

November 10, 1995
ILR 95-H

President R. Lane Beattie, Co-chairman
Speaker Melvin R. Brown, Co-chairman
Members of the Audit Subcommittee
Utah State Capitol
Salt Lake City, Utah 84114

Subject: **Non-Profit Hospitals' Tax-Exempt Status in a Changing Health-care Market**

Dear Legislators,

In the May 31, 1995 meeting of the Audit Subcommittee, our office was assigned to examine the health-care market in the state and to develop questions for a possible legislative task force. We were also given the assignment to check on the tax-exempt status of Intermountain Health Care (IHC) companies. This letter is in response to those assignments.

As part of our efforts to gain an understanding of the relevant issues in the health-care market, we conducted a review of the available literature in the health-care field and studied the relevant court cases. Although our review was not exhaustive, the information that we collected provided valuable insight into the current trends in the health-care industry. We also contacted professors from several universities, representatives from the major hospital chains operating in the state (i.e., IHC and Columbia/HCA), various insurance companies, various county assessors, county attorneys, and other local government leaders, as well as representatives from the Tax Commission. Through these interviews, we were able to establish the respective positions of each group on an array of different issues.

The health-care industry, both on a national level and in the state of Utah, is rapidly changing. Technological advances in the medical industry have increased the importance of hospitals in the delivery of health-care services. In the late 19th Century, hospitals were primarily "poor houses" that offered care to those who could not afford private and individualized medical services. With the development of improved medical technology, hospitals have developed into the primary center of medical care. Furthermore, the emergence of integrated delivery systems, which consist of networks of hospitals, physician organizations, outpatient centers, and other ancillary medical facilities offering a seamless continuum of care, has created an environment of extreme competition. Both the federal government and governments in other states have been looking at whether or not the legislation that currently exists has kept up with the complexities of the

health-care market. Other states have enacted legislation that has attempted to address the changes that have taken place, and additional states are currently considering such legislation. The state of Utah, in order to keep pace with the changing market, also may need to evaluate whether or not legislation needs to be adopted that addresses the on-going changes in the health-care market.

Although a complete review of the different issues in the state health-care market would require a tremendous investment of time and resources, our limited survey of the health-care market has allowed us to identify, in our view, some questions that address the most controversial and complicated issues. We have also compiled, as part of our assignment, an organizational overview of IHC and its subsidiary companies, along with a listing of the property-tax status of the different properties owned and managed by IHC (see attachment). In an effort to consolidate the complex issues that exist in the health-care market, three general "issue areas" have been identified. These three issue areas are very closely related to each other and are best addressed through a collective appraisal. However, a separation of the issues allows a closer examination into specific areas of concern. The three areas, with their corresponding questions, are outlined below:

I. Have the changing health-care market conditions in the state of Utah altered the distinction between investor-owned and non-profit health-care organizations?

This fundamental question is at the core of the majority of issues that have been raised by the different parties that we have contacted. The fundamental difference between an investor-owned hospital and a non-profit hospital is the difference in organization. The non-profit organization is governed by a board of trustees made up of individuals representative of the community, who serve on a voluntary basis. The investor-owned health-care organization is owned by stockholders, and functions in the same business manner as other investor-owned entities. The non-profit organizations believe there are profound differences in how the two organizations operate, and the investor-owned organizations believe that there are very few differences in how the two entities operate. Under this broad, general policy issue, are several other more specific issues that have been raised by interested parties in the health-care market.

The first four issues deal with tax exemption questions. Non-profit health-care organizations are exempt from property tax, sales and use tax, corporate franchise tax, are allowed to use tax-exempt revenue bonds, and donations made to the organization are tax deductible. The majority of attention of the interested parties has been given to the property-tax exemption issue. The **Utah State Constitution** grants a property-tax exemption to charitable, non-profit organizations in Art. XIII, Section 2. In 1980, the Utah County Board of Equalization challenged the tax exemption standards of two of IHC's non-profit hospitals operating in the county. On appeal, the Utah State Tax Commission upheld the exempt status of the hospitals. Utah County

then appealed the Tax Commission decision to the Utah Supreme Court. In 1985, the Utah Supreme Court ruled against IHC and in favor of Utah County who had opposed the property-tax exemption of IHC in the county. The court established a set of six guidelines that were to be used to determine whether or not a non-profit organization qualified for a property-tax exemption. After the Supreme Court issued this decision, different counties in the state began to develop their own set of criteria for determining whether or not to give an exemption to the IHC facilities in their counties. In response to these actions, the Utah State Tax Commission began a series of hearings and conducted research. Eventually, in 1990, the Tax Commission adopted a set of standards for tax exemption that could be uniformly applied to every county in the state. County assessors from three counties (Salt Lake, Utah, and Cache) challenged the constitutionality of the Tax Commission's standards. In 1994, the Supreme Court upheld the constitutionality of the Tax Commission standards.

