APL-2021-00056

To be argued by:
ANDREA M. CHAN
15 minutes requested

COURT OF APPEALS
STATE OF NEW YORK

In the Matter of the Application of

BROOKDALE PHYSICIANS' DIALYSIS ASSOCIATES, INC. f/k/a CHURCH AVENUE ASSOCIATES, INC., SAMUEL and BERTHA SCHULMAN INSTITUTE FOR NURSING AND REHABILITATION FUND, INC. f/k/a SAMUEL SCHULMAN INSTITUTE FOR NURSING AND REHABILITATION FUND, INC.,

Petitioners-Respondents,

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules

-against-

The Department of Finance of The City of New York,

Respondent-Appellant.

APPELLANT'S REPLY BRIEF

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PRELIMINARY STATEMENT

Revenues raised from the collection of property taxes are critical to the survival of municipalities across the State. The need for tax revenue derived from property taxes does not diminish in proportion to the number of properties exempted from the rolls, but rather, the financial burden upon the remaining tax payers is merely increased. Thus, this Court has consistently held that a narrow construction is to be accorded to RPTL 420-a. Such a construction underscores the need to achieve a fair distribution of the real property tax levy that is required and necessary to support a functioning society.

This Court should reject the premise that a statute intended to exempt benevolent organizations from property taxes can be construed to condone a use of property whereby both the tenant and the landlord reap substantial profits. To be sure, there is no reason for Brookdale Dialysis to operate on a for-profit basis yet maintain entitlement to the exemption were it anything other than a guise for profit making. This Court rejected a similar overture when it denied the exemption to a not-for-profit development corporation leasing its building to a for-profit manufacturer. *See Matter of Lackawanna Community Dev Corp. v Krakowski,* 12 NY3d 578 [2009]. Nor is there any justification for the Schulman Fund to claim the exemption while enjoying substantial profits from its lease to Brookdale Dialysis. This Court denied the exemption in a similar case wherein a profitable

lease arrangement was not even benefitting the property owner, but the lessee that sub-let the property. *See Sisters of St. Joseph v New York*, 49 NY2d 429 [1980]. The observation as stated by this Court in *Sisters of St. Joseph* is equally applicable here: "the Legislature could not have intended its express mandate to be so easily circumvented" *Id*. at 441.

ARGUMENT

THE DEPARTMENT OF FINANCE SATISFIED ITS BURDEN OF PROOF TO WITHDRAW THE TAX EXEMPTION AS IT IS CLEAR FROM THE RECORD THAT THE SUBJECT PROPERTY WAS NOT BEING USED FOR AN EXEMPT PURPOSE BUT RATHER WAS BEING LEASED TO A FOR PROFIT ENTITY WHICH IS EXPRESSLY PROHIBITED UNDER REAL PROPERTY TAX LAW 420-A.

Contrary to Petitioner's assertions, the City is fully cognizant that the municipality bears the burden of proof when it seeks to withdraw a previously granted tax exemption and must show that the property is subject to taxation. Indeed, throughout the entirety of this litigation, this is what the City has demonstrated. Further, despite the City's burden, that does not diminish the well-settled precedent in New York that tax exemption statutes are to be strictly construed against the taxpayer seeking the benefit and, in the case of ambiguity, resolve any doubt in favor

of the taxing authority (*see Colt Industries v. Department of Finance*, 66 NY2d 466, 471 [1985]; *Mobil Oil Corp. v. Finance Administrator,* 58 NY2d 95, 99 [1983]).

Real Property Tax Law 420-a provides a mandatory exemption from real property taxes solely to not-for-profit organizations that meet the stringent requirements set forth by the legislature. First, the property must be owned by a nonprofit that is exclusively organized or conducted for religious, charitable, hospital, educational, or moral and mental improvement purposes. Second, the property must be used exclusively in furtherance of such purposes and the exempt purposes must take place physically upon the property. Finally, the property may not be used for pecuniary gain or as a guise for profit making.

All three of these conditions must be met in order to allow a property to be wholly exempt from real property taxes pursuant to 420-a and, here, the City has demonstrated consistently that Petitioners only meet one.

I. The Department Of Finance Did Consider the Building's Use And Discovered That The Building Was Not Being Used By The Shulman Fund For A Charitable Purpose But Rather Was Being Leased To A For-Profit Commercial Enterprise.

