Property Tax Exemption for Nonprofit Hospitals

Woods Bowman, Ph.D.

DePaul University

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Agenda

1. **Observations on property tax exemption**
2. **Hospitals**
3. **Where to go from here?**
   1. *i.* **Eliminate NP status?**
   2. *ii.* **Eliminate exemption?**
   3. *iii.* **Donation credits?**
   4. *iv.* ***Quid pro quo*** (Service In Lieu of Taxes, or SILOTs)**?**
   5. *v.* **Status quo?**
   6. *vi.* **Impact Fees?**

1. Observations on property tax exemption

The property tax

Different from all other taxes.

- It is a "zero-sum" tax

A new rate is calculated every year to collect whatever is needed.

- Rate is budget-driven instead of the other way around, as is the case with all other taxes

Impact of exemption

Exemption shifts tax burden

- Elimination could raise same revenue at *lower rate*
- *Why I call it a zero-sum tax*

If *eliminated*, local governments *could*:

- *Increase* their budgets, but only by increasing their property tax *levy* (increased revenue is not automatic)
- But with a larger base, the *rate* could stay constant

Conversely

When property is *removed* from the tax rolls, local governments *might*:

- *Reduce* their *budgets*, in order to
- *Hold* the property tax *levy* constant.

But they also *could*:

- *Increase* the property tax *levy*, in order to
- *Hold* their *budget* constant

Which is better? It's *political*.

2. Hospitals

Context

Hospitals, universities, houses of worship own most privately exempt real estate

- Governments own much more
- Private exemption not based on ownership alone; property must be used for "charitable" purposes

Example: offices that hospitals provide to their physicians are typically *not* exempt

Why focus on hospitals?

They conflict with a romantic image of nonprofits

- Hospitals are "large and highly commercial" enterprises that "do not look, feel, or act very much like the mental images that most of us have of nonprofit organizations" (Hodgkinson and Weitzman 2001, 5).
- A spokesman for the IL Department of Revenue calls *Provena-Convenant Hospital*, which lost its exemption, a business.
  - Of course, it is. All nonprofits are businesses.
  - What distinguishes unacceptable business from acceptable business?

Why are hospitals exempt?

Most states do not exempt them categorically, but as "institutions of public charity"

- Unlike houses of worship and schools and universities, which are usually exempt categorically

They are unlike other "charities"

Unlike other charities

1. **Hospitals are part of an integrated network of profit-making enterprises** (doctors, insurance, pharmacies) **but only *they* are exempt.**
2. **Many hospitals outsource key mission-specific departments to for-profit companies.**
   - Example: emergency rooms
3. ***Too many* hospitals do not act "charitably" when pursuing "bad debts."**
   - Recent examples: Minnesota, Illinois, and New York

and

- **In the *Provena* case, the Illinois Department of Revenue cited the miniscule amount of charity** (free) **care it provided.**

- **The IL Attorney General failed to legislate a minimum ratio of charity care to total expenses.**
  - Quickly discovered: there is no one-size-fits-all

- **As we begin to contemplate a future with greater numbers of insured persons, what will be the role of charity care, anyway?**

Hospitals argue

They also provide community benefits

- These are hard to quantify
- Every NP provides them – even taxable NPs
- Some benefits are indistinguishable from marketing

But, benefit is not the same as charity

- They aren't "institutions of community benefit" but "institutions of public charity"

Hospitals have a point, but why only them?

3. **Where do we go from here?**

***i.* Eliminate NP status**

***ii.* Eliminate exemption**

***iii.* Donation credits**

iv. Quid pro quo (Services in Lieu of Taxes or SILOTs)

v. Status quo

***vi.* Impact fees**

Econ 101: Principles of taxation

Benefit principle

- Big institutions (e.g., hospitals and universities) use municipal services but do not pay for them
  - Basis for PILOTs & *Quid pro quo* policies

Ability-to-pay principle

- Hospitals, universities, cultural institutions are seen as wealthy and can easily afford to pay
  - *Not* a basis for PILOTS (if it were, school districts would share)

Which is more urgent? A political question.

i. Eliminate NP status?