Due to the property-tax exemption provision in the constitution, and the decisions of the Supreme Court explained above, the authority of the Legislature in dealing with property-tax exemptions for non-profit hospitals is limited. The issues regarding the property-tax exemption of non-profit hospitals are not new. Many of the issues go back 15 to 20 years and have been debated at all levels of government. IHC's legal counsel has indicated that he believes no legislative remedy exists to the property-tax exemption issue. Perhaps the only area in the property-tax exemption debate that could be addressed from a legislative standpoint, is for the Legislature to enact a different set of property-tax exemption standards that would supersede the Tax Commission standards. We have enclosed a description of the organization and tax-exempt status of IHC properties, as per your request.

The sales and use tax and corporate franchise tax exemptions are granted to non-profit health-care organizations in Utah if they qualify for Internal Revenue Code 501(c)(3) status. The state also allows non-profit health-care organizations to issue tax-exempt revenue bonds if the organization has 501(c)(3) status. Although the Legislature has a great deal of latitude in how it chooses to become involved in these issues, any involvement will require a great deal of time, resources, and political will. Any changes in the sales and use tax exemption for non-profit organizations will involve more than just the non-profit health-care sector. Other non-profit organizations may also be affected. Changes in the corporate franchise tax exemption policy may undermine recent state efforts to bring federal and state tax codes into closer alignment. Additionally, efforts to change how tax-exempt revenue bonds are used may prove to be beneficial, but a lot of intensive study is required to adequately determine the proper course of action. Many of these issues are also being debated on the federal level. It may be beneficial to the state of Utah to wait and see how the issues are resolved on the federal level before pursuing a course of action. The remaining issues in this first section address general policy issues that were raised by the interested parties that we contacted.

1. Are the Tax Commission property-tax exemption standards (which the State Supreme Court has upheld as being consistent with the constitution) adequate? Do they contain sufficient requirements to warrant a property-tax exemption for non-profit hospitals?
2. Should the state change the sales and use tax-exemption requirements for non-profit hospitals?
3. Should the state change the corporate franchise tax-exemption requirements for non-profit hospitals?
4. Should the state change how industrial revenue bonds (IRB's) are used by non-profit health-care organizations?
5. Should non-profit hospitals be required to pay a "user fee" for the use of public utilities, such as roads and police protection, in lieu of taxes?
6. What is the impact of the competition between IHC and Columbia/HCA on the University Hospital?
7. What effect does the changing health-care market in Utah, with the move toward hospital-dominated managed-care systems, have on the ability of government-owned, rural hospitals to compete?
8. Should there be a limitation on the amount of reserves that a non-profit organization accumulates? Should limitations be placed on how the reserves are used?
9. Should the satellite facilities and subsidiary companies of non-profit organizations be allowed to be tax-exempt or should they have to qualify for exemption independently from the parent organization?
10. Do investor-owned hospitals provide equal amounts of charity care and community benefits as non-profit organizations? If so, should the organizational components of a non-profit organization alone qualify the organization for tax-exemption?
11. What happens to the equity and/or reserves of a non-profit entity if part or all of the assets are sold to either an investor-owned organization (located either within the state or out of state) or another non-profit organization located in a different state or country?
12. Should there be limitations on a health-care organization (either an investor-owned

organization or a non-profit organization) owning hospitals, insurance companies, and physician practices and clinics? Does the ownership in all three segments of the health-care industry create a conflict of interest?

13. If the ownership of non-profit hospitals in the state was changed to an investor-owned organization, what effect would this have on the health-care market in the state?

