THE “CHARITY CARE” REQUIREMENT FOR HOSPITAL REAL PROPERTY TAX EXEMPTIONS AFTER PROVENA

Edward J. Bernert
Baker Hostetler LLP
65 E. State Street, Suite 2100
Columbus, OH 43215
(614) 228-1541
ebernert@bakerlaw.com

Christopher J. Swift
Baker Hostetler LLP
3200 National City Center
1900 East 9th Street
Cleveland, OH 44114-3485
(216) 621-0200
cswift@bakerlaw.com

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Christopher J. Swift

I. INTRODUCTION

A. This is an updated version of the discussion of state and local real property tax exemptions available to hospitals that was presented at the May meeting in 2009. To request a copy of the 2009 Report, please contact ebernert@bakerlaw.com.

B. Since the 2009 presentation, the Illinois Supreme Court decided Provena Covenant Medical Center v. Illinois Department of Revenue, 236 Ill. 2d 368, 925 N.E.2d 1131, 339 Ill. Dec. 10 (2010), and the Ohio Supreme Court weighed in on the subject of charity care as a requirement for exemption for hospitals in Dialysis Clinic v. Levin, 2010-Ohio-5071, 127 Ohio St. 3d 215.

C. The 2010 Illinois and Ohio decisions leave many questions unanswered, but are useful in reaching an understanding of what an owner of a hospital should consider when seeking to retain the property tax charitable exemption for its hospital or other medical facility.

II. ILLINOIS--THE PROVENA CASE

A. Introduction

1. Provena Covenant Medical Center (Provena Covenant) is a nonprofit, full service general acute-care hospital located in Champaign County, Illinois.

2. Provena Hospitals is the owner of the hospital and qualified under Internal Revenue Code (IRC) §501(c)(3) for a charitable exemption and qualified for exemption from the Illinois sales and use taxes as a charity.

3. The administrative record had erroneously focused on the status of Provena Covenant, but Provena Hospitals was the owner and the failure to document the status of Provena Hospitals ultimately prevented Provena Hospitals from qualifying for the exemption.
4. Provena Covenant had a charity care program in place. In 2002, the relevant tax year, it waived $1,758,940 in charges representing cost to it of $831,724. This measure of care was found to be only 0.723% of Provena Covenant’s revenues for that year.

5. The documented amount of charity care was $268,276 less than the $1.1 million in benefits to Provena Hospitals if the property tax exemption were granted.

6. The hospital’s charity care program benefitted 302 of Provena Covenant’s 10,000 inpatient and 100,000 outpatient admissions. The qualifying percentage of patients was found to be 0.27% of the total patient census.

7. The Supreme Court described these figures as representing “modest” numbers and the small percentages of documented charity care obviously strongly influenced the outcome of the proceedings.

B. Procedure

1. Provena Covenant sought property tax exemption from the Champaign County Board of Review as a charitable institution. The Board of Review denied the exemption.¹

2. Provena Covenant appealed the decision and the Administrative Law Judge (ALJ) assigned to the appeal recommended exemption.

3. The Illinois Director of Revenue disagreed with the recommendation of the ALJ. The appellate court in Provena described the actions of the Director in the following terms:

   The Director disagreed with the ALJ's recommendation and denied an exemption for charitable uses. The primary reason for his decision was that in 2002, the tax year in question, [Provena] devoted only 0.7% of its total revenue to charity care. Of 110,000 admissions in 2002, [Provena] gave free care to only 196 patients and discounted care to only 106 patients; and [Provena] hired collection agencies to recover the

¹ Provena Hospitals also unsuccessfully claimed exemption as a religious institution, but that issue was clearly secondary to the principal issue of whether Provena Hospitals was a charitable organization and whether the property was used for a charitable purpose. The discussion is limited to the claim as a charitable organization.
remaining balances from 64 of the patients to whom it had given discounts.

4. Provena Covenant challenged the decision of the Director in an administrative review to the circuit court, and advanced the following argument:

…under the [Illinois] supreme court's decisions, charities were not defined by percentages and that, in any event, [Provena] dispensed an ample amount of charity to the community in forms other than charity care. [Provena] had a charity-care policy based on federal poverty guidelines, and it advertised the availability of "financial assistance." According to Provena, [it] gave this financial assistance to every patient who needed and requested it, and the number of indigent people who walked in through the door and availed themselves of the charity-care policy simply was beyond [Provena’s] control. Also, Provena argued, considering the meager rates of reimbursement the government paid, treating Medicare and Medicaid patients was itself an act of charity. Provena further argued--indeed, the parties had stipulated--that [Provena] was a faith-based institution founded, organized, owned, and operated as an apostolic mission and health-care ministry of the Catholic Church.

