

ST 96-51

Tax Type: SALES TAX

Issue; Exemption From Tax (Charitable or Other Exempt Type)

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

DEPARTMENT OF REVENUE)	
STATE OF ILLINOIS)	
)	
v.)	Exemption
)	
TAXPAYER)	Daniel D. Mangiamele,
)	Administrative Law Judge
APPLICANT)	
)	

FINAL ADMINISTRATIVE DECISION

APPEARANCE:

Mr. J. Douglas Donenfeld of Sidley & Austin, for TAXPAYER.

SYNOPSIS:

This matter comes on for hearing pursuant to TAXPAYER's (hereinafter referred to as "TAXPAYER" or "taxpayer") protest of the Illinois Department of Revenue's (herein referred to as the "Department") denial of TAXPAYER's request for tax exempt status for purposes of purchasing tangible personal property free from the imposition of Use Tax, and related taxes as set forth in 35 **ILCS** 105/1 *et seq.* At issue is whether TAXPAYER qualifies for exemption as "a corporation, society, association, foundation or institution organized and operated exclusively for charitable ... purposes" within the meaning of 35 **ILCS** 105/3-5(4).

A hearing was held on taxpayer's protest July 6, 1995. On his own motion, the Administrative Law Judge, (hereinafter "ALJ" subsequently reopened the record and held a supplemental hearing August 14, 1996. After thorough review

of the record, the ALJ issued his recommendation that the taxpayer be granted exempt status.

Upon due consideration, I have concluded the underlying recommendation of the ALJ cannot be accepted. While the ALJ's recommendation contained findings of fact and conclusions of law, such findings are incomplete and do not accurately reflect the record as a whole. Furthermore, the ALJ's conclusions of law are cursory and, as demonstrated below, legally incorrect. Accordingly, I reject such findings and conclusions *in toto* and replace them with those set forth below.

When writing this final decision, I remain mindful of my responsibilities to the taxpayers as well as to the State. This decision is based solely on competent evidence produced at the hearing and those legal conclusions which can fairly be drawn from the evidence. I have reviewed with particularity all evidence offered by the taxpayer and admitted into evidence by the ALJ. Additionally, I have apprised myself of the pertinent sections of law pertaining to the issues presented at the hearing. I have considered the entire transcript of record, including the testimony of witnesses and the argument of counsel.

A sufficient record of proceedings was made to permit the appropriate review and issuance of this final administrative decision pursuant to 86 Ill. Admin. Code ch. I, sec. 200.165 (1996). See also, Highland Park Convalescent Home v. Health Facilities Planning Comm., 217 Ill. App.3d 1088 (1991). Accordingly, I am including in this final decision specific findings of fact and conclusions of law.

FINDINGS OF FACT:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of the Department's Tentative Denial of Exemption, wherein TAXPAYER's request for exempt status was denied. Dept. Ex. No. 3.

2. TAXPAYER was incorporated under the General Not For Profit Corporation Act of Illinois March 6, 1984. Taxpayer Ex. A.¹

3. TAXPAYER's Articles of Incorporation indicate that it is organized "exclusively for charitable" and other purposes, such as medical and scientific testing. Taxpayer's Ex. A. Its specific purposes, as set forth in its Articles of Incorporation and by-laws are to:

A. Engage in the professional enterprise of furnishing information, research, clinical studies and performing other services associated with the specialty of pediatric surgery and all its related fields;

B. Provide information and instruction to graduate physicians and other health care personnel in medical specialty education related to pediatrics and pediatric surgery;

C. Conduct research in all branches of clinical medicine, with specialties in pediatrics and pediatric surgery;

D. Provide medical information to patients in connection with the forgoing, without regard to the patient's ability to pay;

E. Propose, encourage, and stimulate research, experiments and studies related to diseases affecting pediatric patients, and foster the education of the medical community and the dissemination of information relating to maladies and illnesses affecting pediatric patients and the alleviation thereof;

F. Engage in such other activities of a charitable and/or medical and educational nature as may be permitted under the provisions of the Illinois Not-for-Profit Corporation Act.

Taxpayer Ex. A, B; Tr. p. 26.

5. TAXPAYER's Articles of Incorporation, effective March 6, 1994, also provide as follows:

A. No part of the net earnings of the Corporation shall inure to the benefit of or be distributable to its

1. Current Departmental regulations (See, 86 Ill. Admin. Code ch. I, Sec. 200.155(c)) require that exhibits be identified by number. While the instant record discloses that this regulation was not followed, I will refer to the exhibits by letter for the sole purpose of avoiding confusion in the record.

members, trustees, officers or other private persons, except that the Corporation shall be authorized and empowered to pay reasonable compensation for services rendered and to make payments and distributions [in further of its corporate purposes].

