

Groundbreaking Legislation on Property Tax and Sales Tax Exemptions for Illinois Hospitals

June 14, 2012

Illinois Governor Patrick Quinn just signed into law a comprehensive and groundbreaking [legislative package](#) that significantly changes the criteria for establishing and maintaining property tax exemptions and sales tax exemptions for Illinois not-for-profit hospitals and their affiliates. The new laws, which became effective on June 14, 2012, are intended to end the controversy and uncertainty surrounding the test for charitable property tax exemptions for hospitals that have plagued the industry for many years.

Concepts Underlying New Exemption Laws

In the underlying legislative findings, the Illinois General Assembly states: “[I]t is essential to ensure that tax exemption law relating to hospitals accounts for the complexities of the modern health care delivery system.” The findings also indicate that the legislation is intended to increase access to hospitals and other health care facilities by low-income and underserved individuals.

Simply stated, to be eligible for property and sales tax exemption, hospitals must demonstrate that the dollar value of the amount of their services or activities that (i) address the health care needs of low-income or underserved individuals and (ii) relieve the burdens of government relating to the health care of low-income or underserved individuals, equals or exceeds the dollar value of a hospital’s property tax exemption.

New Property Tax Exemption Rules

The legislation adds a new Section 15-86 (35 ILCS 200/15-86) to the Illinois Property Tax Code (Code), entitled “Exemptions related to access to hospital and health care services by low-income and underserved individuals.” Significantly, this change relieves hospitals and hospital affiliates seeking a charitable purpose property tax exemption from the previous burden of establishing that they are “institutions of public charity” pursuant to Section 15-65 of the Code. In recent years, the Department and the Illinois courts were increasingly finding that hospitals failed to meet this burden, without providing clear guidance as to what would be sufficient to satisfy the requirement.

Section 15-86(c) provides that a “hospital applicant” shall be issued a charitable exemption for property for which exemption is being sought if the value of qualifying services or activities of the “relevant hospital entity” for the applicable year equals or exceeds the estimated property tax liability for the year for which exemption is sought.

Some key definitions found in the new legislation are set forth in the Appendix attached hereto, including “hospital,” “hospital affiliate,” “hospital applicant,” “hospital owner,” “hospital system” and “relevant hospital entity.” As discussed further below, these definitions establish a more flexible construct designed to address the various ownership and organizational structures existing in today’s health industry environment.

Under the new legislation, the applicant seeking exemption for a hospital can be either a hospital owner or a hospital affiliate. A hospital affiliate is broadly defined as an entity (other than a hospital owner) that controls, is controlled by, or is under common control with one or more hospital owners and that supports, is supported by, or acts in furtherance of the exempt health care purposes of at least one of those affiliated hospitals. Any number of organizational structures will come within this definition. Examples are a parent entity in a health care system, a joint venture between two hospital owners, or a joint venture between a wholly owned subsidiary of a hospital owner and a for-profit developer, provided that it is the hospital owner that directly or indirectly controls that joint venture.

The definition of relevant hospital entity provides choice and flexibility when determining which qualifying services or activities can be included in the Section 15-86(c) value calculation. When the applicant is a hospital affiliate, it can elect to satisfy the Section 15-86(c) quantitative test either (i) by calculating only its qualifying services or activities and comparing the amount to the estimated tax liability of its properties, or (ii) by calculating the qualifying services or activities of the hospital system to which it belongs and comparing the amount to the estimated tax liability of all the properties in that hospital system.

Moreover, if a hospital owner owns more than one hospital, only the value of the services and activities relating to the hospital that includes the property for which exemption is being sought or continued is included in the Section 15-86(c) value calculation, and the corresponding calculation of the relevant hospital entity’s estimated property tax liability will take into account only properties comprising that hospital.

For a multi-state hospital system or hospital affiliate, the value of qualifying services or activities that occur in Illinois and the hospital entity's estimated property tax liability will be calculated only with respect to its property located in Illinois.