Petitioners erroneously assert that the Department of Finance never analyzed the actual use of the Shulman Fund's building (Pet-Resp Br at 3), when, in fact, the use of the property was the sole reason why the tax exemption was originally revoked in the first place. On March 22, 2013, Finance sent a letter informing

Petitioners that a property must be used by the nonprofit owner for an exempt purpose in order to qualify for a tax exemption pursuant to RPTL 420-a, but that it was recently discovered that the subject property was actually being used by a commercial entity that was leasing the Building from the Shulman Fund (R 123). The letter from Finance stated:

> The above-referenced property was previously granted an exemption pursuant to Section 420a of the Real Property Tax Law. Properties are eligible for this exemption if they are owned by a qualifying not-for-profit institution that is using the property for an exempt purpose. Exempt property owners are required to tell the Department of Finance of any changes in the use of the property. It has come to our attention that this property was leased to a commercial entity… and the property was no longer eligible for the exemption... If you have evidence that the property was not leased to a commercial entity, and that the property continued to be used for an exempt purpose… please forward it to us immediately.

(R 123). In 2013, Finance had discovered that according to Department of Buildings records, the subject property was being leased to a commercial entity, Brookdale Dialysis, since September 24, 1996.[1] Thus, the property had been improperly enjoying a full exemption from real property taxes for almost 17 years up until the discovery of the lease.

[1] While the City recognizes that it is the 2017 determination of Finance that is under review, it is the City's obligation to make the Court aware of the case history in its entirety so that the Court may adequately possess a complete understanding of how this appeal evolved and developed.

Finance revoked the tax exemption because the leasing arrangement formed by the Shulman Fund and the dialysis center directly violated the plain language of RPTL 420-a, which provides that "if any portion of such real property is not so used exclusively to carry out thereupon one or more of such [exempt] purposes but is leased or otherwise used for other purposes, such portion shall be subject to taxation" (RPTL 420-a[2]). However, Petitioners challenged the revocation in an Article 78 proceeding brought in Supreme Court, New York County, and in 2014, the lower court annulled Finance's determination.

Subsequently, in 2017, upon renewing their application for exemption, Finance reviewed supplemental information relating to the lease between the Shulman Fund and the dialysis center, and at that point discovered that the income received by the Shulman Fund was in excess of the expenses incurred by the property (R 55). As a result, Finance denied the exemption (*id*.). Finance conducted the income-expense analysis because both the legislature and the courts have declined to grant a tax exemption to leased property unless and "so long as it or a portion thereof… is devoted to such exempt purposes and so long as any moneys paid for such use do not exceed the amount of the carrying, maintenance and depreciation charges of the property or portion thereof.…" (RPTL 420-a[2]; *see also Sisters of St. Joseph v New York*, 49 NY2d 429 [1980]).

Although this analysis is typically invoked when a qualifying exempt organization is leasing its property or a portion of the property to another qualifying tax-exempt entity,[2] courts nevertheless will perform this calculation, seemingly as a safeguard, even when the property is leased to a for-profit commercial entity (*see e.g. Matter of Lackawanna Community Dev Corp. v Krakowski*, 50 AD3d 1469, 1470 [4th Dept 2008] *affd Matter of Lackawanna Community Dev Corp. v Krakowski*, 12 NY3d 578 [2009](where the court had already found that the activities of the for-profit tenant were inconsistent with the petitioner's exempt purpose, the Appellate Division still addressed the property's income and expenses, noting in dicta that "in any event… it is immaterial whether the property is being used in furtherance of petitioner's corporate purpose, in view of the concession of petitioner that the rental income received from the tenant far exceeds its carrying charges and maintenance expenses for the property."); *see also e.g. Genesee Hospital, Inc. v Wagner*, 76 Misc2d 281, 289 [Sup Ct Monroe Co 1973] *rev* 47 AD2d 37 [4th Dept 1975] *affd* 39 NY2d 863 [1976] (where a nonprofit hospital was leasing space to physicians and surgeons in private practice, the lower court reviewed the income and expenses even though the lessees were operating on a for-profit basis finding "that the moneys received by petitioner in the form of rents have, at this

[2] *See e.g. Sisters of St. Joseph v New York*, 49 NY2d 429 [1980]).

point, been insufficient to offset the operating and maintenance costs of subject building.").

Here, the Department of Finance performed such calculation and found that the income exceeded the expenses for the Shulman Fund's property (R 55).[3] Yet Petitioners contend that DOF failed to consider a sufficient amount of information in its calculation (Pet-Resp Br at 20). However, it is evident from the Record that Finance did, in fact, request a list of expenses associated with the property (R 295), which was thereafter provided by Petitioners (R 319) and utilized in coming to a determination to revoke the tax exemption for the subject property (R 408). Petitioner was given ample opportunity to provide all expenses related to the property, and has never asserted it did not disclose all expenses, therefore DOF justifiably relied upon the expenses as submitted.