B. Upon dissolution of the Corporation, the Board of Directors shall after paying or taking provision for the payment of all liabilities of the Corporation, dispose of all assets in such manner, or to such organization or organizations organized and operated exclusively for charitable, educational, religious social welfare, or scientific purposes as shall at the time qualify for an exempt organization or organizations under Section 501(c)(3) of the Internal Revenue Code of 1954 (or the corresponding provision of any future United States Internal Revenue Law), as the Board of Directors shall determine. Any such assets not so disposed of shall be disposed of by the Court of Common Pleas of the county in which the principal office of the Corporation is then located, exclusively for such purposes or to such organizations as said Court shall determine, which are organized and operated for such purposes.

Taxpayer Ex. B

6. TAXPAYER's by-laws, adopted August 6, 1991, are similar to its Articles of Incorporation in that both documents contain provisions that prohibit any part of TAXPAYER's net earnings from inuring to the benefit of private individuals. Taxpayer Ex. B.

7. TAXPAYER has no capital stock or shareholders. Tr. p. 10.

8. TAXPAYER is exempt from federal income taxation under Section 501(a) of the Internal Revenue Code as an organization described in Section 501(c)(3) of that statute. Taxpayer Ex C; Tr. p. 10.

9. HOSPITAL (hereinafter "HOSPITAL" or the "Hospital") is a teaching hospital with respect to NUMS (hereinafter "NUMS"). Tr. p. 18.

10. HOSPITAL specializes in treating chronically ill children. Tr. p. 40.

11. On December 6, 1991 TAXPAYER entered into an agreement (hereinafter "agreement") with HOSPITAL. Under the terms of this agreement, TAXPAYER is responsible for providing HOSPITAL with the following services: such

administrative, supervisory, and teaching services as are necessary or helpful to the efficient functioning of HOSPITAL's Department of Surgery by appropriate personnel; such administrative, supervisory, and teaching services as are necessary or helpful to the efficient functioning of the Foundation Divisions² at the hospital by appropriate personnel; scheduling clinical services; selecting, supervising, training and scheduling Department [of surgery] and Foundation Division personnel, including residents, whose selection may be made by others; consulting with the hospital on the selection of equipment and supplies; participating in quality assurance and utilization review activities; assuming appropriate medical and dental staff responsibilities and participating on committees to which its members are assigned; participating in HOSPITAL's teaching, continuing education, community relations and research activities; providing information on the planning, budgeting, and other needs of HOSPITAL's Department of Surgery and Foundation Divisions; applying for and administering grants in consultation with the hospital; maintaining appropriate Department of Surgery and Foundation Divisions reports and records; complying with hospital medical and dental staff policies, rules and bylaws [sic]; participating in the effective administration of the HOSPITAL's Department of Surgery, as assigned by the department head; providing administrative support to specific hospital-based programs; providing the proper administration of the Foundation Divisions; coordinate the Department of Surgery's and the Foundation Divisions' clinical instruction to clinical trainees of NUMS and other hospital-designated trainees; and, ensuring that individual employees of TAXPAYER fulfill their clinical teaching obligations to NUMS and to hospital-designated academic institutions.

Taxpayer Ex. D.

². The Foundation Divisions are comprised of physicians and surgeons practicing in the divisions of cardiovascular-thoracic surgery, otolaryngology, ophthalmology, orthopaedic surgery, pediatric surgery and plastic surgery. Taxpayer Ex. D.

12. In exchange for the aforementioned services, HOSPITAL agreed to provide TAXPAYER with the following: human resource functions for those HOSPITAL employees funded by TAXPAYER; response to the specific concerns of TAXPAYER members related to efficiency and quality of hospital services, with the specific understanding that in addressing such concerns, HOSPITAL will consider carefully the comments and suggestions of TAXPAYER but that HOSPITAL's chosen course of action must concern all aspects of any given issue (including those which do not pertain to TAXPAYER) and may differ from that suggested by TAXPAYER; provide TAXPAYER personnel with copies of the admitting records and records of operations on a timely basis; provide TAXPAYER personnel with insurance and demographic data regarding specific patients as requested; provide information as requested and available to assist the planning and budgeting needs of TAXPAYER; consult with TAXPAYER with respect to expenditure for which TAXPAYER is required or expected to contribute; maintain full accreditation by the Joint Commission on Accreditation of Healthcare Organizations; and, report to TAXPAYER on a regular basis with respect to the funds of The KUHOSPITAL which are restricted for use within the Department of Surgery or its divisions. *Id.*

13. The eighteen surgeons who practice within TAXPAYER are exclusively surgeons specializing in cardiovascular and thoracic surgery, ophthalmology, orthopedics, pediatrics, oncology, pediatric surgery, and plastic surgery. Tr. pp. 12-13.

