NO. A07-1086

State of Minnesota
In Supreme Court

HealthEast,

Relator,

and

University of Minnesota Physicians,

Intervenor-Relator,

vs.

County of Ramsey,

Respondent.

RELATORS' BRIEF AND APPENDIX

J. Patrick Plunkett (#87221)
John G. Patterson (#144320)
Martin D. Kappenman (#320596)
MOORE, COSTELLO & HART, PLLP
900 Second Avenue South, Suite 1500
Minneapolis, Minnesota 55402-5079
(612) 673-0148

Attorneys for HealthEast, Relator

Michael C. Flom (#140089)
GRAY, PLANT, MOOTY, MOOTY & BENNETT, P.A.
500 IDS Center
80 South Eighth Street
Minneapolis, Minnesota 55402
(612) 632-3000

Attorneys for University of Minnesota Physicians, Intervenor-Relator

Darwin J. Lookingbill (#128132)
RAMSEY COUNTY ATTORNEY'S OFFICE
Ramsey County Government Center West
50 West Kellogg Blvd., Suite 560
St. Paul, Minnesota 55102
(651) 266-3222

Attorneys for County of Ramsey, Respondent

2007 – BACHMAN LEGAL PRINTING – FAX (612) 337-8053 – PHONE (612) 339-9518 or 1-800-715-3582

The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2).

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES

CONSTITUTIONAL PROVISIONS

STATEMENT OF THE ISSUES

1. Did the Tax Court err in finding that HealthEast, owner of the Subject Property, is not a corporation whose property is not taxed in the same manner as other corporations, and therefore must satisfy the so-called "North Star Factors" in order for Minnesota Statutes §273.19, Subd. 1 to be applicable?

   Yes

   Most Apposite Statute:

   Minn. Stat. § 273.19, subd. 1.

2. Did the Tax Court err in finding that HealthEast is not an institution of purely public charity within the meaning of Article X, Section 1 of the Minnesota Constitution, and Minnesota Statutes *§ 272.02*?

   Yes

   Most Apposite Constitutional Provision:

   Minn. Const. Art X, § 1

   Most Apposite Statute:

   Minn. Stat. § 272.02

   Most Apposite Cases:

   Croixdale, Inc. v. County of Washington, 726 N.W.2d 483 (Minn. 2007)

   North Star Research Inst. v. County of Hennepin, 306 Minn. 1, 236 N.W.2d 754 (1975)

   Community Hosp. Linen Serv., Inc. v. Commr. of Taxation, 309 Minn. 447, 245 N.W.2d 190 (1976)

   Assembly Homes, Inc. v. Yellow Medicine County, 273 Minn. 197, 140 N.W.2d 336 (1966)

3. Did the Tax Court err in finding that University of Minnesota Physicians, which operates the Bethesda Clinic as lessee of the Subject Property, is not an institution of purely public charity within the meaning of Article X, Section 1 of the Minnesota Constitution and Statutes §272.02?

Yes

Most Apposite Constitutional Provision:

Minn. Const. Art X, § 1

Most Apposite Statute:

Minn. Stat. § 272.02

Most Apposite Cases:

Croixdale, Inc. v. County of Washington, 726 N.W.2d 483 (Minn. 2007)

North Star Research Inst. v. County of Hennepin, 306 Minn. 1, 236 N.W.2d 754 (1975)

Community Hosp. Linen Serv., Inc. v. Commr. of Taxation, 309 Minn. 447, 245 N.W.2d 190 (1976)

Assembly Homes, Inc. v. Yellow Medicine County, 273 Minn. 197, 140 N.W.2d 336 (1966)

STATEMENT OF THE CASE

Relators, HealthEast and University of Minnesota Physicians ("UMPhysicians"), seek an order from this Court reversing the Tax Court's judgment entered following the Findings of Fact, Conclusions of Law and Order for Judgment [Relators' Appendix ("App.") at 51-75], holding that the portion of the Subject Property leased to the UMPhysicians does not qualify for tax exempt status.

The Subject Property is located at 580 Rice Street in St. Paul, Minnesota, and is the site of a medical clinic known as Bethesda Clinic. HealthEast, the owner of the Subject Property, filed Petitions for tax exemption for assessment in years 2002, 2003 and 2004. The Petitions claim the Subject Property qualifies for tax exempt status under Minn. Stat. §272.02, subd. 7 and §273.19, subd. 1.

STATEMENT OF FACTS

A. The Subject Property is the Site of Bethesda Clinic

The Subject Property is owned by HealthEast, a Minnesota nonprofit corporation which is exempt from federal income taxes as an organization described in § 501(c)(3) of the Internal Revenue Code of 1986, as amended, and Minnesota Statutes Chapter 317A. The Property is the location of a medical clinic known as "Bethesda Clinic", which is operated by UMPhysicians under a lease from HealthEast. [App. at 2.] The Property is located in a low-income neighborhood just north of the State Capitol on the southeast corner of Rice Street and Como Avenue. [App. at 10, 57.]

The Bethesda Clinic facility is a two-story building of approximately 16,000 square feet, built in 1996, consisting of a lobby/waiting room, receptionist station, nurses' station, administrative offices, conference room, examination rooms, x-ray rooms, laboratory, and an on-site pharmacy.[1] [App. at 57.] The building improvements are on parcel 31.29.22.23.0022, and the supportive adjacent paved parking lot of approximately 54 parking stalls is on parcels 31.29.22.23.0020 and 31.29.22.23.0021. [App. at 2, 57-58.]

For assessment year 2002, the Subject Property was leased to and operated as Bethesda Clinic by the University of Minnesota, under a lease for a term of at least one year. [App. at 2; Stipulation ("Stip.") 5, Exhibit ("Ex.") 1 and 2.][2] For assessment years 2003 and 2004, and since that time, UMPhysicians has operated Bethesda Clinic at the Subject Property as the tenant under a lease from HealthEast for a term of at least one year. [App. at 2; Stip. 6; Ex. 3 and 4.]

The Bethesda Clinic treats underserved and low-income populations without regard to ability to pay. [App. at 10.] A large proportion of the patients are on Medical Assistance, Medicare or other governmental health care programs. During the years at issue, almost half of all of the Clinic's charges were billed to Medical Assistance, which pays at rates less than 30% of normal physician charges. The Clinic employs a patient representative to work directly with patients to help identify their needs, coordinate care, and make referrals to other agencies for required services. Bethesda Clinic also provides

---

[1] The parties agree that the pharmacy portion of the Subject Property, consisting of 830 rentable square feet leased to the for-profit Metropolitan Pharmacy, is taxable and not at issue in this case.

[2] During the time the Subject Property was leased to the University of Minnesota, the Subject Property was accorded tax-exempt treatment, and the University of Minnesota's tax exempt status is not at issue in this case.

other supportive services without charge, including transportation coordination and linguistic and translation services. [App. at 11-12.]

Bethesda Clinic is also one of the locations through which the University of Minnesota Medical School Department of Family Practice and Community Health Faculty conducts clinical practice. The Clinic also serves as a clinical program for medical school students and residents who are required to provide direct patient care in order to become practicing physicians in the United States. [App. at 10-11.]

B. How HealthEast is Organized and the Purposes it Serves.

HealthEast is the parent company of a health care system which was formed in 1986 in conjunction with the affiliation of several St. Paul hospitals. In 1987, other hospitals joined the HealthEast Care System. HealthEast Care System currently includes four hospitals: HealthEast St. John's Hospital, HealthEast St. Joseph's Hospital, HealthEast Woodwinds Hospital and HealthEast Bethesda Hospitals (the "Hospitals"). Each of the Hospitals is a Minnesota nonprofit corporation and has been classified by the Internal Revenue Service as a tax-exempt hospital under §501(c)(3) and §170(b)(1)(A)(iii) of the Code. [App. at 84-89; Ex. 50]. HealthEast is the sole corporate member (*i.e.*, "shareholder") of each Hospital, and the Hospitals constitute the principal activity of the HealthEast Care System.