II. What is charity care?

In the debate between investor-owned hospitals and non-profit hospitals, and in the debate between non-profit hospitals and local governments over tax-exemption issues, one of the most controversial areas centers on what constitutes charity care, how it should be calculated, and how much charity care justifies an exemption. This debate has been contentious because the amount of charity care provided by a non-profit hospital is one of the most critical factors in current exemption considerations. Furthermore, investor-owned hospitals claim they provide the same amount of charity care as non-profit hospitals. What constitutes charity care has been defined by various groups in a number of different ways. The following issues have been raised by different parties involved in the health-care market:

1. Should what constitutes "charity care" be legislatively defined?
2. Should the amount of charity care a hospital provides be determined by using the amount the hospital charges minus the amount received, or by the hospital's costs minus amounts received? How should the amount of charity care given to Medicaid and Medicare patients be calculated?
3. How should private donations (both donations of time and money) to a non-profit hospital be counted? Should they be considered part of the hospitals overall contribution to charity?
4. Should bad debt be counted as a charitable contribution?
5. Should a fixed percentage of charity care be required of non-profit hospitals? If so, what should be the required amount?

III. What is community benefit planning?

The third issue area is centered on whether or not the community benefit provided by non-profit hospitals is sufficient in relation to the amount of the tax subsidy received. Charity care is only part of the overall "benefit" to the community provided by non-profit hospitals. Defining what is a "community benefit" is difficult because many of the benefits a community receives from a hospital are non-quantifiable. How the amount of community benefit is calculated, and what counts as a community benefit are areas of controversy and disagreement between the different parties involved. The following issues have been raised by different parties that we have contacted:

1. Should community benefits be legislatively defined?
2. Is the cooperation between the non-profit hospitals and the community sufficient in the community benefits planning process? Is the process truly representative of the community?
3. Do the governing bodies of non-profit health-care organizations constitute sufficient representation of the community? Who in the community should be involved in the process?
4. Is an adequate community needs assessment program in place or being followed?
5. What should "count" as a community benefit?

All of the issues outlined above involve areas of conflict and controversy in the state health-care industry. However, determining whether or not the changing conditions in the state health-care market have changed the distinction between investor-owned and non-profit health-care organizations is the most important issue that needs to be addressed. Resolution of this issue will in large part eliminate the other areas of controversy.

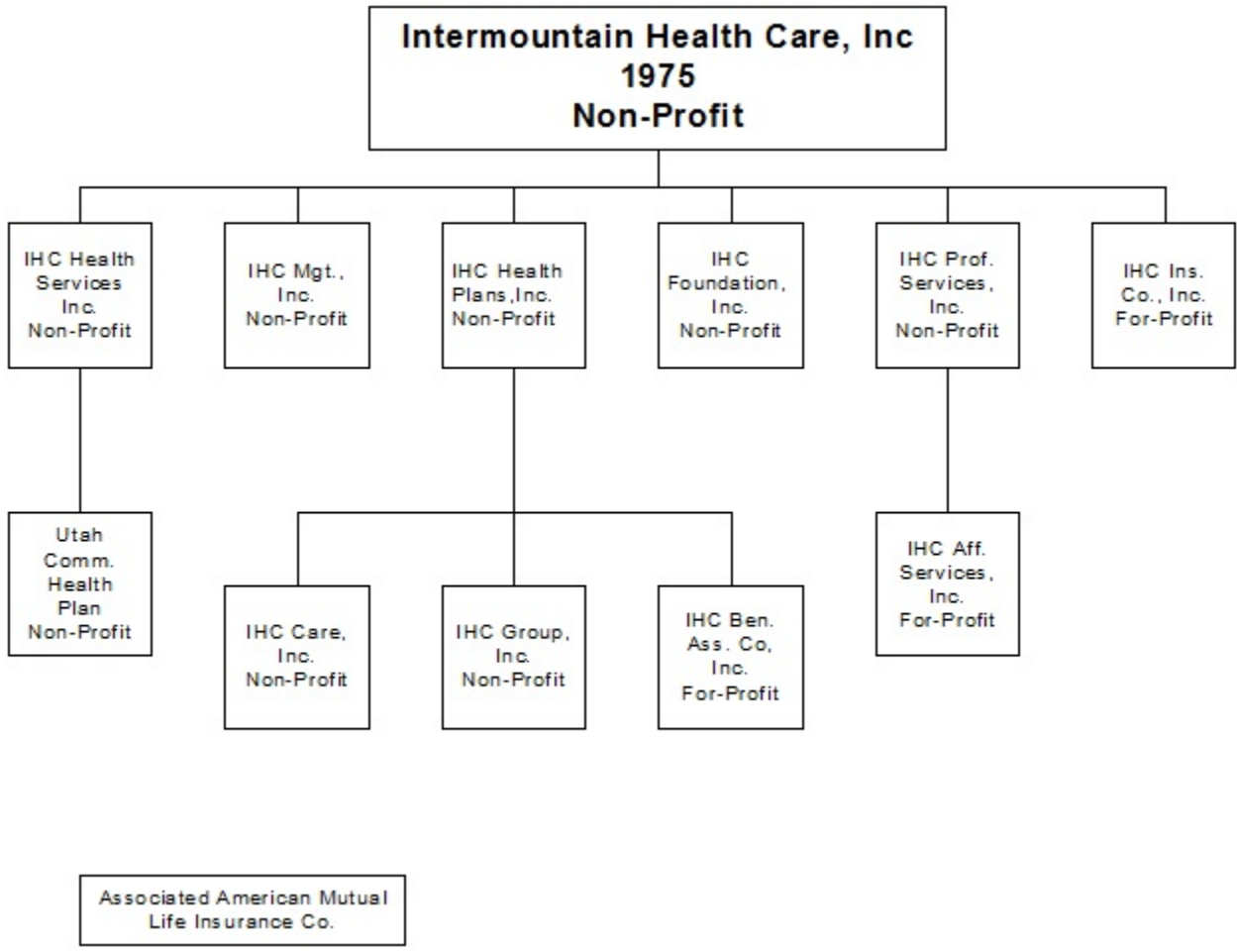
If we can further clarify the issues raised above, or if we can be of additional assistance, please contact us.

