issued a charitable exemption for that property, *if the value of services or activities listed in subsection (e) [(35 ILCS 200/15–86(e) (West 2014))] for the hospital year equals or exceeds the relevant hospital entity’s estimated property tax liability, as determined under subsection (g) [(35 ILCS 200/15–86(g) (West 2014))], for the year for which*

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<sup>115</sup> See *id.* at 1155.

<sup>116</sup> See *Provena Covenant Med. Ctr. v. Dep’t of Revenue of State*, 894 N.E.2d 452, 460 (Ill. App. Ct. 2008), *aff’d sub nom*, 925 N.E.2d 1131 (Ill. 2010).

<sup>117</sup> *Carle Found. v. Cunningham Twp.*, 45 N.E.3d 1173 (Ill. App. Ct. 2016), *vacated for lack of appellate jurisdiction*, 2017 IL 120427, 2017 WL 1090961 (Ill. Mar. 23, 2017). The Illinois Supreme Court decision did not address whether the statute in question was unconstitutional but vacated the case on procedural grounds only, remanding for reconsideration of the substantive issues. *Carle Found.*, 2017 WL 1090961, at \*10. See also, *Oswald v. Hamer*, 73 N.E.3d 536, 551 (Ill. App. Ct. 2016), *appeal allowed* 2017 WL 4342088 (Ill. Sept. 27, 2017) (holding that § 15-86 of the IL statute passed constitutional muster).

<sup>118</sup> See *Carle Found.*, 45 N.E.3d at 1176.

<sup>119</sup> *Id.* at 1177.

<sup>120</sup> *Id.* at 1178 (alteration in original).

<sup>121</sup> *Id.* at 1190.

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exemption is sought.<sup>122</sup>

While the court determined that it was the intent of the legislature to apply this statute retroactively to any pending exemption determinations, such as the foundation's, the statute was found unconstitutional because it exceeded the terms and conditions of the Illinois Constitution.<sup>123</sup> By failing to require the subject property to be "used exclusively for charitable purposes", and instead requiring a hospital to simply "pay for its property tax exemption with . . . services of equivalent value," the legislature essentially added a new exemption that was not authorized by the state constitution.<sup>124</sup> The language of the statute permitted "a charitable exemption for hospital entities that, regardless of whether they use the property exclusively for charitable purposes, provide just enough "[s]ervices that address the health care needs of low-income or underserved individuals" to economically counterbalance the property tax exemption."<sup>125</sup> This statute did not require any charitable use of the property at all.<sup>126</sup>

While this case, along with *Oswald v. Hamer*,<sup>127</sup> where the Illinois District court upheld the constitutionality of the property tax sections of the statute based on a statutory construction reading, exemplify how legislatures and courts are attempting to apply the law with consistency, they also show a need for uniformity in addressing the issue.<sup>128</sup> The court in *Oswald*<sup>129</sup> acknowledged that the plaintiff in the case "relied on the Fourth District's recent decision in *Carle Foundation*"<sup>130</sup> where "the Fourth District concluded that section 15-86 was unconstitutional on its face",<sup>131</sup> but provides that for the reasons set out in its decision "we have reached a different conclusion and respectfully disagree with the court's decision".<sup>132</sup> This continuing dichotomy among courts within states is reflected in other states as well.

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<sup>122</sup> *Id.* at 1184 (alteration in original) (emphasis added).

<sup>123</sup> *See id.* at 1191 (citing ILL. CONST. art. IX, § 6).

<sup>124</sup> *Id.* at 1195.

<sup>125</sup> *Id.* (citation omitted).

<sup>126</sup> *See id.*

<sup>127</sup> *Oswald v. Hamer*, 73 N.E.3d 536, 551 (Ill. App. Ct. 2016), *appeal allowed* 2017 WL 4342088 (Ill. Sept. 27, 2017).

<sup>128</sup> *See id.* (discussing 35 ILL. COMP. STAT. 200/15-86(e) (2017)).

<sup>129</sup> *Id.*

<sup>130</sup> *Id.* (citing *Carle Found. v. Cunningham Twp.*, 45 N.E.3d 1173 (Ill. App. Ct. 2016), *vacated for lack of appellate jurisdiction*, 2017 IL 120427, 2017 WL 1090961 (Ill. Mar. 23, 2017)).

<sup>131</sup> *Id.* at 551.

<sup>132</sup> *Id.*

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#### 4. Michigan

In *Baruch SLS, Inc. v. Tittabawassee Township*,<sup>133</sup> Baruch, a nonprofit corporation, sought property tax exemption for its adult foster facility, Stone Crest.<sup>134</sup> Stone Crest was open to individuals eighteen years of age and older and was licensed as a specialized care unit with programs for the aged, developmentally disabled, physically handicapped, and mentally ill.<sup>135</sup> Baruch had a faith-based philosophy and did not admit individuals who required isolation, restraint, or constant professional nursing care, unless the applicant was being admitted to hospice.<sup>136</sup> No financial disclosures were required for admission, and Baruch contended that admission decisions were not based on an applicant's ability to pay.<sup>137</sup> Baruch never admitted any resident who did not have some ability to pay, but no resident was discharged from the facility for non-payment.<sup>138</sup>

Additionally, Baruch maintained an "Income Based Program," which reduced a resident's monthly rate based on his or her income.<sup>139</sup> Its written policy for this program included eligibility criteria as follows: a resident must have lived at Stone Crest and have made a minimum of twenty-four full monthly payments; a resident must apply for and be determined eligible for Medicaid; and a resident must provide information about all available income.<sup>140</sup> Baruch sought tax-exempt status for real and personal property taxes under sections 211.7o and 211.9 of the Michigan Compiled Laws, but was denied.<sup>141</sup> Ultimately, the tax tribunal held that Baruch was not entitled to a charitable exemption because Baruch did not satisfy factor five of the test for property tax exemption set forth in *Wexford Medical Group v. City of Cadillac*, which stated that an organization could not charge more for services than what was needed to maintain the program.<sup>142</sup>

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<sup>133</sup> *Baruch SLS, Inc. v. Tittabawassee Twp.*, 901 N.W.2d 843 (Mich. 2017).

<sup>134</sup> *Id.* at 850

<sup>135</sup> *See id.* at 846.

<sup>136</sup> *Id.*

<sup>137</sup> *Id.*

<sup>138</sup> *Id.* at 846–47.

<sup>139</sup> *Id.* at 847.