As stated in its Articles of Incorporation,

> "[HealthEast] . . . at all times shall be operated, supervised or controlled in connection with . . . [the Hospitals]."
>
> . . . Subject to the foregoing and within the scope and in furtherance of the charitable purposes herein provided, the corporation

[Healtheast] is organized and shall be operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of Bethesda, St. John's, St. Joseph's and Woodwinds as contemplated by Section 509(a)(3)(A) of the Code, by directly or indirectly advancing, supporting, promoting, conducting, administering or engaging in charitable activities, causes, projects and programs of every kind and nature related or contributing to the promotion of health, the advancement of education and science, the lessening of the burdens of government and the promotion of the social welfare through accomplishment of the foregoing. Specifically, but without limitation, the corporation shall, directly or indirectly:

(i) direct and coordinate the actions of Bethesda, St. John's, St. Joseph's and Woodwinds, as well as the actions of various other affiliated organizations, with respect to the medical, surgical and other health care services of every kind and nature provided by them at their respective hospital and other health care facilities, and the utilization made by them of such facilities;

(ii) administer and operate, on a coordinated basis, the hospital facilities owned or operated by Bethesda, St. John's, St. Joseph's and Woodwinds, as well as other health care facilities owned by various affiliated organizations, to the end that the mutual interests of Bethesda, St. John's, St. Joseph's and Woodwinds, such other affiliated organizations, the general public and the government in securing high quality health care at the lowest reasonable cost are served through delivery of service and utilization of resources in such a manner as to, among other things: (a) achieve economies of scale; (b) eliminate unnecessary duplication of programs and facilities; (c) prevent unnecessary acquisition of equipment; (d) implement efficient staffing patters; and (e) in connection with the foregoing, evaluate, develop, and if suitable under the circumstances, implement innovative programs of the delivery of health care services and utilization of related resources through a functionally related, multi-institutional hospital and health care system;

(iii) foster or engage in educational activities related to the promotion of health and to the care and treatment of the sick, injured, disabled, infirm or aged;

(iv) foster or engage in medical and other scientific research related to the promotion of health and to the care and treatment of the sick, injured, disabled, infirm or aged; and

(v) engage in all manner of activities incidental or related to accomplishment of the foregoing.

[App. at 85-86; Ex. 50.] (emphasis added).

HealthEast's Articles of Incorporation also provide as follows:

> "Upon the dissolution of the corporation, the Board of Directors shall, after paying or making provisions for the payment of all the liabilities of the corporation, dispose of all the assets of the corporation exclusively for the purposes of the corporation in such manner, or to such organization or organizations organized and operated exclusively for charitable, educational, religious, or scientific purposes as shall at the time qualify as an exempt organization or organizations under Section 501(c)(3) of the Code (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 District Court of the county in which the principal office of the corporation is then located, exclusively for such purposes or to such organization or organizations, as said court shall determine, which are organized and operated exclusively for such purposes."

[App. at 88; Ex. 50.]

The Board of Directors and Officers of HealthEast also constitute the Board of Directors and Officers of the Hospitals. [Ex. 85, Statement 26.]

Neither HealthEast, nor the Hospitals, engage in their own fund-raising activities. Instead, the fund-raising activities for HealthEast and the Hospitals is conducted by the HealthEast Foundation, a Minnesota nonprofit corporation which is exempt from federal income taxes as an organization described in § 501(c)(3) of the Code. [Stip. 98.]

The President and the Treasurer of HealthEast are also the President and Treasurer of the Foundation. The Foundation does not have any employees. [Ex. 85, Statement 25.] All persons who perform services on behalf of the Foundation are employed by HealthEast. [*Id.*] The Chair of the HealthEast Board and the President of HealthEast are ex-officio members of the Foundation Board. [Ex. 85, Annual Report to the Community.] The Foundation has its own Board of Directors, because serving as a director of a fund-raising foundation involves a different skill-set (e.g., fundraising) than serving on a hospital Board. [Ex. 85, Annual Report to the Community.]

HealthEast encourages all potential donors to the HealthEast Care System to make those donations to the HealthEast Foundation. [App. at 20; Stip. 98.] The HealthEast Foundation receives the donations and then passes those donations on to HealthEast and its subsidiaries. The donations received by HealthEast and its subsidiaries are used to further the tax exempt purposes of HealthEast and the Hospitals. [App. at 20-22; Stip. 98.] Applicable accounting rules require that the assets of the HealthEast Foundation be included in the net assets of HealthEast as reported on IRS tax return Form 990. [Ex. 82, Statement 3.]

C. **How UMPhysicians is Organized and the Purposes it Serves.**

UMPhysicians is the designated faculty clinical practice organization of the University of Minnesota Medical School (the "Medical School"). UMPhysicians' activities are crucial to the development and maintenance of the clinical skills of the Medical School faculty and the teaching of those skills. [App. at 4; Stip. 16, Ex. 7.]

UMPhysicians is structured as a non-profit corporation under Minnesota Statutes Chapter 317A, and it has non-profit status for income tax purposes under 26 U.S.C. §501(c)(3). [Stip. 12.] It is not disputed that the stated purpose of UMPhysicians is to be helpful to others without immediate expectation of financial reward. [App. at 71, 91-92.]

It is also not disputed that UMPhysicians' Articles of Incorporation restrict transfer of its assets upon dissolution to charitable entities, and not private interests. [App. at 75, 96.]

The Medical School is divided into 18 clinical departments through which Medical School students, residents and fellows receive clinical instruction from the faculty of the Medical School. UMPhysicians was incorporated to consolidate into a single entity the various departmental practice groups in order to take advantage of cost efficiencies so that the clinics could compete more effectively in the medical market. [App. at 5-6; Stip. 18.]

D. Bethesda Clinic's Role Within the Medical School's Department of Family Practice and Community Health.

Bethesda Clinic is one of the locations through which faculty in the University of Minnesota Medical School's Department of Family Practice and Community Health conduct their clinical practices. These clinics provide primary care to patients of all ages, income, races and nationalities. Located in a low-income neighborhood in the core of St. Paul, the Bethesda Clinic treats patients without regard to their ability to pay. Bethesda Clinic serves as a clinical training site for the University of Minnesota Medical School students and residents. As part of their Medical School education, residents are required to participate in and complete formal education requirements in addition to the clinical instruction and training received through the provision of direct patient care. Medical residency programs provide students with training in a medical specialty, develop skills and complete educational requirements for certification by a specialty board. As a result, Bethesda Clinic's medical residency programs are an integral part of the medical education of a Medical School student and is a required element for practicing physicians in the United States. Bethesda Clinic employs staff including psychiatrists, psychologists, and patient representatives. Bilingual staff and transportation services, and culturally sensitive and competent services are also offered on-site. [App. at 10-11; Stip. 59.]

E. <u>Bethesda Clinic Provides Services Without Regard to Ability to Pay.</u>

Bethesda Clinic treats patients without regard to their ability to pay, and treats the underserved and low-income populations of their core neighborhoods in St. Paul. A large proportion of Bethesda Clinic's patients are on Medical Assistance, Medicare and other governmental health care programs, and the Facility maintains a sliding fee schedule for patients with no or inadequate insurance coverage. [App. at 11; Stip. 61, Ex. 37] Bethesda Clinic applied for and obtained status as an Essential Community Provider under Minn. Stat. § 62Q.19 by the Minnesota Department of Health. As an Essential Community Provider, all health plans are required to contract with Bethesda Clinic, even if the Clinic does not maintain a provider contract with the health plan, and Bethesda Clinic must participate in all government programs. [App. at 13-14; Stip. 65.] Bethesda Clinic also provides other supportive services without charge, including transportation coordination and linguistic and translation services. Bethesda Clinic employs a number of patient representatives who work directly with patients to help identify their needs, coordinate care, and make referrals to other agencies for needed services. [App. at 11; Stip. 61.]

