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**An Update: An Analysis of the Tax Exemptions
Granted to Non-Profit Hospitals in Chicago and the
Metro Area and the Charity Care Provided in Return**

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An Update: An Analysis of the Tax Exemptions Granted to Non-Profit Hospitals in Chicago and the Metro Area and the Charity Care Provided in Return

I. INTRODUCTION

Three years ago the Center for Tax and Budget Accountability (“CTBA”) released a study estimating the value of the annual tax benefits granted to non-profit hospitals located in Cook County (the “2006 Report”).¹ The 2006 Report compared the value of these tax breaks to the cost of charity care provided in return. The Report focused on charity care, which is free or reduced-cost medical care delivered to poor and low-income individuals, because state law is clear: Illinois non-profit, charitable hospitals must provide charity care to qualify for the local property tax exemption, and the state and local sales tax exemption. This study is an update to the 2006 Report.

Since tax exemption is, in essence, the use of public funds for a specific public purpose, it follows that government should understand and evaluate whether the forgone tax revenue is being used to provide the desired public benefit. To help decision-makers attain that goal, this study compares the value of the aggregate tax exemptions of non-profit hospitals in Chicago and the Metropolitan Area, against the cost of charity care those hospitals provide in return. Recognizing the valuable role non-profit hospitals play in the health care safety-net, ever-increasing health care costs, private sector retrenchment from providing employees with health care coverage, and on-going fiscal problems confronted by all levels of government, it is hoped that the data produced in this report will inform this crucial debate in a manner that leads to constructive policy solutions.

II. EXECUTIVE SUMMARY

Publicly-funded health care programs – often referred to as the health care safety-net – are intended to provide access to basic, affordable medical care to poor and low-income Americans. As health care costs continue to rise, private coverage moves farther out of financial reach for many families. Over the last ten years, average premiums for family health care coverage have increased 119 percent.² Public programs have stepped in to ensure access to needed health services for the most vulnerable members of society. This, in turn, has put tremendous financial pressure on federal, state and local government budgets, which are already experiencing significant annual budget shortfalls. Growing public health care costs have posed a significant fiscal problem for states like Illinois that have structural imbalances in their tax structure, meaning that annual tax revenue does not keep pace with the inflationary cost alone of providing public services.³ Illinois’ deficit is estimated to be between \$4 billion and \$9 billion for this fiscal year.⁴ Accordingly, it is imperative that all public dollars lawmakers dedicate to foster access to affordable health care are actually applied to that end. This should be the goal in good economic times and bad. However, it is particularly important during severe economic downturns. In difficult economic times when individuals lose their jobs and their employer-sponsored health coverage, the need for essential public services, including health care, increases. At the same time demand for public services is growing, tax revenue that supports services declines, making every available taxpayer dollar that much more important.

The public health care safety-net has three fundamental components, each of which has a specific funding stream: (1) Medicaid, the health care program for low-income families, which is funded principally with federal and state dollars, (2) public hospitals and clinics, which are funded with a mix of federal, state and local tax dollars and (3) publicly-funded charity care, which is also subsidized with federal, state and local tax dollars given to non-profit hospitals in the form of tax breaks.

While Medicaid has been instrumental in stemming the growing tide of the uninsured – in 2007, 59 million Americans received health care coverage through the Medicaid program⁵ – many struggling families do not qualify for the program because their income is not low enough. Today, more than 45 million individuals in the U.S. are uninsured, meaning they do not have private or public health insurance.⁶ This number is expected to increase as the economy sinks further into recession – the Kaiser Family Foundation has estimated that as unemployment grows with the declining economy, the number of uninsured will grow by between 2.6 million and 5.8 million children and adults, depending on how high the unemployment rate climbs.⁷ Charity care, delivered by non-profit, charitable hospitals, is intended to cover a portion of this gap. Charity care is medical care delivered for free or at a reduced cost to uninsured, poor and low-income individuals.

Charity care is funded through tax breaks granted to non-profit, charitable hospitals. Because charity care is funded indirectly through tax breaks rather than by direct appropriations of public dollars, it has not traditionally been viewed as a specific public health care “program.” However, government funds that are provided to non-profit hospitals by means of tax breaks for the purpose of using such funds for a particular public service (*e.g.*, charity care), are no different than public dollars that are directly appropriated to other public programs (*e.g.*, Medicaid). The dollar value of the tax breaks given (*i.e.*, foregone tax revenue) are public dollars in the hands of non-profit hospitals that the law requires be used for a specific public purpose: access to affordable health care by poor and low-income, uninsured individuals through the provision of charity care. Lawmakers have a responsibility to ensure that all public dollars, whether direct expenditures, or indirect expenditures in the form of tax breaks, are used for the purposes intended. Moreover, this is particularly important with the use of public funds given in the form of tax breaks for the very reason that there is less transparency in how these dollars are ultimately used.

Currently, there is considerable confusion in Illinois and nationally around what types of tax benefits require charity care. The confusion has been exacerbated by the fact that there are four different types of tax benefits granted to non-profit hospitals, each of which has different legal requirements: (1) federal income tax exemption, (2) state income tax exemption, (3) state and local sales tax exemption and (4) local property tax exemption. This report focuses on charity care provided compared to the value of tax exemptions granted because Illinois law requires non-profit hospitals to provide charity care for the most valuable tax benefits conferred – the local property tax exemption, and the state and local sales tax exemption.⁸ This report is intended to (1) review the different standards that must be met for the different tax breaks, (2) summarize recent developments in state law and federal reporting on charity care and (3) compare the value of the public dollars given to non-profit hospitals through tax breaks, to the charity care provided in return.

III. KEY FINDINGS

This study analyzes 27 non-profit hospitals and hospital networks in Chicago and the Metropolitan Area (the “Hospitals Studied”). When hospitals that are included in a hospital network are counted, the study includes 47 hospitals total. The study compares the value of the tax exemptions granted to the Hospitals Studied to the cost of the charity care they reported providing in return. Following are the key findings of this study.

- **The Hospitals Studied receive annual tax breaks worth nearly three times the cost of charity care provided.** The most recent annual value of all tax exemptions granted to the non-profit Hospitals Studied is estimated to be \$489.5 million, while the cost of the charity care provided by those Hospitals was \$175.7 million.

- **The amount of the excess tax benefit (the amount by which the value of the tax breaks exceeds the charity care provided) received by the Hospitals Studied – \$327.2 million – would cover the cost of providing charity care to an additional 47,836 low-income, uninsured patients based on the national average cost of a hospital discharge.⁹**
- **Virtually all of the Hospitals included in both this study and in the 2006 Report increased the aggregate amount of charity care delivered over the last three years.** For the Hospitals Studied in both reports, on average, the cost of charity care reported increased from 1.8 percent of total expenses in the 2006 Report, to 2.2 percent of total expenses in this study. It is important to note that this follow-up study to the 2006 Report includes many hospitals the original study did not because at the time of the 2006 Report, charity care data for many hospitals was not yet available.
- **The Hospitals Studied in both this study and in the 2006 Report increased their aggregate charity care provided by \$40.1 million.**
- **The estimated annual value of all tax exemptions received by the Hospitals Studied in both this study and in the 2006 Report increased by \$93.9 million.**
- **Illinois state and local tax exemptions accounted for 91 percent of all tax benefits granted to the Hospitals Studied.** The local property tax exemption was the most valuable tax benefit conferred to the Hospitals Studied, amounting to 57 percent (\$279.4 million) of the total tax exemptions. The state and local sales tax exemption accounted for 32 percent (\$156.1 million) of all the tax breaks conferred. The property and sales tax exemptions, both of which require charity care, totaled 89 percent of the value of the tax subsidies granted by state and local governments.
- **The value of the tax breaks granted to the Hospitals Studied was on average 3.9 percent of total hospital expenses, while the cost of charity care provided by the same Hospitals was on average 2.1 percent of total hospital expenses.**
- **By simply doing a better job of identifying patients eligible for charity care, the Hospitals Studied could have increased the amount of charity care delivered by \$109.5 million, at no additional cost to such Hospitals.** The Hospitals Studied reported a bad debt cost of \$218.9 million. Bad debt is the amount of uncollectible hospital bills. Many hospital finance experts estimate that approximately 50 percent of hospital bad debt is owed by individuals who would qualify for charity care if they were identified for eligibility prior to going through the collections process.¹⁰ Accordingly, better identification of patients eligible for charity care would have increased the amount of charity care delivered by the Hospitals Studied by \$109.5 million, with a corresponding decrease in bad debt.

