



# TAX TRENDS

The newsletter of the Illinois State Bar Association's Section on State & Local Taxation

## Editor's note

By Mary Ann Connelly, Co-editor

This issue of *Tax Trends* contains a very interesting article on the status of the property tax charitable exemption in Illinois for charitable hospital properties. Authors Stanley R. Kaminski and William J. Seitz question whether the passage of health care reform and the *Provena* decision will limit the availability of the property

tax charitable exemption in Illinois for charitable hospital properties. The authors give an historical background of the definition of "charity" in Illinois and provide an analysis of the *Provena* decision. The article questions the impact the *Provena* decision will have on charitable hospitals in Illinois. Read the article to learn their conclusion. ■

## Will the passage of health care insurance reform in combination with the *Provena* decision dramatically limit the availability of not-for-profit hospitals to claim the property tax charitable exemption in Illinois?

By Stanley R. Kaminski, Duane Morris, LLP and William Seitz, Fisk Kart Katz and Regan, Ltd.

For over a century, not-for-profit charitable hospitals have flourished in Illinois, and based on their charitable policies and activities (e.g., being open to all and providing health care to the needy) have routinely received real property tax exemptions for their hospital property. See, *Sisters of the Third Order of St. Francis v. Board of Review*, 231 Ill. 317, 321 (1907). However, as a result of the Illinois Supreme Court decision in *Provena Covenant Medical Center v. The Department of Revenue*, 236 Ill.2d 368 (2010) decided March 18, 2010, this property tax exemption is now in jeopardy for Illinois' charitable hospitals.

In its plurality decision (three to two, out of seven justices), the Illinois Supreme Court held in *Provena* that in determining the charitable use of hospital property, and thus the ability to claim a property tax charitable exemption, a quantitative

analysis must be used to determine if enough charity care was being provided to qualify for the exemption. The Court went on to state that the acceptance of Medicare and Medicaid patients cannot be considered in determining if a hospital is providing charity care. In essence, the Court concluded that it was irrelevant that the payments a hospital received from Medicare or Medicaid for medical services rendered was substantially less than the charges that a private insurance company or non-insured paying patient would incur. Now, if we add to the mix the new Patient Protection and Affordable Care Act (Pub. L. No. 111-148) recently passed by the federal government that purports to assure coverage for almost everyone under Medicare, Medicaid or private insurance, it raises the obvious question of whether in the future charitable hospital's in

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## Will the passage of health care insurance reform in combination with the *Provena* decision dramatically limit the availability of not-for-profit hospitals to claim the property tax charitable exemption in Illinois?

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Illinois will be able to qualify for a charitable property tax exemption in Illinois.

To understand how we got in this mess, let's start with Illinois law prior to the *Provena* decision.

### I. Illinois law prior to *Provena*.

#### What is "charity" generally?

Section 6 of article IX of the Illinois Constitution gives authority to the General Assembly to exempt from taxation property used exclusively for charitable purposes. See, *Ill. Const. 1970, art. IX, §6*. Pursuant to that authority, Section 15-65 of the Property Tax Code provides that in addition to the constitutional requirement that the property be used exclusively for "charitable purposes," an "institution of public charity" must own the property. See, 35 ILCS 200/15-65(a). To be entitled to an exemption, the applicant must prove both ownership (i.e., the property is owned by an institution of public charity) and use (that the property is used for a charitable purpose).

In *Methodist Old Peoples Home v. Korzen*, 39 Ill.2d 149, 233 N.E.2d 537 (1968), the court expressed the public policy considerations behind all property tax exemptions as being as follows:

It has been stated that a charity is a gift to be applied, consistently with existing laws, for the benefit of an indefinite number of persons, persuading them to an educational or religious conviction, for their general welfare or in some way reducing the burdens of government.

*Id.*, 39 Ill.2d at 156-157, 233 N.E.2d at 541 (Emphasis added).

"Charity" is satisfied if it is primarily used for the exempted purpose, and not any secondary or incidental purpose.

#### What is "charity" for a hospital?

There are four Supreme Court cases where the institutions claiming a tax exemption charged fees as a means of financing charity care and other charitable gifts, or they charged fees no higher than the poor could afford. Each was found entitled to an exemption. Two involved hospitals, specifically: *Peo-*

*ple ex rel. Cannon v. Southern Ill. Hospital Corp.*, 404 Ill. 66 (1949), and *Sisters of Third Order of St. Francis v. Board of Review of Peoria County*, 231 Ill. 317 (1907); and two involved charity, generally: *People v. Y.M.C.A. of Chicago*, 365 Ill. 118 (1937) and *Quad Cities Open, Inc. v. City of Silvis*, 208 Ill.2d 498(2004).

