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## Coates' Canons Blog: Pushing Back on Non-Profit Property Tax Exemptions

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\$19 billion. That's the rough market value of exempt property owned by non-profit educational institutions and charitable hospitals throughout North Carolina, according to the most recent figures from the N.C. Department of Revenue.

Under G.S. 105-278.4 and G.S. 105-278.8, property owned by private schools, colleges and universities or by charitable hospitals is exempt from property taxes so long as that property is used for an exempt purpose.

Using average tax rates, the educational and charitable hospital exemptions cost counties somewhere around \$125 million in property tax revenue annually. Toss in at least another \$100 million or so for city property taxes and we're looking at a maybe quarter of a billion dollars in local government revenue eliminated each year by those two exemptions.

That's not to say that universities and hospitals don't contribute to their communities, of course. Duke University claims it adds about \$6 billion to the region's economy annually. That ain't peanuts. While you might quibble with the exact dollar figure, it's obvious that Duke does wonders for Durham. That's true elsewhere as well. Google the phrase "eds and meds" and you'll find hundreds of articles about how universities and hospitals have become economic engines for cities and towns across the nation.

But the many positive benefits that eds and meds can generate for their local communities don't change the fact that in North Carolina and most other states these institutions don't pay taxes on the property they use for their educational or medical missions. Local governments bear the burden of providing police, fire, and other services to colleges and hospitals just as they do for all property owners, without receiving any tax revenue in return. And as is true of any property tax exemption, eliminating taxes on educational and hospital property in a locality raises the tax burden on all other local property owners.

Some communities have been pushing back against these exemptions through legislation, litigation, and negotiation. In Maine, the governor proposed taxing 50% of the value of property owned by non-profits other than religious organizations. In New Jersey, Princeton University recently agreed to pay \$18 million to settle a lawsuit challenging its property tax exemptions. In Rhode Island, the city of Providence negotiated with Brown University to make voluntary payments in lieu of taxes ("PILOTs") of about \$7 million annually.

Might similar efforts work in North Carolina?

Without question, the bigger private universities and hospitals in the state could afford to pay property taxes without closing their doors. Duke University's endowment is \$7 billion. Wake Forest University's exceeds \$1 billion. 2015 revenue for Moses H. Cone Hospital in Greensboro topped \$1.5 billion. The elimination of property tax exemptions for these institutions would not dramatically curtail their operations.

But that might not be true for countless neighborhood-based non-profits operating on shoe-string budgets. Eliminating all non-profit property tax exemptions would certainly have a negative impact on the valuable services these small organizations provide to their communities.

Instead of seeking legislative changes, local governments could instead more aggressively seek PILOTs from the non-profits operating in their jurisdictions. My friends in Durham report that Duke makes a PILOT of \$400,000 year. That helps, but it's a tiny percentage of what the university would pay in property taxes on the billions of \$ in real and personal property owned by the university and associated hospitals. And that PILOT is completely voluntary, meaning if Duke changes its mind down the road the city and county could not legally force the university to continue those payments.

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Outside of Durham, non-profit PILOTs are scarce in North Carolina. A national study of PILOTs reported that there are a few more non-profit PILOT arrangements across the state. But the study doesn't identify them and neither I nor my colleagues at the DOR have heard of them. If you know of a PILOT agreement in your community, please share the details in the comment section below.

Another option would be for taxpayers or local governments to challenge the property tax exemptions received by a university or hospital under North Carolina law. The "use" requirement for both of those exemptions would be the key a successful challenge. If educational or charitable hospital property is not used for an exempt purpose, it is not exempt. (See this post for more on the use requirement.)

In the Princeton litigation local property owners identified a long list of commercial activities undertaken by the university that allegedly undermined its claim for property tax exemptions. Those businesses included patent licensing, research for hire, venture capital investing, real estate investing, commercial television, and private mortgage banking, just to name a few.

The fact that Princeton paid many millions of dollars to make the lawsuit go away suggests that the local taxpayers' allegations had some legal merit. Here's more proof: a comparable lawsuit against a non-profit hospital in Morristown, New Jersey resulted in a settlement under which the hospital agreed to pay the local government \$1 million per year.

It's not a stretch to suggest that some of our state's largest non-profits might be at risk of similar challenges to their exemptions based on their wide-ranging endeavors. If a college or charitable hospital is engaged in activity that appears to be commercial rather than educational or charitable, then the property used in that activity should lose its exemption. In 2003 the state court of appeals relied on this reasoning to uphold Forsyth County's denial of an educational exemption for a university-owned off-campus restaurant that generated substantial profit and catered primarily to non-university customers. In re: University for the Study of Human Goodness & Creative Good Work, 159 N.C. App. 85 (2003).

Outside of the Forsyth County case, our state courts have not offered much guidance on what constitutes commercial activity in a university or hospital setting. Plenty of big-dollar questions remain unanswered. One example: when does a research contract between a private, for-profit corporation and a university or a hospital become commercial and therefore not related to the exempt purpose of that university or hospital?

Given these uncertainties, the decision about how aggressively a local government should pursue additional revenue from non-profits is more political than legal. The assessor can explain how property tax exemptions are determined, but then it's up to the elected officials to decide how to proceed.

## Links

- [www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-278.4](http://www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-278.4)
- [www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-278.8](http://www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-278.8)
- [today.duke.edu/2015/02/impact](http://today.duke.edu/2015/02/impact)
- [www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2015/3/05/should-nonprofits-have-to-pay-taxes](http://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2015/3/05/should-nonprofits-have-to-pay-taxes)
- [www.bloomberg.com/news/articles/2016-10-15/princeton-will-pay-18-million-to-settle-residents-tax-case](http://www.bloomberg.com/news/articles/2016-10-15/princeton-will-pay-18-million-to-settle-residents-tax-case)
- [taxfoundation.org/blog/brown-university-pilots-and-tax-exemptions](http://taxfoundation.org/blog/brown-university-pilots-and-tax-exemptions)
- [en.wikipedia.org/wiki/List\\_of\\_colleges\\_and\\_universities\\_in\\_the\\_United\\_States\\_by\\_endowment](http://en.wikipedia.org/wiki/List_of_colleges_and_universities_in_the_United_States_by_endowment)
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- [canons.sog.unc.edu/the-two-key-questions-for-property-tax-exemptions/](http://canons.sog.unc.edu/the-two-key-questions-for-property-tax-exemptions/)
- [www.princeton.edu/ogc/fieldsvprinceton/Fields-Complaint-2015.pdf](http://www.princeton.edu/ogc/fieldsvprinceton/Fields-Complaint-2015.pdf)
- [www.dailyrecord.com/story/news/2015/11/11/morristown-atlantic-health-agree-landmark-tax-settlement/75593676/](http://www.dailyrecord.com/story/news/2015/11/11/morristown-atlantic-health-agree-landmark-tax-settlement/75593676/)
- [caselaw.findlaw.com/nc-court-of-appeals/1352180.html](http://caselaw.findlaw.com/nc-court-of-appeals/1352180.html)