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City can't impose business tax on parent of health system

The City of Allentown, PA, cannot impose a business privilege tax on revenue received by the parent entity of a healthcare system from providing services to its nonprofit affiliates. A trial court has held that the activity is not engaged in for profit and is therefore not subject to the tax.

The City of Allentown imposes a business privilege tax on any activity "carried on or exercised for gain or profit in the City, including … the sale of merchandise or other tangible personality or the performance of services."

The Good Shepherd Rehabilitation Network is the parent entity of a system that includes a rehabilitation hospital, a long-term care facility, a long-term acute care service entity, and a housing development corporation, all of which are Pennsylvania nonprofit corporations exempt from federal tax as 501(c)(3) charities. They are also deemed "purely pubic charities" exempt from state sales and use taxes.

The Network provides administrative and financial services to most of its affiliated and subsidiary corporations, including human resources, financial administration, information technology, fundraising, and building maintenance. The Network does not bill its subsidiaries for its services but allocates the costs to the subsidiaries based upon the proportionate share of revenues generated by each.

In February, 2018, following an audit, the City issued a bill to the Network for $788,000 in unpaid business privilege taxes for the years 2012-2016. The Network appealed.

The Court concluded that the Network was properly assessed a tax on rental income, but was not liable for a tax on contributions, gifts, grants, management fees, investment income, expense reimbursement, health network labs revenue, insurance reimbursements or management services to the County. Those activities, it said, were not carried on or exercised for the purpose of gain or profit.

The Court noted the mission statement of the Network "to enhance lives, maximize function, inspire hope, and promote dignity and well-being." Its vision statement included assuring best outcomes at reasonable cost and to excel in the delivery of individually focused outcomes.

The Court said the Network was engaged in its activities "as an accommodation to and for the benefit of the controlled entities" and that "its purpose is not to generate profits for itself, but to reduce costs … for all of the subsidiaries."

The Court rejected the City's argument that an entity is engaged in business in the City if it is providing a service and is compensated for it. The Court said that the analysis requires an analysis of gain and profit, not merely compensation.

According to press reports, at least four other nonprofits are contesting the imposition of business privilege taxes on them. (*Good Shepherd Rehabilitation Network v. City of Allentown*, Ct. of Common Pleas, Lehigh County, PA, No. 2018-C-2309, 10/15/19.)