

NO. A07-1086

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State of Minnesota  
**In Supreme Court**

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HealthEast,

*Relator,*

and

University of Minnesota Physicians,

*Intervenor-Relator,*

vs.

County of Ramsey,

*Respondent.*

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**RESPONDENT'S BRIEF**

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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)  
Civil Division Director  
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*

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## STATEMENT OF THE CASE

This case concerns whether a health clinic located at 580 Rice Street in St. Paul, Minnesota is entitled to a property tax exemption. Because the property is leased by HealthEast to UMPPhysicians, the requirements of Minn. Stat. § 273.19, subd. 1 must be met. The Tax Court correctly ruled that the owner of the property, HealthEast, was neither a “corporation whose property is not taxed in the same manner as other property” nor an institution of purely public charity. As a result, the first requirement of that statute was not met. The Tax Court also correctly ruled that UMPPhysicians was not an institution of purely public charity. As a result, the subject property does not qualify for tax exemption even if the requirements of section 273.19 were met.

## STATEMENT OF FACTS

There is no dispute as to the facts that are critical to this case. The parties agree and the Tax Court found that the subject property is owned by HealthEast, the parent corporation for a number of health care entities. Some of the HealthEast subsidiaries are hospitals, some are not for profit corporations and several are for profit taxable corporations. (App. at 53).

HealthEast provides management services for its subsidiaries. A fee is charged for those services based on a percentage of the operating expenses of the subsidiary. During the years at issue, HealthEast had revenues ranging from \$46 to

\$74 million which resulted in profits for most years of between \$3.8 and \$5.8 million. Direct and indirect public support was minimal during this time. (App. at 53).

During the first year at issue, the subject property was leased to the University of Minnesota. For subsequent years, the property was leased to UMPPhysicians. UMPPhysicians is the private practice component of the University of Minnesota Medical School. It was established in order to take advantage of cost efficiencies so that its clinics could compete more effectively in the Minneapolis medical market. (App. at 54).

UMPPhysicians had revenues ranging from \$102 to \$151 million during the years at issue. Profits ranged from \$1.9 million to \$4.5 million. UMPPhysicians receives no direct charitable support. (App. at 54).

## ARGUMENT

### A. The Standard of Review

The standard of review is that 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 a 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. Applicable Rules of Construction**

A claim of exemption from real estate taxes must always begin with the general rule that all property is presumed taxable. *Croixdale, Inc. v. County of Washington*, 726 N.W.2d 483, 487 (Minn. 2007). A statute creating exemption from taxation must be strictly construed. *Care Inst. Inc. – Roseville v. County of Ramsey*, 612 N.W. 2d 443, 447 (Minn. 2000). “The presumption against tax exemption can only be rebutted by ‘clear and express language.’” *DePonti Aviation, Inc. v. State*, 280 Minn. 30, 34, 157 N.W.2d 742, 746 (1968). Another general rule for property to be exempt is that it must be owned by an exempt entity and be put to an exempt use for which that entity was organized, *i.e.* there must be a concurrence of ownership and use. *Ideal Life Church of Lake Elmo v. Washington County*, 304 N.W.2d 308, 313 (Minn. 1981).

**C. The Tax Court Properly Concluded that HealthEast Must Satisfy the North Star Factors in Order for the Subject Property to have Tax Exempt Status**

In this case HealthEast owns the property, but leases it to another entity. The property would therefore normally not qualify for exemption. Relators acknowledge that the narrow exception to this rule found in Minn. Stat. § 273.19, subd. 1 controls whether the property at issue is entitled to an exemption. That section applies because the property was leased during the relevant time period. In order to qualify for the exemption under Minn. Stat. § 273.19, subd. 1, the property must first meet the specific definition of “tax-exempt property” contained

in the statute. If that definition is met, then and only then the property is treated for property tax purposes as the property of the person holding it under the lease.

The definition of “tax-exempt property” in Minn. Stat. § 273.19, subd. 1 is different than the definition of tax-exempt property generally. The section applies only to:

property owned by the United States, the state, a 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.

Id. Relators argue that the property meets this definition because it is owned by HealthEast, a holding company comprised primarily of four hospitals. As a result, they claim that it is a “corporation whose property is not taxed in the same manner as other property.”

