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Illinois Nonprofit Hospital Property Tax Exemptions Upheld: Orrick

On September 20, 2018, the Illinois Supreme Court published its opinion in *Oswald v. Hamer*, which upheld Section 15-86 of the Illinois Property Tax Code ("Section 15-86"), an Illinois statute that provides for a charitable property tax exemption to eligible nonprofit hospitals and their hospital affiliates. *Oswald* helps clarify the conditions that nonprofit hospitals must satisfy in Illinois to remain exempt from the state's property tax. However, the court in *Oswald* did not foreclose the possibility of additional future challenges to Section 15-86 and the property tax exemptions of nonprofit hospitals. As a result, nonprofit hospitals in both Illinois and around the country and the investors that invest in them should anticipate continued scrutiny of the eligibility of nonprofit hospitals for property tax exemptions.

Background

The status of property tax exemptions for nonprofit hospitals has been in flux and under scrutiny for a number of years in Illinois and other states on various grounds, including that the nonprofit hospitals are not engaged in sufficient charitable activities to justify the exemption from property taxes. The uncertainty surrounding nonprofit hospital eligibility for property tax exemption creates risk both for nonprofit hospitals and the investors that invest in them.

The Illinois Constitution places restrictions on the legislature's ability to exempt property from taxation. Section 6 of Article IX of the Illinois Constitution ("Section 6 of Art. IX") permits the legislature to exempt two limited categories of property from property taxation. Most significantly for nonprofit hospitals, the second of these categories includes property used "exclusively for . . . charitable purposes."

Within the constraints of Section 6 of Art. IX, the Illinois legislature enacted Section 15-65 of the Illinois Property Tax Code ("Section 15-65"). Section 15-65 exempts real property from state taxation if two criteria are met: (i) the property is "actually and exclusively used for charitable or beneficent purposes, and not leased or otherwise used with a view to profit" and (ii) the property is owned by an institution of public charity or certain other entities. In other words, Section 15-65 requires both charitable use and charitable ownership to qualify for property tax exemption.

In 2010, uncertainty was introduced into Section 15-65's two-pronged analysis when the Illinois Supreme Court, in *Provena Covenant Medical Center v. Department of Revenue*, held that a nonprofit healthcare organization's hospital complex did not meet the requirements for property tax exemption under Section 15-65. The *Provena* court determined that Section 15-65's charitable use requirement was not satisfied because, in part, the nonprofit healthcare organization failed to demonstrate that it provided more than a *de minimus* amount of free or discounted care. Although the court noted that Section 15-65 did not require a strict "dollar-for-dollar correlation between the value of the tax exemption and the value of the goods or services provided by the charity," the court emphasized that an organization seeking charitable tax exemption should be able to demonstrate that its activities help relieve some of the burdens on the government entities that are for going their

taxes. Because the court's analysis implied the existence of an unknown quantitative or monetary threshold for charitable care and services, *Provena* created a great deal of uncertainty about what standards should be applied for charitable property tax exemptions in Illinois.

In response to *Provena*, Section 15-86 was enacted in 2012 and provided for a charitable property tax exemption specifically for nonprofit hospitals and their hospital affiliates with clearer, more formulaic guidelines to demonstrate eligibility for the property tax exemption. Specifically, subsection (c) of Section 15-86 provides that a charitable property tax exemption shall be issued to a nonprofit hospital or hospital affiliate that can demonstrate that the value of its "qualified services or activities" (as defined by Section 15-86) in a given year is greater than or equal to its estimated property tax liability for that year.

Oswald v. Hamer

In *Oswald*, an Illinois taxpayer challenged the constitutionality of Section 15-86. The taxpayer-plaintiff argued that Section 15-86 is facially unconstitutional because it requires the grant of a property tax exemption under Section 15-86 if the value of a nonprofit hospital's charitable services exceeds its estimated property tax liability without regard to the Illinois constitutional requirement that exempt property be used "exclusively for . . . charitable purposes."

The Illinois Supreme Court rejected the taxpayer-plaintiff's argument and upheld the constitutionality of Section 15-86. The *Oswald* court found that the Illinois legislature intended to comply with the Illinois Constitution when it enacted Section 15-86. Accordingly, the court in *Oswald* construed Section 15-86 to permit, but not require, the grant of a property tax exemption if the requirements of Section 15-86 are satisfied.

Key Takeaways

Illinois Nonprofit Hospitals Must Satisfy the Requirements of the Illinois Constitution and Section 15-86 to Receive Property Tax Exemption

Oswald upheld the constitutionality of Section 15-86 because it is possible for Illinois nonprofit hospitals to comply with the requirements of Section 15-86 and the constitutional requirement that the subject property be used "exclusively for . . . charitable purposes." As a result, both requirements still apply. A nonprofit hospital in Illinois seeking a charitable property tax exemption under Section 15-86 must document the "qualified services or activities" that exceed its estimated property tax liability for that year. Additionally, the hospital must be prepared to demonstrate that the property is used for exclusive charitable purposes in accordance with the requirements of the Illinois Constitution.

Oswald *Maintains Current Illinois Property Tax Exemption Requirements but Leaves the Door Open to Future Scrutiny*

Oswald is a somewhat favorable case for Illinois nonprofit hospitals because it upholds the constitutionality of Section 15-86, which has, for the past several years, provided some additional guidance and clarity on the statutory requirements for a charitable property tax exemption for nonprofit hospitals in Illinois. However, because the taxpayer-plaintiff in *Oswald* asserted a facial challenge to Section 15-86 and because nonprofit hospitals must still show that the subject property is used exclusively for charitable purposes under the Illinois Constitution, the *Oswald* holding does not foreclose the possibility of future challenges to the property tax exemptions granted to individual nonprofit hospitals. Further, *Oswald* is specific to Illinois and is not binding authority on regulators or courts in other states. Therefore, nonprofit hospitals and the investors that invest in them should

continue to monitor developments with respect to the eligibility of nonprofit hospitals for property tax exemptions and anticipate continued scrutiny of those property tax exemptions.

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