PAYMENTS IN LIEU OF TAXES: FIVE THINGS PROVIDERS SHOULD KNOW

In recent years, increasing numbers of municipalities have asked health care entities that might otherwise be exempt from property taxes to enter into payment in lieu of taxes agreements (“PILOTs”). While most prevalent in the Northeast Region of the country, PILOTs are expanding in popularity nationwide as municipalities seek to expand their budgets by taxing some of the largest nonprofits in their districts, which include hospitals and universities. Health care entities that own real property should consider the following issues when evaluating whether to pursue a PILOT.

1. **PILOTs Apply to Nonprofit and For-Profit Entities**

PILOTs may take various forms, including temporary decreases in property tax rates for for-profit entities that relocate or start operations in a particular taxing district. In the health care context, PILOTs typically arise in the form of municipalities that request them from nonprofit health care entities that would otherwise be exempt from local property taxes. While PILOTs are by nature voluntary, nonprofit hospitals may feel pressure to make them, especially in communities where property tax rates are high or local governments are over budget. PILOTs are sometimes used as a tool to resolve disputes between a property owner and the municipality over the taxable status or taxable value of the subject property.

2. **PILOTs Are Voluntary**

Because PILOTs are voluntary, municipalities may use various appeals to persuade nonprofit hospitals to enter into PILOTs. Some municipalities take more of a hard sell approach by proposing new fees or by agreeing to alleviate the burdens of certain other taxes, such as utility taxes, that the hospital might ordinarily owe even if it were exempt from property tax. Municipalities might remind nonprofit hospitals that they control building permits, zoning decisions and other crucial barriers to a sustainable business model and use these as leverage to compel an entity to agree to a PILOT. Finally, and perhaps most importantly, municipalities may build public support for a PILOT program, which can exert immense pressure on health care providers to acquiesce to the municipality’s demands.

PILOTs may indeed increase a hospital’s standing in the community by demonstrating it is a team player or a good neighbor. However, from a financial perspective, because nonprofit health providers would typically not be liable for property taxes, PILOTs will often have an adverse financial impact on health providers that agree to pay them. As stewards of tax-exempt donor funds, hospital governing boards may argue that they have a duty not to make payments that do not fall within the entity’s particular charitable purpose.

3. **PILOTs Are Typically Negotiated on an Ad Hoc Basis**

While PILOT programs may be systematically applicable to all tax-exempt organizations in a particular jurisdiction, often PILOTs are negotiated on an individualized basis. This may make it difficult for health providers to know whether the terms of a particular deal are fair. Localities sometimes increase incentives to concentrate their collection efforts on organizations that have disproportionately high costs of moving (such as those with local licensing or certificate of need obligations), large property holdings or location-specific charitable purposes (e.g., community foundations or hospital supporting organizations). There have also been instances of local governments applying more intense scrutiny to tax exemption applications of those charitable hospitals that did not enter into PILOTs or refusing to provide those organizations with the opportunity to contract with the municipality for public services. In Grand Haven Township, Michigan, for example, the municipal board greenlighted development of a medical office complex only after the hospital agreed to enter into a PILOT with the locality. A significant concern among the township board and the community had been the prospect that the large development would be entitled to a complete property tax exemption, thereby denying the township any tax revenue from the property.

4. **Community Benefits May Count Toward PILOT Payments**

One prominent example of community benefits counting toward nonprofits’ payments under a PILOT is the city of Boston, which currently has the largest PILOT program in the country based on revenues. In the Boston program, community benefits, such as public health initiatives, may count for up to 50 percent of the full PILOT payment. Because of the individualized nature of PILOT agreements,
it may be possible for health providers in other jurisdictions to argue for inclusion of similar provisions in their agreements with municipalities. Due to federal law requirements, such as those under Internal Revenue Code Section 501(r), as well as the long history of nonprofit hospitals providing uncompensated care, this may be a way for hospitals to reap the benefits of PILOT involvement while lessening some of the more burdensome financial requirements.

5. **PILOTs Are Typically Long Term in Nature**

It is not uncommon for PILOT agreements to run for several decades. Agreements can be structured as lump sum payments with annual percentage increases or as a percentage of property value, square footage, hospital beds or productivity metrics. Municipalities sometimes prefer the certainty of lump sum payments over other approaches that could result in wide variation in PILOT amounts from year to year. However, lump sum payments can create a gamble for hospitals. On the one hand, if the hospital acquires significant real property holdings during the term of the PILOT, it might come out ahead. On the other hand, if the hospital divests itself of significant holdings, it might end up paying more than it otherwise would have.

Hall Render assists clients in successful evaluation and negotiation of PILOT agreements with state and local governments. If you have questions or would like additional information, please contact:

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