1. The Community Care Program. Bethesda Clinic provides assistance to its patients in identifying public health care and assistance programs that provide needed health care coverage and financial assistance to needy patients. Because of these efforts to assist patients in enrolling in public health care programs, and Minnesota's generally strong safety net, the majority of UMPhysicians' patients have some form of health insurance. However, 5%-6% of UMPhysicians' patients have a demonstrated financial need and either no insurance or inadequate insurance, and therefore received support from the Community Care Program. Services provided for patients eligible for the Community Care Program are provided at a 50%-90% discount off the standard charges. The level of discount is provided on a sliding scale basis based on the patient's income and family size relative to the federal poverty guidelines. Patients can access up to a 100% discount if certain additional criteria are met regarding available care in the community and consistency with UMPhysicians' research and educational mission. [App. at 11-13; Stip. 62, Ex. 87.]

2. Reduced Rates Accepted for Medical Assistance Patients. Bethesda Clinic not only offers its services without regard to ability to pay, and offers services on a sliding fee scale where appropriate, it accepts all forms of insurance. Bethesda Clinic has a high percentage of patients on Medical Assistance, and deeply discounts its standard fees for those patients. At Bethesda Clinic, almost 50% of charges were billed to Medical Assistance. Medical Assistance pays at rates that are less than 30% of UMPhysicians' charges, resulting in a discount in excess of 70% on services provided to Medical Assistance beneficiaries. [App. at 11-13; Stip. 62, Ex. 87.]

Thus, in addition to services being provided at a discount under the Community Care Program, approximately 35% of Bethesda Clinic revenues are contributed to the care of low-income Medical Assistance patients without reimbursement. [App. at 13; Stip. 63.]

Bethesda Clinic's staff assists patients in identifying insurance that may be applicable, and informs the patient of Bethesda Clinic's policies, including a 20% prompt pay discount. The staff will ask the patient about insurance and advise of Bethesda Clinic's policy requiring patients to pay $50 toward their visit. If a patient notifies the front desk staff they are unable to pay the $50 toward the visit, the staff then discusses the patient's financial status. The staff assists patients in applying for Medical Assistance, and the Community Care Program. The staff provides patients with necessary forms to complete. Bethesda Clinic does not turn a patient away if they need to be seen that day. [App. at 11-13; Stip. 62.]

F. Bethesda Clinic Provides Community Outreach Programs in Multiple Areas.

Bethesda Clinic shows its dedication to community outreach programs and service for its patients in multiple areas, including:

- - Bethesda Clinic has a PharmD, PharmD Resident and Pharmacy student in the clinic, who provide medication assessment and make recommendations regarding drug therapy to maximize patient outcomes. They also provide extensive patient education, including inhaler/asthma education, insulin teaching, diabetes education, smoking cessation, and education on a variety of complicated medications. They also help patients obtain free medications from patient assistance programs through pharmaceutical companies.

-- Bethesda Clinic has a Psychiatrist and two Psychologists who work in the clinic. Although they bill for the patient care they provide, the reimbursement is far below market value, or even the amount necessary to cover their salaries.

-- Residents have been involved in volunteer service to Bethesda Clinic's community, and resident physicians, practicing physicians, pharmacy students, pharmacy residents and faculty have extensively volunteered in the local community and the Family Medicine educational community in many programs.

-- In order to provide a needed service for patients of Bethesda Clinic's community, when the HealthEast Rice Street Clinic ceased providing obstetrical services to their patients, Bethesda Clinic had a call sharing agreement with that clinic during the years at issue to support the remaining providers continuing to perform obstetrical care.

-- Bethesda Clinic has been honored with the "Everyday Angel" recognition from the Guild of St. Paul in recognition of the special care and extra time taken with patients who suffer from chronic mental illness.

-- Bethesda Clinic has been involved in the Hmong Healthcare Coalition, has provided flu shots to the local Hmong Adult Day Care residents, and provides Hmong interpreter services. [App. at 13; Stip. 64, Exs. 54, 55, 56, 57, and 68.]

In addition, a large volume of research is conducted by Bethesda Clinic's staff, largely at the Bethesda Clinic. This research [detailed in Ex. 68] is used to improve the quality of care Family Physicians provide to their patients at the Clinic site, nationally, and internationally through publications and presentations. Bethesda Clinic faculty and staff are the recipients of funded grants and research projects. [Ex. 8.]

G. UMPhysicians and Bethesda Clinic Financial Results

Clinical operations and revenues do not fully support the clinical efforts of Bethesda Clinic's physician faculty, and funding by the University of Minnesota is required to financially support the programs. This support comes in the form of salary support of the Clinic Faculty Physicians and Graduate Medical Education Coordinators via University of Minnesota funding sources, and is added to the "University Supported Clinical Expenses" portion of Bethesda's financial statement. [App. at 16; Stip. 69.] In any year Bethesda may generate a profit, the money stays within the Clinic for future uses. [App. at 16; Stip. 70.]

When factoring in the necessary University supported clinical expenses required to fund the clinical effort of Bethesda's physician faculty, Bethesda Clinic did not generate a profit during the years in question, and in fact incurred a Total Operating Loss of $201,400 in calendar year 2002 [App. at 100; Exs. 17, 19]; $306, 931 in calendar year 2003 [Exs. 18, 19]; and $525,664 in calendar year 2004 [App. at 101; Exs. 18, 19]. These operating losses were generated during a time period UMPhysicians as a whole generated revenues ranging from $102 million to $151 million, resulting in earnings of $1.9 million to $4.5 million. [App. at 54.]

UMPhysicians' compensation for individual physicians is based primarily on a University of Minnesota Family Medicine minimum market valuation, and then secondarily on years of experience and specialty. Experience and specialty may include, but are not limited to, years as a licensed physician, obstetrics, geriatrics, sports medicine, academic achievements, and research grants including ability to gain grants.

Payment of compensation for physicians are derived by four major sources, those being University of Minnesota Medical School funding, Affiliated Hospital funding, UMPhysicians funding, and occasional research based funding. The compensation paid to Bethesda Clinic faculty during calendar years 2002, 2003 and 2004 is reflected on Exhibit 20. As shown, the highest faculty physician salary paid during that time was $158,388 in 2002, $158,388 in 2003, and $160,388 in 2004. [Ex. 20.]

Donations to support medical education and the clinical practice are solicited by the Minnesota Medical Foundation ("MMF") rather than UMPhysicians; accordingly, direct charitable donations are not a significant part of UMPhysicians' revenue. MMF is a Minnesota non-profit corporation which is exempt as a Section 501(c)(3) organization and whose purpose is to raise funds for health-related research and education at the Medical School. MMF provides donation support for the activities of UMPhysicians through the Medical School, not through direct funds from MMF to UMPhysicians for the years in question. [App. at 15; Stip. 68.]

ARGUMENT

A. <u>The Standard of Review</u>

As recently stated by this court in *Croixdale, Inc. v. County of Washington*, 726 N.W.2d 483, 487 (Minn. 2007):

> This court reviews a Tax Court's decision to determine whether the Tax Court had jurisdiction, whether or not the order is justified by evidence or in conformity with law, or whether the Tax Court committed an error of law.