<sup>140</sup> *Id.*

<sup>141</sup> *Id.*

<sup>142</sup> *Id.* *See Wexford Med. Grp. v. City of Cadillac*, 713 N.W.2d 734, 746 (Mich. 2006) (holding that if the overall nature of an institution is charitable, it is a charitable institution for purposes of property tax exemption regardless of how much money it devotes to charitable activities in a particular year and the provider was entitled to property tax exemption as a charitable institution). Factor (5) states, "A 'charitable institution' can charge for its services as long as the charges are not more than what is needed for its successful maintenance." *Wexford Med. Grp.*, 713

In *Wexford*, a 501(c)(3) organization that was jointly owned by Trinity Health Care and Munson Health Care, both 501(c)(3) organizations, claimed property tax exemption.<sup>143</sup> Wexford's mission was "providing access to quality and affordable health care services to the communities it serves."<sup>144</sup> It not only had a charity care policy that gave free and discounted healthcare to people whose income was twice the poverty level, but also had open access for Medicare and Medicaid patients.<sup>145</sup> Wexford claimed that 50% of its patients were Medicare/Medicaid.<sup>146</sup> Moreover, Wexford's expected fee collection was 83% from self-pay patients, 75% from Blue Cross, 40.4% from Medicaid and 60.3% from Medicare.<sup>147</sup> In addition to charitable care, Wexford also participated in offering "classes, lectures, training, testing and screening, and sports physicals."<sup>148</sup>

Wexford argued it was entitled to tax exemption as follows:

[(1)] Real or personal property owned and occupied by a nonprofit charitable institution while occupied by that nonprofit charitable institution solely for the purposes for which it was incorporated is exempt from the collection of taxes under this act[;]

[(2)] The real estate with the buildings and other property located on the real estate on that acreage, owned and occupied by nonprofit trust and used for hospital or public health purposes is exempt from taxation under this act, but not including excess acreage not actively utilized for hospital or public health purposes and real estate and dwellings located on that acreage used for dwelling purposes for resident physicians and their families.<sup>149</sup>

The tax tribunal did not grant exemption to Wexford under sections 211.7o or 211.7r, because serving thirteen Medicare or Medicaid patients in two years was not a sufficient number of charitable care patients for a hospital serving 44,000 patients per year.<sup>150</sup> The court stated that the test to determine who is entitled to property tax

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N.W.2d at 746.

<sup>143</sup> *See id.*

<sup>144</sup> *Id.*

<sup>145</sup> *See id.* at 737.

<sup>146</sup> *Id.*

<sup>147</sup> *See id.*

<sup>148</sup> *See id.*

<sup>149</sup> *Id.* at 738 (alteration in original) (quoting MICH. COMP. LAWS §§ 211.7o, 211.7r (2017)).

<sup>150</sup> *Id.*

exemption is:

(1) The real estate must be owned and occupied by the exemption claimant; (2) the exemption claimant must be a . . . [nonprofit] charitable . . . institution . . . ; (3) the claimant must have been incorporated under the laws of this State; [and] (4) the exemption exists only when the buildings and other property thereon are occupied by the claimant solely for the purposes for which it was incorporated.<sup>151</sup>

The court also stated that tax exemptions are narrowly construed because they disrupt equal taxation.<sup>152</sup> Charitable institutions must be organized chiefly, if not solely, for benevolence, charity, education, or the promotion of science.<sup>153</sup>

Moreover, the charges collected for services should not be more than are needed for the organization's successful maintenance.<sup>154</sup> The determination of the exemption depends on: (1) "whether the organization claiming the exemption is a charitable one," and (2) "whether the property on which the exemption is claimed is being devoted to charitable purposes."<sup>155</sup> Ultimately, the court found that Wexford was a charitable institution entitled to tax exemption.<sup>156</sup>

### C. For-Profits and the Hybrid Influence

While most of the cases discussed in this Article deal with hospitals and health care organizations structured as charitable, nonprofit organizations; there are other organizations (benefit corporations, for example) also incorporated for a public purpose but structured as for-profit corporations with a social mission.<sup>157</sup> How are the property tax exemption decisions being handled in this alternative scenario?<sup>158</sup> While state statutes differ, some require that the benefit

<sup>151</sup> *Id.* at 740 (alteration in original).

<sup>152</sup> *Id.*

<sup>153</sup> *Id.* at 741.

<sup>154</sup> *Id.*

<sup>155</sup> *See id.*

<sup>156</sup> *Id.* at 750.

<sup>157</sup> *See* S.C. CODE ANN. § 33–38–120(E) (2012) (explaining that formation of a corporation does not prohibit the corporation from including in its general powers "consideration for the public welfare, or for charitable, scientific, or educational purposes").

<sup>158</sup> *See* S.C. CODE ANN. § 33–38–140 (2012); *see also* SBC Health Midwest, Inc. v. City of Kentwood, 894 N.W.2d 535, 542 (Mich. 2017) (holding that a Delaware for-profit corporation in Michigan that operated a college and requested a tax exemption under section 211.9(1)(a) of the Michigan Compiled Laws for

corporation have a “general” public purpose, while others allow general and “specific” public purposes.<sup>159</sup> In South Carolina, a “general” purpose is defined as “a material positive impact on society and the environment taken as a whole, as assessed against a third-party standard, from the business and operations of a benefit corporation.”<sup>160</sup> A “specific” public purpose can include any benefit that serves, “one or more public welfare, religious, charitable, scientific, literary, or educational purposes.”<sup>161</sup> Specific purposes can also include any purpose designated by the corporation’s board of directors in keeping with statutory law.<sup>162</sup> While it may be easy to deny the exemption when the corporate purpose is stated in general terms, the “specific” purposes sound much like those designated as exempt in federal and state law, creating a much closer connection to the charitable nonprofit/corporation line. While there is currently no case law addressing handling property tax exemption for benefit corporations, it will not be long until this issue arises.<sup>163</sup>

#### D. Current Solutions

As this Article makes clear, states deal with taxing property owned by charitable nonprofit organizations inconsistently.<sup>164</sup> In addition, the courts are also inconsistent in their interpretation of state statutes.<sup>165</sup> They allow exemptions for some organizations that fall into specified categories, such as churches and educational organizations, and others only when they meet the “charity” standard set out by state statutes.<sup>166</sup> Once the courts have determined that these organizations need not pay property taxes, the states through their municipalities oftentimes seek PILOTS, but again with no consistency.<sup>167</sup> Almost all PILOTS entered into by municipalities are different and depend on the negotiations

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personal property used to operate the college can be eligible for a tax exemption if it meets the statutory requirements).

<sup>159</sup> See S.C. CODE ANN. § 33–38–300 (2012); see also FLA. STAT. ANN. § 607.606 (West 2014) (explaining that a benefit corporation must have a general public benefit purpose and may identify one or more specific public benefits in its articles of incorporation).

<sup>160</sup> S.C. CODE ANN. § 33–38–130(A)(5) (2012).

<sup>161</sup> § 33–38–130(A)(7).

<sup>162</sup> *Id.*

<sup>163</sup> See Lacovara, *supra* note 9, at 823; Dana Reiser, *Benefit Corporation-A Sustainable Form of Organization*, 46 WAKE FOREST L. REV. 591, 608 (2011).

<sup>164</sup> See *supra* Part III; *infra* Part V.