A hospital applicant may for each year elect to use either the value of qualifying services or activities for the hospital year or the average value of those services or activities for the three fiscal years ending with the hospital year. The option of using a three-year average may avoid situations where the same property is exempt one year and taxable the next year because the Section 15-86(c) test is met in one year but not in another.

Qualifying Services and Activities

For more than a decade, Illinois hospitals and the Department have been battling over what hospital activities can be considered to support a charitable purpose property tax exemption. The Department has taken a narrow approach of counting charity care consisting mainly of free and discounted financial assistance to patients. By contrast, new Section 15-86(e) allows consideration of a much broader list of services and activities:

- **Charity care.** Free or discounted services provided pursuant to the relevant hospital entity's financial assistance policy, measured at cost.
- **Health services to low-income and underserved individuals.** Unreimbursed costs for providing without charge, paying for, or subsidizing goods, activities or services for the purpose of addressing the health of low-income or underserved individuals, including financial or in-kind support to affiliated or unaffiliated hospitals, hospital affiliates, community clinics or programs that treat low-income or underserved individuals; paying for or subsidizing health care professionals; providing or subsidizing outreach or educational services for disease management and prevention; free or subsidized goods, supplies or services needed because of medical condition; and prenatal or childbirth outreach.
- **Subsidy of state or local governments.** Direct or indirect financial or in-kind subsidies of state or local governments that pay for or subsidize activities or programs related to health care for low-income or underserved individuals.
- **Support for state health care programs for low-income individuals.** At the election of the hospital applicant for each applicable year, either (i) 10 percent of payments to the relevant hospital entity and any hospital affiliate designated by the relevant hospital entity under Medicaid or other means-tested programs, or (ii) the amount of subsidy provided by the relevant hospital entity and any hospital affiliate designated by the relevant hospital entity to state or local government in treating Medicaid recipients and recipients of means-tested Programs. Unreimbursed costs will be net of fee-for-services payments, payments pursuant to an assessment, quarterly payments and all other payments included on the schedule H of the IRS form 990.
- **Dual-eligible subsidy.** The amount of subsidy provided to government by treating dual-eligible Medicare/Medicaid patients.
- **Relief of the burden of government related to health care of low-income individuals.**
- **Other activities.** Any other activity by the relevant hospital entity that the Department determines relieves the burden of government or addresses the health of low-income or underserved individuals.

The ability to include in the Section 15-86(c) value calculation amounts related to this expansive list of services and activities clearly recognizes the complexities of the delivery of health care to low-income or underserved individuals existing in today's health industry environment. While differences still exist between this expanded scope of what can be considered under Section 15-86(c) and what can be considered under the community benefit and relieving the burden of government bases for federal income tax exemption under Section 501(c)(3), Illinois property tax-exemption standards are now more closely aligned with those federal standards.

Estimation of Exempt Property Tax Liability

Estimated property tax liability means the estimated dollar amount of property tax that the relevant hospital entity would pay if subject to real property taxation, calculated with respect to its full or partially exempt properties. For each property for which the

calculation is made, the estimated property tax liability is determined by multiplying the lesser of (i) the actual assessed value, if any, of the exempt portion of such property, and (ii) an estimated assessed value of the exempt portion of such property, by the applicable equalization factor and tax rate.

New Application Form and Verification Requirements

Each hospital applicant applying for a property tax exemption pursuant to Section 15-86 will now be required to use a new application form to be provided by the Department. The completed application form must specify in and attach to the exemption application the records used in support of the application. Each application or affidavit will now be required to contain a verification by the chief executive officer of the hospital applicant under oath or affirmation stating that each statement in the application or affidavit and each document submitted with the application or affidavit is true and correct. The records submitted with the application must include an exhibit prepared by the relevant hospital entity showing the value of the relevant hospital entity's qualifying services and activities, and the value of the relevant hospital entity's estimated property tax liability. The exhibit will be made available to the public by the chief county assessment officer.