Minn. Stat. § 271.10 (2004). Absent any question of law, we will uphold the Tax Court's decision where sufficient evidence exists for the Tax Court to reasonably reach the conclusion that it did. *Care Inst., Inc.-Maplewood v. County of Ramsey,* 576 N.W.2d 734, 738 (Minn. 1998); *Am. Ass'n of Cereal Chemists v. County of Dakota*, 454 N.W.2d 912, 914 (Minn. 1990).

B. **The Trial Court Erred in Ruling that HealthEast, the Owner of the Subject Property, Must Satisfy the So-Called *North Star* Factors in Order for Minnesota Statutes §273.19, Subd. 1 to be Applicable.**

1. Statutory Availability of Exempt Status for Leased Property

Minn. Stat. § 273.19, subd. 1, provides that "tax-exempt property" that is leased for the term of at least one year can qualify for exempt status. That statute provides in part as follows:

> [T]ax-exempt property held under a lease for a term of at least one year, and not taxable under section 272.01, subd. 2, or under a contract for the purchase thereof, shall be considered, for all purposes of taxation, as the property of the person holding it.

The Statute defines "tax-exempt property" as follows:

> In this subdivision, "tax-exempt property" means property owned by the United States, the state, or school, or any religious, scientific, or benevolent society or institution, incorporated or unincorporated, **or any corporation whose property is not taxed in the same manner as other property.**

Minn. Stat. § 273.19, subd. 1 (emphasis added).

In situations where the property is owned by a qualifying entity under the statute, and the property is subject to a lease for a term of at least one year, the Tax Court has stated that the focus of the statute is upon the tenant, not the owner: "Although the owner-lessor may be a charitable institution, there is no requirement, as Respondent argues, that the subject property, absent the lease, be tax-exempt. The statute looks to the tax status of the lessee, not the lessor." *Little Earth of United Tribes, Inc. v. County of Hennepin*, 1985 WL 3171 (Minn. Tax Ct.), p. 13.

The Tax Court ruled that HealthEast does not qualify under Section 273.19 as a "corporation whose property is not taxed in the same manner as other property," and that, therefore, HealthEast had to establish that it is a "purely public charity" under the so-called *North Star* factors in order for the Subject Property to qualify for exempt status. [App. at 47.]

HealthEast submitted evidence and authorities establishing that HealthEast is the parent company of the HealthEast Care System, which is primarily comprised of four hospitals, all of which qualify for real estate tax exemption under Article X, Section 1 of the Minnesota Constitution, and Minnesota Statutes § 272.02, subd. 1 (3), exempting "all public hospitals" from property taxation.

Despite this evidence, the Tax Court ruled that HealthEast is not a corporation whose property is taxed in the same manner as other property, and that, therefore, HealthEast (as a stand-alone entity) had to satisfy the so-called *North Star* factors. The Tax Court's ruling on this point provides as follows:

> Unlike a land-grant institution whose property is exempt across the board, a hospital such as Petitioner is not per se exempt -- that is "a corporation whose property is taxed in the same manner as other property." Since the Subject Property is not "owned by the United States, the state [or] a school", Petitioner must establish that it is a "benevolent society or institution" -- that is, an institution of purely public charity.

Order Granting Motion to Compel, dated March 17, 2006, at p. 7. [App. at 48.]

There is no basis in the statute or any cases interpreting it that the statute requires a lessor to be "per se" exempt like a land-grant institution. The specific types of entities cited within Minn. Stat. § 273.19, namely, "those owned by the United States, the state, or school, or any religious, scientific, or benevolent society or institution, incorporated or unincorporated" are merely examples of the types of property that are exempt. The statutory reference any other "corporation whose property is not taxed in the same manner as other property," reveals that entities not specifically listed therein, including hospitals, may qualify for the exemption under Minn. Stat. § 273.19.

This ruling, which formed the basis of the Tax Court's analysis requiring HealthEast to satisfy the so-called *North Star* factors, is in error. Under Minn. Stat. § 273.19, subd. 1, the Subject Property is tax-exempt property held under a lease for a term of at least one year, and accordingly the only relevant inquiry should be the "purely public charity" status of the entity leasing the Subject Property -- UMPhysicians.

The Tax Court erred in ruling that because some of HealthEast's property may not be tax exempt, it therefore cannot be considered a "corporation whose property is not taxed in the same manner as other property" under Minn. Stat. § 273.19. Even the examples of property mentioned by the Tax Court are not "*per se* exempt." Under some circumstances, certain property of those entities specifically mentioned within Minn. Stat. § 273.19 is not exempt, just like some hospital-owned property is not exempt. For example, if a religious society owns property and uses it for a purpose other than for the purpose for which the property tax exemption was crated, that property will not be exempt. *In re Collection of Delinquent Real Property Taxes*, 530 N.W.2d 200 (Minn.

1995); *see also Concordia College Corp v. State*, 265 Minn. 136, 120 N.W.2d 601 (1963).

Moreover, the Tax Court's ruling requiring an across the board *per se* exemption for a particular class of entity in order to satisfy Minn. Stat. § 273.19 runs directly contrary to the Minnesota Constitution's acknowledgment that "public hospitals" and "institutions of purely public charity" shall be exempt from taxation. Minn. Const. Art. X, § 1.

C. <u>The Tax Court Erred in Ruling that HealthEast Does Not Qualify as an Institution of Purely Public Charity.</u>

1. <u>The Qualifications for a Public Charity Exemption</u>

The Minnesota Constitution provides as follows:

> Taxes shall be uniform upon the same class of subjects and shall be levied and collected for public purposes, but public burying grounds, public school houses, public hospitals, academies, colleges, universities, all seminaries of learning, all churches, church property, houses of worship, institutions of purely public charity, and public property used exclusively for any public purpose, shall be exempt from taxation except as provided in this section.

Minn. Const. Art. X, § 1.

Minn. Stat. § 272.02, the "exempt property" provision, provides that institutions of "purely public charity" are exempt from taxation. Minn. Stat. § 272.02, subd. 1(6) (2002)[3]. The Minnesota Supreme Court has defined "charity" to generally mean:

---

[3] Minn. Stat. § 272.02, subd. 1, provides, in relevant part: "All property described in this section to the extent herein limited shall be exempted from taxation . . . (6) Institutions of purely public charity . . . ." The Tax Court erroneously referred to Minn. Stat § 272 as revised in by the legislature in 2005, rather than the version of the statute in effect in the years at issue.

> [A] gift, to be applied consistently with existing laws, for the benefit of an indefinite number of persons "by bringing their hearts under the influence of education or religion, **by relieving their bodies from disease**, suffering, or constraint, by assisting them to establish themselves for life, or by erecting or maintaining public buildings or works, or otherwise lessening the burdens of government.

In re Petition of Junior Achievement of Greater Minneapolis, Inc., 271 Minn. 385, 135 N.W.2d 881 (1965) (footnotes omitted)(emphasis added). The burden of proof rests upon the entity seeking exemption to show that it qualifies as a purely public charity under Minn. Stat. § 272.02. *Junior Achievement*, 271 Minn. at 390.

