Advantages and Disadvantages of Tax Exemption

§ 2.1 Source of Tax Exemption

(a) State Ad Valorem Tax (New)

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An organization, to be tax-exempt as a charitable entity, must be organized and operated primarily for one or more of the permissible exempt purposes. This requirement has given rise to an organizational test and an operational test for charitable organizations. If an organization fails to meet either test, it cannot qualify for exemption from federal income taxation as a charitable entity. The organizational test requires the presence of certain provisions in an organization’s articles of organization. The operational test requires that an organization be operated primarily in the conduct of activities that accomplish one or more of its exempt purposes.

*(a) State Ad Valorem Tax (New)*

Although a discussion of state tax law is outside of the scope of this book, it should be noted that an issue of ongoing debate and litigation is whether various healthcare providers, who otherwise qualify for income tax exemption as charities under federal law, can qualify for tax exemption from real property taxes (also known as “ad valorem” taxes) under state law. Many states have statutes that define the term *charitable*, for state property tax exemption purposes, in a much more restrictive fashion than that applied by the IRS in federal income taxation cases. Often, state statutes focus on the substantial provision of charity care.
as a *sine qua non* for granting property tax exemption. The following are some recent examples of this phenomenon:

- In Ohio, a tax examiner recommended that a Cleveland Clinic outpatient facility be denied exemption from local property taxation because it gave only a nominal amount of charity care. The examiner based his recommendation on a recent Ohio Supreme Court ruling that a fitness facility owned by a nonprofit hospital was not entitled to property tax exemption because only a small number of people who used the facility did not have to pay membership dues.\(^\text{17.5}\)

- In Wisconsin, a child care center that was maintained by St. Joseph’s Hospital of Marshfield in a nearby separate building was exempt from state property tax for the portion of the building allocated to children of its own employees, but whether the same treatment applied to an adjacent clinic depended on whether the employees provided diagnosis, treatment, or care to hospital patients.\(^\text{17.6}\)

- In Michigan, an appeals court held that McLaren Regional Medical Center and two independent physician groups were properly denied charitable exemptions under state law because they did not qualify as hospitals serving public health needs or charitable institutions that would be eligible for exemption from ad valorem property tax assessments. The court ruled that the mere acceptance of Medicare and Medicaid patients was insufficient to warrant treatment of the facilities as charitable institutions, and the facilities’ provision of only a negligible amount of free care undermined their position that they were charitable institutions serving a public health purpose.\(^\text{17.7}\)

- In Pennsylvania, a court ruled that the nonprofit Alliance Home of Carlisle, which operates a skilled nursing home, an assisted living compound, and independent living apartments on the same property, was not entitled to a real estate tax exemption for the portion of the property upon which the independent living apartments were located, notwithstanding the tax-exempt status of the portions on which the nursing home and assisted living facilities were located.\(^\text{17.8}\)

\* \(^\text{17.8}\) *BNA Health Law Reporter*, June 24, 2004, at 949.
• In Massachusetts, the Sturdy Memorial Foundation, a charitable foundation that leased property for use by a medical clinic, was not entitled to exemption from real estate taxes assessed by the town of North Attleborough. The appeals court took the position that the foundation failed to demonstrate that its property qualified for exemption under a state law that exempts real estate owned by a charitable organization and occupied by another charitable organization. The court concluded that the medical clinic was not a charitable organization, taking into account the clinic’s physician compensation arrangements and whether it was operated as a public charity.17.9
