

Property Tax Decisions Offer Guidance for Nonprofit Hospitals

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In this article, Kump explains decisions by the Minnesota Supreme Court and Arkansas Court of Appeals that highlight unsuccessful attempts by tax authorities to narrow property tax

exemptions for nonprofit and public hospitals.

All 50 states and the District of Columbia provide a property tax exemption for nonprofit hospitals, and most states also have a similar exemption for publicly owned hospital districts that generally serve rural communities. Like many state tax issues, the rules for these exemptions are not uniform, and each state has its own variation and interpretation of the exemptions. Despite differences, all states and localities must grapple with whether each parcel of property owned by a hospital is included in the tax exemption.

Given the consolidation trend in the healthcare industry, especially across state lines, it is more important than ever for hospitals to be strategic when acquiring new properties, or they risk failing to secure these valuable exemptions. Two decisions, from the Minnesota Supreme Court and Arkansas Court of Appeals, highlight unsuccessful attempts by tax authorities to narrow the exemptions. This article explains each of those decisions and

offers recommendations for nonprofit and public hospitals across the country that may be facing similar opposition from taxing authorities.

Exemptions for Nonprofit Hospitals and Public Hospital Districts

Exemptions for nonprofit hospitals and public hospital districts have substantial crossover, but there are also key differences. Most importantly, a public hospital district is a governmental body run by public officials, while nonprofit hospitals may be private but operated for a public benefit.

For nonprofit hospitals, states generally exempt from property tax all property that is owned by a charitable organization and used for charitable purposes. States often look to whether the nonprofit hospital is a charitable organization under IRC section 501(c)(3), but that is just the starting point. The property must also be used for a charitable purpose, but taxing jurisdictions and hospitals frequently dispute the criteria used to determine whether the property is used for a “charitable purpose” and how to apply those criteria to each piece of hospital property.

For public hospital districts, state laws and guidance vary even more than the laws and guidance governing exemptions for nonprofit hospitals. Some states do not have public hospital districts at all,¹ while other states’ laws

¹E.g., Delaware, Maryland, New Hampshire, North Dakota, Rhode Island, and Vermont. Kaiser Family Foundation, “Hospitals by Ownership Type” (2020).

and guidance are substantially more detailed,² and still others combine the exemption with the exemption for nonprofit hospitals.³ However, the tax exemption for public hospital districts generally covers only property that is used by the hospital district for specific purposes.

Thus, for both the public hospital district tax exemption and nonprofit hospital tax exemption, tax jurisdictions must determine whether each parcel of property should be included as part of the exempt hospital property. This raises several questions for taxpayers. For example, does it matter how far the property is located from the hospital? How closely related must the use of the property be to the hospital's healthcare services? Does a storage warehouse for equipment qualify? What about a small cafe serving the public adjacent to the hospital? Two recent decisions from Minnesota and Arkansas shed light on these questions.

Perham Hospital District

In *Perham Hospital District*,⁴ the public hospital district taxpayer acquired three clinics in Otter Tail County, Minnesota, and the taxpayer challenged the county's classification

of the clinics as taxable commercial properties. The case involved Minnesota's tax exemption for public hospital district property, which includes property "acquired, owned, leased, controlled, used, or occupied by a district for purposes of sections 447.31 to 447.37."⁵

To determine the "purpose" of hospital districts under sections 447.31 to 447.37, the court looked to section 447.33, subdivision 1, which provides that each hospital district "has the powers necessary and convenient to acquire, improve, and run the hospital."⁶ Thus, the question before the court was whether "the District owns, uses, or occupies the Clinics 'for the purposes of sections 447.31 to 447.37,' that is, to improve and run the Hospital."

The court focused on what constitutes a "hospital," and in turn, what it means to "improve" a hospital, for purposes of the statutory exemption. First, the court looked at the dictionary definition of hospital and concluded that "the plain meaning of a hospital is broad: it is a facility that provides patient care."⁷ The court added that the "plain meaning of this term is not so rigid as to rule out the possibility of a hospital providing all types of care, including outpatient care, nor does this plain meaning suggest that a hospital by definition focuses exclusively on inpatient care over outpatient care."⁸

Second, on the meaning of "improve," the court determined the plain meaning of the word means "make or become better."⁹ The court rejected the county's argument for the technical definition of improve in the real property context, which is limited to acts that "increase the value or enhance the appearance of (something)." The court reasoned that the exemption is broad and "extends to real property as well as other types of property, such as personal or mixed property," so the definition should not be limited to a narrow technical definition.

²For example, in Ohio, "all hospital facilities purchased, acquired, constructed, or owned by a public hospital agency" are exempt, and "hospital facility" is comprehensively defined as:

buildings, structures and other improvements, additions thereto and extensions thereof, furnishings, equipment, and real estate and interests in real estate, used or to be used for or in connection with one or more hospitals, emergency, intensive, intermediate, extended, long-term, or self-care facilities, diagnostic and treatment and out-patient facilities, facilities related to programs for home health services, clinics, laboratories, public health centers, research facilities, and rehabilitation facilities, for or pertaining to diagnosis, treatment, care, or rehabilitation of sick, ill, injured, infirm, impaired, disabled, or handicapped persons, or the prevention, detection, and control of disease, and also includes education, training, and food service facilities for health professions personnel, housing facilities for such personnel and their families, and parking and service facilities in connection with any of the foregoing; and includes any one, part of, or any combination of the foregoing; and further includes site improvements, utilities, machinery, facilities, furnishings, and any separate or connected buildings, structures, improvements, sites, utilities, facilities, or equipment to be used in, or in connection with the operation or maintenance of, or supplementing or otherwise related to the services or facilities to be provided by, any one or more of such hospital facilities. Ohio Rev. Code sections 140.08 (emphasis added), 140.01.