As recognized in the concurrence of Justices Hanson and G. Barry Anderson in *Croixdale, Inc. v. County of Washington*, the so-called *North Star* factors are not the proper tool to analyze whether HealthEast, the parent company of a health care system, that provides hospital care for the sick, the aged, and the infirm, is entitled to be exempt from taxation as an "institution of purely public charity" in accordance with Article X, Section 1 of the Minnesota Constitution. Indeed, the "significant risk" identified in *Croixdale, Inc.*, has manifested itself in the present case. *Croixdale, Inc.*, 726 N.W.2d at 492. A "mechanical application of that test" [the *North Star* factors] has denied the "exemption to a charity that our Constitution intended to benefit." *Id.*

The complexities of modern health care necessitate a web of interrelated nonprofit, tax-exempt entities working together to maximize efficiencies and deliver health care. The Tax Court's mechanical application of the *North Star* factors to HealthEast (as a stand-alone entity) fails to acknowledge that reality, and undermine the purpose behind Minnesota's Constitution's recognition of the exemption bestowed upon "purely public charities." If the Court decides to retain the so-called *North Star* factors, it should apply the factors to all nonprofit, tax-exempt organizations within the health care system as a whole, and not to each separate entity.[4]

2. <u>HealthEast Meets the Qualifications for a Purely Public Charity Exemption</u>

The Minnesota Supreme Court in *North Star Research Inst. v. County of Hennepin*, 306 Minn. 1, 236 N.W.2d 754, 757 (1975), set forth six factors to be analyzed when determining whether an organization's activities qualify as exempt. An organization need not meet all six factors in order to qualify for an exemption. *Mayo Found. v. Commissioner of Revenue*, 306 Minn. 25, 236 N.W.2d 767, 773 (1975); *Croixdale, Inc.*, 726 N.W.2d at 490.

The Tax Court erred by taking a narrow, technical view of the corporate structure of the entities comprising the HealthEast Care System and by refusing to recognize that HealthEast, for purposes of determining whether it meets the standard for a purely public charity, must be viewed together with the nonprofit, tax-exempt organizations that comprise the entire Health East Care System (particularly the Hospitals and the Foundation).

In *Community Hosp. Linen Serv., Inc. v. Commr. of Taxation*, 309 Minn. 447, 245 N.W.2d 190 (1976), decided by this Court shortly after *North Star*, the Minnesota Supreme Court recognized an exception to the general rule that courts are reluctant to

[4] Of course, any entity within the health care system which is a for-profit activity and which is not a tax-exempt entity under §501(c)(3) of the Internal Revenue Code, will not qualify as an institution of purely public charity under the Minnesota Constitution.

disregard the separate legal entities of parent and subsidiary organizations in order to grant tax exempt status. In *Community Hosp. Linen,* this court held that where tax-exempt public hospitals organize incorporated associations to perform certain services exclusively for member hospitals on a centralized non-profit and cooperative basis, the property owned and used by the association is not disqualified from tax exemption. Here, the Court is faced with the same situation.

HealthEast was formed in 1986 by several hospitals that joined together to form a single health care system. Each hospital became a subsidiary of HealthEast, and a single Board of Directors (and group of officers) was charged with the governance of HealthEast and each of the hospitals. The mission and function of HealthEast is to perform services exclusively for its member hospitals and other controlled affiliates on a centralized basis. In keeping with the growing complexity in the health care industry in the past thirty years, the services provided by the health care system have changed, but the reasoning utilized by this Court in *Community Hospital Linen* remains in valid.

Community Hospital Linen involved two cooperative associations, Community Hospital Linen Services, Inc. ("Community") and Affiliated Hospital Services, Inc. ("Affiliated"). Four hospitals owned and operated Community "for the sole purpose of performing their required laundry services. Eight hospitals owned and operated Affiliated "for the sole purpose of performing their required collection services and printing services." *Id.* at 449. The court noted the following facts relevant to its analysis:

1) Community and Affiliated were nonprofit organizations organized under Minnesota law;

2) Community and Affiliated were limited by their articles of incorporation to performing services for their members;

3) The membership of Community and Affiliated was limited by their articles of incorporation to hospitals which are tax exempt organizations;

4) Control and management of Community and Affiliated were vested solely in their member hospitals;

5) Representatives designated by the member hospitals serve as the directors and officers of Community and Affiliated without compensation;

6) Community and Affiliated were required by their articles of incorporation to be operated on a non-profit basis for the mutual benefit of the member hospitals without profit or financial gain to themselves;

7) Each Member hospital pays the costs of performing the services rendered to it;

8) Prior to the creation of Community and Affiliated the member hospitals operated redundant facilities separately at separate facilities;

9) The consolidation of the subject operations into Community and Affiliated eliminated the former duplication of facilities and resulted in economies of scale and increased efficiency for the member hospitals.

The question for the Court in *Community Hospital Linen* was "whether the fact that the hospitals own and operate the property through an incorporated association, which is technically a separate legal entity, should disqualify the property for the tax exemption." *Id.* at 453. The Court, after analyzing then existing precedent at length, found that the property should be treated as exempt. *Id.* First, the court looked to the ruling in *State v. Board of Foreign Missions of Augustana Synod*, 221 Minn. 536, 22 N.W.2d 642 (1946), as establishing the principle that "it is immaterial for purposes of property-tax exemption that ownership of a particular piece of property is technically in the name of a separate legal entity so long as the property is actually owned and controlled by a tax exempt organization and is used for appropriate qualified purposes."

Community Hospital Linen recognized that there is an exception to the general rule that courts are reluctant to disregard the separate legal entities of the parent and the subsidiary corporation to grant tax relief when "the subsidiary corporation was created solely for and devoted exclusively to serving the purposes of the parent corporations." *Id.* (citing *State v. St. Paul Union Depot Co.,* 42 Minn. 142, 43 N.W. 840 (1889) (holding as follows: "The state plants itself on the technical ground that defendant is a separate and independent legal entity, and that we have no right to consider the functions which it performs, or the relations which it bears to the railway companies who own its stock and use its depot. We think that is too narrow and technical a view of the case.") Here, the Tax Court has taken the same mistaken narrow and technical view of HealthEast when determining that it is not an institution of purely public charity entitled to an exemption under Minn. Stat. § 272.02, subd. 7.

The factors are present in this case are materially similar to those present in *Community Hospital Linen*:

1) HealthEast is a nonprofit organization organized under Minnesota law [App. at 16-17; Stip. 75];

2) HealthEast is limited by its Articles of Incorporation to exist and operate for the benefit of, to perform the functions of, or to carry out the purposes of Bethesda, St. John's, St. Joseph's and Woodwinds Hospitals [App. at 84-89`; Ex. 50];

3) HealthEast is the sole corporate member (i.e. "shareholder") of each of the Hospitals within the HealthEast Care System [Ex. 55];

4) HealthEast and the Hospitals are under common control and management [App. at 84-89; Ex. 50 and 55];

5) Health East is required by its Articles of Incorporation to be operated on a non-profit basis for the mutual benefit of the hospitals without profit or financial gain to itself; [App. at 84-89; Ex. 50]

6) Each hospital pays the costs of performing the services rendered to it [Ex. 82; Statement 24];

7) Prior to the creation of HealthEast the hospitals operated redundant facilities separately at separate facilities [Ex. 83, p.6];

8) The consolidation of the subject operations into HealthEast eliminated the former duplication of facilities and resulted in economies of scale and increased efficiency for the hospitals. [Ex. 79, Statement 26.]

Just as in *Community Hospital Linen*, the "facts compel the conclusion that the respondent associations are merely arms or agencies of the member hospitals exclusively serving the hospitals in necessary and essential ways." The fact that laundry and billing services were provided in *Community Hospital Linen* and here the services provided were corporate services, including accounting, finance, marketing and human resources, is immaterial. When property viewed in context of the HealthEast affiliate network, HealthEast is a purely public charity entitled to property tax exemption.

Factor One: Whether the stated purpose of the undertaking is to be helpful to others without immediate expectation of financial reward.

Ramsey County does not dispute, and the Tax Court properly concluded, that HealthEast's stated purpose, as demonstrated by its Articles of Incorporation, satisfies this *North Star* factor.

Factor Two: Whether the entity involved is supported by donation and gifts in whole or in part.