<sup>165</sup> See Section III.B.

<sup>166</sup> See Section III.B.

<sup>167</sup> Daniella Corcuera, Note, *Revisiting the Nonprofit Property-Tax Exemption: An Exemption of the Need to Clarify Eligibility*, 32 L.J. & COM. 155, 162 (2013).

between the individual charitable organization and the municipality. A report published by the Lincoln Institute found that since the year 2000, over two hundred localities in over twenty-five states collected PILOTs on an annual basis, and are worth more than \$90 million.<sup>168</sup> Most of the organizations that enter into these PILOTs are larger nonprofits like Harvard, Yale, Massachusetts General Hospital, and Brown University.<sup>169</sup> The remaining ten percent represent various types of organizations including churches, art and cultural organizations, and social service agencies.<sup>170</sup>

### E. Why PILOTs?

PILOTs are seen as one answer to the financial needs of states and local municipalities in these hard economic times, because they are considered a compromise of sorts. No matter the benefits that charitable nonprofit organizations bring to a community, the argument is always that local governments provide services to charities that they do not pay for, and therefore, these organizations should pay for them somehow.

As communities have become more strapped for funding, the arguments in favor of PILOTs have become stronger.<sup>171</sup> One scholar contends that PILOTs, by their very nature, are taxes by a different name, but with no standards or system in place.<sup>172</sup> Because it is difficult to find policies for existing PILOTs, the belief is that it is not the payment of property taxes that is really at issue.<sup>173</sup> “Rather, PILOT policies are at least in part symbolic politics—occasions for local government officials and spokespersons of local charities to negotiate their mutual dependencies and relationships.”<sup>174</sup> Currently,

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<sup>168</sup> Adam Langley et al., *Payments in Lieu of Taxes by Nonprofits: Which Nonprofits Make PILOTs and Which Localities Receive Them?* 1, 13 (Lincoln Inst. of Land Pol’y Working Paper WP12AL1, 2012), <http://www.lincolninst.edu/publications/working-papers/payments-lieu-taxes-nonprofits>.

<sup>169</sup> *Id.* at 2.

<sup>170</sup> *See id.*

<sup>171</sup> *See* JOAN YOUNGMAN, A GOOD TAX: LEGAL AND POLICY ISSUES FOR THE PROPERTY TAX IN THE UNITED STATES 177, 186 (2016).

<sup>172</sup> *See id.* at 176–77; Richard D. Pomp, *The Collision Between Nonprofits and Cities over the Property Tax: Possible Solutions*, in THE COLLISION BETWEEN NONPROFITS AND CITIES OVER THE PROPERTY TAX: POSSIBLE SOLUTIONS 383, 386 (E. Brody ed., 2002).

<sup>173</sup> Kirsten Grønbjerg & Kellie McGiverin-Bohan, *Local Government Interest in and Justifications for Collecting Payments-in-Lieu of (Property) Taxes from Charities*, 7 NONPROFIT POL’Y F. 7, 11–12 (2016).

<sup>174</sup> *Id.* at 12; *see also* Fei et al., *supra* note 4, at 111 (“In 1998, Leland conducted  
*continued . . .*”)

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218 localities in twenty-eight states receive PILOTS, concentrated in the Northeast, with Massachusetts and Pennsylvania accounting for more than half of these.<sup>175</sup>

## F. PILOT Programs—Is This a Solution?

PILOTs are generally negotiated for less than what a nonprofit might pay in property taxes, but reports conclude that they can contribute significantly toward the cost of the public services they consume.<sup>176</sup> As stated above, most of the PILOTs are entered into in the northeast and with hospitals and educational institutions.<sup>177</sup> While these are agreements between nonprofits and municipalities, the term is also used to describe payments from for-profit businesses and state or federal governments, which adds to the confusion.<sup>178</sup> A review of some of the details of PILOT agreements along with some statistics from larger cities provides some information to analyze and draw conclusions.

### 1. Boston, Massachusetts—A Long Standing Program

Although several cities have established PILOT programs,<sup>179</sup> Boston has one of the most notable to date, which is oftentimes seen as a valuable model. In 2012, a Boston Task Force<sup>180</sup> was organized to study how best to address the property tax exemption issue in the city

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a survey of public officials in 73 large cities, and identified PILOTs in only seven cities and six states of the 51 respondents. More recently, Kenyon and Langley and Langley report evidence of PILOTs and draw inferences about the characteristics of localities that receive them. Using media accounts, government reports, other sources, and a survey of 599 cities and towns with the largest nonprofit sectors (171 respondents), report that 218 localities in 28 states received PILOTs. They find that PILOTs are concentrated in the northeastern part of the United States, with Massachusetts and Pennsylvania communities accounting for more than half of the PILOT recipients they identify. Universities and hospitals provide 92 percent of the measured PILOT revenues, which is sensible given their considerable financial resources, though this may partly reflect the survey method.” (citations omitted).

<sup>175</sup> See Fei et al., *supra* note 4, at 112 (showing that universities and hospitals provide ninety-two percent of PILOT revenues).

<sup>176</sup> See Langley et al., *supra* note 168, at 15.

<sup>177</sup> See *id.*

<sup>178</sup> *Id.*

<sup>179</sup> *Id.* at 5 (providing that the following cities have PILOT programs: Boston, Massachusetts; New Haven, Connecticut; Providence, Rhode Island; Cambridge, Massachusetts; Princeton, New Jersey; and Erie, Pennsylvania).

<sup>180</sup> See Eric A. Lustig, *A Continuing Look at Boston’s Revised Payment in Lieu of Taxes (PILOT) Program: Updated Version 2.0*, 50 NEW ENG. L. REV. ON REMAND 1, 11 (2015).

and provide recommendations, many of which were set out in an Urban Institute report.<sup>181</sup> The recommendations for creating PILOTs included the belief that PILOTs should remain voluntary, that all nonprofits should be asked to contribute, except those with total property value less than \$15 million, that PILOTs should be calculated based on 25% of what the nonprofit's property would yield if taxable, that a dollar-for-dollar credit would be offered for services in lieu of taxes (SILOTs) but limited to 50% of the payment, that institutions would receive a credit on their PILOT in the amount of real estate taxes paid on properties that would ordinarily qualify for a tax exemption based on use, and that the new program would be gradually phased in over a five-year period.<sup>182</sup> Once established, the first three years of this PILOT program were documented in a 2015 article,<sup>183</sup> finding that volunteer contributions to the PILOT program by nonprofits increased, with the medical community contributing the largest percentage to date.<sup>184</sup>

Under the four-year-old program, the city asked nonprofits with more than \$15 million worth of tax-exempt property in Boston to write checks twice a year to help offset the cost of police and fire protection, snow removal, and other services.<sup>185</sup> The payments were voluntary contributions in lieu of taxes.<sup>186</sup> In 2012, the city established a structured system and began to incrementally increase the amounts requested of each institution with the goal that, by fiscal year 2016, each nonprofit would be asked to contribute 25% of the property tax bill they would owe if not exempt.<sup>187</sup> However, data shows that, of the nineteen colleges the city asked for payment, thirteen paid less than what was requested during fiscal year 2015, which concluded at the end of June.<sup>188</sup> Among the eight colleges with the most valuable tax-exempt property holdings, Northeastern University and Emmanuel College paid 13% of what the city requested; Emerson College paid 19%; Boston College, 23%; Harvard University, 44%; Wentworth

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<sup>181</sup> See Evelyn Brody et al., *The Charitable Property-Tax Exemption and PILOTs*, URB. INST. 1, 9 (Aug. 29, 2012), <http://www.urban.org/sites/default/files/publication/25746/412640-The-Charitable-Property-Tax-Exemption-and-PILOTs.PDF>.

