

**PROVENA PORTENDS: RECENT DENIAL OF PROPERTY TAX
EXEMPTION TO PROVENA, AN ILLINOIS NONPROFIT HOSPITAL, ITS
IMPLICATIONS FOR CALIFORNIA, AND THE IMPACT OF THE PATIENT
PROTECTION AND AFFORDABLE CARE ACT**

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I. INTRODUCTION

This paper attempts to synthesize the recent decision denying the property tax exemption of a nonprofit hospital in Illinois (Provena) with the examinations of the net economic value provided by nonprofit hospitals in California, who benefited from property tax exemptions. Additionally, the ramifications of these diverse state legal environments are analyzed with respect to the recent enactment of section 501(r) of the Code and its increased disclosure requirements.

A. *Provena (Illinois)*

Though Provena Hospitals, an Illinois corporation, is clearly a non-profit and exempt from federal income tax under section 501(c)(3) of the Code, its federal tax exemption is not binding on the State of Illinois. The Supreme Court of Illinois determined that the hospital is not a charitable organization based on the definition of charitable use unique to Illinois jurisprudence. This determination was made because of the small amount of donations Provena received relative to its service revenue. While the fulcrum of the decision is specific to Illinois' law, the Court's additional use of the 'community benefit standard' to support its decision is of significance to organizations outside of Illinois. In a cost-benefit

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analysis, the court weighed Provena's 'community benefit' of charitable care against the tax benefits from a property tax exemption to demonstrate that Provena's charitable care does not offset the tax benefit.²

²Provena Covenant Med. Ctr. v. Dep't. of Revenue, No. 107328, 2010 WL 966858 (Ill. March 18, 2010).

II. BACKGROUND

Provena Hospitals "is organized as a not-for-profit corporation under Illinois law." In this capacity, as a not-for-profit corporation, "Provena Hospitals owns and operates six hospitals, including Provena Covenant Medical Center (PCMC), a full-service hospital located in the City of Urbana." A significant portion of Provena Hospital's revenue is generated by its hospital PCMC. "Of Provena Hospitals' "net patient service revenue" for 2002, \$113,494,000, or approximately 16%, was generated by PCMC. Unlike its parent, PCMC realized a net gain of income over "expenses and losses" of \$2,165,388 for that year. This surplus existed even after provision for uncollectible accounts receivable (*i.e.*, bad debt) in the amount of \$7,101,000. Virtually none of PCMC's income was derived from charitable contributions. The dollar amount of "unrestricted donations" received by PCMC for the year ending Dec. 31, 2002, was a mere \$6,938." The donations were minimal in contrast to the service revenue and did little to offset the cost of charity care provided by the hospital. "During 2002, the amount of aid provided by Provena Hospitals to PCMC patients under the facility's charity care program was modest. The hospital waived \$1,758,940 in charges, representing an actual cost to it of only \$831,724. This was equivalent to only 0.723% of PCMC's revenues for that year and was \$268,276 less than the \$1.1 million in tax benefits which Provena stood to receive if its claim for a property tax exemption were granted." Both the charitable contributions and charitable care provided by the hospital were limited relative to the hospital's operating revenue. In order to obtain its property tax exemption, the Provena Hospitals applied to the Champaign County board of review to exempt all 43 of the parcels in the PCMC complex from property taxes for 2002. The exemption was requested under Illinois law section 15-65(a) of the Property Tax Code³ on the grounds that the parcels were owned by an institution of public charity and that the property was "actually and exclusively used for charitable

³35 ILCS 200/15-65(a) (West 2002)

or beneficent purposes, and not leased or otherwise used with a view to profit.”⁴

In determination of its opinion the Court applied the test for exemption established under *Methodist Old Peoples Home v. Korzen*⁵, which provides substantial authority in the Second District. Under the test, a charity “earns no profits or dividends but rather derives its funds mainly from private and public charity and holds them in trust for the purposes expressed in the charter.” The Court found that “Provena Hospitals plainly fails to meet the second criterion: its funds are not derived mainly from private and public charity and held in trust for the purposes expressed in the charter. They are generated, overwhelmingly, by providing medical services for a fee.”⁶

A. *Charity Care*

The Court evaluated Provena’s charity care program to determine the extent of the charity relative to its operating budget, revenue, and property tax exemption benefit. The Court highlighted that Provena did not make a concerted effort to publicize its charity care program. “In 2002, PCMC budgeted \$813,694 for advertising and advertised in newspapers, phone directories, event playbills, and Chamber of Commerce publications; on television and radio; and through public signage. It also advertised using ‘booths, tables, and/or tents at community health or nonprofit fundraising events; sponsorship of sports teams and other community events; and banner advertisements at sponsored community events.’ The ads taken out by PCMC in 2002 covered a variety of matters, including employee want ads. None of its ads that year mentioned free or discounted medical care.” The Court further noted that, “[w]hile not mentioned in PCMC’s advertisements, a charity care policy was in place at the hospital, and the parties stipulated that PCMC’s staff made “outreach efforts to communicate the availability of charity care and other assistance to patients.” The charity care program used “a sliding scale” based on income and assets. Recipients of care who met the

⁴Supra note 2

⁵Methodist Old Peoples Home v. Korzen, 39 Ill. 2d at 157

⁶Supra note 2

eligibility guidelines were charged discounted rates. As noted above, these discounts represented a small portion of foregone revenue for Provena. Additionally, the discounts were not offset by donations, which is an important metric specific to the Illinois jurisprudence of charities.⁷

B. *California*

In contrast, in California, private non-profit tax-exempt hospitals were not required to meet this narrow standard of charitable service in order to receive a property tax exemption. California jurisprudence does not contain a requirement similar to that in Illinois, which requires a nonprofit to rely mainly on charitable contributions. However, pertinent to the Provena decision, California reviews economic community benefits less property tax foregone to determine whether the nonprofit hospital is providing a net positive benefit.