Sincerely,

Wayne L. Welsh, CPA
Auditor General

WLW:TLB/lm

Attachments



Description of IHC Organizations

1. Intermountain Health-care, Inc. (Incorporated 9/24/70)

Intermountain Health-care, Inc. is a Utah non-profit corporation. It was organized in 1975 to own or operate the hospitals formerly owned or operated by the LDS Church. In 1982, IHC reorganized, and IHC, Inc. became the parent corporation of several subsidiaries. The corporation oversees the operations of the subsidiaries described below, and is tax-exempt.

2. IHC Health Services, Inc. (Formerly known as IHC Hospitals, Inc. Incorporated 9/1/82)

IHC Health Services, Inc. (Health Services), a subsidiary of IHC, owns, leases, or manages 24 hospitals in Utah, Idaho, and Wyoming. It also owns or leases six ambulatory surgical centers, numerous InstaCare Clinics, Women’s Centers, the Salt Lake Clinic, the Bryner Clinic, and all physician related activities (includes other clinics and private physician practices that have been purchased). Health Services is the main health-care delivery organization in the IHC family. This subsidiary provides occupational health-care, pharmaceutical services, psychiatric and behavioral services, dialysis care, rehabilitation services, and a full range of home health-care services. Other services and areas within Health Services include: Organization Planning and Development, Education Center, Employee Health Services, Employee Relations, Shared Services (which includes Support and Facility Services, Laboratory Services, Home Health/HomeCare Services, Materials Management, and Ask-A-Nurse), Financial Services, and Computer Information Systems Services. Health Services holds approximately 90% of the assets of IHC and its subsidiary corporations, and is tax-exempt (with the exception of certain properties, such as Bryner and Salt Lake Clinics, physician practices and other properties that will be explained below). The following properties listed under individual hospitals all fall under IHC Health Services, Inc.:

<u>LDS Hospital Property</u>	<u>Tax Status</u>
Hospital Campus	Exempt
S.L. Indigent Clinic	Exempt
2 Kidney Dialysis Centers	Exempt
Rose Park InstaCare	Exempt
8 Commercial Homes	Not Exempt
LDS Hosp. Physicians Office Bldg.	46% Exempt
Parking Structure, power plant, greenhouses	97% Exempt
8 parcels of land near LDS Hospital	Exempt
LDS Hospital Medical Office Bldg.	Not Exempt
LDS Hos. Surgical Center Office Bldg.	Not Exempt

“Colonial House” reception center	Not Exempt
Parking Structure	Exempt
Sugarhouse InstaCare	Exempt
Holiday InstaCare	Exempt
Wendover Women’s Center	Exempt