14. TAXPAYER derives most of its patients from HOSPITAL. Tr. p. 39.

15. TAXPAYER charges patients for services and care provided by its surgeons. It also employs a collection service. However, TAXPAYER surgeons do have the ability to write off charges. Tr. p. 41.

16. TAXPAYER physicians do not follow prescribed guidelines before writing off their charges. They also do not have to provide any explanation as to why the charges were written off. *Id.*

17. The terms of each physician's employment are governed by a contract between the physician and the appropriate TAXPAYER division head. Tr. pp. 36-37.

18. All TAXPAYER physicians are contractually obligated to teach, engage in medical research and publish. Tr. pp. 18, 31. They cannot be part of the TAXPAYER group unless they have a faculty appointment at NUMS. Tr. p. 18.

19. TAXPAYER surgeons teach NUMS students that rotate through the hospital in various residency programs. Tr. p. 34.

20. The amount of time which each TAXPAYER physician must devote to teaching activities and research are determined by physician's agreement with the division head. Tr. p. 37.

21. In addition to their teaching responsibilities, TAXPAYER physicians participate in quality assurance and utilization committee review activities at the hospital. Tr. p. 21. They also maintain administrative and professional support responsibilities, such as setting up policies and procedures for the various departments, including cardiovascular surgery, and teaching the residents rotating therein. Tr. pp. 22-23.

22. TAXPAYER physicians also administer the hospital's gait [walking capabilities] lab and ECMO program. Tr. p. 22.

23. The ECMO is a heart and lung machine used on newborns. When they begin treatment, children put on the machine have less than a 5% chance of survival. Tr. p. 22. HOSPITAL charges patients for use of the machine (Tr. p. 42) even though children are flown in from all over the Midwest regardless of their insurance or ability to pay. Tr. p. 22.

24. All ECMO treatments are administered by a specially-trained physician who is medical director of the ECMO program and head educator in that department. Tr. pp. 22, 42-43. TAXPAYER charges patients for the time its physician spends administering treatments. Tr. pp. 42-43.

25. TAXPAYER physicians conduct medical research through the family practice plan (hereinafter "FPP"), an oversight group established to develop and oversee the collection and distribution of moneys for research purposes. Tr. p. 13.

26. Approximately 130 doctors are part of the FPP at HOSPITAL. Tr. p. 33.

27. TAXPAYER physicians receive salaries for their services. These salaries are determined in accordance with the American Association of Medical College Salary Report (hereinafter "AAMCSR"), an independent publication which reports salaries for physicians who are primarily engaged in academic functions. Tr. p. 29.

29. While NUMS does not directly compensate any TAXPAYER physicians (Tr. p. 31), TAXPAYER ties part of each physician's compensation to his or her teaching responsibilities at the hospital. Tr. p. 21. TAXPAYER also considers research activities and patient load when computing a physician's salary. Tr. p. 44.

30. TAXPAYER structures the salaries of those who act as department heads or perform other administrative duties within the hospital in such a way as to compensate these individuals for the performance of such duties. Tr. p. 21.

31. The average physician employed by TAXPAYER for five years makes "slightly over \$300,000.00." Tr. p. 38.

32. TAXPAYER physicians are also eligible for but do not necessarily receive year-end bonuses. Tr. pp. 38, 52. The physicians receive these bonuses on recommendations from their respective department heads. Tr. 52.

33. Department heads make recommendations based on the following factors: patient volume and type of procedures that are used; research activities; publications; academic contributions, including lectures and other training activities; and, providing care to Medicaid patients. Tr. pp. 52-53.

34. After the Department heads issue their recommendations, TAXPAYER's executive committee reviews the information. The executive committee can then accept or reject the recommendation. It can also send the recommendation back to the division head for review and adjustment. Tr. pp. 53-54.

35. Although any income from bonuses is not distributed across the whole TAXPAYER group, the highest bonus ever awarded to a TAXPAYER physician was slightly over \$100,000.00. Tr. p. 54.

36. TAXPAYER does not offer formalized profit-sharing. Tr. p. 38.

37. TAXPAYER receives income from patient services. Tr. p. 32. It also receives unspecified amounts of income from the following sources: its agreement with HOSPITAL; interest income, a laboratory in the ophthalmology department at NUMS; managed care contracting "for all the physicians at the hospital through the family practice plan" and other unspecified sources. Tr. pp. 32-33. Its supervised teaching program is funded by credits from HOSPITAL. Tr. p. 32.