IV. WHY GOVERNMENT SHOULD ENSURE IT RECEIVES THE PUBLIC SERVICES EXPECTED IN RETURN FOR GRANTING TAX SUBSIDIES TO NON-PROFIT, CHARITABLE HOSPITALS

A. Increasing Health Care Costs Strain State and Federal Government Budgets

Most insured Americans purchase private health insurance through their employer. However, as the cost of health care skyrockets, the nation's health care "system" of employer-sponsored health coverage is breaking down. Just 63 percent of employers nationwide offer health benefits to their workers.¹¹ In Illinois, only 60.8 percent of the workforce has employer-provided health insurance, a decline of nearly 15 percent since 1979.¹² As the existing private-sector health care system fails for many low, and increasingly middle income families, the public sector has stepped in to ensure access to basic health care.

Medicaid, the federal-state health care program for qualifying poor individuals, is the largest health care program in the public safety-net. In 2007, Medicaid covered the medical expenses of 59 million poor

Americans, and total Medicaid spending nationwide reached \$305.1 billion.¹³ Illinois and the federal government spent \$12.5 billion on the state's Medicaid program in 2007.¹⁴

A significant amount of public resources are devoted to ensure access to needed medical care for poor and low-income, uninsured individuals. In light of Illinois' severe budget constraints, lawmakers are compelled to evaluate every aspect of the health care safety-net to determine whether government dollars are being spent as anticipated. The state's current budget deficit is estimated to be \$8.95 billion by the Illinois State Comptroller's Office.¹⁵

B. Local Governments Should be Particularly Concerned by Rising Health Care Costs

Historically, charity care has been an integral part of the public health care safety-net.¹⁶ Two different types of hospitals actually provide charity care that is essential to the health care safety-net: public hospitals, typically owned by local governments, and non-profit, charitable hospitals, which are privately owned but receive public dollars to cover the expense of hospital care delivered for free or at a reduced cost to poor and low-income patients. Nationally, 59 percent of the general acute care hospitals are non-profit; 25 percent are public hospitals; and the remainder, 17 percent, are for-profit hospitals.¹⁷ Illinois has a higher percentage of non-profit hospitals than the national average.¹⁸ In Illinois, fully three-quarters of all general hospitals are non-profit, and 18 percent are public hospitals.¹⁹ There are very few for-profit general hospitals in Illinois – just 7 percent.²⁰ The behavior of the different safety-net hospitals toward caring for the uninsured has a direct impact on other such hospitals. When one player in the safety-net does not fulfill its intended role with respect to charity care, the burden for this care is shifted to other safety-net players – either other non-profit hospitals or public hospitals.

Most public hospitals are owned, operated and funded by counties, and play the most significant role in the health care safety-net.²¹ Public hospitals are coming under increasing pressure to support entire communities of low-income residents who have no other avenue of care.²² As a result, local governments, as a primary funder of public hospitals, have much at stake in ensuring that all actors in the safety-net are doing their part, particularly during difficult economic times when budgets are severely constrained.

Cook County operates a health care system that provides needed medical care to some of the poorest individuals and families living throughout the City of Chicago, the County and the surrounding Metropolitan Area. There are more than one million uninsured individuals living in this region.²³ While most of these uninsured residents are working, 41 percent earn just \$25,000 a year or less, meaning they simply cannot afford private health coverage.²⁴ Many studies have concluded that low-income, uninsured individuals often put off getting hospital care when it is needed out of fear of being overwhelmed by medical debt and aggressive hospital billing practices.²⁵ As a result, the uninsured are often sicker when they ultimately seek medical treatment, and their care is more expensive.²⁶ As such, it is not surprising that studies have found that frequently, the uninsured have worse health outcomes than the insured: uninsured heart-attack and trauma patients are less likely to receive surgical interventions; uninsured heart-attack patients have higher mortality; uninsured cancer patients are more likely to be diagnosed at late-stage and have shorter survival; uninsured patients with appendicitis are more likely to have a ruptured appendix; uninsured babies have a poorer survival rate than privately insured babies; and uninsured trauma patients are more likely to die.²⁷

Cook County's Health and Hospital System is the largest provider of indigent care in the County and the State.²⁸ The System provided \$530 million in free or discounted care in fiscal year 2007.²⁹ This care is financed in part with local property tax and sales tax dollars. Approximately 50 percent of the Cook County Health System's budget comes from local tax revenue, with the intent that these tax dollars are used to subsidize care to the uninsured.³⁰

While public hospitals are intended to play a far greater role than non-profit, charitable hospitals in caring for the uninsured, non-profit hospitals are also expected to play a vital role through the provision of charity care.

Non-profit hospitals receive public funds in the form of tax breaks to do so. When non-profit hospitals do not do a good job of providing charity care, or implicitly discourage low-income individuals from seeking care at their facilities (*e.g.*, by employing aggressive billing practices), they effectively encourage low-income populations to seek care at the Cook County hospitals. This shifts the burden, both in terms of patient volume and financial responsibility, to the County health care system. The end result is that more local taxpayer dollars than intended are needed to fund access to affordable care for poor and low-income people.

V. THE VARIOUS TAX EXEMPTIONS GRANTED TO NON-PROFIT HOSPITALS AND WHAT IS REQUIRED IN RETURN

Non-profit, charitable hospitals are granted exemptions from paying various state, local and federal taxes in exchange for delivering necessary, affordable hospital care to poor and low-income individuals. Each of the tax exemptions granted has a different legal standard with which non-profit hospitals must comply. The underlying purpose for each of the subsidies granted to non-profit hospitals is to finance a public service or good the government otherwise would have provided. Following is a summary of the different tax exemptions non-profit hospitals receive and what is required of them in return.

A. The Local Property Tax Exemption

The general rule is that businesses, including hospitals, pay local property taxes on the value of any real property (*i.e.*, land and buildings) owned.³¹ Local property tax revenue is a significant revenue source for most local governments, typically funding essential public services such as education, health care and public safety. However, pursuant to state law (even though the property tax is a locally-imposed tax, it is governed by state law in Illinois and most states), charitable organizations, including non-profit hospitals, are exempt from paying the local property tax as long as certain requirements are satisfied.³² The principle rationale for preferential tax treatment of charitable, non-profit hospitals is that the foregone property tax revenue will be used by these hospitals to ease the burden of local government by providing a public service that the government would otherwise have provided with the tax revenue (*i.e.*, hospital services that increase access to care for poor and low-income individuals).³³

In Illinois, the issue of property tax exemption for non-profit hospitals has been hotly debated and litigated for decades.³⁴ The seminal Illinois Supreme Court case outlining what is required of non-profit hospitals to receive and maintain property tax exemption is *Methodist Old People's Home v. Korzen*.³⁵ At the heart of the debate is what charitable activities must a non-profit hospital provide in exchange for the local property tax break. In *Methodist*, the Illinois Supreme Court ruled that non-profit hospitals must use hospital property for “charitable” purposes in order to be granted, and maintain, an exemption from paying the local property tax.³⁶ This means non-profit hospitals must provide charitable care – affordable, discounted hospital care – to all those in need of it, and place no obstacles in the way of those in need of receiving such charity.³⁷

Unfortunately, while requiring the provision of charity care, the *Methodist* case did not specifically define what constitutes charity care, who qualifies for it, or how much charity care is required of non-profit hospitals. These issues have been left to hospital policy. The holes in the law have led to significant litigation in an attempt to resolve these issues.³⁸

However, later cases have addressed what charity care is not. “Bad debt,” which is an accounting term for the amount of unpaid hospital charges for medical services delivered, does not count as charity care for purposes of the property tax exemption.³⁹ Many hospitals discover through the collections process that a patient with an unpaid balance is either poor or low-income. Non-profit hospitals have argued that value of bad debt should be counted as charity. However, Illinois courts have recognized that the pursuit of payment, which oftentimes entails sending accounts to collection agencies as well as instituting legal action, does not rise to the level of

charitable behavior simply because one has learned a patient is impoverished. There is simply nothing charitable about billing for services rendered. This is a business practice rather than a charitable act.

Illinois courts have also held that the Medicaid shortfall – the amount by which the actual cost of providing care to Medicaid patients exceeds what the state pays providers for such care – does not qualify as charity care for purposes of property tax exemption.⁴⁰ Medicaid is an entirely separate program from charity care, is funded with different revenue sources and targets a separate population. Accordingly, Medicaid shortfalls are not pertinent to charity care.