Alta View Hospital Property

Tax Status

Hospital Campus	Exempt
S.L. Clinic Branch Office	Not Exempt
3 parcels of land (for hospital expansion)	2 Not Exempt, 1 Exempt
Women’s Center	58.9% Exempt
Parking for Physician Offices	Not Exempt
Alta View Medical Plaza	Not Exempt
Surgical Center (IHC owns 42%)	Not exempt

American Fork Hospital Property

Tax Status

Hospital Campus	Exempt
Parking lot	Not Exempt
Clinic	Exempt
Dr. Office	Not Exempt
Land	Not exempt

Bear River Valley Hospital Property

Tax Status

Hospital Campus	Exempt
Land	Not exempt
Physician Office Bldg.	Not Exempt

Cottonwood Hospital Property

Tax Status

Hospital Campus	Exempt
Taylorville InstaCare	Exempt
Kearns InstaCare	Exempt
Medical Mall (3845 W. 4700 S.)	Not Exempt
Baker Clinic	?
Physicians parking	Not Exempt
Hospital parking	Exempt
Wilkinson Bldg. (Back Institute)	Exempt
Physicians Office Bldg.	Not Exempt
Boiler Plant	Exempt

9 Commercial homes

Not Exempt

Delta Community Medical Center Property

Tax Status

Hospital Campus
Commercial residence

Exempt
Not exempt

Dixie Regional Medical Center Property

Tax Status

Hospital Campus
Hospital parking lot
Physician Office Bldg.
3 Commercial homes
4 parcels of land
Jubilee House

Exempt
Exempt
Not Exempt
Not Exempt
Not Exempt
Exempt

Fillmore Community Medical Center Property

Tax Status

Hospital Campus
Land

Exempt
Not Exempt

Garfield Memorial Hospital Property

Tax Status

Hospital Campus
Commercial residence

Exempt
Not Exempt

Logan Regional Hospital Property

Tax Status

Hospital Campus
Day Care Center
Medical Office Bldg.
2 parcels of land
Logan Medical Center Condominiums

Exempt
Not Exempt
21% Exempt
Not Exempt
Exempt

McKay-Dee Hospital Property

Tax Status

Hospital Campus
Ogden Family Clinic
Institute for Behavioral Medicine
Herefordshire Clinic
McKay-Dee Clinic
L.T. Dee Medical Arts Bldg.
Work Medical Clinic

Exempt
Not Exempt
Exempt
Not Exempt
Exempt
13.35% Exempt
Exempt

Family Practice	Exempt
Fairfield Clinic	Not Exempt
4 Commercial homes	3 Not Exempt, 1 Exempt
2 parcels of land	Not Exempt

Orem Community Hospital Property

Tax Status

Hospital Campus	Exempt
Community Education and Counseling	Exempt
6 parcels of land	Exempt
Commercial residence	Not Exempt
PCMC Clinic	Exempt
Medical Office Bldg.	Not Exempt

Primary Children’s Medical Center Property

Tax Status

Hospital Campus	95.44% Exempt
Residential treatment facility	Exempt
7 parcels of land	Not Exempt

Sanpete Valley Hospital Property

Tax Status

Hospital Campus	Exempt
Mt. Pleasant Clinic	Exempt
Ephraim Clinic	Not Exempt
Moroni Clinic	Not Exempt
Manti Clinic	Exempt

Sevier Valley Hospital Property

Tax Status

Hospital Campus	Exempt
Family Health Clinic	Exempt
Commercial residence	Not Exempt

Utah Valley Reg. Med. Center Property

Tax Status

Hospital Campus	Exempt
Springville Insta-Care (property)	Exempt (personal)
Parking for hospital	Exempt
Oncology House	Exempt
Utah Valley Med. Cen. Foundation	Exempt
Hospital classroom	Exempt

Hospital Offices	Exempt
Vacant day care (storage)	Not Exempt
2 rental properties	Not Exempt

Valley View Hospital Property

Tax Status

Hospital Campus	Exempt
Parawon Clinic	Exempt
Physicians Office Bldg.	Not Exempt

Wasatch Canyons Hospital Property

Tax Status

Hospital Campus	99% Exempt
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3. IHC Management, Inc. (Incorporated 10/5/82)

Until recently, IHC Management, Inc. provided management and consulting services to IHC, IHC Health Services, Inc. and the other non-profit IHC subsidiaries. Those services included Financial Planning and Analysis, Internal Audit, Legal and Government Relations, Public Relations and Advertising, Strategic Planning and Marketing, Alternative Delivery Systems, and Financing of Health-care. Now, those services have been folded into IHC Health Services, Inc. IHC Management still exists as a non-profit organization but its purpose is being reevaluated.