None of the Supreme Court decisions adopts a quantitative approach. Applying those precedents, in the oldest case, *Sisters of Third Order*, the Illinois Supreme Court specifically rejected the claim that 5 percent of the total patients being charity patients was too insubstantial to justify an exemption. In the most recent case, *Quad Cities Open*, the Court found that "[a] charity is not defined by percentages." *Quad Cities Open*, 208 Ill.2d at 516, 804 N.E.2d at 509, rejecting the claim that 7 percent of revenue being donated to charities was insufficient to qualify as a charitable purpose exempt from taxation.

To Summarize: To be entitled to a charitable tax exemption from real property tax, generally a not-for-profit charitable hospital in Illinois had to demonstrate that it was a not-for-profit, organized and operated for charitable purposes, open to all, was not set up to profit itself or some person(s), provided charity care, and the hospital was primarily used to provide care to the public. There was no quantitative test to see how much charity care was provided, instead it was the fact it was created for charitable purposes and provided charity care to those who needed it.

#### The push to quantify the property tax charitable exemption

In recent years, the Illinois Department of Revenue in its administrative property tax exemption decisions has attempted to quantify the primary use of property by the use of mathematical tests.

The first appellate review of this approach concerned non-health care related organizations. In both cases, the Department's decision was rejected by the appellate court. See, *Grundy County Agricultural District Fair, Inc. v. Department of Revenue*, 346 Ill. App. 3d 1075 (3rd Dist. 2004) (county fairgrounds: counting number of days that agricultural or horticultural society uses real property for exempt

and non-exempt uses) and *Arts Club of Chicago v. Department of Revenue*, 334 Ill. App. 3d 235 (1st Dist. 2002) (using attendance figures at art gallery and art club to percentage of the total number of visitors who use property for exempt and non-exempt uses).

Thereafter, the Department tried again and this time was successful in its arguments to quantify whether charitable purpose is the primary use of property in a health care provider case. *Community Health Care, Inc. v. Illinois Dept. of Revenue*, 369 Ill. App. 3d 353 (3rd Dist. 2006) (community-based primary care clinic). In *Community Health Care*, the applicant had presented "organization-wide financial data to extrapolate the patient and payor mix" at the Rock Island facility at issue. The Department denied the exemption application, finding that without a *quantification* of the charitable care specifically dispensed at the facility at issue, there was insufficient testimony and evidence to conclude that the subject property was being used for charitable purposes. The appellate court agreed, finding that the applicant's evidence of the level of charitable operations at this facility was "speculative," and that there was "little concrete data to support its conclusion other than reliance on its previous years of historical data and knowledge" at other facilities.

### II. The Illinois Appellate Court's *Provena* decision

The *Provena* case involved whether Provena Covenant Medical Center, a hospital owned by Provena Hospitals, qualified for the charitable real property tax exemption under Illinois law. In this case, the Illinois Appellate Court reviewed and then upheld the Illinois Department of Revenue's administrative decision that had denied Provena a property tax charitable exemption based on a quantitative approach to the charitable tax exemption, like that used in *Community Health Care*. The Illinois Department of Revenue had found that Provena Covenant Medical Center had devoted only 0.7 percent of its total revenue to charity care. At less than 1 percent, the Department concluded that these financial figures fell short of meeting the primary

purpose standard (i.e., Charitable Purpose) as interpreted by the Department. *Provena Covenant Medical Center v. Illinois Dept. of Revenue*, 384 Ill.App.3d 734 (4th Dist. 2008).

Provena argued that under past Illinois supreme court's decisions, charities were not defined by percentages and that, in any event, Provena had 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." Provena 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. Finally, considering the meager rates of reimbursement the government paid, Provena argued that the treating of Medicare and Medicaid patients was itself an act of charity.

The appellate court disagreed with Provena and further held that writing off bad debts is not charity, nor is the receipt of less than adequate Medicare or Medicaid payments, relying in part on *Alivio Medical Center v. Illinois Dept. of Revenue*, 299 Ill. App. 3d 647, 652 (1st Dist. 1998), *Highland Park Hospital v. Department of Revenue*, 155 Ill. App. 3d 272, 280 (2nd Dist. 1987), *Riverside Medical Center v. Department of Revenue*, 342 Ill. App. 3d 603 (3rd Dist. 2003). As a result, the appellate court reversed the trial court decision finding for Provena and denied Provena its property tax exemption.