The most recent, and closely watched case addressing non-profit hospital property tax exemption and charity care is *Provena Covenant Medical Center v. Department of Revenue of the State of Illinois*.⁴¹ Provena is a non-profit, tax-exempt hospital located in Champaign County. The County revoked Provena's local property tax exemption because it was not providing enough charity care. For the year in controversy, the hospital spent just 0.7 percent of its revenue on charity care. The Illinois Department of Revenue held that Provena did not provide enough charity care in exchange for the local property tax exemption.⁴² The Circuit Court reversed the Department's decision without an opinion.⁴³ The case was most recently ruled on by the Appellate Court of Illinois, Fourth District in August, 2008.⁴⁴ The Appellate Court ruled that Provena was not operating for charitable purposes, and therefore did not qualify for property tax exemption.⁴⁵

In its ruling on *Provena*, the Appellate Court went through an in-depth analysis of what constitutes "charity" because charitable behavior is the very foundation for the granting of the property tax break. According to the Court, "[T]he fundamental ground upon which all [tax] exemptions in favor of charitable institutions are based is the benefit conferred upon the public by them and a consequent relief, to some extent, of the burden upon the State to care for, and advance, the interest of its citizens."⁴⁶ Provena argued that the delivery of health care alone is charity.⁴⁷ However, the Court responded by pointing out that being in the hospital business is not charity in and of itself – there is certainly a distinction between charitable giving and selling services.⁴⁸ The Court found that it is hard to distinguish between what Provena, as a charitable organization, does and what a for-profit hospital does. "Charity is generosity and helpfulness, especially toward the needy or suffering. There is nothing particularly kind or benevolent about selling somebody something."⁴⁹ The Court underscored the line of reasoning that "[T]o be charitable, an institution must give liberally. To remove giving from charity would debase the meaning of charity."⁵⁰

The *Provena* case is not over. The hospital appealed the Appellate Court's decision to the Illinois Supreme Court, which has accepted the case for review.⁵¹

B. The State and Local Sales Tax Exemption

The State of Illinois and all cities and counties impose a sales tax on the sale of goods. Generally, businesses pay sales tax on the purchase of goods (*e.g.*, equipment and supplies).⁵² However, non-profit, charitable organizations "organized exclusively for charitable purposes" are exempted from paying the state and local sales tax in Illinois.⁵³ Accordingly, Illinois non-profit, charitable hospitals operated as such, do not pay sales tax. Since the statutory and regulatory language outlining the state and local sales tax is virtually identical to the constitutional language allowing property tax exemption for charitable organizations, the standard for what is required to meet exemption standards is the same: non-profit hospitals must provide charity care in exchange for the state and local sales tax exemption.⁵⁴

C. The Federal Income Tax Exemption

The legal standard charitable organizations must meet for federal income tax exemption is less clear than the standards for the exemptions for the local property tax and the sales tax in Illinois. Again, the general rule is that all businesses are subject to the federal income tax.⁵⁵ However, charitable organizations are exempt from paying the tax.⁵⁶ The current standard non-profit hospitals must satisfy for federal income tax exemption is they

must provide a “benefit to the community” in return.⁵⁷ Activities that qualify as community benefits have not been defined in federal law, making the standard quite vague.

This amorphous community benefits standard grew out of predictions – which turned out to be wrong – on the success of public health care programs in covering the uninsured.⁵⁸ Prior to the advent of Medicaid and Medicare, non-profit hospitals were required to provide charity care to the extent of their financial ability in exchange for federal income tax exemption.⁵⁹ In 1965, when Medicaid and Medicare were enacted, some health care finance experts predicted that these programs would reach all the uninsured, and charity care would no longer be needed.⁶⁰ It was argued that a more flexible standard would be needed for non-profit hospital federal income tax exemption, as it was feared that if such hospitals lost their tax exempt status, they would go out of business. As such, the charity care standard for federal income tax exemption for non-profit hospitals was changed to the community benefits standard in 1969.⁶¹

However, the predictions that the Medicaid and Medicare programs would eliminate the need for charity care were wrong. As the health care industry became increasingly competitive and health care costs soared, the number of uninsured individuals – those not covered by private insurance, Medicare or Medicaid – rose concomitantly. While Medicaid covers 59 million Americans, there are still 45 million additional Americans without public or private insurance.⁶² The standard for federal income tax exemption, however, has been not changed from the community benefits standard. This, despite widespread acknowledgement that the standard is far too broad, and that charity care remains as vital component of the public health care safety-net.

U.S. Senator Charles Grassley has spearheaded an effort at the federal level to review non-profit hospital federal income tax exemption. In hearings held in 2004 by the House Ways and Means Committee on Oversight, the Committee stated that one rationale for requiring charity care in exchange for special federal tax treatment is that the tax exemption is a subsidy for the cost of providing charity care that the federal government would otherwise incur in the absence of exemption.⁶³

Congressional concern over the vague parameters of the community benefits standard and whether this broad standard effectively generates sufficient public benefits to support federal income tax exemption continues to mount. In response to this concern, the IRS developed a new form that non-profit hospitals must file annually with their informational tax return beginning in 2009.⁶⁴ Under the new federal reporting requirement, non-profit hospitals will have to identify the community benefits provided, including charity care.

D. The State Income Tax Exemption

The Illinois income tax rules generally piggyback off of the federal income tax rules. Accordingly, if a charitable organization is exempt from the federal income tax, it is also exempt from the Illinois income tax.⁶⁵ As such, non-profit hospitals that are exempt from paying the federal income tax are also exempt from the Illinois corporate income and replacement taxes.

VI. THE NON-PROFIT HOSPITALS ANALYZED

This study analyzes 27 non-profit hospitals and hospital networks in Chicago and the Metropolitan Area (collectively, the “Hospitals Studied”). When hospitals that are included in a hospital network are counted, the study includes 47 hospitals total. The study compares the annual value of each of the tax exemptions granted to the Hospitals Studied to the cost of the charity care they reported providing in return. Following is the complete list of the Hospitals Studied.

1. Advocate Health Care Network
2. Alexian Brothers Hospital Network
3. Evanston NorthShore HealthSystem (formerly, Evanston Northwestern)
4. Gottlieb Memorial

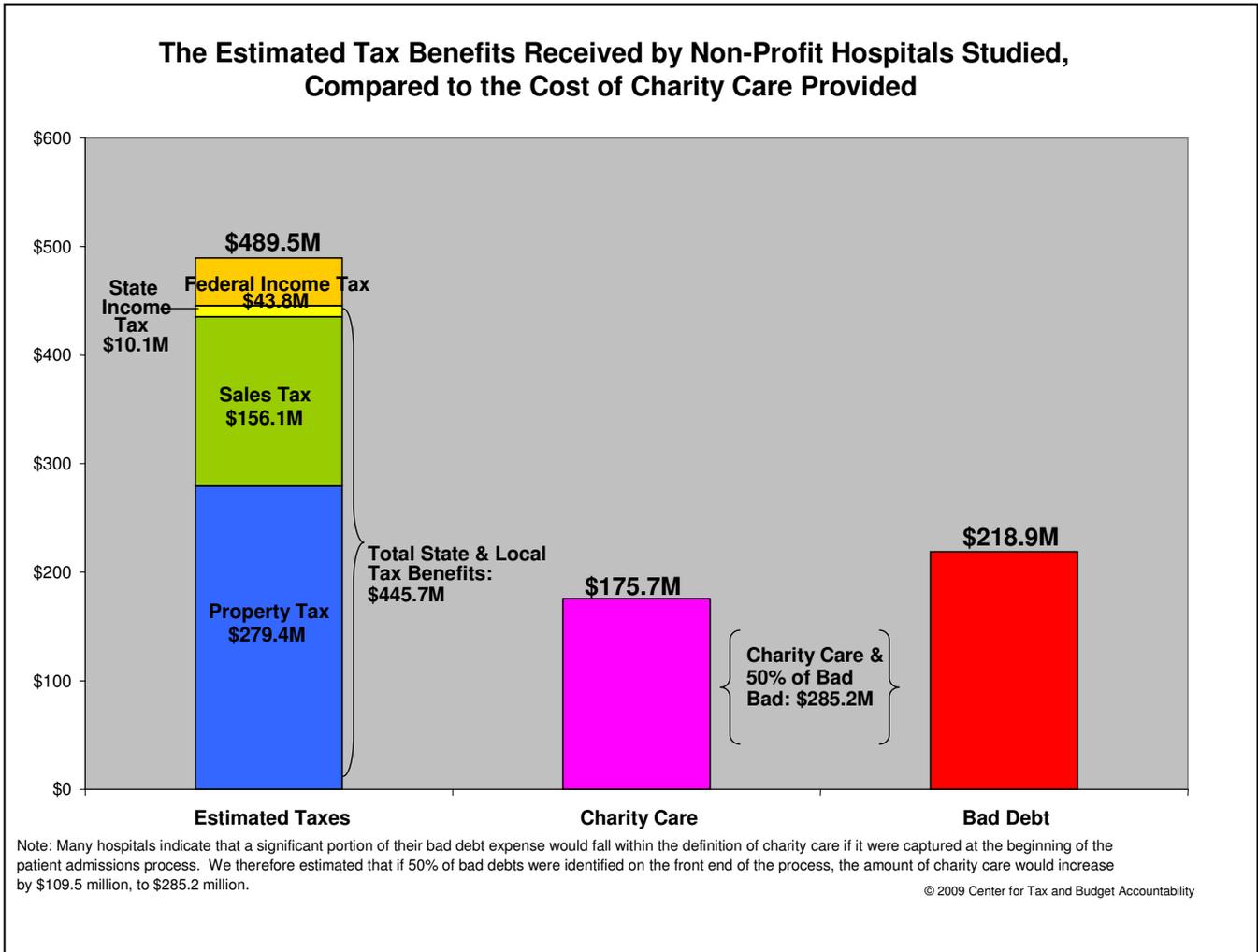
5. Holy Cross
6. Ingalls Memorial
7. Jackson Park
8. Little Company of Mary
9. Loretto
10. Loyola University Medical Center
11. Mercy Hospital
12. Methodist Hospital of Chicago
13. Mount Sinai
14. Northwest Community Hospital
15. Northwestern Memorial Hospital
16. Norwegian American
17. Palos Community Hospital
18. Resurrection Health Care
19. Roseland
20. Rush North Shore Medical Center
21. Rush University Medical Center/Rush Oak Park
22. Saint Anthony Hospital
23. St. Bernard Hospital
24. South Shore Hospital
25. Swedish Covenant
26. Thorek Hospital
27. University of Chicago Hospitals