With this new, more beneficial approach to hospital exemptions comes the possibility of greater scrutiny and enforcement actions by the Attorney General's office and perhaps others focused on the veracity and accuracy of the information contained in exemption applications and affidavits.

Changes to Annual Affidavit Requirements

Section 15-10 of the Code provides that in order to maintain a property tax exemption, the property owner must file with the chief county assessment officer, on or before January 31 of each year, an affidavit stating whether there has been any change in the ownership or use of the property. The new law will now require the owner of hospital property to also certify in the affidavit the satisfaction by a relevant hospital entity of the condition for an exemption under Section 15-86. The affidavit will have to be accompanied by an exhibit prepared by the relevant hospital entity showing the value of its qualifying services and activities under Section 15-86(e) and the value of its estimated property tax liability.

New Sales Tax Exemption Rules

The new legislation also amends the Use Tax Act (35 ILCS 105/), the Service Use Tax Act (35 ILCS 110/), the Service Occupation Tax Act (35 ILCS 115/) and the Retailers' Occupation Tax Act (35 ILCS 120/) by adding to each Act a new section entitled "Hospital Exemption."

Under this new Hospital Exemption provision, a not-for-profit hospital or a hospital affiliate that is not already exempt under another provision of these Acts will satisfy the requirements for sales tax exemption if the value of qualified services or activities for the hospital year equals or exceeds the relevant hospital entity's estimated property tax liability, without regard to any property tax exemption granted under Section 15-86 of the Code, for the calendar year in which a sales tax exemption or renewal of exemption is sought.

Accordingly, by satisfying the same quantitative test for a property tax exemption under new Section 15-86 a hospital owner or hospital affiliate (such terms have the same meanings as in Section 15-86) will also satisfy the requirement for being granted a sales tax exemption or renewal.

New Income Tax Credit Benefiting For-Profit Hospitals

For-profit hospitals will be entitled to a tax credit under the new legislation. A new Section 223 is added to the Illinois Income Tax Act (35 ILCS 5/223), entitled "Hospital Credit." For tax years ending on or after December 31, 2012, the owner of a hospital licensed under the Hospital Licensing Act, but not including an organization that is exempt from federal income taxes under the Internal Revenue Code, is entitled to a credit against income taxes in an amount equal to the lesser of the amount of real property taxes paid during the tax year on real property used for hospital purposes during the prior tax year or the cost of free or discounted

services provided during the tax year pursuant to the hospital's charitable financial assistance policy, measured at cost. If the taxpayer is a partnership or Subchapter S corporation, the credit can be passed through to its partners or shareholders.

This new tax credit could prove to be a big windfall for investor-owned hospitals in Illinois that provide free and discounted health care services to low-income and underserved individuals.

Applicability of New Legislation

The new property and sales tax exemption legislation is applicable to (i) all decisions by the Department on or after the effective date of the legislation regarding entitlement or continued entitlement to charitable property tax exemptions or entitlement to a sales tax exemption or renewal, (ii) all applications for property tax exemption or for a sales tax exemption or renewal filed on or after the effective date, and (iii) all applications for property tax exemption or sales tax exemption or renewal that have either not been decided by the Department before the effective date or for which any such Department decisions are not final and non-appealable as of that date.

Significantly, the new legislation will apply retroactively to the many hospital property tax and sales tax exemption applications and renewal proceedings pending as of its effective date.

Amendments to Fair Patient Billing Act

Simultaneously with the passage of the new property tax and sales tax exemption amendments, [Senate Bill 3261](#) was enacted. It amends the Fair Patient Billing Act (219 ILCS 88/) as follows: (i) the Attorney General is required to adopt standard provisions to be included in all applications for financial assistance no later than June 30, 2013; (ii) the Attorney General is also required to adopt, no later than June 30, 2013, appropriate methodologies for determination of presumptive eligibility for financial assistance; and (iii) by January 1, 2013, a state-wide association representing a majority of hospitals (presumably the Illinois Hospital Association) may submit recommendations for such standard provisions to be included in applications and for methodologies for determination of presumptive eligibility.