Indeed, the use of the property has always been at issue in this litigation, not only in the 2013 determination, but thereafter in both the lower court decision in 2017 (R 8-12) and in the Order of the Appellate Division that is upon review by this Court (*Matter of Brookdale Physicians' Dialysis Assoc. Inc., v Department of Fin. Of the City of N.Y.*, 178 AD3d 443, 444-5 [1st Dept 2019]).

[3] In its 2017 Determination, Finance viewed the property through the lens of the 2014 Decision of Supreme Court, New York County, stating that "[u]nder the court order from a few years back, the for-profit entity was determined to be treated as an NFP organization for purposes of the lease" (R 55), which is why the agency looked to the income and expenses of the property.

II. The Real Property Tax Law Prohibits The Granting Of A Tax Exemption Under 420-a If The Profit-Making Goes Well Beyond The Organization's Traditionally Nonprofit Functions.

Petitioners insist repeatedly throughout Respondents Brief that the Court should disregard the profits being earned on the tax-exempt property at issue, arguing that the courts do not consider profits, but only the use of the property when determining if tax exemption is appropriate (Pet-Resp Br at 4, 6, 7). This is wholly inaccurate. While it is true, of course, that examining the actual, physical use of the property is essential in satisfying the eligibility requirements under the Real Property Tax Law 420-a, that does not mean for courts to ignore when profits are being made.

In fact, the statute mandates that profit-making be reviewed as part of the analysis. Subsection (1)(b) of the statute states the following:

> Real property such as specified in paragraph (a) of this subdivision shall not be exempt if any officer, member or employee of the owning corporation or association shall receive or may be lawfully entitled to receive any pecuniary profit from the operations thereof, except reasonable compensation for services in effecting one or more of such purposes, or as proper beneficiaries of its strictly charitable purposes; or if the organization thereof for any such avowed purposes be a guise or pretense for directly or indirectly making any other pecuniary profit for such corporation or association or for any of its members or employees; or if it be not in good faith organized or conducted exclusively for one or more of such purposes.

(RPTL 420-a[1][b][emphasis added]).

And New York courts have followed this mandate. For example, in *Genesee Hospital v Wagner*, where the subject property was leased by the nonprofit hospital to doctors who used the tax-exempt space for their private physicians' offices, the Court found that there was "a commercialization and profit-making which goes well beyond the hospital's traditionally nonprofit functions." (47 AD2d 37,45 [4th Dept 1975] *affd* 39 NY2d 863 [1976]).

In *Genesee*, even though several physicians testified that "the close proximity of their private offices to the hospital did increase their availability to the hospital and consequently increased the time they had to devote to patient care and to training and educating the interns and residents at the hospital," the Court found this to be unpersuasive (47 AD2d at 41). Nor did it impact the Court's decision that "the added versatility and ability to flow back and forth to the hospital for consultation, patient care and emergencies increased the medical care and teaching function of the hospital" (*id.*). Thus, despite the extraordinary benefit the private office building added to the hospital in bettering patient care, efficiency, and medical training, the Court could not overlook the "commercialization and profit-making" aspect of the private practices.

Petitioners argue that DOF "carefully avoids a substantial portion" of the *Genesee Hospital* Appellate Division decision, when it is actually the Petitioner and

the Appellate Division who fail to address the substantive issue in that case. The privately run dialysis center in this appeal is wholly analogous to the private practices of the physicians in *Genesee Hospital*. Both uses are critical healthcare services and in close proximity to a neighboring hospital, and both businesses have employees who work at both the hospital and the private office.

Nonetheless, despite the very connected and close associations, or "enmeshed" relations, between the hospital and the office building presented in *Genesee*, the Court found that "[w]hile it is argued that the hospital and the physician serve the same purpose in the community, that is, to improve the health care of its citizens, and doubtless this is true, for purposes of a tax exemption statute this is too broad a definition in that it fails to take into account the commercial and private practice nature of the physician's operations in the subject office building (47 AD2d at 46). In denying the exemption in *Genesee*, the court emphasized the "clear distinction" from other cases dealing with commercial, corporate activity, stating that "here, we have third parties receiving pecuniary profit from their own private practice of medicine which is integrally related to the operation of the real property" (*id.* at 41-45). Here, too, the dialysis center is earning a profit from its private commercial enterprise that is "integrally related" to the operation of the subject property, but is in no way related to the Shulman Fund's charitable purpose.