The financial data used to estimate the value of the tax exemptions was pulled from each hospital's IRS Form 990. The cost of charity care reported was collected from the most recent Community Benefit Reports filed by each non-profit hospital with the state. Appendix A contains a detailed description of the methodology and data sources used. This study uses the same methodology as was used in the 2006 Report, with the only change being the new sales tax rate applicable for each Hospital Studied.

A. Findings

Chart 1 below illustrates the key findings of this study. The first column shows that the annual value of all the tax breaks given to the Hospitals Studied is \$489.5 million. The annual value of the tax breaks granted were nearly three times greater than the cost of charity care provided, which totaled \$175.7 million. On average, the value of the combined tax exemptions conferred to the Hospitals equaled 3.9 percent of total hospital expenses, while on average, the cost of charity care provided represents 2.1 percent of total hospital expenses. Of the Hospitals Studied in this 2009 study, 20 were also analyzed in the 2006 Report, while seven are being analyzed for the first time.⁶⁶

Chart 1



The last column in Chart 1 represents bad debt of the Hospitals Studied. Bad debt is an accounting term for unpaid patient accounts. Charity care is the act of providing free or reduced-cost health care to patients a hospital has determined cannot afford care prior to when the collections process is implemented. Case law has determined that charity care does not include the amount of hospital bad debt because no charitable act occurs when a hospital discovers through its collections process that a patient is poor.⁶⁷ However, many hospital finance experts estimate that if hospitals did a better job of identifying patients eligible for charity care on the front-end of the process, rather than through bill collection efforts, approximately 50 percent of bad debts could qualify as charity care.⁶⁸ Accordingly, if the Hospitals Studied did a better job of identifying patients eligible for charity care, they could increase their charity care by \$109.5 million (which would reduce the bad debt column by the same amount), at no additional cost.

The local property tax exemption was by far the most valuable tax benefit non-profit hospitals receive, totaling \$279.4 million for the Hospitals Studied, 57 percent of the total tax benefit. The sales tax exemption was the second most valuable tax benefit, amounting to \$156.1 million annually for the Hospitals Studied, representing 32 percent of the total benefits received. Much less significant in value were the income tax breaks. The federal income tax break for the Hospitals Studied was estimated to be worth \$43.8 million annually, 9 percent of all tax breaks received. The Illinois income tax break was valued at \$10.1 million annually, just 2 percent of the total tax breaks.

The Hospitals Studied in this 2009 study and in the 2006 Report increased their charity care by \$40.1 million. Meanwhile, the estimated annual value of all tax exemptions received by those Hospitals increased by \$93.9 million.

Chart 2 below shows the estimated value of the total tax breaks granted for each Hospital Studied and the cost of the charity care reported by each such Hospital. Seven Hospitals Studied provided more charity care than the estimated value of their tax benefits: Holy Cross, Loretto, Mount Sinai, Roseland, Saint Anthony, St. Bernard and South Shore Hospitals. Three other Hospitals – Jackson Park, Methodist, and Norwegian American Hospitals – provided charity care within \$1 million of the value of their tax exemptions. The remaining 17 Hospitals Studied received an excess tax benefit – the value of their tax breaks significantly exceeded the cost of charity care provided. The total excess tax benefit, the amount by which the public dollars given exceeded the charity care provided, received by the Hospitals Studied was an estimated \$327.2 million. The amount of the excess tax benefit for the Hospitals Studied could be used to provide charity care to 47,836 poor and low-income, uninsured patients, using the U.S. Department’s Health and Human Services estimated average cost of a hospital discharge of \$6,840.⁶⁹

Chart 2: Estimated Value of the Tax Benefits Received Compared to Charity Care Provided (in millions)

Hospital/Hospital Network	Total Estimated Tax Benefits Granted	Charity Care Provided	Excess Tax Benefit
Advocate Health Care Network	\$99.6	\$29.1	\$70.5
Alexian Brothers Hospital Network	\$41.7	\$12.8	\$28.9
Evanston-NorthShore (formerly Evanston Northwestern)	\$35.1	\$11.6	\$23.5
Gottlieb Memorial Hospital	\$5.2	\$1.7	\$3.5
Holy Cross Hospital	\$2.2	\$3.5	--
Ingalls Memorial Hospital	\$10.6	\$2.6	\$8.0
Jackson Park Hospital	\$3.9	\$3.1	\$0.8
Little Company of Mary	\$13.7	\$2.7	\$11.0
Loretto Hospital	\$1.0	\$4.8	--
Loyola University Medical Center	\$23.5	\$11.1	\$12.4
Mercy Hospital & Medical Center	\$5.8	\$3.6	\$2.2
Methodist Hospital of Chicago	\$0.8	\$0.5	\$0.3
Mount Sinai	\$3.5	\$5.8	--
Northwest Community Hospital	\$11.2	\$4.3	\$6.9
Northwestern Memorial Hospital	\$48.1	\$20.8	\$27.3
Norwegian American Hospital	\$2.9	\$2.7	\$0.2
Palos Community Hospital	\$12.8	\$3.1	\$9.7
Resurrection Health Care	\$43.4	\$21.5	\$21.9
Roseland Community Hospital	\$0.6	\$3.6	--
Rush North Shore Medical Center	\$5.7	\$1.0	\$4.7
Rush University Medical Center/Rush Oak Park	\$37.7	\$5.2	\$32.5
Saint Anthony Hospital	\$2.4	\$4.0	--
St. Bernard Hospital	\$1.9	\$2.7	--
South Shore Hospital	\$0.6	\$1.3	--
Swedish Covenant Hospital	\$9.9	\$1.4	\$8.5
Thorek Hospital	\$7.0	\$1.2	\$5.8
University of Chicago Hospitals	\$58.6	\$10.0	\$48.6
TOTAL	\$489.4	\$175.7	\$327.2

Chart 3 below shows the estimated value for each the tax exemptions granted to each of the Hospitals Studied. One of the most important findings of this study is that the two most valuable tax benefits received by the Hospitals Studied are given by Illinois state and local governments: the local property tax exemption and the state and local sales tax exemption. Each of these tax breaks requires non-profit hospitals to provide charity care. The value of these two tax breaks to the Hospitals Studied equaled \$435.5 million – fully 89 percent of all the tax benefits conferred. However, charity care reported by the Hospitals Studied amounted to only \$175.7 million – this falls short of the estimated value of property and sales tax exemptions by \$259.8 million.