HealthEast is supported by substantial donations and gifts, which are directed to HealthEast's affiliate, the HealthEast Foundation, which in turn distributes those contributions to HealthEast and other HealthEast affiliates. HealthEast Foundation receives charitable contributions from over 5,000 individuals, business and other organizations. HealthEast Foundation made grants of the following amounts to HealthEast and its controlled nonprofit, tax-exempt affiliates for each of the following fiscal years: approximately $1.5 million for fiscal year 2001; approximately $1.2 million for fiscal year 2002; approximately $838,000 for fiscal year 2003; approximately $1.2 million for fiscal year 2004; and approximately $1.3 million for fiscal year 2005. [App. at 20-22; Stip. 98; Ex. 60, Annual Report to the Community.] The Foundation has also guaranteed the performance by HealthEast under an agreement with Children's Hospital that serves as the basis for the establishment of HealthEast Woodwinds Hospital. [Ex. 83, p.17]. The foregoing demonstrates that HealthEast satisfies this *North Star* factor.

Factor Three: Whether the recipients of the "charitable benefits" are required to pay for the assistance in whole or part.

The Tax Court erred by clinging to a narrow, technical application of this *North Star* factor and refusing to consider the charity care provided by the HealthEast Hospitals.

The HealthEast Care System has written policies and procedures in effect for community service, charity care and financial aid, all of which are rooted in Judeo-Christian values. [Exs. 58, 59.] The total amounts of traditional charity care provided by the HealthEast Care System in fiscal years 2001 through 2005 were as follows:

$2,474,415 in fiscal year 2001, $1,845,156 in fiscal year 2002; $2,535,611 in fiscal year 2003; $3,537,000 in fiscal year 2004; and $4,579,178 in fiscal year 2005. [Ex. 60-64, 85-86 (Annual Reports to the Community)]

The total amounts of un-reimbursed care to special populations (Medicare, Medicaid, UCare, Minnesota Care) in fiscal years 2001 through 2005 were as follows: $26,615,115 in fiscal year 2001; $37,954,215 in fiscal year 2002; $47,770,433 in fiscal year 2003; $55,992,000 in fiscal year 2004; and $64,475,586 in fiscal year 2005.

In addition to amounts for traditional charity and unreimbursed care to special populations, HealthEast Care System also provided services to the low income and broader community (community education; support groups; screenings; equipment; prescription and medical donations; patient and family services; counseling and spiritual support; professional health education and research and cash contributions). The total amount of those services in fiscal years 2001 through 2005 were as follows: $7,137,183 in fiscal year 2001; $6,997,847 in fiscal year 2002; $6,853,064 in fiscal year 2003; $6,884,000 in fiscal year 2004; and $8,506,536 in fiscal year 2005. [Ex. 60-64, 85-86 (Annual Reports to the Community).]

The HealthEast Care System's financial aid and charity care policies are advertised to the community through various means, including the HealthEast internet website and patient billing statements.

HealthEast Hospitals provide interpreter services for patients, health education and screening, and some transportation services, such as taxi service, for patients. In addition, HealthEast physicians and nurse practitioners speak on health issues at community events, publish articles and books on health issues, participate in public service announcements, and volunteer their time to serve as team doctors for sporting events in the community. [App. at 18; Stip. 84.] The above-described benefits provided without requirement of payment demonstrates that HealthEast satisfies this factor.

Factor Four: Whether the income received from gifts and donations and charges to users produce a profit to the charitable institution.

The Tax Court erred by failing to look at the entire Health East Care System when analyzing factor four. The Tax Court further erred by determining that in order to meet factor four, HealthEast must demonstrate that it accepts contributions or donations. The Tax Court apparently improperly conflated this factor with factor two, which addresses whether the entity involved is supported by donations in whole or part.

With respect to this factor the Minnesota Supreme Court has recognized that where profits are used to further the charitable objectives of the organization and not for private gain, the exemption should be granted. *American Association of Cereal Chemists v. County of Dakota*, 454 N.W.2d 912, 915 (Minn. 1990); *Mayo Foundation v. Commissioner of Revenue*, 236 N.W.2d 767, 773 (1975). Moreover, *North Star* cites *Assembly Homes, Inc. v. Yellow Medicine County*, 273 Minn. 197, 140 N.W.2d 336 (1966), which provides as follows:

> Nor does the fact that an organization claiming exemption as one of "purely public charity" operates at a profit derived from charges made to its patients nullify it status as an institution of "purely public charity" if under its charter its operations are intended for the benefit of the public generally and thereunder none of such profits can be paid to stockholders or others.

(quoted with approval in the concurring opinion in *Croixdale, Inc.*, 726 N.W.2d at 495).

There is no dispute that HealthEast is a non-profit entity and that any revenue that exceeds expenses is utilized for the purpose of furthering its charitable mission, not for the benefit of shareholders or members. It is well recognized that the term "non-profit" does not require that an organization operate without generating a profit. Rather, the term "non-profit" means that the profits generated by the organization are used by it to further its charitable mission, and are not distributed to private persons. *See* Minn. Stat. §317A.011, Subd. 6, which defines a nonprofit corporation under the Minnesota Nonprofit Corporation Act. HealthEast, a nonprofit entity, has established that it satisfies this *North Star* factor.

Factor Five: Whether the beneficiaries are restricted or unrestricted, and if restricted, is the class of persons to whom charity is available one having a reasonable relationship to the charitable objectives.

The Tax Court recognized that the beneficiaries of Bethesda Clinic's services and programs are, for the most part, unrestricted; but the Tax Court erred by finding that conclusion irrelevant based on its overly technical application of the *North Star* factors, which looked only to HealthEast rather than the entire HealthEast Care System for an analysis of factor five. Likewise, Ramsey County has relied upon the same argument that HealthEast must be viewed narrowly and therefore provides no charity care.

As recognized by the tax court, Health East Care System's beneficiaries are "for the most part, unrestricted." [App. at 70; Tax Court Order and Memorandum]. The facts set out in the above analysis of *North Star* factor three evidence the fact that the beneficiaries of HealthEast's charity are unrestricted. HealthEast does not restrict the class of persons to whom its charity is made available. HealthEast's tax exempt entities, including the HealthEast Hospitals, will not refuse non-emergency services that, in the opinion of the ordering physician, are medically necessary, solely because of a patient's inability to pay. [Ex. 58, p.2.] HealthEast's policy regarding the treatment of individuals who lack the ability to pay undermines any claim that HealthEast's beneficiaries are restricted.

Moreover, as detailed above, the HealthEast Care System provided traditional charity care in the following amounts: $2,474,415 in fiscal year 2001, $1,845,156 in fiscal year 2002; $2,535,611 in fiscal year 2003; $3,537,000 in fiscal year 2004; and $4,579,178 in fiscal year 2005. [Ex. 60-64 and 85-86 (Annual Reports to the Community)], and unreimbursed care to special populations (Medicare, Medicaid, UCare, Minnesota Care) in the following amounts: $26,615,115 in fiscal year 2001; $37,954,215 in fiscal year 2002; $47,770,433 in fiscal year 2003; $55,992,000 in fiscal year 2004; and $64,475,586 in fiscal year 2005. [Ex. 60-64 and 85-86 (Annual Reports to the Community).]

The HealthEast Care System also provided services to the low income and broader community (community education; support groups; screenings; equipment; prescription and medical donations; patient and family services; counseling and spiritual support; professional health education and research and cash contributions). The total amount of those services provided in fiscal years 2001 through 2005 were as follows: $7,137,183 in fiscal year 2001; $6,997,847 in fiscal year 2002; $6,853,064 in fiscal year 2003; $6,884,000 in fiscal year 2004; and $8,506,536 in fiscal year 2004. [Ex. 60-64 and 85-86 (Annual Reports to the Community).] The significant financial commitment to charity care and services to the broader community demonstrates that HealthEast's policy to provide charitable services to its community without restriction is put into practice on a daily basis, and that HealthEast satisfies *North Star* factor five.