4. IHC Health Plans, Inc. (Incorporated 12/27/83)

IHC created IHC Health Plans, Inc. (“HP”) to pursue new opportunities in health-care finance and delivery. As a non-profit corporation, HP develops and administers health-care benefit plans. HP markets a full-coverage PPO health insurance plan called “Health Choice” to Utah employers. HP also offers HMO plans through its subsidiary IHC Care, Inc. IHC Health Plans, Inc. offers several managed care plans: Health Choice, Select Med, SeniorCare, IHC Care (explained below), IHC Group (explained below), and IHC Benefit Assurance Company, Inc. (also explained below). The services provided by IHC Health Plans, Inc. include: Marketing and Sales, Operations and Finance, Peer Review, Quality Review, Actuarial Services, and Health-care Services.

5. IHC Foundation, Inc. (Incorporated 10/5/82)

IHC Foundation, Inc. exists to support the charitable, educational, and scientific activities of IHC and other qualifying tax-exempt organizations. The Foundation receives funds from grants, donations, and other sources. The Foundation enables local medical clinics to provide health-care services to homeless and destitute persons. It has helped fund research projects at

IHC hospitals and several nursing education programs in the state of Utah. It is a non-profit organization.

6. IHC Professional Services, Inc. (Incorporated 11/29/82)

IHC organized IHC Professional Services, Inc. (“PSI”) in 1982 as a non-profit organization. The charge of this corporation was to develop and implement innovative health-care management and delivery programs in order to contain health-care costs. Previously, IHC operated surgical and occupational health centers in Connecticut, Ohio, Wyoming, and California. PSI is no longer engaged in these activities. Currently, PSI operates a residential treatment center (Heritage School) for disturbed adolescents in Orem, Utah.

7. IHC Insurance Company, Inc. (Incorporated 2/24/87)

IHC formed this company in 1987 to enable IHC to obtain reinsurance coverage, which can only be obtained through an insurance company. Therefore, IHC formed this insurance company to acquire the reinsurance. IHC Insurance Company, Inc. is an off-shore insurance entity located on Grand Cayman Island, and is organized as a for-profit entity.

8. Utah Community Health Plan (Incorporated 11/02/83 as “IHC Insurance Servicing, Inc.”; Name changed May, 1989)

Utah Community Health Plan is a managed care program created in 1989 for small businesses who have been unable to offer health insurance to their employees. Utah Community Health Plans is a non-profit subsidiary of IHC Health Services, Inc.

9. IHC Care, Inc. (Incorporated 1/8/85)

IHC Care, Inc. is a federally-qualified, non-profit health maintenance organization marketed in Utah. IHC Health Plans, Inc. is the sole member, or owner, of IHC Care, Inc.

10. IHC Group, Inc. (Incorporated 5/22/91)

IHC Group, Inc. is a federally-qualified, non-profit group model HMO, that is a subsidiary to IHC Health Plans, Inc.

11. IHC Benefit Assurance Company, Inc. (Incorporated 6/16/92)

IHC Benefit Assurance Company, Inc. is an indemnity corporation formed to provide indemnity products for use with the HMO products of other IHC companies. This corporation is organized as a for-profit entity, and is a subsidiary to IHC Health Plans, Inc.

12. IHC Affiliated Services, Inc.

IHC Affiliated Services, Inc. (“ASI”), a proprietary subsidiary of IHC Professional Services, Inc., administers IHC’s participation in the national purchasing program named AmeriNet, as well as other vendor programs in which IHC and its subsidiaries participate. AmeriNet is a national purchasing organization owned by its four founding members (IHC Health Services, Inc. is one of the founders). IHC Health Services, Inc. contracts with ASI to market AmeriNet products to hospitals and other groups of purchasers. ASI also performs some construction management services for IHC and its subsidiary corporations and administers IHC Rehabilitation Services, a joint venture between IHC Health Services, Inc. and Don Wortley. ASI is a for-profit entity.

13. Associated American Mutual Life Insurance Company (Incorporated 12/18/69)

Associated American is a mutual life insurance company organized under the insurance laws of the state of Utah. It also functions as an employee benefits company under ERISA.