

## **The Threat to Hospital Property Tax Exemption**

The basis for hospitals' exemption from property taxes has been raised in the context of the debates over hospital charity care and collection policies. Critics claim that hospitals are not providing charity care and benefits to their communities in amounts sufficient to justify their tax exempt status.

In Illinois, the State Constitution permits the Legislature to exempt from taxes, property that is "exclusively used for charitable purposes." The Illinois Legislature has adopted such an exemption as Section 15-65 of the Property Tax Code. Non-profit hospital property is tax exempt under this provision. Over the years, Illinois courts have applied a six-factor analysis, based on the Illinois Supreme Court case of *Methodist Old People's Home v. Korzen*.<sup>1</sup> The *Methodist* analysis is applied on a case-by-case basis, to determine whether certain property meets this "exclusively charitable" standard. Until recently, there have been few challenges to hospital property tax exemption in Illinois.

In the last year, two Illinois hospital property tax challenges have generated concern among the hospital community. In Urbana, Illinois, Provena Covenant Hospital was denied its property tax exemption when the Illinois Department of Revenue agreed with a recommendation of the Champaign County Board of Review to return the hospital to the tax rolls. In August 2004, the Cook County Board of Review rejected a challenge to the property tax exemption of Resurrection Health Care.

The Provena case raises the question of whether the typical modern day hospital satisfies the *Methodist* six factor analysis. Some recent court decisions involving medical office buildings, not hospitals, have applied the *Methodist* analysis in a very narrow manner and ruled the property was taxable. In the Provena case, the County Board of Review, relying in part on these court decisions, took a similar approach in recommending against Provena. Consequently, there is concern that the Department of Revenue, or a court, will take a similar approach, which could precipitate challenges to the exempt status of all non-profit Illinois hospitals.

### **How Hospitals Meet the Current Criteria for Exemption**

The *Methodist* test has been used over and over by the courts to determine whether property is exclusively used for charitable purposes. Examples include an analysis of property owned by churches, retirement centers, art galleries, and medical clinics. No Illinois court has applied the six-factor *Methodist* analysis directly to property with a hospital located on it; however, the following outline illustrates how hospital property would meet the six criteria for demonstrating the charitable use.

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<sup>1</sup> 39 Ill. 2d 149 (1968).

**1. The benefits derived are for an indefinite number of persons for their general welfare or in some way reduces the burdens on government.**

The relief of disease and illness for the general welfare of the community is the type of benefit that is eligible for exemption.<sup>2</sup> By providing this benefit to the community, a hospital is relieving a burden of government. This guideline is satisfied as long as the hospital's services are available to the members of the community and there is no discrimination against patients based on race, religion, gender or national origin.

**2. The organization has no capital, capital stock, or shareholders, and does not provide profit in a private sense to any person connected with it.**

Non-profit hospitals that receive a tax exemption from federal income tax under Section 501(c)(3) of the Internal Revenue Code do not have capital stock or shareholders. No person or organization profits from the operation of a non-profit hospital, and any profit that may be realized goes back into hospital resources for staff, facility improvements, and new medical technologies. As with federal tax exemption, none of the hospital's earning may inure to the benefit of private individuals.

**3. Funds are derived mainly from private and public charity, and the funds are held in trust for the objects and purposes expressed in the organization's charter.**

At first glance, it would appear that no modern hospital would satisfy this guideline because its funds are not "derived from public or private charity." However, early court decisions indicate that the real focus should be on whether the hospital derives its funds from its charitable activities.<sup>3</sup> Thus, so long as a hospital derives its funds primarily from providing health care, it satisfies this standard. In any event, more recent decisions have put little weight on this guideline and have instead focused on the organization's use of its revenues and whether the organization has provided services to those who were unable to pay.

**4. Charity is dispensed to all who need and apply for it and the hospital does not place obstacles in the way of those who would avail themselves of it.**

Hospitals satisfy this criterion by having and following reasonable charity care policies and by providing emergency care to patients regardless of their ability to pay. Additionally, the Illinois Supreme Court has stated that a hospital cannot be expected to

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<sup>2</sup> *Sisters of Third Order of St. Francis v. Board of Review of Peoria County*, 231 Ill. 317, 83 N.E. 272, 274 (1907).

<sup>3</sup> *Congregational Sunday School and Publishing Society v. Board of Review*, 290 Ill. 108, 125 N.E. 7, 10 (1919).

“extend its benefactions to those who did not need them, or to those who did not seek admission.”<sup>4</sup> Illinois hospitals consistently offer financial assistance and even free care to persons who qualify and ask for assistance with their bills. But, many individuals choose not to return completed applications for financial assistance. Hospitals are not placing obstacles in the way of providing charity care by expecting payment from people who can pay<sup>5</sup> or who choose not to avail themselves of financial assistance.

**5. The property is actually and factually used for charitable purposes.**

The hospital’s property must in fact be used for providing health care. If the property is used for purposes that are not related to a charitable purpose, then it is not eligible for exemption.

**6. The exclusive, or primary, use of the property is for charitable purposes.**

While the Constitution and statute state that the property must be “exclusively” used for charitable purposes, the courts have interpreted this word as meaning “primarily” in this context.<sup>6</sup> Thus, so long as the primary, as opposed to any incidental or secondary, use of the hospital’s property is for health care, the hospital satisfies this guideline.

Excerpted from the IHA Task Force on Charity and Tax Exemption Report accepted by the IHA Board of Trustees on March 24, 2005.

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<sup>4</sup> *Sisters of Third Order of St. Francis v. Board of Review of Peoria County*, 231 Ill. 317, 83 N.E. 272, 274 (1907).

<sup>5</sup> “Sound business dictates that hospitals inquire into the ability of a prospective patient to pay, and it is the generally accepted practice of all hospitals.” *People v. Southern Illinois Hospital Corporation*, 404 Ill. 66 (1949).

<sup>6</sup> *McKenzie v. Johnson*, 98 Ill.2d 87, 456 N.E. 2d 73 (1983).