38. TAXPAYER had \$16.5 million dollars in gross patient billings during its most recently completed fiscal year. Tr. p. 28. *Id.*

CONCLUSIONS OF LAW:

On examination of the record established this taxpayer has not demonstrated, by the presentation of testimony or through exhibits or argument, evidence sufficient to overcome the Department's *prima facie* case. Accordingly, under the reasoning given below, the determination by the Department that TAXPAYER does not qualify for exemption from Use and related taxes as a "corporation, society, association, foundation or institution organized and operated exclusively for charitable ... purposes" within the meaning of 35 **ILCS** 105/3-5(4) must stand. In support thereof, I make the following conclusions:

A. Statutory Considerations and the Burden of Proof

Taxpayer herein claims the right to an exemption from Use and related taxes pursuant to 35 **ILCS** 105/3-5(4),³ which provides in relevant part that:

Exemptions. Use of the following tangible personal property is exempt from the tax imposed by this Act:

(4) Personal property purchased by a government body, by a corporation, society, association, foundation, or institution organized and operated exclusively for charitable, religious or educational purposes ...[.]

It is well established in Illinois that a statute exempting property or an entity from taxation must be strictly construed against exemption, with all facts construed and debatable questions resolved in favor of taxation. People Ex Rel. Nordland v. Home for the Aged, 40 Ill.2d 91 (1968); Gas Research Institute v. Department of Revenue, 154 Ill. App.3d 430 (1st Dist. 1987). Based on these rules of construction, Illinois courts have placed the burden of proof on the party seeking exemption and have required such party to prove by clear and convincing evidence that it falls within the appropriate statutory exemption. Metropolitan Sanitary District of Greater Chicago v. Rosewell, 133 Ill. App.3d 153 (1st Dist. 1985).

B. The Basic Framework

Illinois courts have not addressed the precise issue raised by this taxpayer, which is whether a not-for-profit corporation that provides most of its healthcare services to ill children constitutes a "corporation, society, association, foundation, or institution organized and operated exclusively for charitable... purposes ..." within the meaning of 35 **ILCS** 105/3-5(4). However, in Yale Club of Chicago v. Department of Revenue, 214 Ill. App.3d 468 (1st Dist. 1991), the court analyzed appellant's claims for educational and religious

³. The ALJ indicated that the relevant provisions were found in 35 **ILCS** 120/2-5(11). Those provisions, contained in the Retailer's Occupation Tax Act (hereinafter "ROTA"), apply to sales made at retail. This applicant is a health care service provider, not a retailer. Thus, it is not technically subject to ROTA. Therefore, its request is, in legal reality, one for exemption from Use and related taxes under 35 **ILCS** 105/3-5(4).

exemptions under the Retailer's Occupation Tax Act according to the body of case law developed for analysis of property tax exemptions. While the court's analysis of the educational exemption has limited relevance to the disposition of the present case, its reliance on Methodist Old People's Home v. Korzen (hereinafter "Korzen"), 39 Ill.2d 149 (1968) provides the basic framework for analyzing TAXPAYER's exemption claim.

In Korzen, the Illinois Supreme Court confronted the issue of whether appellant's senior citizen's home was exclusively used for charitable purposes, and therefore, exempt from property taxes under the Revenue Act of 1939. The court began its analysis by noting that "... a charity is a gift to be applied consistently with existing laws, for the benefit of an indefinite number of persons, persuading them to an educational or religious conviction, for their general welfare - or in some way reducing the burdens of government." 39 Ill.2d at 157 (citing Crerar v. Williams, 145 Ill. 625 (1893)). The court also observed that the following "distinctive characteristics" are common to all charitable institutions: 1) they have no capital stock or shareholders; 2) they earn no profits or dividends, but rather, derive their funds mainly from public and private charity and hold such funds in trust for the objects and purposes expressed in their charters; 3) they dispense charity to all who need and apply for it; 4) they do not provide gain or profit in a private sense to any person connected with it; and, 5) they do not appear to place obstacles of any character in the way of those who need and would avail themselves of the charitable benefits it dispenses. *Id.*

C. Taxpayer's Organizational Documents and Federal Tax Exemption

TAXPAYER's Articles of Incorporation and bylaws indicate that its stated purposes are "exclusively charitable." Such statements, coupled with those that provide for distribution of assets to other charitable organizations and prohibit pecuniary benefit to TAXPAYER's members, trustees, officers or other private persons, provide evidence that TAXPAYER is "organized" for charitable

purposes as required by Section 105/3-5(4). They do not however, relieve TAXPAYER of its burden of proving that its operations are exclusively or primarily charitable. Korzen, *supra*.