### III. The Illinois Supreme Court's *Provena* decision

This brings us to the Illinois Supreme Court's *Provena* decision. Two members of the Court removed themselves from consideration of the case, which left five members of the Court to hear the case. The case was significant because as noted above the appellate court had upheld the use of a quantitative analysis in determining if Provena Medical Center qualified as being used primarily for charitable purposes. As a result, the appellate court looked to see the percentage of charitable care provided and concluded that Provena's charitable use was insufficient for the property to qualify for the charitable exemption.

The Illinois Supreme Court in *Provena*, in a plurality decision, upheld the appellate

court's decision. Significantly, the Supreme Court agreed that discounted medical care treatment under Medicare and Medicaid could not be used to determine if charitable care is occurring. However, while three (3) members of the Court suggested that the charitable test was a quantitative test, the remaining two members did not believe a specific percentage of charity care was required. Nevertheless, the Supreme Court's decision has raised the serious issue of whether charitable hospitals in Illinois will have to meet some quantitative (percentage) of charitable care (without counting Medicare or Medicaid) before their hospitals can qualify for the Illinois charitable real property tax exemption. In this same regard, it opens the even more nebulous question of what percentage of charity care is needed and what exactly now qualifies as charity care.

### IV. Where does this leave Charitable Hospitals in Illinois?

By the passage of the Patient Protection and Affordable Care Act (the "Act") by federal government, Medicaid has now been expanded to millions of additional individuals, and the law now requires that substantially all persons not covered by Medicaid or Medicare have private medical insurance. As a result, charitable hospitals should generally not have to worry about receiving some payment for their services. While these payments may be substantially less than needed to cover the hospital's costs, especially the Medicaid payments, according to the *Provena* decision (or at least the majority decision in *Provena*), this factor is irrelevant to whether the hospital is providing charity care. But what does this mean? Will charitable hospitals ever be entitled to a property tax exemption in the future? Or, does it mean that charitable hospitals have to just become more creative in providing charity care to be entitled to such an exemption? Moreover, how much charity care or charitable activity will be enough, e.g., 5 percent, 10 percent or 50 percent? No doubt, this problem will likely be more difficult for hospitals in urban areas, since charitable hospitals in rural areas - where there may be a shortage of hospitals - may more easily qualify for the exemption in that the availability of the hospital itself would appear to lessen the burden on government, and thus be a charitable basis to give a tax exemption. See, *People ex rel. Cannon v. Southern Illinois Hospital Corp.*, 404 Ill.

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66 (1949).

Other charitable hospitals may have to offer charity care not normally covered by Medicare, Medicaid or private insurance to qualify for the tax exemption. For instance, while the health reform will expand Medicaid and provide 32 million uninsured Americans with coverage by the time it's fully in place in 2019, the Congressional Budget Office estimates that about 23 million people may remain uninsured for reasons including exemptions from the requirement to buy health insurance. They project that about one-third of those people, approximately eight million, will be undocumented immigrants. This is because the health reform legislation specifically prohibits illegal immigrants from buying health insurance, even with their own money, from the federal exchanges that are to be created by 2014. The law also contains exemptions from the mandate to buy health insurance for people with religious objections, those who are imprisoned and members of American Indian

tribes, and those for whom the least expensive insurance would cost more than 8 percent of their income. The remainder of the uninsured would be people who are eligible for Medicaid but do not enroll and those who would rather pay a fine than buy insurance. See, Congressional Budget Office (2010). "Health Care." ([www.cbo.gov/publications/collections/health.cfm](http://www.cbo.gov/publications/collections/health.cfm)). However, providing medical care to such persons may be cost prohibitive because of the already reduced payments for Medicare and Medicaid, and the fact that such persons may be difficult to easily identify and target for free medical care.

### Conclusion

Undoubtedly, the impact of the *Provena* decision along with the passage of Health Care Insurance Reform has put Illinois' property tax exemption for charitable hospitals on life support. Whether the Illinois legislature can or will help cure the problem is questionable. And, whether most not-for-

profit hospitals can modify their practices to keep their exemption will be difficult to say the least. However, unless something is done, with higher taxes and less revenues, many hospitals necessary to the health of Illinois will have a more difficult time surviving while providing the same quality of care that patients are used to in Illinois.

**Practice Tip:** An Illinois hospital seeking an Illinois real property tax charitable exemption should make sure it quantifies its charitable care at the location at which it is seeking its tax exemption. In addition, a hospital may have to regrettably consolidate some of its charitable care at this location. It may also have to expand its charitable activities at this location and include more than just hospital care, e.g., free day care, free vaccinations, etc. At the very least, these changes should assist the hospital in any challenge to its claim to a charitable exemption, and hopefully will allow it to ultimately survive such a challenge. ■



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