The Tax Court implicitly found that HealthEast is not a “corporation whose property is not taxed in the same manner as other property.” The court properly concluded that this phrase applies only to entities such as land grant institutions, railroads and others that are entitled to an exemption for all the property they own, or whose property is subject to a different method of taxation, such as the gross earnings tax. The Tax Court found that HealthEast is not one of the types of entities covered by the statute.

Relators suggest that because HealthEast is the parent company for some hospitals (as well as for other entities) it should be considered a hospital. As a hospital it should qualify as a “corporation whose property is not taxed in the same

manner as other property.” This argument confuses the legal status of the entities involved and is at the core of Relators’ erroneous reasoning. HealthEast is not a hospital. It is a holding company that owns hospitals, clinics, and other health care related entities. The Tax Court specifically found that HealthEast is “a holding company that owns and provides management services for a fee to a number of its subsidiary hospitals and clinics.” (App. at 53).

Relators also suggest that the phrase “corporation whose property is not taxed in the same manner as other property,” is a “catch-all” for every type of entity that could possibly have exempt property. If that were the case, then there would be no reason to have a specific definition of tax-exempt property in this subdivision. The definition in this statute explicitly leaves out several entities that could own exempt property under Minn. Stat. § 272.02. For example, public burying grounds, public hospitals, and governmental entities other than the state or federal government are not included in the definition. To have all of those entities included as corporations “whose property is not taxed in the same manner as other property” renders the statutory definition meaningless. Furthermore, adopting Relators’ view of the statute would require HealthEast to be either a hospital or an institution of purely public charity. Relators have proven neither.

Relators assert that “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 acknowledgement that ‘public hospitals’ and ‘institutions of purely public charity’ shall be exempt

from taxation.” Rel. Brief at 19. This argument fails to recognize this Court’s history of interpreting those constitutional exemptions. Article X of the Minnesota Constitution states in section 1 that “public hospitals” and “institutions of purely public charity” “shall be exempt from taxation.” Yet there is a large body of case law holding that property of either of those types of institutions must prove that the property it owns is used for its exempt purposes for exemption to be granted. *See, e.g., Croixdale, Inc. v. County of Washington*, 726 N.W.2d 483, 488 (Minn. 2007); *Abbott-Northwestern Hospital, Inc. v. Hennepin County*, 389 N.W.2d 916, 919, 61 A.L.R.4<sup>th</sup> 1099 (Minn. 1986). There is nothing contrary to the state Constitution in the Tax Court’s observation that a hospital’s property is not *per se* exempt, and that it would therefore not fit the category of “corporations whose property is not taxed in the same manner as other property.”

Because the property at issue is not owned by a “corporation whose property is not taxed in the same manner as other property,” the Tax Court correctly ruled that the owner of the property would need to be a “benevolent society or institution”. The “benevolent society or institution” requirement of section 273.19 has been held by the Tax Court in *Little Earth of United Tribes, Inc. v. County of Hennepin*, 1985 WL 3171 (Minn. Tax) to be the equivalent of that for an institution of purely public charity:

The property is owned by Little Earth, which the parties have stipulated is an institution of purely public charity. Under normal and approved usage, an institution of purely public charity would be considered a "benevolent society or institution" in the words of the statute.

*Little Earth* at \*13. As will be demonstrated below, HealthEast cannot meet the standard to be treated as a purely public charity.

**D. The Tax Court Properly Concluded that HealthEast is Not an Institution of Purely Public Charity**

**a. The owner of the property, HealthEast, must qualify as an institution of purely public charity—not HealthEast Care System.**

Relators apparently recognize that HealthEast on its own does not qualify as an institution of purely public charity for property tax purposes. There is no dispute that HealthEast is a management company that charges a fee to its subsidiaries for administrative services. It provides no patient care, generates substantial revenue and income, and has minimal direct or indirect public support.

In order to avoid the obvious conclusion that HealthEast does not qualify as an institution of purely public charity, Relators urge this court to look at the entire “health care system” owned by HealthEast. They claim that “[t]he complexities of modern health care necessitate a web of interrelated nonprofit, tax-exempt entities working together to maximize efficiencies and deliver health care.” As a result, they urge the court to depart from a “mechanical application” of the factors applied in *North Star Research Inst. v. County of Hennepin*, 306 Minn. 1, 236 N.W.2d 754 (1975).