A similar rationale applies to TAXPAYER's exemption from federal income tax. Like taxpayer's organizational documents, its exemption from federal income tax does not, in and of itself, establish that TAXPAYER operates for exclusively charitable purposes. *Cf.* People ex rel County Collector v. Hopedale Medical Foundation, 46 Ill.2d 450 (1970). Moreover, while this exemption establishes that TAXPAYER is a "charity" for purposes of Sections 501(a) and 501(c)(3) of the Internal Revenue Code, those Sections do not preempt Section 105/3-5(4) or the other statutory provisions governing Illinois Use Tax exemptions. Consequently, neither this exemption, nor the statements contained in taxpayer's organizational documents, are dispositive of its entitlement to exemption from Use and related taxes under Illinois law. Therefore, the remaining analysis must focus on the extent to which TAXPAYER sustained its burden of proving that its operations are in fact exclusively charitable.

E. Evidentiary Issues

Much, if not most, of the evidence pertaining to TAXPAYER's operations rests on the testimony of its sole witness, WITNESS. In his capacity as taxpayer's administrator, WITNESS was a competent witness as to TAXPAYER's operations. However, taxpayer failed to substantiate significant portions of WITNESS's testimony with appropriate documentary evidence.

For example, WITNESS's testimony as to TAXPAYER's income and expenses was not supported by appropriate financial statements. While taxpayer is not legally obligated to furnish such statements, it is difficult to gain a clear understanding of TAXPAYER's financial condition, and thereby determine whether TAXPAYER in fact satisfies the second prong of the Korzen test (requiring that the purported charity earn no profits or dividends, but rather, derive their

funds mainly from public and private charity and hold such funds in trust for the objects and purposes expressed in their charters) without them.

WITNESS testified that TAXPAYER derives the "majority" of its income from patient services (Tr. p. 32) and had \$16.5 million in gross patient billings during its most recently completed fiscal year (Tr. p. 28). The \$16.5 million figure could be significant. However, it cannot be placed in its proper context without appropriate financial statements.

More importantly, absent financial statements, the record lacks objective evidence which would establish specifics as to the exact amounts of revenue which TAXPAYER received from sources other than patient revenue. Consequently, the record lacks objective means for verifying that such revenues were in fact the major source of TAXPAYER's income. Therefore, I must conclude that WITNESS's use of the word "majority" as a quantitative measure of TAXPAYER's total income vis-a-vis patient services was self-serving and conclusory.

The evidence pertaining to TAXPAYER's expenditures is likewise incomplete. WITNESS testified that TAXPAYER incurred \$7 million in combined "charity" and Medicare write-offs during its most recent fiscal year. (Tr. p. 28). He also indicated TAXPAYER's cardiovascular and oncology divisions made donations to the hospital foundation during TAXPAYER's most recently completed fiscal year (Tr. p. 26), and, that TAXPAYER devotes approximately 10% of its total revenues to research activities. (Tr. pp 25-26). Even assuming the latter statement to be an accurate representation, it can only account for 10% of TAXPAYER's total expenditures. Thus, the rest of WITNESS's testimony regarding expenditures falls short of establishing percentages as to, or otherwise accounting for, the remaining 90%.

Percentages do not necessarily govern analysis of a purported charity's expenditures. Nonetheless, without them, it is very difficult to discern whether TAXPAYER in fact holds its funds in trust for the objects and purposes expressed in its charter, as required by Korzen. Because the aforementioned rules

governing taxpayer's burden of proof place the responsibility for alleviating such difficulties squarely on the taxpayer, and use of the word "charity" is conclusory at best, I conclude that taxpayer has failed to prove that it satisfies this requirement.

Further, WITNESS's testimony indicates that the salaries for TAXPAYER physicians are determined according to the AAMCSR and that such salaries ran between "50 and 75%" of those earned by physicians in private practice. (Tr. p. 29). However, taxpayer did not introduce the relevant portions of the AAMCSR or any other evidence which objectively establish salary ranges for physicians primarily engaged in academic functions or private practice. Absent such evidence, I must discount this portion of WITNESS's testimony.

WITNESS also indicated that there were "instances" where a TAXPAYER physician would receive a salary comparable to his or her peers even though that physician's practice was not particularly profitable or efficient.⁴ However,

⁴. The testimony which relates to compensation based on profitability was as follows:

Q. [By taxpayer's counsel] In calculating salaries for its physicians, does TAXPAYER look to such things as a physician's patient billings, profitability and efficiency?

A. [By WITNESS] Not always.

Q. Are there instances where a physician is not particularly profitable or efficient and that individual receives salary levels similar to his or her peers within the organization.

A. Yes.

Tr. p. 30.

Q. [By taxpayer's counsel] In computing the salary levels for your physicians, do you consider their research and educational activities?

A. Yes.

Q. Are there instances where a person may not have a particular [sic] high patient load but is extremely active in education and research and his or her compensation would be comparable to someone with an active patient load?