Chart 3: The Estimated Value of Each of the Tax Exemptions for All Hospitals Studied

Hospital	Estimated Value of Property Tax Exemption	Estimated Value of the State and Local Sales Tax Exemption	Estimated Value of Illinois Income Tax Exemption	Estimated Value of Federal Income Tax Exemption	Estimated Value of All Tax Exemptions
Advocate Health Care Network	\$56,518,583	\$31,764,838	\$2,139,173	\$9,235,952	\$99,658,546
Alexian Brothers Hospital Network	\$21,822,588	\$7,968,068	\$2,243,129	\$9,684,786	\$41,718,571
Evanston NorthShore (formerly Evanston Northwestern)	\$21,945,266	\$13,176,660	\$0	\$0	\$35,121,927
Gottlieb Memorial Hospital	\$2,868,574	\$1,887,846	\$79,029	\$341,212	\$5,176,661
Holy Cross Hospital	\$868,024	\$1,270,517	\$0	\$0	\$2,138,542
Ingalls Memorial Hospital	\$5,870,107	\$3,279,185	\$257,442	\$1,122,223	\$10,528,956
Jackson Park Hospital	\$1,678,056	\$539,805	\$322,754	\$1,397,839	\$3,938,455
Little Company of Mary	\$7,088,853	\$2,329,801	\$818,976	\$3,541,079	\$13,778,709
Loretto Hospital	\$791,327	\$176,244	\$0	\$0	\$967,572
Loyola University Medical Center	\$10,970,461	\$12,557,923	\$0	\$0	\$23,528,384
Mercy Hospital	\$3,458,490	\$2,301,611	\$0	\$0	\$5,760,101
Methodist Hospital of Chicago	\$199,319	\$598,418	\$0	\$0	\$797,737
Mount Sinai	\$2,140,325	\$1,444,388	\$0	\$0	\$3,584,713
Northwest Community Hospital	\$6,525,396	\$4,670,580	\$0	\$0	\$11,195,975
Northwestern Memorial Hospital	\$33,886,354	\$14,235,368	\$0	\$0	\$48,121,722
Norwegian American Hospital	\$1,964,660	\$904,411	\$0	\$0	\$2,869,072
Palos Community Hospital	\$5,685,231	\$4,090,463	\$547,425	\$2,363,527	\$12,686,646
Resurrection Health Care	\$26,641,030	\$16,798,921	\$9,072	\$39,166	\$43,488,188
Roseland Community Hospital	\$352,844	\$299,104	\$0	\$0	\$651,948
Rush North Shore Medical Center	\$2,445,954	\$3,304,607	\$0	\$0	\$5,750,561
Rush University Medical Center & Rush Oak Park	\$24,050,964	\$13,646,771	\$0	\$0	\$37,697,735
Saint Anthony Hospital	\$1,670,358	\$670,885	\$0	\$0	\$2,341,244
St. Bernard Hospital	\$1,050,270	\$726,413	\$18,109	\$78,188	\$1,872,981
South Shore Hospital	\$357,254	\$258,817	\$0	\$0	\$616,071
Swedish Covenant Hospital	\$6,042,093	\$2,820,834	\$206,113	\$889,901	\$9,958,940
Thorek Hospital	\$3,100,575	\$804,674	\$574,848	\$2,481,927	\$6,962,024
University of Chicago Hospitals	\$29,455,449	\$13,594,201	\$2,931,950	\$12,658,796	\$58,640,397
Total	\$279,448,407	\$156,121,354	\$10,148,020	\$43,834,597	\$489,552,378

VII. COMMUNITY BENEFITS PROVIDED BY THE HOSPITALS STUDIED

Two factors that are frequently injected into the charity care discussion are community benefits and Medicaid shortfalls. The problem is that charity care – *not* community benefits – is the standard for the local property tax exemption and sales tax exemption.⁷⁰ Furthermore, case law has determined that Medicaid shortfalls are not relevant to charity care.⁷¹ As such, repeated attempts to bring these issues back into the debate only obfuscate, rather than inform the public discussion.

To be sure, non-profit hospitals provide many benefits to their communities. One such benefit is providing care to Medicaid beneficiaries. Hospitals note that the reimbursement received from the state for Medicaid services does not cover the actual cost of the care. This is borne out of industry data. According to the Illinois Hospital Association, Medicaid reimbursements cover 96 percent of actual cost.⁷²

Other community benefits non-profit hospitals provide are access to unprofitable services desired in local communities, such as trauma units, neonatal intensive care units and community health clinics. These services are subsidized in part by other hospital revenue.

Under state law, Illinois non-profit hospitals report a number of activities as community benefits. In addition to the ones mentioned above, these include items such as language services, hospital donations, volunteer services provided by hospital employees, and medical education and research. While these hospital services certainly add value to the community, they are not services unique to non-profit hospitals. Nor do many of these benefits increase health care access to low-income, uninsured individuals. Rather, many of these services are provided by non-profit and for-profit hospitals alike, as competitive business practices and marketing tools.

Finally, some note the contributions non-profit hospitals make in bringing jobs and economic development to local communities. However, this is hardly a charitable activity that either Congress or Illinois lawmakers had in mind when granting charitable hospitals privileged tax status. Any employer, whether for-profit or not, provides this benefit. Certainly, Illinois hospitals play a vital role in the state's economy, employing more than 235,270 individuals statewide.⁷³ However, providing access to health care to vulnerable members of society is the "charitable" act required by the charity care standard – not economic development.

Chart 4 below lists the community benefits reported by each of the Hospitals Studied.

Chart 4: Community Benefits Reported by the Non-Profit Hospitals Studied

Community Benefits Reported by the Non-Profit Hospitals Studied													
Hospital/Hospital Network	Fiscal Year End	Charity Care	Language Assistant Services	Government Sponsored Indigent Health Care	Donations	Volunteer Services	Education	Government Sponsored Program Services	Research	Subsidized Health Services	Bad Debts	Other Community Benefits	Total
Advocate Health Care Network	Dec. 31, 2006	\$29,135,000	\$1,334,000	\$164,226,000	\$8,944,000	\$2,913,000	\$44,471,000	\$0	\$0	\$14,250,000	\$30,760,000	\$0	\$296,033,000
Alexian Brothers Hospital Network	Dec. 31, 2006	\$12,810,171	\$198,539	\$74,890,843	\$330,491	\$770,210	\$1,815,070	\$42,970	\$0	\$482,096	\$9,246,137	\$1,521,598	\$102,107,925
Evanston-NorthShore HealthSystem	Sept. 30, 2006	\$11,607,866	\$343,258	\$76,964,169	\$218,008	\$1,381,892	\$13,037,705	\$0	\$5,352,000	\$17,754,322	\$16,594,000	\$2,385,557	\$145,638,577
Gottlieb Memorial Hospital	Dec. 31, 2006	\$1,649,700	\$78,500	\$13,971,000	\$5,500	\$215,200	\$0	\$0	\$0	\$465,060	\$6,994,721	\$25,800	\$23,405,481
Holy Cross Hospital	June 30, 2007	\$3,530,383	\$0	\$0	\$0	\$26,780	\$69,096	\$5,101,288	\$0	\$0	\$14,101,323	\$0	\$22,828,870
Ingalls Memorial Hospital	Sept. 30, 2006	\$2,576,488	\$5,705	\$15,826,466	\$93,597	\$273,682	\$193,240	\$0	\$0	\$1,759,376	\$24,553,570	\$320,180	\$45,602,304
Jackson Park Hospital	March 31, 2007	\$3,077,384	\$600	\$628,447	\$0	\$11,542	\$3,240,098	\$943,263	\$0	\$5,306,536	\$24,468,080	\$0	\$37,675,950
Little Company of Mary Hospital	June 30, 2007	\$2,733,268	\$532	\$6,848,266	\$0	\$779,828	\$0	\$0	\$0	\$5,454,672	\$14,233,498	\$702,258	\$30,752,322
Loretto Hospital	June 30, 2007	\$4,799,112	\$789	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$3,836,506	\$0	\$8,636,387
Loyola University Medical Center	June 30, 2007	\$11,102,127	\$1,551,211	\$37,603,000	\$318,289	\$410,528	\$20,552,166	\$0	\$2,231,249	\$403,968	\$33,820,318	\$1,105,249	\$109,096,105
Mercy Hospital & Medical Center	June 30, 2007	\$3,593,750	\$162,310	\$0	\$0	\$314,895	\$912,749	\$0	\$0	\$1,873,664	\$4,740,598	\$17,262	\$11,615,218
Methodist Hospital of Chicago	Sept. 30, 2006	\$484,474	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$294,465	\$1,584,010	\$3,088	\$2,366,037
Mount Sinai Hospital	June 30, 2007	\$5,752,800	\$640,300	\$0	\$3,632,500	\$92,800	\$5,962,600	\$0	\$104,000	\$14,852,000	\$52,480,000	\$2,402,000	\$85,919,000
Norwegian American Hospital	Sept. 30, 2006	\$2,671,550	\$5,587	\$0	\$28,111	\$59,582	\$0	\$0	\$0	\$354,901	\$13,761,271	\$0	\$16,881,002
Northwest Community Hospital	Sept. 30, 2006	\$4,248,100	\$285,600	\$45,032,500	\$366,600	\$1,046,800	\$913,400	\$0	\$28,000	\$1,826,200	\$26,095,000	\$1,029,900	\$80,872,100
Northwestern Memorial Hospital	August 31, 2006	\$20,816,000	\$389,000	\$98,761,000	\$1,365,000	\$642,000	\$51,737,000	\$0	\$20,023,000	\$2,411,000	\$32,419,000	\$1,245,000	\$229,808,000
Palos Community Hospital	Dec. 31, 2006	\$3,073,000	\$12,512	\$47,349,000	\$82,994	\$53,290	\$449,856	\$0	\$0	\$856,604	\$12,093,000	\$60,907	\$64,031,163
Resurrection Health Care	June 30, 2007	\$21,451,673	\$579,443	\$89,881,581	\$1,132,337	\$78,466	\$43,788,036	\$0	\$0	\$13,410,709	\$157,311,257	\$2,308,728	\$329,942,230
Roseland Community Hospital	March 31, 2007	\$3,646,000	\$0	\$0	\$0	\$9,182	\$0	\$555,360	\$0	\$0	\$15,062,133	\$0	\$19,272,675
Rush North Shore Medical Center	June 30, 2007	\$1,028,000	\$41,027	\$7,241,000	\$177,256	\$409,435	\$880,867	\$0	\$36,988	\$1,416,727	\$7,368,164	\$0	\$18,599,465
Rush University Medical Center/Oak Park Hospital	June 30, 2007	\$5,178,617	\$370,173	\$40,299,260	\$419,587	\$1,926,537	\$33,350,893	\$0	\$10,565,000	\$6,627,176	\$33,719,409	\$2,122,309	\$134,578,961
Saint Anthony Hospital	June 30, 2007	\$4,008,995	\$207,726	\$8,351,754	\$0	\$43,089	\$174,570	\$1,204,234	\$0	\$3,610,515	\$9,671,000	\$100,000	\$25,371,863
St. Bernard Hospital	Dec. 31, 2006	\$2,716,486	\$0	\$361,493	\$0	\$0	\$102,813	\$0	\$0	\$4,520,571	\$8,471,029	\$0	\$16,172,392
South Shore Hospital	Dec. 31, 2006	\$1,317,252	\$868	\$0	\$120,916	\$0	\$0	\$266,178	\$0	\$152,258	\$4,400,872	\$0	\$6,258,344
Swedish Covenant Hospital	Sept. 30, 2006	\$1,435,000	\$355,696	\$4,890,000	\$19,568,000	\$118,372	\$0	\$0	\$0	\$3,991,299	\$7,472,000	\$23,820,184	\$61,650,551
Thorek Hospital	June 30, 2007	\$1,212,000	\$9,650	\$0	\$3,070	\$7,022	\$4,743	\$0	\$0	\$1,519,400	\$3,841,832	\$189,341	\$6,787,058
University of Chicago Hospitals	June 30, 2007	\$10,026,716	\$715,534	\$87,192,866	\$218,000	\$229,175	\$36,784,547	\$0	\$15,000,000	\$0	\$55,330,000	\$93,508	\$205,590,346
		\$175,881,912	\$7,288,540	\$818,318,445	\$37,022,257	\$11,813,087	\$258,440,449	\$8,113,293	\$53,340,237	\$103,593,520	\$624,428,718	\$39,452,869	\$2,137,493,326

