

## Covenant v. Wauwatosa: A Taxing Decision for Outpatient Clinics

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Practice Area: Health Law & Nonprofit and Tax Exemption

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The Wisconsin Court of Appeals today released a decision which potentially threatens the tax-exempt status of hospital outpatient departments throughout the state. In this case, *Covenant Healthcare System, Inc. v. City of Wauwatosa*, the Court of Appeals determined that the St. Joseph Outpatient Center in the City of Wauwatosa (the "SJOC") constitutes a "doctor's office" and therefore is ineligible for property tax exemption under Wisconsin law. In reaching this decision, the Court of Appeals essentially rejected the trial court's analysis of the role of outpatient medical services in a contemporary hospital setting.

### Background

SJOC is an off-campus hospitalbased outpatient department of St. Joseph Regional Medical Center, Inc., a Wisconsin non-profit corporation ("St. Joseph"). SJOC is located approximately five miles from an acute care inpatient hospital operated by St. Joseph in Wauwatosa, Wisconsin. St. Joseph provides various outpatient services at SJOC, including cardio/pulmonary, laboratory, outpatient surgery, pain management, wound care, pediatric rehabilitation, physical therapy and a women's healthcare center. SJOC also includes twenty-four-hour "Urgent Care" services. The Urgent Care services are generally on an outpatient basis, although the patients needing inpatient care are stabilized and then transferred to an emergency unit or admitted to inpatient status at a hospital, and SJOC has a number of beds that can accommodate overnight stays in an emergency.

### The Non-Profit Hospital Exemption

Section 70.11(4m) of the Wisconsin Statutes provides an exemption from property taxes for non-profit hospitals. The exemption generally applies to property "used exclusively for the purposes of any hospital of ten beds or more devoted primarily to the diagnosis, treatment or care of the sick, injured or disabled...." By its terms, the exemption is not available for hospitals that are "operated principally for the benefit of or principally as an adjunct of the private practice of a doctor or a group of doctors," nor is it available to property used "as a doctor's office."

As hospitals increasingly provide patient services through free-standing outpatient departments, municipal assessors have stepped up their scrutiny of those outpatient departments as potential "doctors' offices" under the nonprofit hospital exemption. The line between traditional doctors' offices and traditional hospital operations has become more difficult to define, however, and the Wisconsin courts have provided little guidance on where that line should be drawn. Prior to the Covenant case, hospitals generally looked to two appellate decisions for guidance: *St. Elizabeth Hospital, Inc. v. City of Appleton* (a 1987 decision), and *St. Clare Hosp. of Monroe, Wis., Inc. v. City of Monroe* (a 1997 decision). The Wisconsin Supreme Court has yet to address the "doctor's office" language in the nonprofit hospital exemption.

In *St. Elizabeth*, the Court of Appeals found that a “First Care” area of a hospital’s emergency room did not qualify as a non-exempt “doctor’s office” based on various factors including exclusivity of use, the reasonable necessity of the facility to the hospital’s efficient functioning, and the integration of the area within the hospital. In *St. Clare* on the other hand, the Court of Appeals determined that an attached clinic was properly classified as a “doctor’s office” based upon various factors including the absence of inpatient facilities in the clinic, the presence of physician offices in the clinic, and the fact that most patients were seen by appointment during business hours. Significantly, in *St. Clare* the hospital had purchased an existing doctor’s practice and built a new building to house that practice; almost all of the doctors had an actual office in that facility. As the Court of Appeals noted in that case, “by definition, ‘a doctor’s office’ is the building where doctors have their offices.”

### **Covenant and St. Clare**

In *Covenant*, the Court of Appeals distilled its analysis to this simple distinction:

- A doctor’s office is a place where doctors see patients, mostly by appointment, during scheduled business hours, and have their offices.
- A hospital, on the other hand, is a place that offers inpatient, overnight care.

Since the SJOC (1) did not provide inpatient services, (2) provided the doctors with a space to do paperwork (even though the provided space was no more than a cubicle), and (3) saw most patients by appointment, during business hours, the Court of Appeals concluded that SJOC must therefore be a “doctor’s office.” Relying on *St. Clare*, the Court of Appeals essentially concluded that an outpatient clinic is the functional equivalent of a doctor’s office. This conclusion is potentially at odds with the decision, however.

In *St. Clare*, the hospital purchased a private physician practice, employed the physicians, built a new building to house the practice, and connected the building to the main hospital facility. The new clinic facility had its own business and administrative offices and medical records storage, as well as separate billing and other software systems. The *St. Clare* Clinic continued to operate virtually independent of the hospital.

By contrast, SJOC moved operations from an existing (and tax-exempt) outpatient hospital to a new facility that is totally integrated with and operating under the same license as the main hospital, with integrated patient, registration and pharmacy records; a unified billing system; and shared department heads, physician privileges, and medical staff bylaws. SJOC was built to meet construction standards applicable to hospitals but not to doctor’s offices. As noted by the trial court in *Covenant*, the facts concerning SJOC are “altogether different” from those presented in *St. Clare*.

The Court of Appeals recognized that the non-profit hospital exemption is to be strictly but *reasonably* construed. The Court of Appeals implicitly suggests that 24/7 inpatient care is the of an exempt hospital facility. This position is difficult to reconcile with other Wisconsin precedent confirming exemptions for hospital facilities that are used for such diverse activities as a day care center, an internship and residency program, and chaplain housing.

The Court of Appeals’ decision was not unanimous. Judge Fine authored a strong dissent, in which he stated that the extensive findings by the Circuit Court “ineluctably lead” to the exact opposite conclusion, that SJOC should be exempt under the nonprofit hospital exemption.

### **Implications**

The *Covenant* decision, if allowed to stand, will have a far-reaching impact on Wisconsin nonprofit hospitals. Potentially, any free-standing outpatient department of a hospital could now be re-characterized as a “doctor’s office” if it meets the three-part test identified by the Court of Appeals. Further, given language in the *St. Clare* decision that proximity to the main hospital campus is not dispositive, the Court of Appeals’ decision could be extended even to on-campus outpatient departments that meet these criteria.

As of this point, it remains to be seen whether Covenant will appeal this decision to the Wisconsin Supreme Court. In the meantime, the decision almost certainly will be the subject of intense interest among assessors across the state as they look to increase their tax rolls and property tax revenues. Nonprofit hospitals should begin reviewing the exemption status of their freestanding outpatient facilities in order to assess whether those exemptions may be vulnerable to challenge in the tax years to come.

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