June 18, 2019

Appellate Division Reverses Tax Court on Kean University Restaurant Tax Exemption

In a case of first impression, New Jersey's Appellate Division reversed the Tax Court's decision in *Gourmet Dining, LLC v. Union Township*, 30 N.J. Tax 381 (Tax Ct. 2018), which denied a property tax exemption to a restaurant on Kean University's campus. Kean contracted, through a management agreement, with Gourmet Dining, LLC, for the "exclusive right to operate, manage and control" the restaurant in question for a 10-year period, wherein Gourmet was designated the "exclusive manager" for that period of time. The agreement required the annual payment by Gourmet to Kean of $250,000 for the first nine years and $500,000 for the 10th year. Gourmet also agreed to pay Kean's operating foundation 12.5 percent of the gross revenues derived from the restaurant. Revenue generated by the restaurant and paid to Kean was slated to fund scholarship programs, and since its opening the restaurant generated more than $377,000 for such programs. Moreover, more than 85 percent of the restaurant's employees were students of Kean.

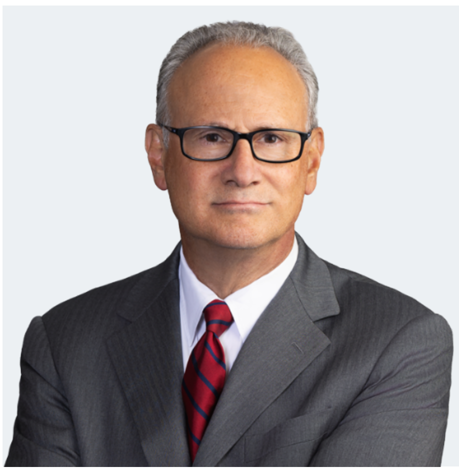
The Tax Court denied the exemption on the ground that the restaurant was not used for public purposes, which is a statutory requirement for tax exemptions pursuant to N.J.S.A. 54:4-3.3 and N.J.S.A. 54:4-3.6. The Appellate Division disagreed, noting, "We are convinced ... that the [tax] court took an unduly narrow view of the facts." The Appellate Division noted that "the restaurant is unique because it is located on-campus. The record shows that the University's students and their parents regularly dine at the restaurants. Moreover, the University views the restaurant as an important recruiting tool for students and faculty." The Appellate Division also concluded that the restaurant "provides students, other members of the University community, and visitors to the campus an alternative dining experience." Additional facts that weighed in favor of its public purpose were that the restaurant "provides revenues that are specifically earmarked for scholarships for University students," that "approximately eighty-five percent of the restaurant's employees are University students," and that "the restaurant will use produce grown on the University's property and will provide compostable waste for the University's science program, where it will be used for research by faculty and students."

The Appellate Division also emphasized "the concept of public purpose 'must expand when necessary to encompass changing public needs of a modern dynamic society.'" The court held that "when all of the relationships between the restaurant and the University are considered, they warrant the conclusion that the subject property is being used for a public purpose."

The Tax Court also denied the exemption on the grounds that the restaurant's management agreement was "functionally a lease" to a for-profit organization under N.J.S.A. 54:4-2.3 and N.J.S.A. 54:4-3.6, which also deprived the restaurant of an exemption. The Appellate Division again disagreed. In that regard, the Appellate Division noted, a lease is a possessory interest in land. The management agreement gave Gourmet the "exclusive right to operate, manage and control the restaurant, not the property," and was therefore more akin to a license which permits use, rather than a possessory interest in land. Therefore, the Appellate Division held that Gourmet was not subject to local property taxation under either N.J.S.A. 54:4-2.3 or N.J.S.A. 54:4-3.6. This holding has a much broader implication since N.J.S.A. 54:4-2.3 and N.J.S.A. 54:4-3.6

typically exclude from exempt status the leased portion of property if the lessees are not themselves nonprofit or nonexempt entities. Under the Tax Court's rationale, a license or a management agreement was the equivalent of a lease, which could deprive a property of exempt status. The Appellate Division has settled the issue and permits exemptions under management or similar agreements provided there is a continuum of the public use of the property.

Authors



Christopher John Stracco

Of Counsel

Parsippany, NJ | (973) 966-8220

cstracco@daypitney.com

Katharine A. Coffey

Partner

Parsippany, NJ | (973) 966-8323

kcoffey@daypitney.com

Peter J. Wolfson

Partner

Parsippany, NJ | (973) 966-8298

pwolfson@daypitney.com