Attempting to persuade this Court to overlook the profits being earned by both the Shulman Fund and the dialysis center, Petitioners cite to *Adult Home at Erie Station v Assessor* as controlling (10 NY 3d 205 [2008]). Yet, the facts in Adult Home are readily distinguishable from those in this matter. In *Adult Home*, two organizations claimed that their property was being used for "charitable" purposes pursuant to RPTL 420-a and should therefore be exempt from the real property tax (*Adult Home* at 212). The two property owners were Adult Home at Erie Station, Inc. (AHESI) and Regional Economic Community Action Program, Inc. (RECAP). AHESI's property was used for the operation of an adult care facility that was established for "the purpose of providing long-term residential care, room, board, housekeeping, personal care… and supervision" to the elderly (*id.*), while RECAP used its property to "engage[] in social work, helping homeless people, alcoholics, drug addicts and other afflicted members of society to become productive and useful citizens" (*Adult Home* at 215). For both organizations, the Court looked to the actual use of the property and found that they were clearly charitable uses: AHESI used the property "to house impoverished elderly" (*id.*) and RECAP provided housing "solely to people struggling from alcoholism, drug addiction and the like on condition that they participate in programs designed to help them" (*Adult Home* at 216).

The fact that both properties charged some of its residents for housing at market rates was not dispositive. In AHESI's case, only 10% of the residents were charged market rates and the remaining 90% were considered to qualify as poor persons who either were recipients of SSI or had no more than $2000 in assets and $50 in disposable income (*Adult Home* at 215). As for RECAP, the Court distinguished its properties from a regular commercial apartment complex in that "apartments in commercial complexes are not provided solely to people struggling against alcoholism, drug addiction and the like on condition that they participate in programs designed to help them" (*Adult Home* at 216).

By contrast, there is no claim by Petitioners here that the dialysis services are in any way discounted or provided for free to the community. There is no evidence in the Record of any charitable work that the dialysis center performs for the benefit of the neighborhood or its residents. As expressed in Appellant's principal brief, the only distinguishing feature is that Brookdale Dialysis is permitted to operate its commercial business on a property that is completely free of real property taxes.

Furthermore, the Court in *Adult Home* noted that it was viewing the economic benefit "to a charitable organization," indicating that even if a court were to consider allowing profit earning on a tax-exempt property, the economic benefit should go to the charitable organization, as opposed to the situation here, where a commercial enterprise is earning income as a private business, as the dialysis center does in this

matter. The economic benefit is also not dispositive "by itself" in determining whether a tax exemption should be granted. The Court will look to "how the property is used" and, in *Adult Home*, found that AHESI's use of housing the impoverished elderly was "undoubtedly a charitable activity" (*Adult Home* at 215), and as for RECAP, "[i]t can hardly be questioned that providing an acceptable place for people to live while they participate in social work programs advances the goal of keeping them in programs and thus of helping them overcome their troubles" (*Adult Home* at 216).

By contrast, the facts in the instant appeal could not be more dissimilar. Here, the primary use and the physical use of the subject property is the operation of a for-profit dialysis center, whose earnings inure to the benefit of a commercial enterprise. The dialysis profits do not go to any charitable organization. Appellants do not deny that dialysis serve an essential and crucial need, but the test is not whether a use is important. The test is whether the use of the property is charitable and in furtherance of the nonprofit owner's charitable purpose. One cannot argue, as Petitioners repeatedly do, that merely because dialysis treatment is a life extending and important service, that it should readily equate to a charitable use.

Petitioner's reliance on *Congregation Rabbinical College of Tartikov v Town of Ramapo*, 17 NY3d 763 (2011), is equally misplaced. In *Tartikov*, plaintiff was a not-for-profit college organized for religious and educational purposes and owned a

property where "the sole use… had been the operation of a summer camp with a religious curriculum" (*id*. at 764). The town had revoked the property's RPTL 420-a exemption arguing that the land was actually being used by the contractor who had licensed a portion of the property in order to operate the camp (*id*.). The Court ruled in favor of plaintiff as it was able to demonstrate that plaintiff "was closely involved in the operation of the religious summer camp, as evidenced by its approval of the camp's personnel, religious curriculum, and purveyors of Kosher food" (*id.* at 765). There, the Court found that because "plaintiff retained general supervision and control over the camp's operation," that the tax exemption should remain (*id.*).