<sup>182</sup> *Id.*

<sup>183</sup> *See id.*

<sup>184</sup> *Id.* at 11.

<sup>185</sup> *Payment in Lieu of Tax (PILOT) Program*, CITY BOS., <https://www.boston.gov/departments/assessing/payment-lieu-tax-pilot-program> (last updated Aug. 8, 2017).

<sup>186</sup> Brody et al., *supra* note 181, at 9.

<sup>187</sup> *See id.*

<sup>188</sup> Lustig, *supra* note 180, at 4–5.

Institute of Technology, 50%; and Suffolk University, just over 50%.<sup>189</sup> Meanwhile, medical institutions, the other major nonprofit group that the city asked to enter into PILOT agreements, for the most part provided the requested amounts.<sup>190</sup> Of those sixteen medical institutions, eleven paid the requested amounts during fiscal year 2015.<sup>191</sup>

The following chart details some of the major cities that have established PILOT programs, most of which are situated in the northeast.<sup>192</sup>

<b>U.S. Cities That Receive the Most PILOT Revenue</b>					
Table created by Kenyon and Langley <sup>193</sup>					
City	State	Year	PILOT REVENUE		Number of Nonprofits Making PILOTs
			Total \$	% General Revenue	
Boston	MA	2015	27,925,183	0.84%	36
New Haven	CT	2015	10,936,010	1.49%	2+
Providence	RI	2016	8,233,374	0.94%	7
Cambridge	MA	2015	8,919,135	0.64%	15
Princeton	NJ	2015	3,610,000	5.93%	6
Erie	PA	2015	2,862,897	0.44%	13
Baltimore	MD	2015	2,411,533	0.07%	15
Lancaster	PA	2015	1,614,344	2.08%	38
Lebanon	NH	2016	1,553,546	4.78%	1
Ithaca	NY	2014	1,550,619	0.86%	2
Pittsburgh	PA	2015	419,000	0.07%	41 (in 2012)

<sup>189</sup> See *id.*

<sup>190</sup> See *id.* at 11.

<sup>191</sup> Matt Rocheleau, *Many Colleges Missing Mark on Voluntary Payments to City*, BOS. GLOBE (July 21, 2015), <https://www.bostonglobe.com/metro/2015/07/21/many-boston-colleges-fall-short-voluntary-payments-city/D8jVTjEKrPkMOZq8N4q83M/story.html>.

<sup>192</sup> Brody et al., *supra* note 181, at 8.

<sup>193</sup> The table shows updated data for the localities identified as receiving the most PILOT revenue in a 2012 survey, and later still received a PILOT. Daphne A. Kenyon & Adam H. Langley, *Nonprofit PILOTs*, LINCOLN INST. 2 tbl.1 (Nov. 2016), <http://www.lincolninst.edu/sites/default/files/pubfiles/nonprofit-pilots-policy-brief-v2.pdf>. The table “shows combined PILOT revenue for the city, county, and school district.” *Id.* “General revenue is from the Census Bureau’s 2013 Survey of State and Local Government Finances, but adjusted for inflation to match year with PILOT revenue for each city.” *Id.*

Another group, the Massachusetts Municipal Association, has gone one step further than voluntary PILOTs and has proposed a bill (H. 2584, S. 1451), which would allow cities and towns, upon local acceptance, to require certain charitable nonprofit organizations to make payments in lieu of taxation to host cities and towns equal to 25% of what they would pay if the property were not exempt.<sup>194</sup> The bill would require cities and towns to adopt bylaws or ordinances to provide for these agreements.<sup>195</sup>

## 2. *Legislative Attempts That Have Failed*

As successful as some PILOT programs have been, examples of failed attempts to create PILOT programs through legislation can be found in several states. Two examples can be found in New Hampshire and Massachusetts. In New Hampshire, Representative David Hess introduced a bill to expand the business enterprise tax to include large nonprofits, colleges, and universities.<sup>196</sup> The tax was a 0.75 percent levy on interest, dividends, and compensation above a threshold. It would have exempted churches and other religious institutions and would have applied only to nonprofits with more than \$1.5 million in gross operating expenditures annually.<sup>197</sup> Representative Hess admitted to targeting hospitals, colleges and universities, but because the legislation cast so wide a net and included smaller organizations as well, the bill was opposed by the state Ways and Means Committee.<sup>198</sup>

In Lowell, Massachusetts, state Representative David Nangle recently proposed a revised bill,<sup>199</sup> after meeting resistance from small nonprofits in an earlier attempt, that was also thwarted. The new bill was meant to apply to charities “whose five highest-paid employees collectively make more than \$2.5 million annually.”<sup>200</sup> Representative

<sup>194</sup> S. 1451, 189th Gen. Court (Mass. 2015).

<sup>195</sup> See MASS. MUNICIPAL ASS’N, <https://www.mma.org/mmabills> (last visited Aug. 15, 2017).

<sup>196</sup> See H.B. 1509, Reg. Sess. (N.H. 2014).

<sup>197</sup> See *id.*; see also Jennifer DePaul, *Short on Revenue, State and Local Governments Turn to Nonprofits*, TAX ANALYSTS (Jan. 27, 2014), <http://www.taxanalysts.org/content/short-revenue-state-and-local-governments-turn-nonprofits>.

<sup>198</sup> *Taxing hospitals legislation on life support*, BUS. & INDUSTRY ASS’N N.H. (Jan. 31, 2014), <http://web.biaofnh.com/CWT/External/WCPages/WCWebContent/WebContentPage.aspx?ContentID=1404>.

<sup>199</sup> See Bill H. 3526, 190th Gen. Court (Mass. 2017).