The State Auditor of California has reviewed the status of non-profit hospitals to determine whether California received net benefits from the exemption of income and property taxes for non-profit hospitals. In 2007, the California State Auditor produced a report on *Nonprofit Hospitals*⁸; the report estimated that California received greater net benefit from the charitable care provided less the tax revenue foregone. However, the report highlighted specific limitations the auditor's encountered that impacted their ability to derive their findings. This was most succinctly described in the reports subtitle: "Inconsistent Data Obscure the Economic Value of Their Benefit to Communities, and the Franchise Tax Board Could More Closely Monitor Their Tax-Exempt Status." The report recommended improved economic value reporting to verify that exempt organizations were providing a net benefit to counties that grant the exemption from property tax. The report noted that though California state law⁹ required reporting of a community benefit plan to the Office of Statewide Health Planning and Development, the law lacked "specific guidance regarding the content" which led to a

⁷*Supra* note 2

⁸*Nonprofit Hospitals* (December 2007 Report 2007-107)

⁹Health and Safety Code, Section 127355

lack of "uniformity of content and methodology." This failure "precludes the meaningful comparison of plans" between hospitals.¹⁰ Therefore, even if an accurate determination of the foregone revenue from the property tax exemption could be made, the extent of any offsetting benefit could not be made from the data provided from the nonprofit hospitals. However, the report also noted that challenges existed in determining the accurate amount of foregone revenue due to challenges within the County Assessors' office. The information required for an accurate determination of foregone revenue which was not fully captured through the process of exemption from state property taxes.

In California, the State Board of Equalization determines whether a nonprofit hospital meets the requirements of California Revenue and Taxation Code, Section 214 to qualify for the property tax exemption, referred to as the 'welfare exemption' in state law. Upon determination of an eligible organization, the State Board of Equalization issues an organizational clearance certificate to the qualified nonprofit. In turn, the nonprofit provides the organizational clearance certificate to the respective county assessors when applying for exemption from payment of property taxes. The 2007-107 State Audit report recommended that the Board of Equalization include a process to verify the accuracy of the values reported on the annual property statistical report submitted by the County Tax Assessor. In February 2009, the California State Auditor issued a follow up report that addressed the status of the findings and recommendations from the 2007-107 report. The report entitled, '*California State Auditor Report 2009-406*,¹¹' noted that in response to the recommended action the Board of Equalization "now includes a review of the exemption values contained in the county assessors' annual statistical reports. [The Board of Equalization] also stated that it uses a survey review worksheet to examine individual exemption claim records for proper classification by the county assessors and to ask questions of assessors personnel on their practices and procedures."¹² This enhanced practice provides the accurate property value

¹⁰*Supra* note 8

¹¹*California State Auditor Report 2009-406*

¹²*Ibid.*

information necessary to refine one component of the cost-benefit analysis performed by the State Auditor to determine if California receives a net benefit from the property tax exemption. However, the equation was still limited by the lack of uniformity in data submitted to the Office of Statewide Health Planning and Development.

C. *New Disclosures*

Both the proper method and full disclosure of net community benefit is now met through the recent changes due to the Patient Protection and Affordable Care Act¹³("PPACA"). The PPACA expands the reporting requirements of nonprofit hospitals, specifically on the issue of community benefit, in the disclosure requirements on IRS Form 990 Schedule H Part 1 Number 7, 'Financial Assistance and Certain Other Community Benefits at Cost.' These reporting requirements were codified into the Code under section 501(r)(4) 'Financial Assistance Policy.'¹⁴ The new information specifies the purview and manner of the financial assistance community benefit information to be reported by the nonprofit hospital. With statutorily enforced consistency, the new reporting regime creates uniformity in the information provided by nonprofit hospitals.

III. CONCLUSION

Nonprofit hospitals should be aware of the increased information available to their state legislature to perform a cost benefit analysis of the hospital's property tax exemption and the potential impact to the relative strength of their exemption based upon their respective state's jurisprudence. Though it is unlikely that the increased transparency from the changes in reporting requirements for federal tax would have impacted the outcome of the Provena case, the decision in the case and the increased information raises the visibility of the significance of

¹³Pub. L. No. 111-148, 124 Stat. 119

¹⁴26 U.S.C. §501(r)(4) (2010)

property tax exemption. Additionally, for California, the state has evaluated the situation in the recent past due to its commission of the nonprofit hospital audit. These recent events may encourage lawmakers and jurists to determine that there is a responsive climate to further scrutinize the property tax exemptions of nonprofit hospitals in their local jurisdictions.