

**Tax-Exempt Status: Illinois Hospital Loses Tax-Exempt Status – Again
 (Part One of a Two-Part Series)**

Over the past year, tax-exempt healthcare organizations have faced increasing scrutiny regarding a central aspect of their organization structure: non-profit status.¹ After a June 2015 decision from a New Jersey court revoking the state property tax exemption for Morristown Memorial Hospital, other courts and regulators have provided additional insight into the issue of tax-exempt status for healthcare organizations. In a notable decision on this issue, on January 5, 2016, the Illinois Fourth District Court of Appeals issued its opinion in *Carle Foundation v. Cunningham Township*, which maintained the 2004 revocation of the state property tax exemption for *Carle Foundation Hospital*, a hospital located in Urbana, Illinois.² As another example of recent challenges to hospitals' property tax exemptions, the *Carle Foundation* case serves as further evidence of growing scrutiny regarding the tax-exempt status of many healthcare enterprises across the U.S. In this first article of a two-part series examining the trend of regulatory scrutiny into the tax-exempt status of healthcare enterprises, this Health Capital Topics article will detail the *Carle Foundation* decision, as well as discuss how the *Carle Foundation* decision fits into the overall regulatory landscape regarding state-level scrutiny of tax-exempt status in healthcare.

The upholding of the property tax revocation in the *Carle Foundation* case marked the latest turn of events for the hospital regarding its tax-exempt status. In this case, Carle Foundation, the owner of *Carle Foundation Hospital*, owned four parcels of land, operating a hospital on two of the four owned parcels, a day care center on the third owned parcel, and a power plant on the fourth parcel.³ Prior to 2004, the four parcels were exempted from property tax under Illinois law as a result of the charitable benefit accruing to the Urbana community through the operations of the hospital.⁴ Beginning in 2004, however, the defendant, Cunningham Township, began taxing the four parcels at full value.⁵ Carle Foundation sought to re-establish its exemption after Illinois altered its tax code for hospital tax-exempt status in 2012 by enacting Section 15-86.⁶ Section 15-86, signed into law on June 14, 2012, under Public Act 97-688, granted a charitable property tax

exemption to a healthcare enterprise if the *value of charitable services provided by the enterprise exceeded that enterprise's estimated property tax liability in the year for which it sought an exemption.*⁷ Based on the standard for property tax exemptions in Section 15-86, Carle Foundation petitioned to the Illinois court to reinstate the exemption for Carle Foundation and to retroactively apply the standard to taxable years 2004 through 2011, when the foundation lost its property tax-exemption. The trial court ruled Section 15-86 applied retroactively, providing the basis for Carle Foundation to have the exemption reinstated from 2004 to 2011; Cunningham Township then appealed.⁸

In its January 2016 ruling, the Illinois Fourth District Court of Appeals ultimately denied the exemption by finding the standard for tax exemptions under Section 15-86 unconstitutional. In its analysis, the court considered Section 15-86's standard of charity care services in excess of the value of the property tax exemption against Article IX, Section 6 of the Illinois Constitution, which provides the basis for property tax exemptions in the State of Illinois.⁹ Article IX, Section 6 states:

*"The General Assembly by law may exempt from taxation only the property of the State, units of local government and school districts and property used exclusively for agricultural and horticultural societies, and for school, religious, cemetery and charitable purposes."*¹⁰
 [Emphasis Added]

The court stated that this provision contained three significant aspects: (1) the Illinois General Assembly may implement only more restrictive requirements than the constitution for eligibility of charitable exemptions, (2) properties owned by entities other than "*the State, ... local government, and school districts*" must be exempt from property tax based on the "*exclusive use*" of that property for charitable purposes, and (3) that "*exclusively*" may be interpreted as "*primarily*," since a strict reading of the former could revoke charitable exemptions in unintentional circumstances, such as when the property fails to be used for charitable purposes an entire 100% of the time.¹¹ The court found

that, instead of requiring Carle Foundation to use the property exclusively for charitable purposes, Section 15-86 “...merely require[d] the hospital to... pay for its property tax exemption with certain services of an equivalent value,”¹² since the modified code granted the charitable exemption if the value of Carle Foundation’s charitable services equaled or exceeded its estimated property tax liability for the particular calendar year the exemption is sought.¹³ Due to this expansion of conditions that satisfy requirements for a property’s charitable exemption, the court found Section 15-86 unconstitutional,¹⁴ thereby invalidating the trial court’s ruling that the Carle Foundation parcels were exempt from property taxes from 2004 to 2011.

