

Management Alert

Illinois Department of Revenue Upholds the Decision to Deny Provena Covenant Medical Center a Property Tax Exemption

Introduction

The Illinois Department of Revenue (IDR) issued its Final Administrative Decision on September 26, 2006 upholding the ruling of the Champaign County, Illinois taxing authority to deny Provena Covenant Medical Center's (Provena) appeal to regain its property tax exemption. Provena is a full-service, general acute care hospital in Urbana, Illinois that is a division of Provena Hospitals. Provena Health is the parent corporation of Provena Hospitals, and is a Catholic health system that includes several Illinois hospitals.

Although the application of this decision is arguably limited by the statutory and case law upon which it was decided, the Provena decision has served as a "wake up call" to hospitals and charitable not-for-profit organizations around the country, should other taxing bodies begin scrutinizing similarly drafted local property tax laws. Many legislators and state attorneys general, however, view the Provena decision merely as the most recent step in a national movement, led by Senator Charles F. Grassley (R-IA), to review or revise federal Community Benefit Standards in order to make non-profit hospitals accountable for providing greater amounts of charity care to their constituents – a vision shared by Illinois Attorney General, Lisa Madigan (D-IL).

In fact, Anne Murphy, Senior Counsel to the Illinois Attorney General, stated in the wake of the Provena decision that the Attorney General's Office believes that the case was correctly decided consistent with the Illinois Constitution and case precedent. Her statement is unsurprising in light of the Illinois Attorney General's recent unsuccessful efforts to pass a charity care bill requiring Illinois hospitals to devote at least 8% of their annual operating income to providing charity care.

The Ruling

IDR framed the issue in the Provena Decision as "whether the property used by [Provena] is owned by a charitable organization and if so whether the property is used by the organization exclusively for charitable purposes." Illinois law provides an exemption from property taxation if the subject property is "actually and exclusively used [by an institution of public charity] for charitable or beneficent purposes, and not otherwise used with a view to profit." The Provena decision explained that the "exclusively" standard should not be interpreted literally, but instead that the standard would be met where providing charity care is the primary purpose and is not merely an "incidental act of beneficence." Illinois case law holds that an organization generally will be deemed to have a charitable purpose if:

- (1) the benefits derived are for an indefinite number of people;
- (2) the organization has no capital, capital stock or shareholders, earns no profits or dividends, but rather derives its funds mainly from public and private charity;
- (3) the organization dispenses charity to all who need and apply for it;
- (4) it does not provide gain or profit in a private sense to any person connected with it; and
- (5) it does not place obstacles in the way of those who need and would avail themselves of the charitable benefits it dispenses.

IDR ultimately concluded that Provena did not qualify for a property tax exemption because Provena failed to prove by clear and convincing evidence that it uses its property “exclusively for charitable purposes.” IDR considered several factors in reaching its conclusion.

Amount of Charity Care Provided

One of the critical issues in the Provena decision was what, if any, minimum amount of free care a hospital must provide before IDR would recognize the institution’s primary purpose as the provision of charity care. According to IDR, however, Provena failed to come close to such a threshold, as it spent only 0.7% (\$831,724) of its 2002 income (\$113,000,000) on providing charity care. IDR therefore found that Provena had failed to prove that its “primary purpose” was providing charitable care because the amount of charity care provided was “so seriously insufficient that it simply [could not] withstand the constitutional scrutiny required to justify a property tax exemption,” especially because the value

of the \$1,100,000 property tax exemption sought was worth more than the amount of charity care provided by Provena. More importantly, the decision fails to establish a threshold percentage under which IDR would find that an entity meets the charitable care test. A reasonable assumption, however, is that IDR will make such determinations on a case-by-case basis.

Provision of Emergency Services

The Provena decision also held that Provena’s primary purpose was not charitable even though Provena treated anyone seeking treatment for emergency medical conditions. Instead, IDR urged that Provena was merely complying with the Emergency Medical Treatment and Active Labor Act (EMTALA) – a federal law requiring acute care facilities to examine and treat emergency medical conditions and women in labor.