VIII. CONCLUSION

Federal, state and local governments grant non-profit hospitals tax-exempt status with the expectation that these hospitals will provide a public benefit in return. This historically has meant providing low-income individuals who cannot afford to pay for hospital services, access to necessary health care. Legal precedent at all levels of government clearly suggests an expectation – and for Illinois local property tax exemption and the state and local sales tax exemption, a requirement – that non-profit hospitals deliver free or discounted care to low-income, uninsured individuals who cannot afford health care (*i.e.*, charity care).

Appendix A: Methodology

This study uses the same methodology as was used in the 2006 Report.

The primary source of financial data for this study was collected from the tax returns of the Hospitals Studied. Federal Form 990 is the tax return filed by organizations exempt from federal income taxes. The three most recent tax returns for the Hospitals Studied were used (typically, for tax years 2003, 2004 and 2005). The following information was gathered from the tax returns of the Hospitals Studied:

- Annual hospital income or loss. For purposes of estimating the property tax exemption, and federal and state income tax exemptions, annual income or loss was obtained from the three most recently-filed tax returns for the Hospitals Studied.
- Earnings before interest, taxes, depreciation and amortization (EBITDA). EBITDA is a widely-accepted metric for measuring profitability. A three-year average EBITDA was calculated for purposes of valuing the property tax exemption for each of the Hospitals Studied. However, when a Hospital Studied had an extraordinary loss in one year, resulting in a three-year average EBITDA loss, the loss year was omitted from the calculation, and a two-year average EBITDA was computed for purposes of estimating the property tax exemption.
- Operating revenue. When a Hospital Studied had a three-year average EBITDA loss due to more than one loss year, operating revenue was used as an alternative measurement for valuing the property tax exemption. The average ratio of EBITDA to operating revenue of the Hospitals Studied with a positive average EBITDA was applied to the three-year average operating revenues of the Hospitals Studied with EBITDA losses to determine the Hospital's pro forma EBITDA.
- Supply expense. A three-year average supply expense was determined for each of the Hospitals Studied to estimate the value of their sales tax exemption.
- Total contributions. Direct, indirect and government contributions were used in the calculation of estimated federal and state income tax.
- Total hospital expenses. The amount claimed for total expenses for each Hospital Studied was used for purposes of measuring charity care and the value of tax exemptions as a percentage of overall expenses. Evaluating what percentage of total hospital expenses are consumed by charity care and covered by tax exemptions, places those items into a context that allows measuring their relative importance. Total expenses reported on each of the Hospitals' most recent tax return was used, rather than a three-year average. Using a three-year average most likely would have lowered overall expenses. Therefore, total expenses as reported in this study may be overstated relative to the three-year average EBITDA and supply expense. As a result, the value of tax exemption for the Hospitals Studied, measured as a percentage of total expenses, may be understated.

The annual amount of charity care provided for each Hospital Studied was obtained from the Community Benefit Reports. The Community Benefits Act requires that charity care be reported at cost, based on the cost-to-charge ratio on each hospital's Medicare Cost Report, which is another public report that is filed annually with the Center for Medicare and Medicaid Services.

These data sources provide a sound basis for calculating charity care and tax exemption values because they were prepared by the non-profit hospitals being studied, are public records and are updated annually. However, it is important to note that there is a mismatch in years between the charity care reported and the financial data used to estimate the value of the tax exemptions. The Community Benefit Reports used were for hospital fiscal

year 2006 or 2007 (see Chart 4), while the tax returns used for financial data were for fiscal years ending 2003, 2004 and 2005. This problem is somewhat mitigated by use of a three-year average for financial information, which should level out peaks and valleys in financial results, allowing for a fairly accurate comparison.

It is also important to reemphasize that Illinois has no legally mandated, uniform standard of who qualifies for charity care. Rather, the provision of free or discounted care is based on individual hospital policy and varies from hospital to hospital. Charity care policies for the Hospitals Studied varied from offering free care to individuals earning an income equal to or below the federal poverty level, to 200 percent of the federal poverty level. The Hospitals Studied generally provided for sliding discounts depending on income for individuals earning between 200 percent and 400 percent of poverty. The discounts offered differed depending on the hospital. Hence, comparing the amounts of charity care provided across Hospitals Studied does not provide much information about the exact populations being served, nor how extensive hospital efforts are given local demographics.

Bad debt expense data was culled from the Community Benefit Reports. The Community Benefits Act requires bad debt to be reported at cost. However, the amount of bad debt reported by many of the Hospitals Studied in their Community Benefit Reports matched the amount of bad debt reported in their financial statements. That is problematic because bad debt expense is generally reported at charges – not cost – in financial statements.⁷⁴ Therefore, this study adjusted the bad debt to cost for the Hospitals Studied that stated bad debt at charges, by multiplying the cost-to-charge ratio reported in each hospital’s Medicare Cost Report.

Recognizing that non-profit hospitals have difficulty identifying patients eligible for charity care, and that a portion of bad debt may qualify as charity if it were captured before patients are sent through the billing and collection process, this study estimates what hospital charity care would be if 50 percent of the reported bad debt, computed at cost, were considered potential charity care.

The value of other community benefits, such as the unreimbursed cost of providing Medicare, Medicaid and other government health care program services; language services; donations; volunteer services; education; research; and hospital-subsidized health care services was obtained from the Community Benefit Reports.