5. The circuit court found in favor of Provena Covenant. The Director of Revenue appealed, and, the appellate court denied the exemption.

6. The Illinois Supreme Court accepted the case for appeal and in a plurality decision affirmed the denial of the exemption.

C. The Illinois Law

1. Ill. Const. 1970, art. IX, §6. It provides:

"The General Assembly by law may exempt from taxation only the property of the
[s]tate, units of local government and school districts[,] and property used exclusively for agricultural and horticultural societies[,] and for school, religious, cemetery[,] and charitable purposes. The General Assembly by law may grant homestead exemptions or rent credits." Ill. Const. 1970, art. IX, §6.

The Illinois statute, 35 ILCS 200/15-65(a) (West 2002) provides:

"All property of the following is exempt when actually and exclusively used for charitable or beneficent purposes[,] and not leased or otherwise used with a view to profit:

(a) Institutions of public charity."

2. Under Illinois law, in order to qualify for the charitable exemption, the applicant must meet a two-part test: (1) the property must be owned by an institution of public charity, and (2) the property must be actually and exclusively (interpreted by the courts to mean “primarily”) used for charitable or beneficial purposes and not leased or otherwise used with a view to profit. 35 ILCS 200/15-16 (West 2002).

D. The Illinois Supreme Court Decision Generally

1. The decision of the Illinois Supreme Court in Provena did not live up to its advance billing. The seven-member Court was short-handed for the decision because two justices recused themselves. The remaining members of the Court split into a plurality of three and the decision of the remaining two justices that joined in denying the exemption for Provena, but under very narrow grounds.

2. The plurality decision announced some provocative conclusions, including requiring a certain undefined quantum of charity care to qualify for exemption and an analysis of whether the individual localities “granting” the exemption actually benefitted from the claimed charitable activities. Ultimately, the force of those declarations is diminished because of the absence of a majority of the full Court accepting those determinations.
3. All five of the justices participating in the decision found that Provena Hospitals failed to establish its claim to be a charitable institution, principally because the evidence was limited to a discussion of Provena Covenant, i.e. the individual hospital rather than Provena Hospitals, the actual owner of the hospital and proper party to claim exemption.

E. The Plurality Decision

1. The issue as framed by the Court was a mixed question of fact and law. Under Illinois law, the Supreme Court was not reviewing the decision of the Court of Appeals, but the determination of the Director of Revenue and the standard of review was significantly deferential. The determination of the administrative agency would be reversed only upon a finding of clear error.

2. Because tax exemption is the exception in Illinois, the one claiming exemption must establish a clear and convincing basis for exemption.

3. The Supreme Court determined that under Illinois law, the fact that Provena Hospitals qualified for exemption under IRC § 501(c)(3) or that its purchases were not subject to Illinois sales or use taxes were not dispositive of the availability of the property tax exemption. In the absence of the specific statutory exemption for a hospital, its owner must qualify as “an institution of public charity.”

4. In Methodist Old Peoples Home v. Korzen, 39 Ill. 2d 149, 157, 233 N.E.2d 537, 541-42 (1968), the Illinois Supreme Court listed six "distinctive characteristics of a charitable institution;"

   (1) the institution bestows benefits upon an indefinite number of persons for their general welfare, or the benefits in some way reduce the burdens on government;

   (2) the institution has no capital, capital stock, or shareholders and does not profit from the enterprise;

   (3) the funds of the institution are derived mainly from private and public charity and are held in trust for the purposes expressed in the charter;

   (4) charity is dispensed to all who need it and apply for it;
(5) the institution puts no obstacles in the way of those seeking the charitable benefits; and

(6) the primary use of the property is for charitable purposes.

5. The Court concluded that Provena Hospitals met the first and fourth elements of the *Korzen* test. Provena Hospitals did not have any capital, capital stock or shareholders. The Court also found that no private inurement existed although some hospital operations were outsourced to third parties.

6. The Court found that the use of third party vendors cannot defeat exemption because of the necessity of such outsourcing. The issue was whether the managers benefitted and the Court found no disqualifying benefit to the managers.

7. Provena Hospitals did not receive other than a minor amount of free-will donations. The Court found that the amount of charitable contributions to the Provena Hospitals was too small to be considered and there was no showing that “other revenue” was charitable in nature. The Court focused on the receipt of compensation for services rendered. This observation would be true for hospitals generally.