³E.g., Wash. Rev. Code section 84.36.040 ("Real and personal property leased to and used by a hospital for hospital purposes is exempt from property taxation if the hospital is established under chapter 36.62 RCW or is owned and operated by a public hospital district established under chapter 70.44 RCW.").

⁴*Perham Hospital District v. County of Otter Tail*, 969 N.W.2d 366 (Minn. 2022).

⁵Minn. Stat. section 447.31 subd. 6 (emphasis added).

⁶*Perham Hospital*, 969 N.W.2d at 369.

⁷*Id.* at 372.

⁸*Id.*

⁹*Id.* at 374.

The court ultimately found that the clinics on the three parcels of property were operated to improve and run Perham Hospital and were therefore exempt from property tax.

North Arkansas Medical Services Inc.

Taxing jurisdictions often attempt to impose restrictions on nonprofit hospitals seeking a property tax exemption for new properties. In *North Arkansas Medical Services Inc.*,¹⁰ the taxpayer, a nonprofit hospital, sought a tax exemption for seven parcels of land in Harrison, Arkansas, including clinic buildings, parking areas, and a vacant lot. In Arkansas, like many other states, the taxpayer “seeking the tax exemption must show that it is a charitable organization and that the property claimed exempt is used exclusively for charitable purposes.”¹¹

The assessor focused on the word “exclusively” in the statute and argued that the hospital and its clinics were “not used exclusively as a public charity” because they are operated or “used” to provide medical care in exchange for money.¹² According to the assessor, the clinics and additional parcels were “part of the hospital” but were not exempt because less than half the healthcare provided by the clinics was free of charge.

The court rejected the assessor’s position and affirmed the lower court’s decision finding that the assessor’s “more-than-half-free-clinic threshold was found nowhere in Arkansas law.”¹³ While the court did not consider the purpose of each of the seven parcels of property individually, the court emphasized that the “receipt of money for the activities carried out in the clinics does not disqualify them from being considered a charity.”¹⁴ The court noted that the hospital uses its revenue to pay salaries, buy equipment, and pay for maintenance and that

therefore, the hospital used all the parcels at issue in “furtherance of the hospital’s charitable mission.”

Conclusion

As local jurisdictions face increased budgetary constraints and look for ways to increase revenue, nonprofit hospitals and public hospital districts must protect their valuable property tax exemptions. The *Perham* and *North Arkansas Medical Services* decisions demonstrate that there are nuances in the law that taxpayers can use to their advantage against aggressive tax assessors.

The Minnesota Supreme Court recognized the shifting landscape of the healthcare industry and opted for a broad definition of hospital that includes many departments and locations of one facility. This evolution of the healthcare industry was better articulated by the lower tax court, which stated: “Evolution of the healthcare industry and Congress’ passage of the [Affordable Care Act] have fundamentally changed ‘what it is that hospitals do.’ Most importantly, facilities like Perham Hospital — which have undertaken to address identified community healthcare needs — now operate departments offering services that may formerly have been associated with clinics.”¹⁵

The court’s decision in *Perham* is limited to the exemption for public hospital districts, but the reasoning is sound and could be applied to exemptions for nonprofit hospitals as well. Hospitals are not a single brick building on a city block anymore. They can be complex integrated health systems that use clinics and outpatient facilities for services that used to be performed in a central hospital building with substantial resources and equipment all in one place. And as the court found in *North Arkansas Medical Services*, property used for multiple purposes should not automatically disqualify the hospital from claiming the property is tax exempt.

While some localities may seek to carve out some hospital properties from the scope of exempt properties, tax exemptions are

¹⁰ *Hardesty v. North Arkansas Medical Services Inc.*, No. 05CV-17-275 (Ark. Ct. App. Sept. 25, 2019).

¹¹ *Id.* (citing *Sebastian County Equalization Board v. Western Arkansas Counseling and Guidance Center Inc.*, 296 Ark. 207, 752 S.W.2d 755 (1988)).

¹² *Id.*

¹³ In fact, the assessor’s testimony confirmed that the “primary” or “majority” property usage test was only “talked about at the training meeting in group discussion” and never codified. *Id.*

¹⁴ *Id.*

¹⁵ *Perham Hospital District*, No. 56-CV-18-1196 at *27.

grounded in law. Taxpayers should not automatically acquiesce to the demands of tax assessors. Hospitals must act intentionally when acquiring new properties and structuring property transfers and should be prepared to show how the property furthers their charitable goals or supports the hospitals with specific evidence showing how any revenue is used. This requires both thorough knowledge of property tax laws as well as a comprehensive understanding of the hospital's business and the complex relationships between related entities. Absent such strategic planning, nonprofit hospitals and public hospital districts risk falling on the wrong side of the pivotal line between a charitable or public facilities and private, for-profit enterprises. ■

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