I. Methodology Used in Estimating the Value of Tax Exemptions

In estimating the value of the tax exemptions for the Hospitals Studied, this study uses the model developed by Drs. Nancy Kane and William Wubbenhorst of the Harvard School of Public Health.⁷⁵ This methodology was selected for two reasons. First, it is both recognized and well-respected nationally. Second, it closely approximates the actual value of property tax exemptions computed for non-profit hospitals in other states that currently make such valuations.⁷⁶

A. Estimating the Property Tax Exemption

The Cook County Assessor’s Office is the governmental agency that places a value on real estate for property tax purposes in Cook County. However, the Assessor’s Office does not currently assess property owned by non-profit, tax-exempt organizations, including hospitals. Hence, there is no data set available from the Assessor’s Office for use in determining the value of property held by non-profit hospitals, which is needed to determine the value of the exemption from paying property taxes.

There are three basic methods of property valuation: the comparison method, the income method and the replacement cost method. The Assessor’s Office currently uses the income approach, or a combination of the income and the replacement cost approaches, for assessing for-profit hospital property.⁷⁷ Accordingly, this study applied the income method of valuation to estimate the value of property owned by the Hospitals Studied. Because of limited access to financial data, it was not possible to estimate hospital value using the replacement cost method.

In nearly all cases, this study's valuation methodology for hospital property yielded reasonable results. However, it posed two problems. First, when a Hospital Studied had a three-year average EBITDA loss, the income method placed a negative value on its property. This meant that, for purposes of this study, the local property tax exemption for such hospitals was determined to have no value. This would not occur if the Assessor's Office was determining such property tax value, because the Assessor would have applied the replacement cost approach in these circumstances. As noted above, insufficient information made it impossible to use the replacement cost method in this study. As such, an alternative methodology was used for Hospitals Studied with a three-year average EBITDA loss. For purposes of estimating the annual property tax exemption in this instance, if a Hospital Studied had an average EBITDA loss due to one loss year, the loss year was eliminated from the calculation, and a two-year average EBITDA was calculated. When a Hospital had more than one loss year, the average ratio of EBITDA to operating revenues was calculated for all Hospitals Studied with a positive average EBITDA. This average ratio was then applied to the three-year average of the loss Hospital's operating revenue to determine the pro forma EBITDA for such Hospitals to estimate the value of their property tax exemptions.

The Assessor's Office also has historically undervalued the fair market value of property for assessment purposes. The income method of valuation on the other hand, is designed to determine actual fair market value. This initially resulted in an estimated property tax exemption for the Hospitals Studied much greater than what the Assessor would find. The formula, therefore, had to include a "discount factor" that would yield a close approximation of the amount of property tax the Assessor would calculate. The state equalization multiplier, which the Illinois Department of Revenue computes annually to account for the undervaluation of Cook County property, was used as the basis for determining the discount factor for this study's methodology. In Illinois, the total assessed valuation of real estate in each county must be 33.3 percent of the total fair market value of all property in such county. The state equalization multiplier is applied in the property tax assessment formula to achieve this requirement. Because the Assessor's valuation of property is typically lower than fair market value, the equalization multiplier usually increases property value for estimating property taxes owed. This study therefore used the reciprocal of the state equalization multiplier as a reasonable proxy for the discount factor in the current Cook County assessment process.

The first step in estimating the value of property tax exemption of the Hospitals Studied was determining the value of the real property they own. This required determining each hospital's three-year average EBITDA (or pro forma EBITDA in the case of the Hospitals Studied with a three-year average EBITDA loss), and then capitalizing that amount to project cash flow of the hospital into future years. When the Assessor's Office applies this methodology, it is attempting to estimate the market "rent" of the property being valued. A capitalization rate of 14.5 percent was used because this is the rate applied to for-profit hospitals by the Cook County Assessor's Office.⁷⁸ The formula for this calculation is:

$$\text{Average EBITDA} \div \text{the capitalization rate} = \text{estimated value of hospital property}$$

The discount factor discussed above was then applied to the estimated fair market value of hospital property, resulting in the discounted value of the property. Next, the complex Cook County assessment formula was applied to the discounted property value. Commercial property in Cook County is assessed at 38 percent of the value of the property. Accordingly, the discounted value was multiplied by 38 percent, to determine what is called the "assessed valuation." Next, an equalization multiple of 2.7076, determined by the Illinois Department of Revenue, was multiplied by the "assessed valuation." This resulted in the "equalized assessed value." Lastly, the "equalized assessed value" was multiplied by an average property tax rate for all of Cook County. While local property tax rates vary substantially depending on the taxing districts in which the property is located, the study applied an average tax rate of 8.34 percent.⁷⁹ This was the average Cook County property tax rate 2005, the most recent year for which an average tax rate was available. The study recognizes that if these properties were assessed by the County Assessor's Office, actual tax rates in effect would apply rather than an average rate.

It is important to note that in 2007, the Cook County Assessor valued the aggregate value of the property tax exemption for all non-profit hospitals located in Cook County.⁸⁰ While CTBA's 2006 Report and the Assessor's report did not include the same hospitals (the Assessor's Office evaluated all 54 non-profit hospitals in Cook County, while CTBA's 2006 Report included 41 non-profit hospitals, a few of which are located outside Cook County), the estimates of the aggregate value of the property tax benefits were similar. The Assessor's Office valued the property tax benefit for all County non-profit hospitals between \$238 million and \$241 million. CTBA's 2006 Report estimated the value of the property tax benefit for the Hospitals Studied at \$209 million.

B. Estimating the Sales Tax Exemption

To estimate the value of the aggregate sales tax exemption for the Hospitals Studied, this study used a three-year average of supply expenses as reported by each hospital on its Federal Form 990, multiplied by the sales tax rate applicable for each hospital.

C. Estimating the Federal and State Corporate Income Tax Exemptions

To estimate the value of the aggregate federal corporate income tax exemption for the Hospitals Studied, the study used a three-year average of net earnings, less total contributions for such hospitals, reduced by their estimated property and state income tax expenses. This resulted in estimated taxable income for each of the hospitals. Next, this estimated taxable income figure was multiplied by the federal corporate income tax rate of 34 percent, to compute the estimated value of federal income tax exemption.

The Illinois corporate income and personal property replacement taxes were calculated by beginning with estimated federal taxable income determined under the preceding paragraph, and then adding back any estimated state corporate income and replacement tax deducted in calculating federal income tax liability. A tax rate of 7.3 percent was then applied to this sum, which includes both the 4.8 percent corporate income tax and the 2.5 percent personal property replacement tax rates.

Appendix B: Hospitals Studied in both this Study and the 2006 Report

Hospitals Studied in both this study and the 2006 Report:

1. Advocate Health Care Network
2. Alexian Brothers Hospital Network
3. Evanston NorthShore HealthSystem (formerly, Evanston Northwestern)
4. Gottlieb Memorial
5. Holy Cross
6. Jackson Park
7. Little Company of Mary
8. Loyola University Medical Center
9. Mercy Hospital
10. Mount Sinai
11. Palos Community Hospital
12. Resurrection Health Care
13. Roseland
14. Rush North Shore Medical Center
15. Rush University Medical Center/Rush Oak Park
16. Saint Anthony Hospital
17. St. Bernard Hospital
18. South Shore Hospital
19. Thorek Hospital
20. University of Chicago Hospitals

Hospitals Studied for the first time:

1. Ingalls Memorial
2. Loretto
3. Methodist Hospital of Chicago
4. Northwest Community Hospital
5. Northwestern Memorial Hospital
6. Norwegian American
7. Swedish Covenant

Hospitals included in the 2006 Report, but not in this study:

1. St. James Hospitals

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Endnotes

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- ² Kaiser Family Foundation and the Health Research and Educational Trust, “Employer Health Benefits Survey 2008 Annual Survey,” 2008.
- ³ Center on Budget and Policy Priorities, “13 States Face Total Budget Shortfalls of at Least \$23 Billion in 2009; 11 Others Expect Budget Problems,” December 18, 2007.
- ⁴ Illinois Office of the Comptroller, “FY2010 Budgetary Outlook.” <http://www.ioc.state.il.us/ioc-pdf/dwhreportFeb2009.pdf>; Center for Tax and Budget Accountability’s analysis of the Illinois Commission on Government Forecasting and Accountability’s updated FY 2009 revenue estimate (published November 2008), FY 2009 state short term borrowing, FY 2008 Medicaid liability carryover to FY 2009 and decrease in potential FY 2009 revenue from the sale of the 10th casino license.
- ⁵ National Association of State Budget Officers, “Fiscal Year 2007 State Expenditure Report,” December, 2008.
- ⁶ U.S. Census Bureau data on health insurance coverage for 2007.
- ⁷ Kaiser Commission on Medicaid and the Uninsured, “Rising Unemployment, Medicaid and the Uninsured,” January 2009 (estimating the increase in number of uninsured based on unemployment rates of seven percent, up to ten percent).
- ⁸ Art. IX, Sec. 6, Illinois Constitution of 1970, 35 ILCS 15-65, *Methodist Old People’s Home v. Korzen*, 39 Ill.2d 149 (1968), 35 I.L.C.S. 120/1g, 86 Il. Admin. Code § 130.2005.
- ⁹ U.S. Department of Health and Human Services, Agency for Healthcare Research and Quality (2006 data on the national average cost of a hospital discharge).
- ¹⁰ J. Colombo, *Hospital Property Tax Exemption in Illinois: Exploring the Policy Gaps*, 37 Loy. U. Chi. L.J. 493, 519 (2006).
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- ¹² Center for Tax and Budget Accountability and Northern Illinois University, “The State of Working Illinois,” 2005.
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- ¹⁴ *Id.*
- ¹⁵ Illinois Office of the Comptroller, “FY2010 Budgetary Outlook,” <http://www.ioc.state.il.us/ioc-pdf/dwhreportFeb2009.pdf>.
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- ¹⁷ General Accountability Office, “Non-Profit Hospitals: Variation in Standards and Guidance Limits Comparison of How Hospitals Meet Community Benefit Requirements,” September 2008.
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- ²¹ The Kaiser Commission on Medicaid and the Uninsured, “Stresses to the Safety Net: The Public Hospital Perspective,” June 2005.
- ²² *Id.*
- ²³ Gilead Outreach and Referral Center, “The Voice of the Uninsured,” April 2008. Chicago and the Metropolitan Area includes the City of Chicago, suburban Cook County, DuPage County, Kane County, Kendall County, Will County, Grundy County, Lake County and McHenry County.
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- ²⁵ Kaiser Commission on Medicaid and the Uninsured, “Sicker and Poorer, The Consequences of Being Uninsured,” May 2002; Institute of Medicine, “The Uninsured are Sicker and Poorer,” C. Phend, “Minorities and Uninsured Have Poorer Trauma Survival,” October 20, 2008.
- ²⁶ *Id.*
- ²⁷ C. Phend, “Minorities and Uninsured Have Poorer Trauma Survival,” October 20, 2008.
- ²⁸ Cook County Health and Hospital System data.
- ²⁹ Based on Medicare Cost Report data analyzed by Health Management Associates.
- ³⁰ Cook County, “2009 Executive Budget Recommendation, Revenue Estimate.”
- ³¹ 35 ILCS 9-70, 15-10.
- ³² Art. IX, Sec. 6, Illinois Constitution of 1970, 35 ILCS 15-65, *Methodist Old People’s Home v. Korzen*, 39 Ill.2d 149 (1968).

³³ *Methodist Old People's Home*.

³⁴ See, e.g., *Methodist Old People's Home*, 39 IL2d 149 (1968), *Alivio Medical Center v. Illinois Department of Revenue*, 299 Ill. App. 3d 647 (1998), *Riverside Medical Center v. Illinois Department of Revenue*, 342 Ill. App. 3d 603 (2003), and *Eden Retirement Center v. Illinois Department of Revenue*, 213 Ill. 2d 273 (2004).

³⁵ *Methodist Old People's Home*.

³⁶ *Id.*

³⁷ *Id.* See also, *Eden Retirement Center v. Illinois Department of Revenue*, 213 Ill. 2d 273 (2004).

³⁸ See, e.g., *Methodist Old People's Home*, 39 IL2d 149 (1968), *Alivio Medical Center v. Illinois Department of Revenue*, 299 Ill. App. 3d 647 (1998), *Riverside Medical Center v. Illinois Department of Revenue*, 342 Ill. App. 3d 603 (2003), and *Eden Retirement Center v. Illinois Department of Revenue*, 213 Ill. 2d 273 (2004).

³⁹ *Alivio Medical Center v. Illinois Department of Revenue*, 299 Ill. App. 3d 647 (1998) (bad debt is not tantamount to charity).

⁴⁰ See *Riverside Medical Center v. Department of Revenue*, 342 Ill. App. 3d 603, 610 (2003).

⁴¹ *Provena Covenant Medical Center, v. Department of Revenue of the State of Illinois*, 229 Ill. 2d 694 (November 26, 2008) (Leave to appeal to the Illinois Supreme Court granted).

⁴² *The Department of Revenue of the State of Illinois v. Provena Covenant Medical Center*, No. 04-PT-0014, (Final Administrative Decision).

⁴³ *Provena Covenant Medicaid Center v. Department of Revenue*, 2006-MR-597, Circuit Court Order (Aug. 8, 2007).

⁴⁴ *Provena Covenant Medical Center v. Department of Revenue*, 384 Ill. App. 3d 734(4th Dist. 2008).

⁴⁵ *Id.*

⁴⁶ *Id.*, at 462 (citing *School of Domestic Arts & Science v. Carr*, 322 Ill. 562, 569 (1926))

⁴⁷ *Id.* At 464.

⁴⁸ *Id.* at 466, 467.

⁴⁹ *Id.* at 467.

⁵⁰ *Id.*

⁵¹ *Provena Covenant Medical Center, v. Department of Revenue of the State of Illinois*, 229 Ill. 2d 694 (November 26, 2008) (Leave to appeal to the Illinois Supreme Court granted).

⁵² 35 I.L.C.S. 120.

⁵³ 35 I.L.C.S. 120/1g.

⁵⁴ See 86 Il. Admin. Code § 130.2005.

⁵⁵ 26 U.S.C. § 61.

⁵⁶ 26 U.S.C. § 501.

⁵⁷ Rev. Rul. 69-545, 1969-2 C.B. 117 (1969).

⁵⁸ See D.M. Fox and S.C. Schaffer, *Tax Administration as Health Policy: Hospitals, the Internal Revenue Service, and the Courts*, *Journal of Health Politics, Policy and Law*, 16 (1991), at 262.

⁵⁹ Rev.Rul. 56-185, 1956-1, C.B. 202.

⁶⁰ See Congressional Budget Office, *Health Care Trends and the Tax Treatment of Health Care Institutions*, August 1994.

⁶¹ Rev. Rul. 69-545, 1969-2 C.B. 117 (1969).

⁶² National Association of State Budget Officers, "Fiscal Year 2007 State Expenditure Report," December, 2008 (number of Medicaid beneficiaries for 2007); U.S. Census Bureau (number of uninsured individuals for 2007).

⁶³ Advisory from the Committee on Ways and Means, Subcommittee on Oversight, *Houghton Announces First Hearing in a Series on Tax Exemption: Pricing Practices of Hospitals*, June 15, 2004, <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=1673>.

⁶⁴ IRS Form 990, Schedule H.

⁶⁵ 35 I.L.C.S. 2/205.

⁶⁶ The Hospitals Studied in this 2009 study and the 2006 Report can be found in Appendix B.

⁶⁷ *Alivio Medical Center v. Illinois Department of Revenue*, 299 Ill. App. 3d 647 (1998) (bad debt is not tantamount to charity).

⁶⁸ J. Colombo, *Hospital Property Tax Exemption in Illinois: Exploring the Policy Gaps*, 37 *Loy. U. Chi. L.J.* 493, 519 (2006).

⁶⁹ U.S. Department of Health and Human Services, Agency for Healthcare Research and Quality (2006 data on the national average cost of a hospital discharge).

⁷⁰ *Methodist Old People's Home*, 39 IL2d 149 (1968) (charity care is required for local property tax exemption), 86 Il. Admin. Code § 130.2005 (charity care is required for sales tax exemption).

⁷¹ *Riverside Medical Center v. Illinois Department of Revenue*, 342 Ill. App. 3d 603 (2003).

⁷² Illinois Hospital Association, "Hospital and Health Care Financial Statistics,"

<http://www.ihatoday.org/about/facts/finstats.pdf> (last accessed on March 10, 2009).

⁷³ *Id.*

⁷⁴ See the American Institute of Certified Public Accountants guidelines.

⁷⁵ See N. Kane and W. Wubbenhorst, *Alternative Funding Policies for the Uninsured: Exploring the Value of Hospital Tax Exemption*, *The Milbank Quarterly*, Vol. 78, No. 2, 2000.

⁷⁶ See *Id.* at 193.

⁷⁷ The information was obtained from numerous conversations with the Cook County Assessor's Office during 2005.

⁷⁸ The capitalization rate is based on numerous telephone conversations with the Assessor's Office.

⁷⁹ The average Cook County tax rate was calculated based on data reported by the Office of the Cook County Clerk.

⁸⁰ Cook County Assessor's Office, "Exempt Hospitals: Valuation Estimates and Appraisal Methodology," (November 2007).