Inadequate Charity Care Policy and Practices

IDR also identified inconsistencies in the application of Provena’s charity care policies and practices. For example, Provena engaged third parties that aggressively collected unpaid patient charges. Additionally, Provena dispensed charity care by reducing a patient’s bill on a sliding scale basis depending upon the patient’s financial status in relation to federal poverty income guidelines. “For example, a patient whose portion of billed charges was \$50,000 and whose income was at a level allowing for a 50% waiver of charges would be left with a \$25,000 bill after application of the sliding scale, [while] a patient at the same level on the poverty income scale with billed charges of \$1,000 would be left with an outstanding bill of only \$500 after the sliding scale is applied.” IDR stated that the mechanical application of this sliding scale was inconsistent with providing meaningful charity

care because it failed to consider a patient's true ability to pay for services rendered in relation to the amount of the outstanding portion of the bill. IDR also criticized Provena's failure to publicize its charity care policy within the community and its charity care policy's statement that Provena would dispense charity care "to the extent that it is financially able" to do so, as further evidence that Provena did not provide charitable services to all who need and apply for it. Additionally, IDR emphasized the fact that 97.7% of Provena Health's annual operating income came from patient revenue despite the guidelines set forth in *Methodist Old People's Home v. Korzen*, 233 N.E.2d 537 (1968), suggesting that the funds of a charitable organization should be derived mainly from public and private charities. Finally, IDR flatly rebuffed as inconsistent with case precedent Provena's attempt to argue that it should be able to characterize unreimbursed Medicaid and Medicare costs as charity care.

The American Hospital Association, the Illinois Hospital Association, the Metropolitan Chicago Healthcare Council, the Catholic Hospital Association, and the Illinois Catholic Hospital Association all have expressed outrage at the Provena decision, but believe that the Circuit Court in Springfield will overturn it on an appeal that Provena has vowed to make. Should the case fail to be overturned at the Circuit Court level and if Provena appeals the Circuit Court's decision to the Illinois Appellate Court and loses there too, that case (subject to possible review and reversal by the Illinois Supreme Court) would become binding precedent on all Illinois circuit courts – a frightening prospect for future charitable organizations considering whether to challenge denial of a property tax exemption on similar grounds.

In the meantime, however, the Provena decision provides critical guidance to Illinois not-for-profit charitable

hospitals searching for ways to avoid challenges to their property tax exemptions and attempting to identify clues regarding the legislative direction of state policy makers. We have therefore compiled below a checklist of lessons learned from the Provena decision and other charity care best practices that may help not-for-profit organizations insulate themselves from similar challenges. We note, however, that each organization must determine whether the costs of implementing such practices outweigh the benefits realized from property tax exemption. In light of both federal and state trends to reevaluate whether hospitals are deserving of such exemptions and recently decided IDR cases, there is no guarantee that implementing any or all of the below suggestions will inoculate an organization from the growing tide of scrutiny. Instead, hospitals may be better advised to contact their local lobbying organization to express their concern and learn how to become involved in efforts to eliminate this growing trend.

Charity Care Best Practices

Charity Care Practices

1. Ensure that the amount of charity care provided at least equals the amount of any property tax exemption sought.
2. Identify clear financial eligibility standards based upon a patient's relation to federal poverty standards that meaningfully considers a patient's true ability to pay charges.
3. Offer greater charity care to patients shouldering catastrophic expense beyond their financial means.
4. Implement effective strategies to communicate the availability of charity care to the community.

5. Train staff to identify patients in need of assistance.
 6. Refrain from stating in your charity care policy that the organization's financial well-being is a consideration in determining how much charity care the organization will provide.
 7. Aggressively seek charitable forms of revenue (e.g., grants, charitable gifts, etc.) and make a record of such attempts.
 8. Require third-party contractors to provide a certain minimum percentage or dollar amount of charitable care each year that is consistent with your organization's charitable care policies.
 9. Differentiate in your financial statement among charity care based upon financially determined need, other discounted programs, uncompensated shortfall from government payout programs and bad debt.
2. Ensure quality of the comparability data used to determine executive compensation.
 3. Value total compensation, including the value of all benefits (e.g. social club dues, entertainment, and other discretionary expenditures).
 4. Make the Compensation Committee's decision-making process known to the full Board of Directors.
 5. Make a record explaining how and why the Compensation Committee and Board made certain executive-level compensation decisions.

If you have any questions regarding the Provena Decision, please contact the Seyfarth Shaw attorney with whom you work, or any Health Care attorney on our website, www.seyfarth.com.

Billing and Collection Policies

1. Provide payment plans to patients that takes into consideration their ability to pay.
2. Make charity care and discount policies readily available to patients.
3. Wait a reasonable period of time for a patient to file a charity care application or pay outstanding balances before using collection efforts.
4. Avoid aggressive or harassing collection practices.
5. Use legal action sparingly and only when authorized by senior management.

Executive Compensation

1. Ensure independence of compensation committee and outside compensation consultants.

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