This argument is not supported by anything in the record. No facts were introduced that would support the need for “a web of interrelated nonprofit, tax-exempt entities” to provide health care services. Even if there was factual support

for this argument, Relators fail to demonstrate why health care holding companies should be granted special status. Further, they provide no authority for this court to grant such a special status. Exemptions from property taxes are normally created by the legislature.

Relators also attempt to persuade this court to look to the entire HealthEast Care System rather than HealthEast standing alone by analogizing to this Court's decision in *Community Hosp. Linen Serv., Inc. v. Commr. of Taxation*, 309 Minn. 447, 245 N.W.2d 190 (1976). That case, however, created a narrow exception to the rule that a property must be owned and used by the charitable organization. The Tax Court appropriately distinguished *Community Hospital* when it noted:

In *Community Hospital*, the charitable entity owned and controlled the subsidiary that owned the property and has been created solely to provide non-charitable services for the parent hospitals. Here, however, HealthEast owns the Subject Property rather than HealthEast's various affiliates...*Community Hospital* did not involve imputing the charitable donations of an affiliated entity to an entity that would not otherwise be exempt. Nor did it attribute the exempt status of a subsidiary to its parent.

(App. at 65). In order for *Community Hospital* to apply, the property must be owned by a subsidiary of the exempt entities and used for exempt purposes. There is no authority for imputing tax-exempt status from a subsidiary to a parent or for attributing the combined attributes of the subsidiaries to the parent.

In support of their argument for extending the rule in *Community Hospital* to HealthEast, Relators cite eight factors that they claim are materially similar to

those in *Community Hospital*. However, they blatantly leave out one critical distinction. In *Community Hospital*, each of the owners of the subsidiary was an exempt entity and the property would have been exempt if used by one of the owners alone. Here, HealthEast Care System is not composed entirely of tax-exempt entities. There is no dispute that HealthEast owns taxable for profit entities as well. Furthermore, there is no evidence or support offered for the proposition that the property would be exempt if held by any of HealthEast's subsidiaries. If it were owned by one of the hospitals, it would not be exempt because it is being used as a clinic, not a hospital. The nature of the other subsidiaries would need to be examined to see if any of them could qualify for an exemption.

**b. Neither HealthEast nor HealthEast Care System meets the *North Star* standards.**

When examining HealthEast as a stand-alone corporation, it is clear that the *North Star* factors are not met. Relators assert that the Tax Court erred when it concluded that HealthEast did not satisfy the second, third, fourth and fifth factors of the *North Star* test. Relators fail to offer any evidence whatsoever that HealthEast, as a stand-alone corporation, meets any of these disputed factors. Rather, they only provide financial figures from other various subsidiaries and continue to assert that HealthEast, through its subsidiaries, satisfies the test.

Even if this court looks to the consolidated operations of HealthEast Care System, the criteria in *North Star* would not be met. For example, Relators claim

that factor two which requires substantial charitable contributions is met because the HealthEast Foundation made contributions to HealthEast and its controlled subsidiaries in the relevant years in amounts ranging from \$838,000 to \$1.5 million a year. Those contributions are minimal in the context of the consolidated revenues of the various HealthEast entities. Total revenues during the relevant time period ranged from \$482 to \$636 million. As a result, the charitable contributions were no more than 0.3 percent of revenues in any year.

Consequently, HealthEast Care System does not receive an “adequate percentage of its revenue from altruistic supporters” as is required by the second factor of the *North Star* test. Skyline Preservation Foundation v. County of Polk, 621 N.W.2d 727, 733 (Minn. 2001), *citing* Care Institute—Maplewood v. County of Ramsey, 576 N.W.2d 734, 739 (Minn. 1998).

Similarly, Relators argue factor three of *North Star* is met because of the amount of charity care, Medical Assistance and other unreimbursed care provided by the HealthEast subsidiaries. Factor three looks to whether recipients of charitable benefits are required to pay for the assistance in whole or in part. Relators provide no context for the manner in which the charity care is delivered or what percentage of the normal charge recipients are expected to pay. Those charges are not compared to the amount paid by patients covered by third party insurance or Medical Assistance. Thus there is nothing in the record to distinguish the charity care patients from any other patient treated.

