Coates' Canons Blog: The Charitable Hospital Exemption

By Chris McLaughlin

Article: https://canons.sog.unc.edu/the-charitable-hospital-exemption/

This entry was posted on April 23, 2019 and is filed under Finance & Tax, Property Taxes

The national trend towards consolidation of the healthcare industry under large providers is very evident across our state. Be it the purchase of western Carolina's largest non-profit hospital system by an even larger healthcare provider or the continued expansion of Novant and Vidant health systems in central and eastern Carolina, our state has seen more and more hospitals and clinics operating under larger and larger corporate umbrellas.

These healthcare mergers and acquisitions raise the stakes for counties deciding when to grant the property tax exemption for charitable hospitals created by G.S. 105-278.8. If one of these mega-providers receives the exemption for one of its hundreds of hospitals and clinics, does that mean all of that mega-provider's locations should be exempt? Novant alone operates over 600 healthcare sites. The tax dollars involved are enormous.

Knowing the importance of this decision, a number of counties have reached out to my colleague Kirk Boone and I for guidance on what qualifies as a chartable hospital. I have written extensively about charitable property tax exemptions (see this law review article and blog posts here and here). But I have not focused specifically on the charitable hospital exemption in G.S. 105-278.8.

That statue doesn't provide any bright-line eligibility rules beyond mandating that the operator of the hospital be a non-profit corporation and observing that a hospital may charge patients "who are able to pay" without automatically being disqualified for the exemption. Instead of bright-line rules, G.S. 105-278.8 offers two rather ambiguous and subjective standards for determining what is charitable. The hospital must have "humane and philanthropic objectives" and must benefit "a significant rather than limited segment of the community without expectation of pecuniary profit."

Those standards do not offer tax officials much help to decide how charitable a hospital must be in order to qualify for the exemption under G.S. 105-278.8. What percentage of a hospital's services must be provided free or at reduced rates? Must a substantial portion of the hospital's revenue consist of charitable donations or grants? If so, how much? The statute doesn't tell us.

Nor can we find much help from court decisions interpreting G.S. 105-278.8. The only reported opinion that that wrestled with the statute is from a 30-year old Court of Appeals case, In re: Foundation Health Systems. This opinion offers sparse analysis, spending barely a page to reach two quick conclusions about what makes a taxpayer eligible for the charitable hospital exclusion. First, it adopted an expansive definition of the term "hospital" by deciding that an outpatient clinic with operating rooms could qualify for the exemption under G.S. 105-278.8 despite not offering 24-hour nursing or in-patient (overnight) care. Second, it concluded that the taxpayer could qualify as charitable because it offered emergency/urgent care without regard for the patient's ability to pay and because it charged rates lower than those of a major local hospital.

A much more detailed analysis of what it means for a medical center to be charitable in the property tax context was provided by In re: Pavillon International, a 2004 Court of Appeals case involving a non-profit drug addiction treatment center. The Pavillon case actually arises under G.S. 105-278.7, the "general" charitable exemption. But because that statute uses essentially the same definition of "charitable" as does G.S. 105-278.8, the Pavillon court's analysis is relevant to the charitable hospital exemption.

(The fact that both statutes use nearly identical definitions for the term "charitable" calls into question the need for a specific exemption aimed at charitable hospitals if they would also be covered by the general charitable exemption. Why did the General Assembly create what appears to be a duplicate exemption for charitable hospitals? The only substantive difference between the two statutes is the unusual description of the type of property covered by the charitable hospital exemption. It covers not only property owned by the hospital—the usual standard—but also property "held for" a hospital's exclusive use. Does that broaden G.S. 105-278.8 to cover property leased but not owned by a charitable hospital? I'll get

back to that question in a future blog post.)

In the Pavillon case, the appellate court concluded that the treatment center was charitable because of these five factors:

1. The rates charged by the center were close to those charged by government institutions and well below those charged by for-profit institutions providing similar services. The center charged $12,500 for its four-week residential treatment program, as compared to $5,000 charged by state institutions and up to $50,000 charged by private, for-profit institutions.
2. The amount of free care provided by Pavillon was “not inconsiderable when compared to the client fees it has generated.” Over a three-year period the center earned $5 million in patient fees and provided $1.8 million in free care, meaning for every $1 the center earned in income it provided roughly 40 cents of free care. Another way of looking at it: free care was roughly 40% of paid care.
3. No patients were ever rejected due to financial reasons. What’s more, the center reserved 10% of its beds for indigent patients.
4. The center provided a number free services to the community beyond its regular treatment programs, including free training to mental health professionals and educational resources for school systems and churches.
5. The center could not continue to operate without charitable donations. Over a typical one-year period, the center’s revenues consisted of $2.9 million in patient fees and $1.1 million in charitable donations. Put another way, over 25% of the center’s total revenue came from charitable donations.

The Pavillon court’s analysis offers rough benchmarks that a county should use to determine when a hospital is charitable for purposes of G.S. 105-278.8. Does it mean that the amount of free care provided must always be at least 40% of paid care? No, but the Pavillon opinion does suggest that the amount of free care must be substantial. I can’t say exactly where the threshold lies, but a figure well below the 40% approved by the Pavillon court should not be sufficient for the exemption.

The test should be even more stringent for charitable contributions, because the court’s reasoning implies that if a hospital could operate without charitable contributions then it could not qualify as for the charitable exemption. The percentage of charitable contributions doesn’t need to be over 25% as it was for Pavillon, but it needs to be close.

The other three factors listed by the court are also important. How does the taxpayer’s rates compare with those charged by similar medical facilities? Are patients ever rejected due to inability to pay? Does the taxpayer provide other benefits to the community besides its free/reduced care?

While the Pavillon case does not create specific bright-line rules for when a hospital is charitable, it gives us much more guidance than does the text of G.S. 105-278.8 or the one previous case to interpret that statute. County tax officials would be wise to use the Pavillon opinion to develop the questions they ask of taxpayers seeking the charitable hospital exemption. If a taxpayer cannot meet standards similar to those created by the Pavillon court, then the taxpayer should not receive the charitable hospital exemption.

Links

- www.americanprogress.org/issues/healthcare/reports/2018/12/05/461780/provider-consolidation-drives-health-care-costs/
- investor.hcahealthcare.com/press-release/hca-healthcare-completes-purchase-mission-health
- businessnc.com/low-profile-novant-stays-on-offense-with-expansions/
- locateincarolina.com/healthcare/vidant-health-system/
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_105/GS_105-278.8.html
- scholarship.law.unc.edu/cgi/viewcontent.cgi?article=6690&context=nclr
- www.leagle.com/decision/1989974386se2d5881935
- caselaw.findlaw.com/nc-court-of-appeals/1395623.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_105/GS_105-278.7.html