Amendments to Hospital Uninsured Patient Discount Act

Senate Bill 3261 also amends the Hospital Uninsured Patient Discount Act (210 ILCS 89/) to require hospitals to provide medically necessary free care to individuals with family income of up to 200 percent of the federal poverty guidelines in urban areas and up to 125 percent of the federal poverty guidelines in rural areas.

Implications

The new legislation is expected to have many important implications, including the following:

- Hospitals will need to gather the information necessary to make the value calculations required by new Section 15-86 of the Code, determine who is the relevant hospital entity for purposes of making these calculations, and determine whether to use data for the hospital year in question or use a three-year average.
- The new laws will have a significant effect on how the Department will determine property tax and sales tax exemption matters. New application and exhibit forms will be required. It is not clear how long it will take the Department to be in a position to begin implementing the new laws.
- Hospitals will need to evaluate how the new quantitative test will affect existing property and sales tax exemption applications or renewals, many of which have been pending for several years.
- Hospitals that may have held off (in some cases for years) filing property tax exemption applications for certain of their properties should now consider whether to now file new applications for those properties.

- In preparing property tax exemption applications and affidavits, hospitals should take into account whether and to what extent the information presented has implications for preparation of other filings required of hospitals by the Illinois Attorney General, the Internal Revenue Service and other government agencies.
- For a decade or more the battle between Illinois hospitals and the Department over property tax exemptions has been followed throughout the United States, with other states considering whether to curtail hospital property tax exemptions. However, by seeking to provide greater access to health care services for low-income and underserved individuals and establishing a quantitative standard for determining property tax exemptions for hospitals and their affiliates, the new Illinois law may become a model to be followed by other states.
- Already, some critics are expressing the opinion that the new law is unconstitutional. They contend that the Illinois Supreme Court has made clear in *Eden Retirement Center, Inc. v. Department of Revenue*, 213 Ill. 2d 273, 291 (2004), that the requirement that property be used exclusively for a charitable purpose is mandated by the Illinois Constitution and thus cannot be eliminated by the Illinois General Assembly. On the other hand, some commentators believe that it is unlikely that the constitutionality of the new law will be litigated in the courts.

Appendix – Key Definitions

Section 15-86(b) of the Property Tax Code sets forth several key definitions:

- “Hospital” is defined as any institution, place, building, buildings on a campus, or other health care facility located in Illinois that is licensed under the Hospital Licensing Act and has a hospital owner.
- “Hospital owner” means a not-for-profit corporation that is the titleholder of a hospital, or the owner of the beneficial interest in an Illinois land trust that is the titleholder of a hospital.
- “Hospital affiliate” means any corporation, partnership, limited partnership, joint venture, limited liability company, association or other organization other than a hospital owner that directly or indirectly controls, is controlled by, or is under common control with one or more hospital owners and that supports, is supported by, or acts in furtherance of the exempt health care purposes of at least one of those hospital owners’ hospitals.
- “Hospital system” is defined as a hospital and one or more other hospitals or hospital affiliates related by common control or ownership.
- “Hospital applicant” means a hospital owner or hospital affiliate that files an application for a property tax exemption.
- “Relevant hospital entity” means (i) the hospital owner, in the case of a hospital applicant that is a hospital owner, and (ii), at the election of a hospital applicant that is a hospital affiliate, either the hospital affiliate or the hospital system to which the hospital applicant belongs, including any hospitals or hospital affiliates that are related by common control or ownership.
- “Hospital year” means the fiscal year of the relevant hospital entity, or the fiscal year of one of the hospital owners in the hospital system if the relevant hospital entity is a hospital system with members with different fiscal years, that ends in the year for which the exemption is sought.

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