Factor Six: Whether dividends, in form or substance, or assets upon dissolution are available to private interests.

There is no dispute that HealthEast meets the Factor Six. HealthEast's Articles of Incorporation, consistent with its mission as a purely public charity, restrict transfer of assets upon dissolution to charitable, educational, religious, or scientific purposes that qualify under Section 501(c)(3). [App. at 88; Ex. 50.]

D. <u>The Tax Court Erred in Ruling that UMPhysicians Does Not Qualify as an Institution of Purely Public Charity</u>.

The Tax Court stated that, "if HealthEast fails to qualify as a purely public charity, the second part of the analysis is unnecessary in as much as the property cannot be exempt." [App. at 63.] Nevertheless, the Tax Court proceeded with the second part analysis and ruled that UMPhysicians also does not satisfy the *North Star* factors. As shown below, this ruling is also erroneous.

Factor One: Whether the stated purpose of the undertaking is to be helpful to others without immediate expectation of financial reward.

The Tax Court had noted that Respondent does not challenge this factor, and the Tax Court found it satisfied. [App. at 71.]

Factor Two: Whether the entity involved is supported by donations and gifts in whole or in part.

Due to Bethesda Clinic's significant level of free and reduced services to its patients, Bethesda Clinic's patient service revenue is inadequate to cover the costs of providing services. Accordingly, and in order to operate, Bethesda Clinic is required to obtain financial support from other sources, the most significant of which is salary support from University of Minnesota funding sources, shown as the "University Supported Clinical Expense" portion of the financial statements. [App. at 16; Stip. 69.] This support is substantial -- in 2002, it amounted to $415,000; in 2003 it was $415,000; and in 2004 it was $430,000. [App. at 100-101; Exs. 17-19.] The University of Minnesota provides significant salary support to Bethesda Clinic's physician faculty, such that during the relevant years approximately 95% of salaries came from University of Minnesota funding sources and 5% from UMPhysicians funding sources for the years in question. For calendar year 2002, total faculty salaries of $1,102,425 was made up of $1,039,334 University of Minnesota funding sources, compared to $63,091 UMPhysicians funding sources; for 2003, the numbers were the same as salaries were in a "freeze" mode; and in 2004, total faculty salaries of $1,238,685 was comprised of $1,166,754 University of Minnesota funding sources, and $71,931 UMPhysicians sources. [Ex. 20.]

Nevertheless, the Tax Court ruled that UMPhysicians does not satisfy Factor Two because it "is not supported by donations and gifts in whole or in part." [App. at 72.] To reach this result, the Tax Court disregarded the reason that direct charitable donations are not a significant part of UMPhysicians' revenue -- UMPhysicians has agreed to direct all charitable giving in support of its programs to the Minnesota Medical Foundation ("MMF") rather than solicit direct charitable contributions from the general public. [App. at 15-16; Stip. 68.] MMF is closely affiliated with the University of Minnesota, and is the foundation designated by the University to raise funds for the Medical School, School of Public Health, Minnesota Masonic Cancer Center and related centers and programs at the University of Minnesota's academic health center. [App. at 15-16; Stip. 68.] As it does with HealthEast, the Tax Court insists that charitable funding through the University or MMF cannot be considered, but rather that "the focus here must be on UMPhysicians as an entity rather than on the Minnesota Medical Foundation or the University of Minnesota Medical School." [App. at 72.] Such a ruling is unsupported by any authority, and ignores the recognized role of affiliated entities such as charitable foundations as the source of charitable funding. Indeed, this Court has recognized the charitable attributes of both foundations and the institutions they support, in cases such as *Mayo Foundation v. Commissioner or Revenue*, 306 Minn. 25, 236 N.W.2d 767 (1975), holding that the Mayo Clinic and the Mayo Foundation, both prior to and after their merger, were institutions organized and operated exclusively for charitable and educational purposes and thus were exempt by statute from sales and use taxes.

Although the Tax Court properly recognizes that "no amount or percentage of donations is required to find *North Star* Factor Two" [App. at 72], the Tax Court nevertheless disregards not only the substantial funding described above, but also the fact that Bethesda Clinic faculty and staff have also been recipients of funded grants and research projects. [Ex. 8.] In *Cook Area Health Service, Inc. v. County of St. Louis*, File No. C6-00-100312, 2001 Minn. Tax LEXIS 16 (Minn. Tax Ct. Apr. 27, 2001), funding in the form of federal grants was considered a donation toward meeting *North Star* Factor

Two in that case. Through all these sources, UMPhysicians is substantially supported by donations and gifts.

Factor Three: Whether the recipients of the "charitable benefits" are required to pay for the assistance in whole or in part.

It is undisputed in this case that Bethesda Clinic treats all patients without regard to ability to pay, and has a Community Care Program with sliding scale fees based on federal poverty guidelines for qualifying individuals. Under the Community Care Program, eligible patients receive services at a 50-90% discount off the standard charges, and can even access up to a 100% discount if certain additional criteria are met regarding available care in the community and consistent with UMPhysicians' research and educational mission. [App. at 11-13; Stip. 62, Ex. 87.]

In addition to the 5-6% of UMPhysicians' patients who have received support from the Community Care Program, Bethesda Clinic has a high percentage of patients on Medical Assistance, and it deeply discounts its standard fees for those patients. Almost 50% of Bethesda Clinic's charges were billed to Medical Assistance during the relevant time frame. Medical Assistance pays at rates that are less than 30% of UMPhysicians' charges, resulting in a discount of over 70% on services provided to Medical Assistance beneficiaries. [App. at 11-13; Stip. 62, Ex. 87] This results in approximately 35% of Bethesda Clinic revenues being contributed to the care of low-income Medical Assistance patients without reimbursement. [App. at 13; Stip. 63.] Aside from these medical services, Bethesda Clinic also provides supportive services without charge, including transportation coordination, and linguistic and translation services. Bethesda

Clinic employees a number of patient representatives who work directly with patients to help identify needs, coordinate care, and make referrals. [App. at 11; Stip. 61.] Finally, Bethesda Clinic offers community outreach programs and service for its patients in multiple areas including medication assessment, psychological services at rates well below market rates, and services provided in connection with the Hmong Health Care Coalition, including flu shots and Hmong interpreter services. [App. at 13; Stip. 64, Exs. 54-57, 68.]

There is simply no basis for the Tax Court conclusion that the record "lacked evidence" establishing that UMPhysicians' patients receive services at less than market cost or value. [App. at 72.] The deep discounts described above, together with the fact that hundreds of thousands of dollars must be poured into Bethesda Clinic each year during the years in question, because Bethesda Clinic does not generate sufficient revenue to fund its operations, vividly demonstrate that Bethesda Clinic patients receive services free of charge or at considerably reduced rates.

This case is more like *Cook Area Health Service, supra*, finding that Factor Three was satisfied where the Cook Clinic offered services at below market rates for those who did not have insurance and could not afford to pay full price. The Court found in that case that the below market rates were charitable and not a type of "business arrangement." *Cook Area Health Service, supra.*

The Michigan Supreme Court recently analyzed a similar application for real estate tax exemption by a medical clinic, and concluded that reduced rates offered by a charity care program, combined with financial losses incurred by accepting low rate

Medicare and Medicaid patients, supported granting the exemption. *Wexford Medical Group v. City of Cadillac*, 474 Mich. 192, 713 N.W.2d 734 (2006). Indeed, the Michigan Supreme Court reached its conclusion despite the fact that only two patients took advantage of the charity care program in that case during one of the years at issue, and only eleven patients used it in the other year. *Id.* at p. 197. In reaching its conclusion, the Michigan Court described the beneficial and charitable nature of the clinic in language that is equally applicable to the Bethesda Clinic:

> Petitioner has a charity care program that offers free and reduced-cost medical care to the indigent with no restrictions. It operates under an open-access policy under which it accepts any patient who walks through its doors, with preferential treatment given to no one. Although petitioner sustains notable financial losses by not restricting the number of Medicare and Medicaid patients it accepts, it bears those losses, rather than restricting its treatment of patients who cannot afford to pay.

