

2020 Vision: Protecting Your Hospital's Tax-Exempt Status

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The manner in which medical services are being provided to patients is rapidly changing. Procedures that used to be performed in hospitals and required overnight stays are now being performed at outpatient clinics. Similarly, technological advances have decentralized hospital administration and the way in which treatment is provided. This should not come as a surprise to anyone that has any level of familiarity with the health care system, which includes just about anyone who goes to a doctor on a regular basis.

It should also come as no surprise that the law often lags behind technological advances and is often in a state of playing "catch up." This trend is readily apparent when it comes to the property tax exemption for Wisconsin hospitals. The good news is that the courts are now taking the advances in hospital care into account when affirming eligibility for property tax exemption, particularly as to clinics and outpatient facilities. That said, hospitals must be vigilant in obtaining and maintaining their exemption.

This *Legal Update* offers guidance for Wisconsin nonprofit hospitals that may be filing tax exemption applications for calendar year 2020. Later in this *Legal Update*, we briefly discuss recent developments at the federal level involving hospital exemptions under § 501(c)(3) of the Internal Revenue Code.

Property Tax Exemption for Nonprofit Hospitals

In Wisconsin, all property is subject to taxation unless it is explicitly deemed exempt by statute. The Wisconsin Statutes provide that the following type of property is exempt:

(4m) NONPROFIT HOSPITALS. (a) Real property owned and used and personal property used exclusively for the purposes of any hospital of 10 beds or more devoted primarily to the diagnosis, treatment or care of the sick, injured, or disabled.... This exemption does not apply to property used ... as a doctor's office.

(Wis. Stat. § 70.11(4m)). The legislative intent behind this exemption is to encourage not-for-profit hospitals to provide care for the sick.

Applications for property tax exemption must be filed by March 1. This includes exemption applications for newly constructed property as well as for existing and previously non-exempt property whose use has changed in a way that now makes it eligible for exemption. The property owner bears the burden of proving that the property is exempt and the Wisconsin courts interpret the statutory exemptions narrowly. Hospitals should start analyzing and preparing their exemption applications well in advance of the filing deadline.

All real property is assessed based on its "fair market value" as of January 1 of each year. The Wisconsin Property Assessment Manual ("WPAM") makes it clear that in the case of partially completed improvements, the assessor must value the improvements as they exist on the assessment date. Accordingly, hospitals with facilities currently under construction need to document the state of building as of January 1, 2020. Key documentation may include photographs and time-lapse construction progress videos. Assessors typically conduct an on-site inspection when there have been significant construction changes, and may also request additional documentation such as construction contracts and blueprints.

Assessors frequently utilize the cost approach when valuing new construction. One way to assess value for an under-construction project is to look at construction draws. This method has the appeal of simplicity but does not always produce accurate results. For example, if there have been construction draws of \$12 million as of January 1 on a \$30 million dollar project, an assessor might be inclined to give the property a fair market value of \$12 million as of that date. It is entirely possible, however, that \$1 million of that work was done on grading, soil stabilization, or other site development work that adds no value to the building from a "fair market value" perspective. Accordingly, the owner should be armed with knowledge of the actual condition of the building, including statements from the project manager, showing the value of what is "in the ground" as of the assessment date.

While it is important that new exemption applications document *value* as of January 1, the most important piece of the application involves documentation of exempt *use*. Recent litigation has focused on whether outpatient clinics or satellite hospital facilities are being used as a "doctor's office," which may disqualify the facility from exemption. The Wisconsin courts have identified the following list of factors that must be considered and evaluated when determining whether real property is used as an exempt hospital or as a doctor's office:

1. Do physicians own or lease the facility or equipment or are they hospital owned?
2. Do physicians at the facility receive "variable compensation," that is, compensation based on their productivity?
3. Do physicians at the facility employ or supervise non-physician staff, or receive extra compensation for such duties?
4. Does the facility and hospital generate separate billing statements or use separate billing software?
5. Do the physicians in the facility have office space in the facility?
6. Does the facility provide care on an outpatient, as opposed to inpatient, basis?
7. Is the facility only open during regular business hours during which time the physicians generally see patients by appointment or is there 24/7 urgent care?