By contrast, no such relationship or nexus to the property owner exists here. Indeed, there has never been any assertion that the Schulman Fund is even remotely involved in any aspect of Brookdale Dialysis' ongoing for-profit business operations. The Shulman Fund does not maintain to have any control over or supervision of the dialysis center. It merely leases the property to the center and collects rent on the lease from its tenant as would any landlord.

Even more significant, and unlike the facts here, the Court in *Tartikov* found that the operation of the summer camp was truly in furtherance of the principal use of the property for the land owner's corporate purposes and was expressly set forth in the college's Certificate of Incorporation (*Tartikov v Ramapo*, 72 AD3d 869, 872 [2d Dept 2010]). Here, the Schulman Fund's stated purpose does not align with the

use of the property. The Shulman Fund is organized to "provide funds and manage assets," not to provide dialysis services. Petitioner repeatedly attempts to conflate the purposes of the Shulman Fund with that of Brookdale Hospital and the Nursing Institute in order to create the same nexus to the dialysis center as that found in *Tartikov*, claiming that the dialysis center is a "hospital purpose." Yet, as noted many times throughout this litigation, Brookdale Hospital is not the owner of the property – the Shulman Fund is – and thus, the proper analysis under *Tartikov* is whether a private profit-earning dialysis center is an acceptable use of a tax-exempt property that furthers the Shulman Fund's stated purpose of providing funds and managing assets in support of Brookdale Hospital and the charitable fundraising activities of the organization. Appellants submit that it is not.

III. It Was Proper For Finance To Revoke The Tax Exemption On The Entire Building Because Pursuant To The Lease Terms, Brookdale Dialysis Maintains Control Over All Three Floors of The Subject Property.

Petitioner maintains that Brookdale Dialysis only occupies the first floor of the Building and the basement, and that Finance should not have revoked the tax exemption for the entire building because the second floor has always remained unoccupied (Pet-Resp Br at 56). This argument fails for two reasons. First, Brookdale Dialysis maintains control over all three floors, including the second floor. In December of 1995, Brookdale Dialysis entered into a written lease for the

Building (R 68). An amendment to the lease was entered into in March of 2014 (R 100). Aside from renewing the lease for an additional five years and defining the amount of rent payable, the original lease remained "in full force and effect" (R 101).

The original lease included an irrevocable option for Brookdale Dialysis to lease the second floor of the building, stating:

> "4.01 In consideration of and subject to the terms, covenants and conditions herein contained and reserved on the part of the Tenant to be kept, observed and performed, the Landlord hereby grants the Tenant the exclusive and irrevocable option… to rent and lease all or any portion of the second floor of the Building…" (R 71).

Further, the Schulman Fund could not lease the second floor "for any purpose whatsoever" without Brookdale Dialysis' consent, which could be "granted or withheld in the tenant's sole and absolute discretion" (R 72). Should the option have expired, the Schulman Fund was nonetheless prohibited from renting the second floor to medical offices providing dialysis or other nephrology services (R 73). Furthermore, at the inception of the original lease, when Brookdale Dialysis rehabilitated the first floor and basement levels of the building, it also spent monies partially refinishing the second floor of the building (R 145). Thus, Brookdale Dialysis retains complete control over how and even whether the second floor of the building gets used.

Second, even if the dialysis center did not retain control over the second floor and the irrevocable option to lease it, Petitioner's argument still fails because Real

Property Tax Law 420-a only permits a tax exemption on a vacant space where there is a use that is in good faith contemplated by the owner. RPTL 420-a(3) provides that:

> Such real property from which no revenue is derived shall be exempt though not in actual use therefor by reason of the absence of suitable buildings or improvements thereon if (a) the construction of such buildings or improvements is in progress or is in good faith contemplated by such corporation or association

Thus, a nonprofit owner cannot simply own property and allow it to remain vacant for years without demonstrating that there is a contemplated and intended use for the property. Here, the Shulman Fund has permitted the second floor of the Building to lay vacant while still enjoying a tax exemption on the property for at least 17 years. This "warehousing" of commercial space while failing to pay taxes thereon offends entirely the spirit and purpose of a tax exemption statute that is reserved for nonprofit entities that are actually using their tax-exempt space for a charitable purpose.

CONCLUSION

The Order appealed from should be reversed and the petition should be dismissed.

Dated: New York, New York
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CERTIFICATE OF COMPLIANCE

I hereby certify that this brief was prepared using Microsoft Word 2016, and according to that software, it contains 4183 words, not including the table of contents, the table of cases and authorities, this certificate, and the cover.

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Joseph J. Kroening