Wexford Medical Group, 713 N.W.2d at 747.

Similarly in this case, the evidence amply demonstrates that a significant number of Bethesda Clinic's patients are the beneficiaries of service that is free or at a price considerably less than market rate. Accordingly, *North Star* factor three is met.

Factor Four: Whether the income received from gifts and donations and charges to users produce a profit to the charitable institution.

The Tax Court found that Factor Four was not met, despite the undisputed facts that Bethesda Clinic incurred a total operating loss of $201,400 in calendar year 2002; $306,931 in 2003; and $525,664 in 2004. It is also undisputed that University of Minnesota funding sources contributed $415,000 in calendar years 2002 and 2003, and

$430,000 in 2004 in financial assistance to support Bethesda Clinic's operations. [App. at 74, 100-101.]

The rationale for the Tax Court's ruling on Factor Four is that while Bethesda Clinic showed a loss, UMPhysicians was profitable during those years. [App. at 74.] The Tax Court conclusion fails to take into account that Factor Four does not preclude a charitable institution making a profit, so long as the profits are used to further the organization's charitable objectives instead of for private gain. *See American Association of Cereal Chemists, supra*, 454 N.W.2d at 915. This Court recently stated that, "Factor Four is not intended to discourage charitable institutions from engaging in financial planning with an eye toward long term viability." *Croixdale, Inc.*, 726 N.W.2d at 490.

Even if the Bethesda Clinic were to generate a profit in any year, the money stays within the clinic for future uses. [App. at 16; Stip. 70.] This case is like *Cook Area Health Service, supra*, in which the Tax Court found that Factor Four was met. The Court noted that even though Cook Clinic had a small gain or loss for the preceding five years, it was not attempting to make a profit. In *Wexford Medical Group, supra*, the Michigan Supreme Court unequivocally rejected the narrow conclusion adopted by the Tax Court in this case, in language that is equally applicable here:

> [T]he idea that an institution cannot be a charitable one unless its losses exceed its income places an extraordinary – and ultimately detrimental – burden on charities to continually lose money to benefit from tax exemption. A charitable institution can have a net gain – it is what the institution does with the gain that is relevant. When the gain is invested back into the institution to maintain its viability, this serves as evidence, not negation, of the institution's "charitable" nature.

713 N.W.2d 747-48 (citation omitted).

The evidence in this case fully supports Factor Four – Bethesda Clinic operated at a substantial Total Operating Loss for the years in question, and the Bethesda Clinic and UMPhysicians have operated in accordance with their charitable principles and intent at all relevant times.

Factor Five: Whether the beneficiaries are restricted or unrestricted, and if restricted, is the class of persons to whom charity is made available one having a reasonable relationship to the charitable objectives.

The Tax Court disposes of this factor in summary fashion, referring to *Allina Medical Clinics v. County of Meeker*, File Nos. C0-02-256, C9-03-363, and C7-040288 (Minn. Tax Ct. Feb. 18, 2005), to conclude that "UMPhysicians does not lessen the burden of government since it seeks insurance and government forms of payment before providing charity care." [App. at 74-75.] However, Bethesda Clinic is far different than the Allina Clinic in Meeker County. As the *Allina* Court itself noted: "Meeker County has not been identified as a medically underserved area." *Allina* at pp. 38-38. In stark contrast, the Bethesda Clinic is in a medically underserved area in the inner city of St. Paul, and has been granted Essential Community Provider status under Minn. Stat. § 62Q.19. The Tax Court also fails to take into account Bethesda Clinic's significant subsidizing of the cost of care provided to its patients in light of the government's underpayment of Medicaid and other government programs.

In *Wexford Medical Group*, the Michigan Supreme Court described this activity as "lessening the government's burden of covering the full cost of a person's care," 713 N.W.2d at 748, and rejected the argument advanced by the Tax Court in this case, in language that is especially appropriate: "[E]ven though petitioner helps to enroll patients in Medicare and Medicaid, it still subsidizes the cost of care in light of the government's underpayment, thus lessening the government's burden of covering the full cost of a person's care." 713 N.W.2d 748.

In *Cook Area Health Service, supra*, the Tax Court found that because of the existence of the Cook Clinic, the government did not have to own and operate its own hospital, and that Factor Five was thereby satisfied. In that case, the Tax Court rejected the County's argument that the Petitioner did not lessen the governmental burden since government was making a payment through a federal grant. The Court reasoned that because of the Cook Clinic, the government did not have to own and operate its own hospital, and accordingly found Factor Five satisfied as part of the analysis granting charitable status to the Cook Clinic. *Cook Area Health Services, supra.*

Like the clinic in *Wexford Medical Group*, Bethesda Clinic lessens the government's burden of covering the full cost of a person's health care. Like the facility in *Cook Area Health Services*, the existence of the Bethesda Clinic means the government does not have to provide a different facility to serve Bethesda Clinic's patients. Factor Five is amply satisfied in this case.

Factor Six: Whether dividends in form or substance, or assets upon dissolution are available to private interests.

Noting that UMPhysicians' Articles of Incorporation restrict transfer of assets upon dissolution to charitable entities, and that Respondent does not contest this factor, the Tax Court found that UMPhysicians meets *North Star* Factor Six. [App. at 75.]

CONCLUSION

Both HealthEast and UMPhysicians meet the classic attributes of charity as defined by this Court. The Bethesda Clinic provides free and below-cost medical care to anyone who needs it without qualification, and its charitable work lessens the burdens of government in ways that make a special contribution to the public. These are the very types of benefits to the public that the exempt property statute is meant to encourage and promote.

This Court noted in *Skyline Preservation Foundation v. County of Polk*, 621 N.W.2d 727, 732 (2001) that, "although exemptions are to be strictly construed, they should not be interpreted in a manner that frustrates the very purpose of exemption." The Tax Court ruling does not take issue with the positive attributes of HealthEast, UMPhysicians or the Bethesda Clinic, but instead denies public charity status by narrowly focusing on their organizational structures. By refusing to attribute to HealthEast or UMPhysicians the substantial charitable donations and charitable services provided through their closely-aligned affiliated entities, and by finding that any profit or increase in net worth negates their charitable status, even when those funds are themselves invested in the entity to fund more charitable benefits, the Tax Court ruling improperly honors "form over substance."

For all the reasons set forth above, Respondents respectfully request the Tax Court's decision be reversed, such that the Subject Property be granted exemption from Real Estate taxes for the years at issue.

Respectfully submitted,

Dated: August 15, 2007.

MOORE, COSTELLO & HART, PLLP

By John G. Patterson

J. Patrick Plunkett, (#87221)
John G. Patterson (#144320)
Martin D. Kappenman (#320596)
900 Second Avenue South, Suite 1500
Minneapolis, MN 55402-5079
Telephone: (612) 673-0148

ATTORNEYS FOR PETITIONER RELATOR HEALTHEAST

Dated: August 15, 2007.

GRAY, PLANT, MOOTY, MOOTY & BENNETT, P.A.

By Michael C. Flom

Michael C. Flom (#140089)
500 IDS Center
80 South Eighth Street
Minneapolis, Minnesota 55402
Telephone: (612) 632-3000

ATTORNEYS FOR INTERVENOR-RELATOR UNIVERSITY OF MINNESOTA PHYSICIANS

(based upon STP·145342 1)

GP:2251597 v1