<sup>200</sup> Sacha Pfeiffer, *State lawmaker takes another crack at taxing nonprofits*, BOS. GLOBE (Mar. 24, 2017), <https://www.bostonglobe.com/business/2017/03/23/state->

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Nangle explained that YMCAs and Boys and Girls Clubs would not be effected by this legislation,<sup>201</sup> but several nonprofit CEOs across the state opposed the bill.<sup>202</sup>

#### IV. THE BRITISH EXAMPLE—A SOLUTION?

The United Kingdom uses a rating system to tax charities.<sup>203</sup> It is believed that this system began as a means to assist or relieve the poor,<sup>204</sup> as a poor tax became compulsory in the United Kingdom in 1597.<sup>205</sup> The system now defines how charities should be taxed, giving the local municipalities guidance in taxing charitable organizations owning property.<sup>206</sup> And while this system had its own confusing history, with its beginnings to assist the poor, it seems relevant to look to this system given that our charitable exemption history in the United States had its beginning in the United Kingdom.

Dating back to 1865, in the *Mersey Docks and Harbour Board v. Cameron* cases,<sup>207</sup> Lord Westbury was quoted as stating that: “Trustees who are in law the tenants or occupiers of valuable property upon trust for charitable purposes, such as hospitals . . . are in principle, ratable, notwithstanding that the buildings are actually occupied by paupers who are sick or insane.”<sup>208</sup>

Yet, this notion was not universally accepted and only a limited number followed this idea, and exemptions continued on an erratic basis for years.<sup>209</sup> There was no uniformity in the treatment of charities, but in general, charitable properties were undervalued; their

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rep-takes-another-crack-taxing-  
nonprofits/IEDWXk0GMYeMU4j3CQRFQP/story.html.

<sup>201</sup> *Id.*

<sup>202</sup> *Id.*; see also Kevin Miller, *LePage's plans to end revenue sharing, tax nonprofits run into opposition in Legislature*, PORTLAND PRESS HERALD, <http://www.pressherald.com/2015/04/03/lawmakers-skeptical-of-lepage-plans-to-eliminate-revenue-sharing-tax-nonprofits/> (last updated Apr. 4, 2015) (explaining that the Legislature's Taxation Committee in Maine voted against the plan to tax nonprofits with property values greater than \$500,000).

<sup>203</sup> Report of the Committee on the Rating of Charities and Kindred Bodies, 1959, Cmnd. 831, at 2 (UK) [hereinafter *The Pritchard Committee Report*].

<sup>204</sup> *Id.*

<sup>205</sup> *Id.*; see JAMES KESSLER & OLIVER MARRE, *TAXATION OF CHARITIES AND NONPROFIT ORGANISATIONS* 1202 (10th ed. 2015) (noting that “ragged schools” for educating the very poor were exempt in 1869 under the Exemption from Rating Act).

<sup>206</sup> *The Pritchard Committee Report*, *supra* note 203, at 14–19.

<sup>207</sup> See *Mersey Docks & Harbour Bd. Trs. v. Cameron* (1865) 11 Eng. Rep. 1405 (HL).

<sup>208</sup> *Id.* at 1427.

<sup>209</sup> Chantal Stebbings, *An Effective Model of Institutional Taxation: Lunatic Asylums in Nineteenth-Century England*, 32 J. LEGAL HIST. 31, 45 (2011).

ratable values were generally between twenty-five percent and seventy-five percent of their true net annual values.<sup>210</sup>

A report of a committee that studied the rating of charities, the Pritchard Committee Report,<sup>211</sup> states that the rating system in the United Kingdom provided “a practical basis for local taxation.”<sup>212</sup> It evolved over three hundred and fifty years, from something like an income tax “levied to relieve the poor into a tax on the occupation of land levied to pay for a wide range of social and environmental services other than the relief of the poor.”<sup>213</sup> The Pritchard Committee Report attempted to create a replacement of the old system, understanding that it was “impracticable to eliminate all the elements of arbitrariness . . . .”<sup>214</sup> It furthermore attempted to find “a reasonable balance of conflicting arguments and interests, consistent with simplicity, certainty and economy in administration.”<sup>215</sup>

The Pritchard Committee Report concluded with its recommended system, which has survived to the present day as follows:

(12) The time has come to introduce a measure of uniformity and certainty into the rating reliefs enjoyed by bodies within our terms of reference. A satisfactory scheme should be simple and economical to administer and should not add materially to the rates borne by other classes of ratepayer. The essential basis should be mandatory relief for the great majority of the classes of organisation which have in the past enjoyed some measure of relief . . .

(19) There is some justification for the proposal to give a greater measure of relief to “local” bodies than to others, but it is impracticable to draw a clear line between these two classes and, in the interests of simplicity and ease of administration, there should be a single rate of mandatory relief for all charities . . .

(21) Local authorities should have power to give further relief to charities at their discretion

(22) Organisations on the fringe of the field of charity should be eligible for relief at the discretion of the local

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<sup>210</sup> See KESSLER & MARRE, *supra* note 205, at 1203.

<sup>211</sup> *Id.* at 1204.

<sup>212</sup> The Pritchard Committee Report, *supra* note 203, at 20.

<sup>213</sup> *Id.*

<sup>214</sup> *Id.*

<sup>215</sup> *Id.*

authorities. The simplest practical solution is to leave the amount of the relief for these organisations entirely in the hands of the local authorities . . .

(24) Rating authorities should be given power to grant relief to a particular body within the field for discretionary relief in any of the following three ways:

(i) For the ensuing rate period only.

(ii) For a specified term of years, not exceeding five, with power to decide at any time, being not more than two years before the expiry of one term, upon the amount of relief for the succeeding term and the length of that term.

(iii) For an indefinite period, subject to notice of not less than one clear financial year to discontinue or reduce the relief . . . .<sup>216</sup>

As discussed in Part VI, the clarity of this tax scheme can be replicated to some degree as a Model Code in the United States.<sup>217</sup>

## V. POLICY CONSIDERATIONS

As Professor Joan Youngman states in the Preface to her book, *A Good Tax*, “The property tax is a mainstay of independent local government revenue in this country. It is the largest single local tax and supplies nearly half of all general revenue from local sources. It accounts for most school district independent revenue and almost all school district tax revenue.”<sup>218</sup> While this tax can be traced to medieval times, it has changed at any given time based on current economic need and local politics.<sup>219</sup> Many see it as “an important instrument of land policy.”<sup>220</sup>

The property tax is “visible and transparent”<sup>221</sup> as it provides support for local governments.<sup>222</sup> And since property is immovable and identifiable, it is a source easily identified for the imposition of taxes. “The tax on land is also one of the few available means of raising public revenue that does not impede economic efficiency, because the fixed supply of land cannot be altered in response to the

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<sup>216</sup> *Id.* at 43–45 (alteration in original).

<sup>217</sup> *See infra* Part VI.

<sup>218</sup> YOUNGMAN, *supra* note 171, at ix.

<sup>219</sup> *See id.* at 1.