A. Yes.

WITNESS did not indicate that such "instances" were commonplace nor did he specify how many times TAXPAYER actually awarded comparable salaries to physicians that did not generate a significant amount of revenue vis-a-vis their colleagues. Lacking these specifics, or other objective, documentary evidence that would establish same, the aforementioned rules governing applicant's burden of proof mandate an inference that would support taxation. Accordingly, I infer that such "instances" are in fact isolated and therefore, legally insufficient to sustain applicant's burden of proof. *Cf.*, MacMurray College v. Wright, 38 Ill.2d 272 (1967).

The aforementioned failures of proof are significant in light of the line of Illinois Supreme and Appellate Court decisions that pertain to the charitable status of hospitals and health care organizations. In the first such decision pertinent to the instant case, Sisters of the Third Order of St. Francis v. The Board of Review of Peoria County, 231 Ill. 317 (1907) (hereinafter "Sisters of the Third Order") the Illinois Supreme Court noted that while hospitals do not lose exempt status solely because they require payment from patients who are able to pay, or forfeit such status merely because they receive contributions from outside sources, they must devote all income received "to the general purposes of the charity" and prohibit any portion of such income from inuring to "the benefit of any private individual engaged in managing the charity." *Id.* at 321. The court went on to indicate that "[t]he question of whether or not [a given hospital] is an [exempt] institution of public charity depends not at all upon what class of physicians are permitted to practice there, so long as the institution is not conducted for the purpose of benefiting physicians of that class." *Id.* at 323.

Here, taxpayer did not substantiate WITNESS's testimony concerning TAXPAYER's financial condition. To the extent that the preceding analysis

renders most of this testimony conclusory and self-serving, TAXPAYER failed to prove that it devotes all of its income to the purposes set forth in its Articles of Incorporation and bylaws. More importantly, the failure of proof regarding salaries, coupled with the evidence establishing that bonuses are partially tied to patient volume and type of procedure used,⁵ provide strong indicators that TAXPAYER is operated for the benefit of the surgeons who practice within it and that part of TAXPAYER's income inures to the pecuniary benefit of such surgeons.

F. Other Considerations Affecting TAXPAYER's Charitable Status

In Highland Park Hospital v. Department of Revenue, 155 Ill. App.3d 272 (2d Dist. 1987), (hereinafter "HPH"), appellant sought exemption for a facility which it used as an immediate care center. Appellant billed patients for services provided and employed formal collection efforts. However, it wrote off approximately 6% of its total patient revenues as "free care" once the debts proved to be uncollectible.

Appellant in HPH also circulated advertisements to promote the center's services. Among other things, these advertisements described the available services and set forth appellant's hours. They also advised that care was available without appointment and that services were provided on a low-cost basis when compared to other facilities. However, the advertisements did not mention that free care was available to those unable to pay.

The court held against exemption. It reasoned that because the advertisements failed to mention free or charitable care, the record lacked evidence to establish that the general public knew such care was available at the facility. HPH at 280. The court also found it significant that those who received "free care," (i.e. the 6% whose bills were ultimately written off), were unaware they were receiving cost-free services at the time care was

⁵. See, discussion of Lutheran General Health Care System et al v. Department of Revenue, 231 Ill. App.3d 652 (1st Dist. 1992), *infra* pp. 20-23.

provided. *Id.* For these reasons, and because appellant made efforts to collect patient revenues before writing them off, the court concluded that the alleged 6% "free care" was, in reality, "nothing more than bad debts." *Id.*

Unlike the appellant in HPH, this taxpayer did not submit any advertisements for the record. While taxpayer is not required to submit such evidence, HPH indicates that it can be of assistance in establishing two factors related to the third and fifth prongs of the Korzen test: first, that the general public knew that TAXPAYER provided free care; and second, that those who received free care were aware they were receiving it at the time of service.

With respect to the first factor, WITNESS testified that although TAXPAYER charges for its services, it "takes care of anybody who walks in the door." (Tr. pp. 40-41). Such testimony does not, in and of itself, establish that such persons, (whom, for purposes of the present discussion, will be assumed members of the general public), *in fact know* that TAXPAYER provides free care at the time they "walk in." Thus, absent advertising or other indicia establishing that TAXPAYER made the general public aware of its free services, I conclude that taxpayer's evidence pertaining to this factor is inconclusive, and therefore, legally insufficient to sustain taxpayer's burden of proof.

WITNESS also testified that TAXPAYER physicians provide immediate care and do so before "any type of discussion at all on finances."⁶ This testimony,

⁶. WITNESS's testimony on the issue of free care was as follows:

Q. [By taxpayer's counsel] In what form is charity care given by TAXPAYER, in what forms?

A. You have a situation where somebody would come in with absolutely no money, as I said. In the ECMO program, it is not unusual for someone to be flown in.

