Challenges to the Tax Exemption for Real Property for Not-For-Profit Hospitals

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• “No good deed goes unpunished. Life is so unfair that one is more likely to get into some sort of trouble than be rewarded if one attempts to do a good deed.”
Chuck Winslow’s Father
(Not Pictured)

• “The good Lord, in order to test us all, made more horses behinds than He made horses.”

[Source: Congressional Budget Office Nonprofit Hospitals and the Provision of Community Benefits paper dated December 2006]

- Corporate Income Tax (Federal)  $2.5 Billion
- Tax-Exempt Bonds (Federal)  1.8
- Charitable Contributions (Federal)  1.8
- Corporate Income Tax (State)  0.5
- Sales Tax (State & Local)  2.8
- Property Tax (Local)  3.1
- TOTAL  $12.6 Billion

State & Local Total = $6.4 Billion
Pressure To Justify Exemption

• Tax exemption = a quid pro quo
  – Subsidy to advance social good
  – Unmet community need
  – Supplement/advance governmental program

• Complaints and criticisms from
  – Academics
    • See, e.g., Colombo, “The Provena Tax Exemption Case: The Demise of Community Benefit?”, 55 EOTR 175 (February 2007)
  – Unions
  – Class action lawyers
  – Congress and State Legislatures
  – State AG’s and State Tax Authorities
  – Media
  – For profit competitors

Federal Tax Exemption Standards

• Early IRS Test (Rev. Rul. 56-185)
  – Based on relief of poverty notion of charity
  – Charity care to extent of financial ability
  – Informal 5% test
  – No definition of charity care
  – Some states follow a variation of this approach

• Current IRS Test (Rev. Rul. 69-545)
  – Community control
  – Serve broad cross-section of community
  – Provide substantial “community benefit”
  – No absolute charity care requirement
  – Some states follow a variation of this approach
Federal and State Standards
(Which is the tail? Which is the dog?)

- Federal exemption standards based on state law concepts of charity
  - Many concepts overlap
  - Federal law influences state policy
  - State law influences Federal policy
  - Recap of Federal rules
  - IRS focus on fact gathering
  - Difference between FP and NFP hospitals
  - Community benefit test still correct one?
  - Can there be “bright line” tests?
  - January 2008 Report will influence both Federal and state policy

Approaches To State Exemption

- State exemption standards unique
  - Common elements between state and Federal standards
  - But, state usually standards usually more restrictive than Federal
- State policy themes
  - Pure charity care approach
  - Modified community benefit approach
  - Billing and collection overlay
  - Excessive compensation overlay
  - Complex structure/joint venture overlay
  - Local nature of real property tax
Billing & Collection Overlay

• Role in state tax exemption cases
• Former AGs
  – Mike Hatch, Minnesota
  – Jim Petro, Ohio
  – Phill Kline, Kansas
• Class action lawyers
  – Dickie Scruggs
• Elements
  – Written charity care policies
  – Disclosure of charity care benefits
  – Mandating payment plans
  – Procedural limits on collection activities
  – “Most favored” payer billing

Excessive Compensation Overlay

• Former AGs
  – Mike Hatch, Minnesota
  – Jim Petro, Ohio
• Class action lawyers
  – Dickie Scruggs
• Blogs – www.wherethemoneygoes.com
• Unions – “studies” and “white papers”
• Lake Wobegon Effect
  – Everyone above average
  – Average moves up
The Pure Charity Care Approach

- Illinois (Department of Revenue and the Courts)
  - Provena Covenant Medical Center, Urbana, Illinois
  - Proposed legislation – at least 8% charity care
  - Community Health Care – 27% discounted or free care not enough
- Ohio (BOE and Department of Taxation approach)
  - Charity care at the particular facility
  - Sliding scale – ratio charitable services to all services
    - Greater than 5% - generally exempt
    - Between 2% and 5% -- case-by-case
    - Less than 2% -- generally not exempt

What Is Charity Care?