<sup>220</sup> *Id.*

<sup>221</sup> *Id.*

<sup>222</sup> *Id.* at 2.

tax.”<sup>223</sup> Article I, Section 9 of the U.S. Constitution prohibits “any ‘direct’ federal tax unless . . . imposed in proportion to population.”<sup>224</sup>

While property tax was an important source of revenue during the nineteenth century, it has become more of an important source for local government as states became dependent on sales and income tax in the twentieth century.<sup>225</sup> “The use of the property tax as a local revenue source reflects its particular suitability for that function. Some local government services have a special relationship to real property, such as fire protection, road maintenance, and public safety.”<sup>226</sup> Use of these funds to provide efficient local government services and enhanced property values is important. For the most part, these types of taxes are transparent and allow local governments to be accountable to their citizens.<sup>227</sup>

The tax disputes arising because of the state mandated exemption of property tax for certain charitable organizations has changed over time based on political and social beliefs and attitudes. While there are many historical and policy reasons for allowing charitable tax-exempt property to be exempt from taxes, there are just as many reasons for taxing them.<sup>228</sup> “Almost all western countries (and many underdeveloped countries) recognise the desirability of supporting nonprofit organisations by granting tax exemptions to charities and to donors. The details differ but there is a broad international consensus that some reliefs are in principle justified.”<sup>229</sup> Yet, there is also the belief that “no exemption should be granted unless it will be beneficial to a substantial segment of the population of the state and unless all similar properties or similarly situated taxpayers are accorded the same treatment.”<sup>230</sup> Some of the greatest difficulties arise because similar properties and/or similar taxpayers are not being taxed equally when it comes to taxing the property of nonprofit charitable

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<sup>223</sup> *Id.* at 3. For example, the 1696 tax on windows in England; it was believed that the number of windows indicated property wealth. *Id.* To avoid the tax, homeowners boarded up their windows or built homes with few windows causing negative effects not only on aesthetics but also on health. *Id.*

<sup>224</sup> *Id.* at 8.

<sup>225</sup> *See id.* at 8–9.

<sup>226</sup> *Id.* at 9.

<sup>227</sup> *Id.*

<sup>228</sup> *See generally* JAMES KESSLER, ETIENNE WONG & MARY ASHLEY, TAXATION OF CHARITIES & NON-PROFIT ORGANISATIONS 1–19 (11th ed. 2017) (citation omitted) (outlining policy issues in charity taxation).

<sup>229</sup> *Id.* at 5.

<sup>230</sup> INT’L ASS’N OF ASSESSING OFFICERS, STANDARD ON PROPERTY TAX POLICY 17 (2010); Int’l Ass’n of Assessing Officers, *Standard on Property Tax Policy*, in FERDINAND P. SCHOETTLE, STATE AND LOCAL TAXATION: THE LAW AND POLICY OF MULTI-JURISDICTIONAL TAXATION 65, 67 (2003).

organizations.

Some argue that exemption from property tax facilitates the work of the charitable organizations by allowing as much available funding as possible to be directed toward the mission.<sup>231</sup> Organizations provide benefits to the public and deliver services that may not be provided by private businesses oftentimes more effectively or less costly than the state.<sup>232</sup> And an altruistic view provides that some charities “promote important values, including voluntarism, self-responsibility, and participative democracy[,]” and provide a “mechanism for encouraging philanthropy.”<sup>233</sup>

James Douglas explains that western civilization developed systems for the allocation of resources.<sup>234</sup> They symbolize the market, the ballot box, and the charitable nonprofit sector.<sup>235</sup> Douglas explains that the importance of this third (nonprofit) sector is that it does not just affect certain segments of the population, but affects everyone.<sup>236</sup> Similarly, the Commission on Private Philanthropy and Public Needs states:

[T]he contributions of voluntary organizations to broad scale social and scientific advances have been widely and frequently extolled. Charitable groups were in the forefront of ridding society of child labor, abolitionist groups in tearing down the institution of slavery, civic-minded groups in purging the spoils system from public office. The benefits of nonprofit scientific and technological research include the great reduction of scourges such as tuberculosis and polio, malaria, typhus, influenza, rabies, yaws, bilharziasis, syphilis and amoebic dysentery. These are among the myriad products of the nonprofit sector that have at least indirectly affected all Americans and much of the rest

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<sup>231</sup> See Bruce R. Hopkins, *Giving USA: Charitable Donations Grew in 2012, but Slowly, Like the Economy*, in TAX EXEMPT ORGANIZATIONS: CASES AND MATERIALS, *supra* note 19, at 34, 35 (Matthew Bender ed., 3d ed. 2014).

<sup>232</sup> See KESSLER ET AL., *supra* note 228, at 5.

<sup>233</sup> See *id.* at 5; see also Hopkins, *supra* note 231, at 35 (alteration in original) (“Philanthropic giving fares best in a known environment, and has been dependent, in part, on certain factors holding true over the decades, including the charitable tax deduction . . .”).

<sup>234</sup> James Douglas, *Why Charity: The Case for a Third Sector*, in TAX EXEMPT ORGANIZATIONS: CASES AND MATERIALS, *supra* note 19, at 52, 52.

<sup>235</sup> See *id.*

<sup>236</sup> *Id.*

of the world besides.<sup>237</sup>

Others believe that tax exemption is warranted based on a market and social theory, called the “subsidy theory.”<sup>238</sup> The subsidy theory states that “charitable organizations relieve the government of burdens by providing essential goods and services that the government otherwise would be responsible for delivering.”<sup>239</sup> The theory is premised on the notion that charitable purposes and organizations are worthy of promotion, and it is the government that should promote them through an indirect subsidy—the tax exemption.<sup>240</sup> Some critics have perceived the subsidy theory to be an incomplete explanation for the exemption because it has not been regarded as universally applicable to all nonprofit organizations.<sup>241</sup>

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<sup>237</sup> Comm’n on Private Philanthropy & Pub. Needs, *Giving in America, Towards a Stronger Voluntary Sector*, in TAX EXEMPT ORGANIZATIONS: CASES AND MATERIALS, *supra* note 19, at 41, 44.

<sup>238</sup> Nina J. Crimm, *An Explanation of the Federal Income Tax Exemption for Charitable Organizations: A Theory of Risk Compensation*, 50 FLA. L. REV. 419, 430 (1998).

<sup>239</sup> *Id.*; see H.R. REP. NO. 75-1860, at 19 (1938) (“The exemption from taxation of money or property devoted to charitable and other purposes is based upon the theory that the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare.”); see also *McGlotten v. Connally*, 338 F. Supp. 448, 456 (D.D.C. 1972) (“[T]he Government relieves itself of the burden of meeting public needs which in the absence of charitable activity would fall on the shoulders of the Government.”).

<sup>240</sup> For example, the theory provides that charitable organizations deliver “charity”, which includes health care services to the poor free of charge because, in part, the provision of such services is recognized as a community benefit under traditional trust law, and it relieves the government of the burden of providing such services. Mark A. Hall & John D. Colombo, *The Charitable Status of Nonprofit Hospitals: Toward a Donative Theory of Tax Exemption*, 66 WASH. L. REV. 307, 332–38 (1991). These are the same factors used by the IRS and courts in determining whether an organization deserves tax-exempt status as a “charitable” organization. See, e.g., Treas. Reg. § 1.501(c)(3)–1 (2017).