The care is immediately given prior to any type of discussion at all on finances. If the person has absolutely no finances or is limited, it is dealt with. It is not unusual even if people have the ability, if it is a low-level ability, for the doctors to just send me a note and say waive the charges, period.

Tr. p. 27.

coupled with that as to the ECMO treatments for critically ill newborns (Tr. p. 22), could establish that, unlike HPH, TAXPAYER patients know they are receiving free care at the time of service. However, I would note that, based on their low chance of survival, ECMO patients are in life or death situations when they begin treatment at TAXPAYER. Thus, such patients *must* receive immediate care due to the severe nature of their illnesses. Accordingly, common sense dictates that finances are discussed after treatments commence.

It is also noted that WITNESS's statement regarding discussion of finances, together with the evidence establishing that TAXPAYER charges for its services and those of the physician that operates the ECMO machine, implies that, at some unspecified point, those who receive treatment at TAXPAYER will have to pay for it. Thus, I find it highly unlikely that those receiving free care know that they are obtaining cost-free service at the time it is provided.

In addition, WITNESS testified that TAXPAYER provides totally free care to between 5% and 6% of its total patient base. (Tr. pp. 27-28, 45). Inasmuch as this percentage is virtually identical to that alleged to be charitable in HPH, and the preceding analysis establishes that TAXPAYER has failed to prove compliance with the two considerations set forth therein, I conclude, as did the HPH court, that such percentage amounts to nothing more than bad debts.

I also find it significant that TAXPAYER employs a collection service. Such services, by their very nature, lack the "warmth and spontaneity indicative of charitable impulse." Korzen, *supra* at 158. Thus, TAXPAYER's employment of such a service, even if only on an infrequent basis, seems equally non-charitable and suggests TAXPAYER operates more like a for-profit business than a beneficent institution. *Cf.*, HPH, *supra*.

Judge Alexander P. White's analysis in Chicago Osteopathic Properties Corporation v. Department of Revenue, 88 L 51164 (Circuit Court of Cook County, August 6, 1992), (hereinafter "COPC"), provides additional criteria for determining whether TAXPAYER's operations qualify as charitable. Using the

Korzen criteria as a starting point, Judge White looked at the following factors to determine if a "significant portion of the services provided at [appellant's property were] provided without receiving any payment or with substantial discount[:]" first, the percentage of uncompensated care; second, the opportunity cost in terms of "the difference between Medicare payments and the greater amount which could be collected from the patient but is not due to [managerial or individual physicians' decisions to] `accept assignment[;]'" and, third, writedowns. *Id.* at 34.

As noted above, TAXPAYER's uncompensated care can reasonably be attributed to bad debts. Furthermore, while Medicaid patients presumably account for 46% of TAXPAYER's total patient base (Tr. pp 27-28), and assuming for this discussion that it incurred \$7 million in combined "charity" and Medicaid write-offs during its most recently completed fiscal year (Tr. p. 28), TAXPAYER's acceptance of Medicare and Medicaid assignments constitutes a business decision which does not, in and of itself, establish that its operations are charitable. More importantly, TAXPAYER did not submit any evidence establishing what opportunity costs it incurred by accepting assignment or the nature and extent of any losses attributable to other writedowns. Without such evidence, and absent other proof establishing conformity with the criteria set forth in HPH, *supra*, I conclude that TAXPAYER has failed to sustain its burden of proof with respect to charitable operations.

Taxpayer seeks to defeat the preceding analysis by relying on Lutheran General Health Care System et al v. Department of Revenue, 231 Ill. App.3d 652 (1st Dist. 1992), (hereinafter "Lutheran General"). There, the court held in favor of exemption for a portion of the subject property that was used to provide medical services to in-patients of Lutheran General Hospital and Lutheran General Hospital-Lincoln Park.

Another portion of the subject property, which the court also held exempt, was used by appellant's affiliated foundation as an out-patient clinic. The

foundation consisted of a multi-specialty physician's group formed in affiliation with Lutheran General Hospital. The physicians employed there provided medical care services to patients. They also devoted approximately 52% of their time to educational, research and administrative responsibilities and would not be considered for employment if they had no desire to teach. Those physicians were not allowed to maintain private practices. Their salaries, which were less than those paid in private practice, were based on patient-care activities as well as educational, administrative and research responsibilities.

The above considerations suggest that the terms of employment for TAXPAYER surgeons are similar to those of the foundation physicians in Lutheran General. Nevertheless, unlike Lutheran General, the instant record does not establish those facts for TAXPAYER.