The January ruling in *Carle Foundation* served as another example of increasing regulatory scrutiny regarding tax-exempt status of healthcare enterprises. Much of this trend can be examined in light of previous Illinois cases on the matter. In 2004, the same year Carle Foundation lost its tax-exempt status, *Provena Covenant Medical Center* (Provena) also had its charitable exemption revoked.¹⁵ In 2010, the Illinois Supreme Court upheld the revocation of Provena’s charitable exemption, on grounds that Provena provided an inadequate amount of charity care services to maintain tax-exempt status for state property taxes.¹⁶ However, since the beginning of 2015, regulatory scrutiny on this topic has increased in frequency nationally. As discussed in an August 2015 Health Capital Topics article, entitled “*The Morristown Decision and its Potential Impact on Tax-Exempt Entities*,” a New Jersey court affirmed the denial of tax-exempt status for Morristown Memorial Hospital in New Jersey, on the grounds that Morristown Memorial Hospital and the land on which the hospital sits were “being used substantially for profit.”¹⁷ Additionally, Maine recently attempted to pass a repeal of property tax exemptions for “properties owned by certain nonprofit organizations with an assessed value in excess of \$500,000,”¹⁸ and Connecticut included a provision in its budget to grant municipalities the power to tax certain new property acquired by non-profit hospitals.¹⁹ Finally, in a noteworthy ruling for healthcare organizations currently participating, or considering participation, in an *accountable care organization* (ACO), on April 8, 2016, the IRS denied federal tax-exempt status under Section 501(c)(3) for the commercial ACO affiliated with a tax-exempt healthcare system.²⁰

The second installment of this two-part series on regulatory scrutiny surrounding tax-exempt status for

healthcare organizations will discuss the April IRS ruling, as well as examine the potential obstacles healthcare organizations must navigate in light of this scrutiny.

- 1 “Hospital property tax exemption under attack in Illinois” By Nicole Jobe, Thompson Coburn, LLP, March 8, 2016, <http://www.thompsoncoburn.com/news-and-information/health-law-checkup-blog/blog/16-03-08/hospital-property-tax-exemption-under-attack-in-illinois.aspx> (Accessed 4/15/2016).
- 2 “Carle Foundation v. Cunningham Township” 45 N.E.3d 1173, 1195-96 (Ill. App. Ct. 2016).
- 3 *Ibid*, p.1776.
- 4 *Ibid*.
- 5 *Ibid*.
- 6 *Ibid*.
- 7 “Laws of the State of Illinois: Ninety Seventh General Assembly” The General Assembly of the State of Illinois, 2012, https://www.cyberdriveillinois.com/publications/pdf_publication/s/2012_session_laws.pdf, (Accessed 4/29/16), p. 129 – 130.; “Exemptions related to access to hospital and health care services by low-income and underserved individuals” 35 ILCS 200/15-86(c) (Ill. 2016).
- 8 Carle Foundation, 2016, p.1778.
- 9 *Ibid*, p.1190.
- 10 ILL. CONST. art. IX, sec. 6.
- 11 Carle Foundation, 2016, p.1191-92.
- 12 *Ibid*, p.1194.
- 13 “Exemptions related to access to hospital and health care services by low-income and underserved individuals” 35 ILCS 200/15-86(c) (Ill. 2016).
- 14 Carle Foundation, 2016, p.1191-92.
- 15 “Hospital Found ‘Not Charitable’ Loses Its Status as Tax Exempt” By Lucette Iagnado, Wall Street Journal, February 19, 2004, <http://www.wsj.com/articles/SB107714142727933052> (Accessed 4/6/2016).
- 16 “Provena Covenant Medical Center v. Department of Revenue” 925 N.E.2d 1131 (2010); “Illinois Supreme Court Rejects Hospital’s Claim for Charitable Property Tax Exemption” By Scott R. Metcalf, Franczek Radelet, April 1, 2010, <http://www.franczek.com/frontcenter-574.html> (Accessed 4/6/2016).
- 17 “The Morristown Decision and its Potential Impact on Tax-Exempt Entities” Health Capital Topics, Vol. 8, No. 8 (August 2015).
- 18 “An Act Making Unified Appropriations and Allocations for the Expenditures of State Government, General Fund and Other Funds, and Changing Certain Provisions of the Law Necessary to the Proper Operations of State Government for the Fiscal Years Ending June 30, 2016 and June 30, 2017” Bureau of the Budget, State of Maine, 2015, <http://www.maine.gov/budget/documents/2016-2017BiennialBudgetLanguage1-9-15.pdf> (Accessed 4/28/16).
- 19 “2015 State Policy Round-Up” National Council of Nonprofits, September 28, 2015, <https://www.councilofnonprofits.org/sites/default/files/document/s/2015%20State%20Policy%20Round-Up.pdf> (Accessed 4/15/2016).
- 20 “Private Letter Ruling No. 201615022” Internal Revenue Service, April 8, 2016, <https://www.irs.gov/pub/irs-wd/201615022.pdf> (Accessed 4/28/16).



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