It should also be noted that the exemption for a nonprofit hospital is not an all-or-nothing proposition—partial exemptions are permitted. For example, in a seminal case interpreting the breadth of the nonprofit hospital exemption, *Covenant Healthcare System, Inc. v. City of Wauwatosa*, the Wisconsin Supreme Court upheld Covenant Healthcare System's application for an exemption for 3 out of 5 floors in an outpatient clinic. The other floors did not fall within the criteria for the hospital exemption because they were doctors' offices, among other reasons.

Another use-related issue involves the exempt status of vacant space in newly constructed hospital facilities. The WPAM acknowledges that "hospitals often construct oversized additions to anticipate technological and industrial changes and to reduce the unit cost of construction." Assessors will generally treat this space as exempt so long as it meets the following conditions:

- The hospital is exempt.
- The space is attached to an existing hospital.
- The projected use of the space is declared in the board minutes, in the general building plans, and in the blueprints and is consistent with exempt hospital use.
- The building specifications and actual construction-to-date include features appropriate for hospital space.
- The owner annually declares by affidavit that the space will be used as hospital space that would normally be exempt.

Hospitals intending to seek exemption for vacant space in new construction should ensure that they have appropriate documentation for these elements as of January 1.

Wisconsin law states that property tax exemption claims are strictly construed in favor of taxability. Given today's climate of tight budgets, assessors are understandably conservative in their exemption determinations as they try to protect their tax base. Vigilance and thorough preparation are the keys to obtaining exemption under § 70.11(4m). Hospitals that are planning to file an exemption application by March 1 of this coming year, particularly for property that might have been taxable in the past as a physician clinic, should begin preparing their exemption applications no later than January 1 with an eye on these requirements.

Finally, note that owners of property exempt under sec. 70.11, Wis. Stats., are required to file a Tax Exemption Report form with the municipal clerk in each even-numbered year. Reports are due March 31, 2020.

Federal Tax Exemption under IRC § 501(c)(3)

Hospitals claiming exemption under IRC § 501(c)(3) have been under the microscope for the past several years; judging from events in 2019, that pattern will continue in 2020.

Senator Charles Grassley (R-Iowa) is back at the helm of the Senate Finance Committee and is once again pushing for increased transparency and oversight, including hospital adherence to community benefit requirements. In February 2019, Senator Grassley asked that IRS Commissioner Charles Rettig provide a briefing on the scope of IRS audits of tax-exempt hospitals on matters including charity care, financial assistance, and billing and collection policies. Senator Grassley called into question hospital compliance with the standards set by Congress and made it clear that he expects IRS enforcement to include all of the tools in its toolbox, including denial of exempt status. He specifically asked for details on how many hospitals have been found to be out of compliance with § 501(c)(3) requirements and how the IRS is dealing with noncompliant hospitals. In October of this year, Senator Grassley wrote to the University of Virginia Health System regarding a news report that the System's financial assistance and debt-collection practices did not comply with its obligations as a tax-exempt entity, as well as regarding possible issues on overcharging.

Nonprofit hospitals and health systems can expect increasing scrutiny on Schedule H of Form 990. Past analyses of Schedule H reporting have found inaccuracies and inconsistencies in reporting of community benefits and financial assistance policies, including how financial assistance policies are publicized – these areas should receive particular attention when preparing 990 forms in the coming year. Form 990 is due on the 15th day of the 5th month following the end of the organization's taxable year. Hospitals and health systems with September 30 fiscal years will need to file their 990 forms by February 15, while organizations on a calendar year have a due date of May 15.

Conclusion

Nonprofit hospitals remain under attack regarding their tax-exempt status. It is extremely important—now more than ever—for administrators to have a familiarity with the law and the criteria necessary to maintain their exemptions into the future. Proper planning heading into 2020 is an important key to that success.

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