



SUMMARY OF ARGUMENTS IN *ESTATE OF LEWIS, et. al. v. PRINCETON UNIVERSITY AND BOROUGH OF PRINCETON*

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NEW JERSEY'S COLLEGE AND UNIVERSITY PROPERTY TAX EXEMPTION

This report discusses a recent challenge to the property tax exemption the Borough of Princeton granted several Princeton University buildings. By law, New Jersey municipalities must exempt such buildings from property taxes if they are "actually used for colleges, schools, academies or seminaries..." but not those sections leased to profit-making organizations or otherwise used for non-tax exempt purposes (N.J.S.A., § 54:4-3.6).

Connecticut law also exempts college and university property from property taxes under the exemption that applies to property used for scientific, educational, literary, historical, or charitable purposes or to preserve open space. Organizations qualify for this exemption only if they are exclusively organized for these purposes and actually used the property for those purposes (CGS § [12-81\(7\)](#)).

QUESTION

Summarize the parties' arguments in *Estate of Lewis, et. al. v. Princeton University and Borough of Princeton*.

SUMMARY

In June 2013, the New Jersey Tax Court refused to dismiss a suit brought by Princeton borough residents and property owners against the Borough of Princeton and the University of Princeton disputing the university's nonprofit, tax-exempt status and the eligibility of 19 university buildings for the statutory property tax exemption for buildings used by nonprofit organizations. (The university asked the court for partial summary judgment and the borough asked to have the case against it dismissed.) No trial date has been set. The parties are currently negotiating out of court.

The issues are: whether (1) Princeton

University is a nonprofit organization and (2) certain university practices, such as operating a retail food court in a student center, serve a college purpose, as required by the New Jersey law for the tax exemption.

The university and the plaintiffs cited the same standard for determining whether an organization qualified for the exemption, but differed sharply on whether the university qualified as a nonprofit organization and whether the 19 buildings were being used for college purposes.

Princeton University claimed that it operates as a nonprofit organization, distributing neither dividends nor profits to individuals. The plaintiffs, though, claimed that the university functions like a commercial operation because it patents and licenses the technology faculty members develop and shares some of the generated income with them.

With regard to the buildings, the parties characterized their uses differently. For example, the university claimed its infirmary provides comprehensive health services to students and their dependents largely without cost to them. The plaintiffs argued the infirmary provides medical services not just for students but for university staff and their families, "thereby providing medical services to literally thousands of employees and their spouses and children in direct competition with local physicians."

NEW JERSEY'S PROPERTY TAX EXEMPTION FOR NONPROFIT ORGANIZATIONS

The dispute centers on whether Princeton University qualifies for New Jersey's property tax exemption for nonprofit organizations (N.J.S.A. § 54:4-3.6). By law, colleges, schools, academies, and seminaries are exempt from paying property taxes on buildings "actually used for colleges, schools, academies or seminaries..." but not any part of a building that is "leased to profit-making organizations or otherwise used for purposes which are not themselves exempt from taxation." The law specifies the profit-making part is "subject to the taxation and the remaining portion only shall be exempt."

Three-Prong Test

New Jersey courts apply a three-prong test to determine if an organization qualifies for the property tax exemption for nonprofit organizations. Applying that test, an organization qualifies for the exemption if it:

1. is organized for a tax-exempt purpose,
2. actually and exclusively uses the property for that purpose, and
3. is not operating or using the property for profit (*Paper Mill Playhouse v. Millburn Township* (95 NJ 503 (1984))).

Prong One—Tax Exempt Purpose

Princeton. Princeton University argued that it is a tax-exempt organization based on its charter, "letters of good standing" from the state attesting to its nonprofit status, and its 501 (c) (3) federal income tax exemption. It also claimed it "pays reasonable salaries and other benefits to its faculty and staff, distributing no dividends or profits to individuals (*Brief of Defendants in Support of Motion for Partial Summary Judgment*, October 24, 2012).

Plaintiffs. The plaintiffs challenged the university's tax-exempt status and its eligibility for the nonprofit property tax exemption, citing the university's distribution of \$120 million to individual faculty members since 2008 from the income it generates from licensing its patents, income the plaintiffs labeled as "surplus income" or profit (*Plaintiffs' Memorandum of Law in Opposition to Defendant Princeton University's Motion for Partial Summary Judgment*, April 19, 2013).