<sup>241</sup> See, e.g., *Developments in the Law—Nonprofit Corporations*, 105 HARV. L. REV. 1578, 1620–21 (1992) [hereinafter *Developments in the Law*] (explaining subsidy theory, scrutinizing its shortcomings, and suggesting a tax expenditure analysis revealing its weaknesses). A critic of the subsidy theory suggests that: “[E]mbedding substantive policy programs in the tax system forces ill-equipped tax administrators and legislative tax committees to make substantive policy decisions. Congressional spending eludes proper scrutiny by substantive policy committees whenever Congress includes such spending programs in tax legislation. Similarly, this practice forces the IRS to make substantive policy decisions when formulating regulations that interpret legislation.” *Id.* at 1621 (citations omitted); see also STANLEY S. SURREY & PAUL R. MCDANIEL, TAX EXPENDITURES 95–96, 106 (1985) (discussing administrative burdens of implementing substantive income tax policies).

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## VI. A UNIFORM MODEL

What is clear from the literature, and a review of statutory and case law, is that consistency in this area is not only needed, but will provide the charitable sector with stability in one critical area of this constantly changing philanthropic world. It is time to propose clear standards that can be adopted in every state, and administered in local counties and municipalities. However, adoption depends on economic need, philosophy around tax exemption, politics, strength and size of the charitable sector, and taxing standards and authorities within each state.<sup>242</sup> Since taxes at the local level, especially property taxes, hold such critical importance and are structured to meet a great number of fiscal needs, a consistent tax scheme must address these as much as possible.<sup>243</sup>

A review of how hospitals have navigated property tax exemption provides a variety of potential solutions for addressing this issue, as seen in the cases discussed earlier.<sup>244</sup> Many states have required that hospitals qualifying for a charitable exemption under state statutes offer a specific amount of charitable care annually.<sup>245</sup> This has caused problems for several reasons. First, many state constitutional provisions, which are the basis for property tax exemptions, require that property be used exclusively for a charitable purpose.<sup>246</sup> “Allowing a hospital that mostly provides care under a fee-for-service model to claim an exemption simply by offering a portion of its care for free or reduced prices would likely have constitutional problems in many states.”<sup>247</sup> Second, the exemption is meant for truly charitable

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<sup>242</sup> See generally SCHOETTLE, *supra* note 230, at 15–33 (citations omitted) (discussing the history and role of state and local taxes, and setting forth principles that should guide tax design).

<sup>243</sup> See *id.* at 18–20, 597–98 (citations omitted) (discussing the historical importance of property tax revenue to local government, and noting a trend towards uniformity in other areas of state taxation).

<sup>244</sup> See, e.g., *Hosp. Utilization Project v. Commonwealth*, 487 A.2d 1306, 1317 (Pa. 1985); *AHS Hosp. Corp. v. Town of Morristown*, 28 N.J. Tax 456, 496 (2015).

<sup>245</sup> Gabriel O. Aitsebaomo, *The Nonprofit Hospital: A Call for New National Guidance Requiring Minimum Annual Charity Care to Qualify for Federal Tax Exemption*, 26 CAMPBELL L. REV. 75, 77 (2004) (citing TEX. HEALTH & SAFETY CODE ANN. § 311.031(2) (West 2004); CAL. HEALTH & SAFETY CODE § 127355 (Deering 2003)).

<sup>246</sup> See generally Elizabeth Siegal & Scott Metcalf, *Property Tax Exemptions: An Overview of State Constitutional and Statutory Provisions*, CIVIC FED’N (2000), <https://www.civiced.org/civic-federation/publications/property-tax-exemptions-overview-state-constititional-and-statutory-pro> (providing an inventory of local government assessing practices regarding the granting of property tax exemptions to nonprofit organizations).

<sup>247</sup> Jennifer Carr, *The Growing Fight Over Hospital Tax Exemptions*, TAX

organizations and not organizations with for-profit missions, subsidiaries and partnerships.<sup>248</sup>

New Jersey recently attempted to pass a bill that would have required nonprofit hospitals to pay a fee per bed to offset costs to their communities, but it was vetoed by Governor Christie.<sup>249</sup> The bill was to apply statewide,<sup>250</sup> the fee would have been mandatory, and would have applied only to charitable institutions.<sup>251</sup>

These attempts at providing equity when dealing with hospitals, and oftentimes universities, have fallen short.<sup>252</sup> The solutions do not deal with issues of equity or valuation.<sup>253</sup> The questions continue to be, what is being taxed, and is it being taxed consistently across the board? The scholarly literature and much of the case law discusses mostly the large nonprofit charitable organizations, while leaving the smaller organizations out of the conversation or left to be dealt with later, when putting together PILOTs and other agreements.<sup>254</sup> The fact that these smaller organizations do not have the same power or voice as the larger groups makes it all the easier to leave them out of the discussions.<sup>255</sup> The hybrid organizations discussed briefly in this Article would also benefit by contributing to any proposed solution.<sup>256</sup>

One theory, the feasibility of which was explored by author Robert Grimm, is to enact the “donative theory,” which sets a thirty-three percent threshold for all tax exemptions and deductions as a property tax solution.<sup>257</sup> Criticizing the traditional theories and refining and

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NOTES (Oct. 1, 2016), <https://www.taxnotes.com/exempt-organizations/exempt-organizations/growing-fight-over-hospital-tax-exemptions/2016/10/01/m95n?highlight=jennifer%20carr>.

<sup>248</sup> Jamie C. Yesnowitz et al., *State & Local Tax Alert*, GRANT THORNTON 9–10 (Jan. 13, 2017), [https://www.grantthornton.com/~/\\_/media/content-page-files/tax/pdfs/SALT-general/2017/Outlook-2017-01-13-17.ashx](https://www.grantthornton.com/~/_/media/content-page-files/tax/pdfs/SALT-general/2017/Outlook-2017-01-13-17.ashx) (citing Carr, *supra* note 247) (“As New Hampshire state Rep. David Hess (R) noted: ‘Hospitals and private universities are big businesses . . . I think we need to start a conversation about why we are carving out a special exception for them.’”).

<sup>249</sup> Alex Wolf, *Christie Pocket-Vetoes NJ Hospital Tax Exemption Bill*, LAW360 (Jan. 19, 2016, 5:43 PM), <https://www.law360.com/articles/747999/christie-pocket-vetoes-nj-hospital-tax-exemption-bill>.

<sup>250</sup> S. 4903, 216th Leg., Reg. Sess. (N.J. 2015).

<sup>251</sup> *See id.*

<sup>252</sup> *See* Rashi Fein, *On Achieving Access and Equity in Health Care*, 83

MILBANK Q. 1, 7–9 (2005).