- Definitions vary
  - Much debate and confusion
  - Much demagoguery
- Generally
  - Charity care = no expectation of payment
  - Bad debt = expect payment but bad credit decision
- Timing of charity care versus bad debt decision
  - HFMA Statement 15 approach
- Written charity care policies
  - Available to patients
  - Medically necessary care
  - Income/asset test
  - Catastrophic event test
  - Sliding scale based on percentage of FPL
Texas – Modified Community Benefit 
(Alternative Tests)

• 1 -- Charity care and government-sponsored indigent care that is reasonable in relation to
  – Community needs,
  – Available resources of the provider, and
  – The tax benefits received by the provider
• 2 -- Charity care and government-sponsored indigent care = at least 4% of provider’s net patient revenue
• 3 -- Charity care and government-sponsored indigent care = at least 100% of provider’s tax benefits; or
• 4 -- Charity care and community benefits = at least 5% of net patient revenue, and charity care and government sponsored indigent care = at least 4% of net patient revenue

Which Standard: Charity Care? 
Community Benefit? Something New?

• Pure Community Benefit – Critics say
  – Proves too much
  – Doesn’t tell the difference between FP and NFP
  – Doesn’t provide enough quid for the pro quo
• Pure Charity Care –
  – “At the end of the day, even a nonprofit organization has to make enough money to cover its costs and set aside reserves for asset replacement and other capital projects. If it cannot do so, it is not a financially viable enterprise and it will go out of business. There is no magic money tree that nonprofit hospital managers can go to and pick off $100 bills to pay their costs. At some point, if government keeps piling on uncompensated care obligations without some kind of offsetting revenue enhancement, the hospital will simply no longer be able to operate.” [Colombo, 55 EOTR at 180-181.]
Marshalling Your Evidence

• First consideration—what is the “subject property” and what data exists that captures how that property is used?
  – Scenario 1: Community hospital
  – Scenario 2: Medical office building used by community hospital’s employees as outpatient clinic
  – Scenario 3: Large research and teaching hospital
  – Scenario 4: Off-campus laboratory used by researchers at large research and teaching hospital

Marshalling Your Evidence

• Charity Care
  – What are the hospital’s policies?
  – Are they written?
  – Publicly available?
  – Are the policies implemented?
  – How is charity care accounted for in financial systems?
  – Is there charity care that is provided but not accounted for?
Marshalling Your Evidence

• Charity Care (con’t)
  – Is there data that demonstrates the value of charity care that is provided at the subject property?
  – How have the charity care policies changed and, importantly, how has accounting for charity care changed?
  – Caution: Medicare/Medicaid Cost Reports

Marshalling Your Evidence

• Research
  • What kind of research is conducted?
  • How is research funded?
  • How has research benefited the medical sciences generally or underrepresented patient populations?
  • How has research benefited hospital’s patients?
  • Published research?
Marshalling Your Evidence

• Education
  – Does the hospital support medical education (residents, interns, fellows)?
  – Does the hospital sponsor allied health programs?
  – Does the hospital provide internships or other training for high school or college students?
  – Does the hospital provide educational programs for its patients or the community generally?

Marshalling Your Evidence

• Other Considerations
  – Emergency Room
  – Serving underrepresented patient populations
Discovering Opposing Evidence

- Most evidence is in your hands, discovery will be limited to asking for information that
  - (1) will be presented to the trier of fact or
  - (2) has been reviewed or will be relied upon by the opposing party’s witnesses
- Use requests for admissions to narrow the issues

Discovering Opposing Evidence

- Opposing party will likely develop evidence from public sources—ask for all evidence on which that party’s witnesses will rely, for example:
  - Form 990s of other hospitals for purposes of comparisons
  - Medicare/Medicaid cost reports of other hospitals for purposes of comparisons
  - Information submitted to government entities by your hospital in connection with public financing (e.g., county bonds)
Discovering Opposing Evidence

- Opposing party will likely develop evidence from public sources—ask for all evidence on which that party’s witnesses will rely, for example:
  - what information is publicly available about charity care and other community services on your website?
  - what information is publicly available about other hospital’s charity care and community services on their websites?

Summary & Conclusions

- Exemption is a quid pro quo
  - Overlaps between Federal and State rules
  - But State laws and unique and local
- Whatever the standard –
  - Have to count and document
  - Have to justify subsidy received compared to community benefit provided
- Charity care isn’t a clearly defined term
- Statues are old and out of date and don’t reflect today’s environment