In support of their argument, the plaintiffs cited court decisions holding that, "where organizational profits or surplusage goes to individuals or entities other than the claimant organization, the claimant may not have an entitlement to property tax exemption." Distributing patent income to faculty members is part of the university's "commercialization activities," which "extend to acting as a partner in technology start-ups with faculty," the plaintiffs added. "That the University is seeking to license patents to reduce its operating losses from its scholarly activity, does not alter the fact that this business causes the institution to 'take... on the nature of a commercial enterprise,'" they stated.

Prong Two—Determining Use

Princeton. The plaintiffs claimed that 19 university buildings do not qualify for the statutory property tax exemption because the university does not actually use them for college purposes, as the statute requires. Princeton University argued that the buildings serve "the core educational purpose of a well-known University and, therefore are college or school purposes within the meaning of N.J.S.A. 54:4-3.6." Among other things, the buildings are used to conduct classes and seminars; house faculty and staff offices, academic departments, and libraries; provide services to students, faculty, and staff; and serve as gathering spaces for the Princeton academic community.

Princeton also described each building and its academic uses. For example, it explained how the McCosh Infirmary houses University Health Services (UHS), which provides "comprehensive health services to Princeton University undergraduate and graduate students and their dependents," and does so "largely

without cost to the student” and without billing insurance carriers for the medical care provided. “All UHS staff, including physicians, are paid a salary by the University,” it added.

Princeton’s description of the Frist Center suggests the university defines college purposes broadly, stating that its café and food gallery provide “opportunities for all components of the University community to be involved in campus life and to create an atmosphere for individuals and groups to interact and learn from one another.”

Plaintiffs. The plaintiffs claimed that the 19 buildings are used for nonacademic purposes and thus do not qualify for the property tax exemption. For example, they claimed the McCosh Infirmary “is a medical provider not simply for students but for the University staff and their families, thereby providing medical services to literally thousands of employees and their spouses and children in direct competition with local physicians” (emphasis in the original).

The plaintiffs’ analysis of the other buildings followed a similar line. For example, they claimed the Frist Center’s café and food gallery are retail operations “open to the public and to staff, accepting cash and credit cards.” They also noted that “the student meal plan is only incidentally used at the Food Gallery and at highly restricted hours, that no showing is made that the Frist Food Gallery is primarily student-based in its usage and only incidentally used by staff,” all of which “give rise to a factual issue as to the fundamentally commercial nature of these facilities.”

Prong Three—Profit Making

Princeton. While the second prong concerns whether Princeton used the buildings for college purposes, the third prong concerns whether those purposes generate profits for the university. Citing *Trenton v. State Division of Tax Appeals* (65 N.J. Super. 1(1960)), Princeton claimed that the issue turns on whether it (1) intentionally operated these buildings to make a profit and (2) used any such profits to operate and develop the university.

In *Trenton*, the Appellate Court held, “in granting the tax exemption to colleges...not conducted for profit, the state does not demand that no ‘profit’ shall be made in any year, but rather that the real purpose of the school’s existence shall not be the making of money. So long as the ‘profit goes back into the cause of education, it subserves the public need of training our youth.’”

Princeton argued that it met this standard, claiming, among other things, that it does not intentionally run the buildings to generate profits nor does it use them for profit-making purposes. "The University's 2010-2011 audited financial statements and federal Form 990 indicate the various services provided in the improvements owned by the University are operated as part of the not-for-profit University. Any net income generated from providing such services becomes part of the University's general income fund which is used for the University's educational purposes," Princeton stated. Furthermore, "no surpluses, if any, can be traced back to an individual other than the University to be used in the maintenance, expansion, and the development of the University and its facilities," it added.

Plaintiffs. The plaintiffs argued that Princeton intentionally used the buildings to generate profits. For example, they claimed the university runs the McCosh Infirmary "in substantial part as a corporate benefit program offered not only to employees but also to their families, competing directly with medical and counseling practices in the community." Further, Princeton failed to show that "the bulk of expenditures are used for student care as opposed to employee and dependent care." Consequently, Princeton offered "no evidence of any kind...to sustain the taxpayer's burden of proving entitlement to the exemption for McCosh."

The plaintiffs made a similar argument with regard to the café, food gallery, and the Frist Center's other facilities, stating, "there is no apparent statutory authorization for employee cafeterias, coffee and dessert bars, and computer and software businesses as exempt properties." Regarding the latter, the University made no showing about "why it is necessary for the University to have its own computer sales business with discounted product for its faculty and staff in competition with local businesses...."

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