8. According to the Plurality, Provena Hospitals did not dispatch charity to all who needed it and placed obstacles in the way of those requiring charity. The Court found neither charitable ownership nor charitable use of the property.

9. The Plurality’s discussion of the lack of charity attributable to Provena Hospitals provided some of the most provocative conclusions in the decision. The Plurality defined “charity” as a gift for the benefit of an indefinite number of people. Charitable status is conditioned on whether the activity relieves the burdens and provides some compensating benefit to government.

10. According to the Plurality, while the benefit need not meet the exemption benefit dollar for dollar, there must be benefit as the sine qua non for the exemption. The services provided were said not to relieve the various government entities of their burdens.

11. The Supreme Court found that in an earlier case, *People ex rel. Cannon v. Southern Illinois Hospital Corp*, 404 Ill. 66 (1949), evidence of benefit to the government from the services rendered had been established, where the services were deeply discounted.
and the hospital was the only hospital in the region. The Provena Court in contrast found no showing of charity in the present case.

12. Strikingly, the Provena Court focused on the lack of benefit to the localities foregoing revenue from the property tax. The services provided need not benefit all of the localities foregoing revenue, but there must be some benefit.

13. This focus on the benefits to the localities is problematic when one considers that many localities, especially specialized localities such as water districts or mass transit districts have no obligation to attend to the health needs of their citizenry and, therefore, would not likely “benefit” from the existence of a hospital located in their districts.

14. The Supreme Court focused on the absence of the advertising of the charity program. The Court accepted that no patient was turned away. Provena Hospital was faulted, however, for not advertising the availability of charitable care.

15. Moreover, non-paying patients were immediately turned over for collection and, in that respect, Provena Hospital operated like a for-profit operation.

16. The Plurality observed that the Provena Hospital could not rationalize the failure to provide charity care based on the lack of need by area residents for charity care. The discussion seemed to conclude that if there were not a sufficient number of needy patients in the Champaign area, Provena Hospital should have looked to serve another community. Moreover, the Plurality's reading of the statistical information suggested that there should have been more charitable care based on the population of the locality.

17. The Plurality cited several factors supporting the conclusion of non-charity: (a) uninsured patients paid more than insured patients; (b) the billings could have generated surpluses even after the write-offs; and (c) some the patients were cross-subsidized by patients that were required to pay.

18. The Plurality observed that Provena Hospitals could not be faulted for requiring patients with means to pay, but such cross-subsidization was not consistent with a charitable intent.

19. The Plurality concluded that charity was not limited to “almsgiving,” but if compensation for services was received, there was no gift and if there was no gift, there was no “charity.” Slip Opinion at 24.
F. Participation in Medicare and Medicaid as Charity

1. Provena Hospitals was provided little credit for the losses realized upon acceptance of Medicare and Medicaid patients.

2. The Plurality observed that while participation in those federal programs was voluntary, the insurers provided reliable streams of revenue and the participation enabled Provena Hospitals to qualify for favorable federal income tax treatment.

3. The Plurality observed that one of the Amicus, Catholic Health Association, does not treat participation in Medicare and Medicaid as charity. Moreover, Provena Hospitals itself did not treat Medicare and Medicaid as charitable in its own financial statements.

4. The Plurality then concluded that participation in the federal programs did not qualify as gifts and thus did not constitute charity.

G. Community Benefits

1. Provena had argued that the charitable nature of its operations is revealed by contributions other than charity care, including:

   Crisis Nursery Services & Support;

   Volunteer (community benefit) classes/services;

   Emergency Medical Services (training & support to community and area agencies);

   Charitable subsidy of an ambulance service;

   Donations to Other Not-for-Profits (less the value to Provena Covenant of such participation);

   Behavioral health community benefits; and

   Subsidy for graduate medical education.

2. The Plurality first questioned whether these community benefit factors were even relevant to the property tax exemption.

3. The Plurality made a clear distinction between the community benefits utilized for federal income tax purposes and the standards for the property tax exemption.
4. In footnote 13, at page 26 of the Slip Opinion, the observation is made that the federal government through the IRC had abandoned the charity care requirement as the touchstone in response to the Medicare and Medicaid programs. The reader is left with the strong suspicion that any community benefit other than charity, i.e. “free care,” would not suffice for the Plurality.

5. The Plurality then questioned the significance of the community benefits to a finding of charity for each of the claimed benefits on multiple bases, including (a) the providing of contributions to other entities, which like the contributions by non-charitable entities is not charity per se for the contributor, (b) the existence of business purposes such as encouraging members of the community to use the hospital or increasing the prestige of the institution, (c) the providing of services in exchange for compensation, or (d) the conclusion that the services at issue did not constitute the principal use of the premises.