For instance, there is no evidence that TAXPAYER surgeons are prohibited from maintaining their own private practices. The Lutheran General court viewed this prohibition as a mechanism for enforcing the proscriptions against pecuniary profit and profiting from the enterprise set forth in Korzen and Sisters of the Third Order. Lutheran General, *supra* at 661-662. Because the aforementioned rules governing inferences require those that support taxation, I conclude that the instant matter is factually distinguishable from Lutheran General in this regard.

It is also noted that the physicians in Lutheran General were required to devote 52% of their time to teaching, research and administrative responsibilities. While TAXPAYER's surgeons are also required to perform similar duties, (which do not directly involve patient care or matters pertaining to a given surgeon's non-exempt private practice), taxpayer did not submit any employment contracts. Without such contracts which pursuant to WITNESS's testimony (Tr. p 37) govern the amount of time that each TAXPAYER surgeon must devote to teaching and research, taxpayer has failed to prove that the amount of time which its surgeons devote to exempt activities (such as

education and research) parallels that required of the Lutheran General foundation physicians.

Lutheran General can also be distinguished from the instant case in that there, the appellant adhered to a formal policy of not taking legal action against delinquent accounts. Here, TAXPAYER employs a collection service. Employment of such a service, even if only on isolated occasions, is distinctly non-charitable.⁷ More importantly, as opposed to Lutheran General, TAXPAYER does not have or adhere to a non-enforcement policy with respect to its delinquent accounts.

It may be true that TAXPAYER surgeons can, in their discretion, write-off patient charges at any time. (Tr. p. 41). Such discretion is nevertheless subjective by its very nature. Hence, it lacks the uniformity and even-handed enforcement characteristic of adherence to a formal policy authorizing such write-offs. Consequently, any cost-free services dispensed pursuant to such discretion can reasonably be considered isolated examples of "charitable" operations. Cf. MacMurray College v. Wright, *supra*.

WITNESS's testimony provides another basis for distinguishing this case from Lutheran General. Such testimony establishes that, unlike their counterparts in Lutheran General who received *only* salaries for their services, TAXPAYER surgeons are eligible for, and in fact receive, bonuses *in addition to* their regular salaries.⁸

⁷. See discussion, *supra* at 19.

⁸. WITNESS's testimony on bonuses was as follows:

Q. [By applicant's counsel] Would you tell us a little bit about these bonuses? In other words, who makes the determination with respect to the bonuses and what are the criteria utilized in determining bonuses for physicians?

A. Well, first of all, let me say that not everybody gets a bonus. The physician -- the determination for these bonuses come from recommendations from their [the TAXPAYER physicians] division heads. The division head is part of the foundation. He is a division head of the hospital in the specialty for which the doctors are working.

These bonuses must be approved by TAXPAYER's executive committee (Tr. pp. 53-54), which is also responsible for authorizing "other expenditures" in years where TAXPAYER's income exceeds its expenses. (Tr. p. 54) Nevertheless, TAXPAYER (or any organization) cannot pay bonuses *unless* its annual expenses do not exceed its yearly income. Therefore, I conclude that these bonuses are paid out of, and the executive committee authorizes payment thereof from, TAXPAYER's profits.

TAXPAYER also bases the amount of these bonuses, in part, on a surgeon's capacity to generate patient revenues. For this reason, and those set forth above, I conclude that the bonuses violate the proscriptions on pecuniary profit and profiting from the enterprise set forth in Korzen and Sisters of the Third Order. Accordingly, I further conclude that, for all the aforementioned reasons, TAXPAYER is not a "corporation, society, association, foundation, or institution organized and operated exclusively for charitable... purposes ..." within the meaning of 35 **ILCS** 105/3-5(4). The ALJ's recommendation to the contrary was, therefore, in error.

The way that bonuses are figured out is by [sic] the division heads take a look at the year end, see how the division had done, and then go back and determine contributions by each of the physicians in various areas.

Those areas include one, being patient volume and type of procedures that are used, and therefore money that is generated. But it goes far beyond that. They take a look at the research that has been done by each physician, what contributions has that research provided, what types of books, lectures they have done, all their academic participation in the training of fellows and residents from Northwestern University; also their time spent as far as providing care to Medicaid patients. So that if a doctor spends a large portion of time, as many junior physicians do, taking care of the Medicaid population, they are not hurt by the fact that Medicaid tends to pay a lower amount.

So that they take all that into account, and then make a determinations on what type of bonus they feel the individual should get. And it could be that the division head decides that everybody in his division deserves the same amount, or it could be that there is a differential between each of the physicians based on the criteria I have just told you.

Tr. pp. 51-53.

WHEREFORE, for the reasons set forth above, it is my decision that the Department's Tentative Denial of Exemption be affirmed.

Date

Kenneth E. Zehnder,
Director,
Illinois Department of Revenue