<sup>253</sup> *See id.*

<sup>254</sup> Langley et al., *supra* note 168, at 1.

<sup>255</sup> Carr, *supra* note 247.

<sup>256</sup> *See id.*

<sup>257</sup> *See* Robert Grimm, *Targeting the Charitable Property-Tax Exemption to Collective Goods*, in PROPERTY-TAX EXEMPTION FOR CHARITIES: MAPPING THE BATTLEFIELD, *supra* note 19, at 321, 321–22.

expanding other theories, Professors Mark A. Hall and John D. Colombo developed the donative theory, which posits that only those charitable organizations funded substantially by philanthropic donations deserve and should be entitled to tax exemption.<sup>258</sup> Their arguments draw on economics “strongly buttressed by the leading theories of distributive justice and by the pluralistic values that characterize the third [nonprofit] sector.”<sup>259</sup> The donative theory suggests that the primary rationale for the charitable exemption is to subsidize those organizations capable of attracting a substantial level of donative support from the public—that is, donative nonprofits.<sup>260</sup>

Mr. Grimm suggests that targeting property tax exemptions to collective goods and the belief that “a substantial amount of donations given by the public represent worthiness and an acknowledgment of citizens’ willingness to allow a nonprofit to receive governmental subsidies,” indicates that most nonprofits would lose their property tax exemption.<sup>261</sup>

While these solutions have merit, a simpler approach might be to commission the American Bar Association to address the issue in a Model Code, giving incentive for states to follow suit in a more consistent manner when taxing property owned by charitable nonprofit organizations. Such an effort would require legislatures to pass statutes with consistent language and state courts to interpret the laws in keeping with established law.<sup>262</sup> The Code would set forth which properties would be taxed and at what rate, delineate what kind of exempt organization (i.e. educational, charitable, cultural) was taxable, what size based on gross income (i.e. greater than \$500,000), based on ownership, use or both, much like the United Kingdom. There would be a mandatory tax based on size (determined by yearly gross income) for organizations falling within a defined class (similar to Boston’s PILOT program), with smaller organizations owning property required to pay less or nothing at all. While there would be consistency, there would also be some discretion provided to local governments (terms of

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<sup>258</sup> See Mark A. Hall & John D. Colombo, *The Donative Theory of the Charitable Tax Exemption*, 52 OHIO ST. L.J. 1379, 1383–84 (1991).

<sup>259</sup> *Id.* at 1389 (alteration in original).

<sup>260</sup> See *id.* at 1389–90, 1433 (asserting that the donative theory has a “unique ability to tie together all of the major components of the taxation of charities.”). The theory fits donative nonprofits better than commercial nonprofits, which, because they generate income from other sources, do not rely on contributions to the same extent as donative nonprofits. “It explains the deduction for charitable contributions, the income tax exemption, and the property tax exemption.” *Id.* at 1433. It also “nicely explains” the sales tax exemption for charities. *Id.* at 1433 n.152.

<sup>261</sup> Grimm, *supra* note 257, at 343–44.

<sup>262</sup> See Cornell L. Sch. Legal Info. Inst., *supra* note 18.

years, etc.) in recognition of their needs.

Another option is a sliding scale fee based on gross income for all organizations, regardless of size, with a requirement that these groups focus on revitalization efforts by creating City Districts. The city of Philadelphia partnered with businesses, government and academic leaders (including the University of Pennsylvania and Drexel University) to create economic development in a University City District.<sup>263</sup> Penn, Drexel and the University of Sciences together contribute sixty-five percent of the Districts' \$5.2 million annual budget.<sup>264</sup> Such an effort would allow the exempt organizations to focus on their missions and include as part of their operations, a piece that encourages community revitalization. If the tax-exempt organization is an educational organization, the effort could focus on education; if it is an arts organization, it could focus on arts and culture.<sup>265</sup> The risk with this type of tax scheme would be requiring too much diversion of mission as charitable organizations focus on varying projects to meet their tax commitments, which might lead to mission drift.

## VII. CONCLUSION

It is best to remember Adam Smith's maxim when devising a tax scheme.<sup>266</sup> It states that:

The subjects of every state ought to contribute to the support of the government, as nearly as possible in proportion to their respective abilities[,] . . . [t]he tax which each individual is bound to pay ought to be certain, and not arbitrary[,] . . . [e]very tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it[,]

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<sup>263</sup> See Jacob Adelman, *Study Calls for University City, W. Center City 'Innovation District'*, PHILA. INQUIRER, [http://www.philly.com/philly/business/real\\_estate/commercial/study-calls-for-ucity-w-center-city-innovation-district-20170517.html](http://www.philly.com/philly/business/real_estate/commercial/study-calls-for-ucity-w-center-city-innovation-district-20170517.html) (last updated May 18, 2017); *Philadelphia's University City District*, PA. MUN. LEAGUE, <http://www.pamunicipalleague.org/index.asp?SEC=F3C35D8B-41DF-4E00-A538-A2E1B9961060&DE=0FE1634E-BE13-44CA-AAD8-10763F9471DA> (last visited Oct. 2, 2017).

<sup>264</sup> *Philadelphia's University City District*, *supra* note 263.

<sup>265</sup> See generally *id.* (describing the positive impact of the University City District developments on the local community); see also Liz Eliano, *Museum Troubles in Boston, City Wants More \$\$\$*, HYPERALLERGIC (Jan. 3, 2012), <https://hyperallergic.com/44174/boston-pilot-nonprofits/>.

<sup>266</sup> See MILL, *supra* note 1, at 802 (quoting ADAM SMITH, *THE WEALTH OF NATIONS* bk. v, ch. ii (1776)).

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. . . [and] [e]very tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state.<sup>267</sup>

While PILOTs are being instituted more frequently, they are inconsistent, leave too much to local and municipal decision-making, are oftentimes seen as arbitrary, and can be used as political blackmail or land use tools.<sup>268</sup> PILOTs provide little revenue in the long term and can lead charitable nonprofits to raise fees or in extreme situations cut their services.<sup>269</sup> The better solution is a Model Act, drafted with enough guidance for states to adopt their own, similar statutes.

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<sup>267</sup> See *id.* at 802–03 (alteration in original).

<sup>268</sup> See Evelyn Brody, *The States' Growing Use of a Quid-Pro-Quo Rationale for the Charity Property Tax Exemption*, 56 EXEMPT ORG. TAX REV. 269, 286–88 (2007).

<sup>269</sup> See NSFRE Gov't Relations Comm., *Payments in Lieu of Taxes*, ASS'N FUNDRAISING PROFS. 1, 2 (Jan. 1997), [http://www.afpnet.org/files/contentdocuments/pilot\\_position\\_paper.pdf](http://www.afpnet.org/files/contentdocuments/pilot_position_paper.pdf).