6. Thus, it seems clear that the Plurality did not consider these community benefits to add much to the case for exemption.

H. Concurrence/Dissent

1. Justice Burke concurred in part and dissented in part, with Justice Freeman joining in the opinion.

2. The decision of the Director of Revenue was upheld on the basis of the failing by Provena Hospitals to establish a record that the entity (Provena Hospitals) qualified for exemption. The decision to deny exemption on the basis of the status of Proven Hospitals was unanimous among the participating justices, but the decision was based on a failure of proof.

3. On the question of whether the activities conducted on the premises were non-charitable, Justices Burke and Freeman did not join with the Plurality and the Dissent would have found that the activities justified exemption.

5. The dissenters accepted the *Wexford* analysis that imposing a certain level of charity care is improper in the absence of legislative action and would tend to be arbitrary.

I. Conclusion

1. The provocative conclusions, including the requirement of some quantum of charity care expressed by the Plurality (reflecting only three of the seven justices) ensures that those conclusions lack much precedential value. Moreover, the fact that the only part of the decision that commanded a majority was based on a failure to make a sufficient record would suggest a consignment of the *Provena* decision to secondary status.

2. As expected, some observers have emphasized the narrowness of the actual determination of the majority of the court and the lack of precedential value of the Plurality opinion.

3. On the other hand, it would not be surprising if the Illinois Department of Revenue sought to apply the reasoning of the Plurality decision in future cases especially because there appears to be some support for the Plurality analysis from decisions from several appellate districts in Illinois.

4. As discussed below, we believe that the *Provena* decision should be considered in the context of other state supreme courts that have addressed the issue of charity care.

III. OHIO

A. Dialysis Clinic-Background

1. The Ohio Supreme Court recently affirmed the denial by the Ohio Board of Tax Appeals (BTA) of a property tax charitable-use exemption for a dialysis center. *Dialysis Clinic, Inc. v. Levin*, 2010-Ohio-5071, 127 Ohio St. 3d 215.

2. Dialysis Clinic is a tax-exempt organization under IRC 501(c)(3) and operates 195 outpatient dialysis centers in 26 states, including the West Chester facility in Butler County, Ohio.

3. As is common with end-stage renal dialysis centers, the majority of the patients are Medicare and Medicaid patients.

4. Dialysis Clinic followed Medicare and Medicaid regulations and sought payment from all patients, but if the patient was indigent,
the amount not recovered from public or private insurance was written off.

5. Dialysis Clinic produced surpluses although the facility in Butler County lost money every year.

6. Half of its excess revenue was dedicated to support kidney research and half to subsidize its own operations.

7. The Tax Commissioner had denied the exemption because neither acceptance of reimbursement from Medicare and Medicaid nor the write-off of bad debts constituted charitable acts.

8. The BTA denied exemption because it said that Dialysis Clinic conceded that it provided no free or charitable service at the subject property. Further, the BTA could distinguish no difference between the operation of the Dialysis Clinic and for-profit organizations. Finally, the BTA rejected the claim for charitable status based on contributions to other charities, which the BTA claimed was a vicarious charitable use and not qualifying for exemption.

B. Supreme Court Analysis in Dialysis Clinic

1. In a 4-3 decision, the majority of the Court concluded that an institution is “charitable” under Section 5709.121 of the Ohio Revised Code (“ORC”) only if its core activities qualify as charity under the standards for determining the charitable use of property pursuant to ORC Section 5709.12(B).

2. The majority of the Supreme Court upheld the determination of the BTA that Dialysis Clinic was not a charitable institution.

3. The Majority rejected the claim of exemption based solely on federal income tax exemption and found specifically that federal law and state law were different. Moreover, the federal tax law was determined to be more lenient than state law specifically on the question of the need for care for the indigents. ¶25-26. There is no basis to conclude that the Dissent would disagree with this conclusion.

4. The Majority also rejected the proposal that an incidental use for charity would qualify.

5. The Majority concluded that to qualify for the charitable exemption, the services in question must be provided “on a nonprofit basis to those in need, without regard to race, creed, or ability to pay.” ¶30.
6. The Supreme Court affirmed the denial of exemption, but both the Majority and the Dissent specifically rejected the Tax Commissioner’s position that there is a certain quantum of charity care that must be provided.

7. Both the Majority and the Dissent of the Supreme Court refused to find that acceptance of Medicare and Medicaid benefits prevented exemption. “In the age of Medicare and Medicaid, the usual and ordinary indigent patient may have access to government benefits, and the modern healthcare provider is not required to forego the pursuit of those benefits to qualify for charitable status.” ¶ 42.