- **Blue Cross/Blue Shield precedent** (1986)
- **Forced conversion might change the practice of medicine**
  - In 114 comparative hospital studies, NPs performed better in terms of quality of care (14 studies), and accessibility for unprofitable patients (28 studies) (Schlesinger and Gray 2006, Table 16.1).
  - 11 studies found that for-profits performed better on both criteria.
- **Consequences are hard to predict**

ii. Eliminate exemption?

Per economic theory: a tax on hospitals would have a low "deadweight loss"

- Demand for their services is highly inelastic.
- A tax would be a small proportion of total cost

But, elimination would raise cost & escalating health cost is already a problem

What about teaching/research hospitals?

iii. Donation credits?

Reduce property tax bill by the amount of voluntary monetary contributions

- Since charitable contributions are deductible, their fruits should not be taxed either

1 in 5 general hospitals would have no property tax liability (my rough estimate from NCCS data)

- 1 in 5 would pay something
- 3 in 5 would pay "full freight"

iv. Require *quid pro quo* (SILOTs)?

This option is gaining traction

- Brody (2007) "The States' Growing Use of a Quid Pro Quo Rationale for the Charity Property Tax Exemption," *Exempt Organization Tax Review* 56(3): 269-288.

***Quid pro quo* requires services of equal value & those benefiting & paying must be same group**

- Logical conclusion: only service to local residents would justify exemption
- Probably unconstitutional (*Camps Newfound-Owatonna* v. *Town of Harrison*, No. 94-1988)

Hospital SILOTs

- **Technical problems:**
  - Bad debt vs. "pure" charity
  - Cost vs. charges
- **My 1999 paper showed how to resolve them & how hospitals can "work off" exemption.**
  - "Buying Charity Care with Property Tax Expenditures," *Journal of Policy Analysis and Management* 18(1): 120-125.
  - But, why deny this option to for-profit hospitals?

⇒ something to think about ⇐

- **In many states, cultural institutions are also exempt as "institutions of public charity"**
  - They serve no more impecunious people; probably fewer.
- **By the logic of *SILOTs*, shouldn't they have to "work off" their exemptions too?**
- **But how? *SILOTs* open a can of worms**

V. Status quo?

- **Exemption matters less than people think**
  - Taxes are capitalized into land values
- **Taxpayers residing in a community *when property is removed from tax rolls* lose**
  - Bowman, 2001. "The Property Tax Exemption as an Exit Tax on Capital," *Proceedings of the 93rd Annual Conference on Taxation*, National Tax Association, pp. 180-184.
- **Future property taxpayers are *substantially* unaffected**
    - Many studies show capitalization to be 50% to 90%

however

- **Taxpayers will not countenance the *status quo* if it includes continuation of "uncharitable" collection practices**

- **The industry needs to police itself better**

vi. Impact Fees?

One-time fee when property is removed from the tax rolls or when major improvement occurs.

- See: Bowman (2002) "Impact Fees, an Alternative to PILOTs," pp. 301-319 in Evelyn Brody (ed.), *The Property Tax Exemption: Mapping the Battlefield*. Washington DC: Urban Institute Press.

Compensates taxpayers who feel impact prior to capitalization

⇒ An alternative to PILOTs ⇐

- **It is transparent, simple to administer, and** (I think) **legal**
  - It is one-time, like a special assessment, which is legal

- **But it derives from the *ability to pay principle* of taxation**
  - PILOTs derive from the *benefit principle* of taxation

My view

- **PILOTs are the worst response, ever**
  - What's to like? They neither apply to all exempts nor are payments uniform, they lack transparency, & don't raise much money.
- ***Quid pro quo* commercializes charity.**
- **Charity as legal construct is too narrow.**
- **Conclusion** (pick one)**:**
  1. Broaden concept of charity.
  2. Leave well enough alone. (Public finance dictum: "the best exemption is an old one.")
  3. Charge impact fees.

What about hospitals?

The amount of "charity care" that society needs is shrinking.

- If the concept of charity is not extended for all public charities to include general public benefits,
- Then the hospital exemption will become untenable ("Leave well enough alone," drops off the list of options.)

The End

wbowman@depaul.edu