8. A key factor in holding against the taxpayer was the indigent policy of Dialysis Clinic, which explicitly stated that it was “not a charity or gift to patients [and that Dialysis Clinic] retains all rights to refuse to admit and treat a patient who has no ability to pay.” ¶11.

9. Although evidence was given that Dialysis Clinic did not turn patients away for an inability to pay, the majority of the Court was not persuaded to disregard Dialysis Clinic’s own policy statement that explicitly reserved the right to refuse to treat indigent patients.

10. The Dissent disagreed with this analysis, reasoning that a reservation of the right to refuse treatment is not proof that Dialysis Clinic denied services to indigents.

C. Conclusions from the Dialysis Clinic Decision

1. Although Dialysis Clinic lost, the core problem with its case was the reservation to refuse to admit indigents by an express policy statement. This should be a correctible problem to the extent, if any, that other hospitals have such a policy.

2. Ohio hospitals can take comfort that the Court found that (a) a certain quantum of charity care was not required and (b) the acceptance of Medicare and Medicaid payments did not prevent a finding of charity care.

D. Cleveland Clinic Foundation Litigation

1. It appears that the charity care issue is still being litigated in Ohio even after the Dialysis Clinic case. In a Final Determination of the Ohio Tax Commissioner in Cleveland Clinic Foundation, DTE No. KE 4775, October 20, 2005, unreported, the Tax Commissioner declared that a charitable health facility must have “as its primary purpose the provision of health services to those in need without
regard to ability to pay.” The Tax Commissioner also stated that at a minimum four percent (4%) of the persons being served must be charity cases.

2. The Cleveland Clinic Foundation appealed. The appeal is before the BTA in Cleveland Clinic Foundation (Beachwood Family Health and Surgery Center) et al v. Wilkins et al, Case Nos. 2005-V-1726, 2006-V-99 and 2006-H-117. The case is undergoing discovery and already has produced a Supreme Court decision on the confidentiality of trade secrets and whether a party seeking exemption has waived confidentiality protection merely by filing for exemption when the filed exemption application is a public record. Cleveland Clinic Foundation v. Levin, 120 Ohio St.3d 1210, 2008-Ohio-6197. (The Supreme Court found that the Cleveland Clinic had not waived its claim to confidentiality.) The final resolution of this appeal is probably some time off.

3. Presumably the Tax Commissioner will be hard-pressed to argue that a certain quantum of charity care is necessary after Dialysis Clinic.

4. The Cleveland Clinic case, if litigated to conclusion, could provide additional direction as to the scope of the charitable exemption from property taxes for medical facilities.

IV. Observations

A. The cases in Illinois and Ohio, while both likely to be limited to their facts in some respects, nevertheless are helpful, especially when considering these decisions in the context of decisions of other state supreme courts.

B. The idea that a certain quantum of charity care is required absent a legislative enactment to that effect is not dead, but would appear to be on life support. Many state supreme courts, most recently Ohio, have rejected a certain charity care requirement absent legislative action.

C. Likewise the issue of whether participation in the Medicare and Medicaid programs precludes qualification for a hospital under a state charitable property tax exemption is uncertain, but the Ohio Supreme Court’s decision that such participation does not prevent exemption seems to be in the mainstream of the current law.

D. Unless the state statutes provide otherwise, one should assume that the qualification of the owner of the property under federal tax law as an IRC 501(c)(3) entity will not be sufficient in and of itself for state or local property tax purposes. Moreover, many of the state courts have declared that the state property tax laws are tougher than federal tax law.
E. Hospitals need to examine their charity care programs and be prepared to demonstrate some level of charity care. Because the new Schedule H of the IRS Form 990 requires increased disclosure of charity care data, that information will now be available to the state and local taxing authorities.

F. Hospitals need to examine their bad debt collection policies to strengthen their position in litigation. There likely will be non-property tax legal requirements that impact on collection practices.

G. Hospitals need to do a better job of advertising their charity care policies to potential beneficiaries.

H. It would not be expected that many hospitals would have a policy like that of Dialysis Clinics that reserves the right to refuse to treat indigents. Those medical facilities that do have such a policy should revisit the policy if property tax exemption is desired.

I. Hospitals should not expect to obtain much benefit from non-indigent type of community benefits provided especially when the benefits can be classified as benefiting the operation of the hospital or when the benefit can be classified as the making of a donation to a charity as opposed to doing charitable work.