The practices of HealthEast Care System are no different than those of the petitioner in Chisago Health Services v. Commr. of Revenue, 462 N.W.2d 386

(Minn. 1990), where this court found:

The fact that CHS discounts its market fees in accepting Medicare and Medicaid payments does not, by itself, constitute the extension of charity to the patients involved. As the Tax Court noted, there is little conceptual difference between these discounts and the business discounts negotiated by HMO's and health insurers on behalf of their insureds with both public and private clinics and hospitals. As to the open door policy, the Tax Court found it did benefit a relatively small number of patients, but that, in practice and on the whole, the open door policy was no more than writing off uncollectible bills, a business practice not unlike that of other health care providers.

Id. at 391. As a result, factor three of *North Star* is not met by the business practices of the HealthEast controlled entities.

With respect to factor four of *North Star*, Relators argue that the existence of profits within the organization is not relevant so long as those profits further the charitable mission, citing *American Association of Cereal Chemists v. County of Dakota*, 454 N.W.2d 912, 915 (Minn. 1990). *American Association of Cereal Chemists*, however, only says that realization of a profit is not decisive. It doesn't provide a blanket exception as argued by Relators. The appropriate inquiry is into how the profits are used and whether salaries and other benefits exceed the amount of the charitable contribution. *Allina Medical Clinics v. County of Meeker*, 2005 WL 473908 (Minn. Tax). As in *Allina*, salaries far exceed HealthEast's direct and indirect public support for each of the years. Thus, factor four is not met.

Finally, Relators have not demonstrated that HealthEast meets factor five because they have failed to address the subfactor requiring a showing that the business of HealthEast reduces the burden of government. Although Relators claim that medical services are provided to all patients regardless of ability to pay, they do not address the issue of whether all alternative forms of payment including Medical Assistance are exhausted before charity care is provided. Considering the amount of Medical Assistance care claimed, it is likely that this avenue of payment is actively pursued. If so, then the burden on government is not relieved. Id. at \*11.

In summary, Relators apparently no longer argue that HealthEast, the owner of the property, is an institution of purely public charity. They argue instead that HealthEast Care System, which is comprised of the various tax-exempt non-profit and taxable for profit entities owned by HealthEast, meets the test of *North Star*. Even on a consolidated basis, the test of a charitable institution is not met. Allowing an exemption for an entity composed in part of for profit corporations would be unprecedented.

**E. The Tax Court Properly Concluded that UMPHysicians is Not an Institute of Purely Public Charity**

Since the owner of the property, HealthEast is not entitled to tax-exempt status, the property cannot be exempt and it is unnecessary to consider whether UMPHysicians is an institution of purely public charity. The Tax Court, however, decided to continue the analysis and found that even if HealthEast was an institution of purely public charity, UMPHysicians was not. The Tax Court was correct in that ruling.

In its argument that UMPHysicians meets the *North Star* test, Relators again urge the court to ignore the status of the legal entity at issue. The lessee in this case is UMPHysicians, not the Bethesda Clinic. The Bethesda Clinic has no separate legal status. It is only one of several clinics operated by UMPHysicians. The operations of the Bethesda Clinic are relevant only if UMPHysicians meets the test of a purely public charity. If it does, then Relators would need to prove that the property at issue (Bethesda Clinic) is used in furtherance of the overall charitable purpose of UMPHysicians. The operations of one clinic cannot be used to convey charitable status on the entire corporation. If the focus is on UMPHysicians, there can be no question that the *North Star* test is not met.

**1. UMPHysicians does not meet the second *North Star* criteria.**

The first factor UMPHysicians fails to meet is number two, which addresses whether the entity involved is supported by donations and gifts in whole or in part.

Relators admit that UMPHysicians receives no donations or gifts. They urge the Court to ignore this fact because of claimed support from the University of Minnesota or the Minnesota Medical Foundation. If support is received from those entities, it is not recorded on any of the financial statements publicly filed by UMPHysicians. The corporation's 990 returns make no claim of direct or indirect public support. (App. at 16; Stip., 71, 72, 73; Ex. 47, 48, 49 at line 1d). The parties have also stipulated to the lack of charitable donations. (App. at 15; Stip. 68).

Relators argue that the University of Minnesota supports the salaries of the Bethesda Clinic physicians. If that is true, the support apparently does not run through UMPHysicians as it is not reported on the financial statements. Relators also reference the Minnesota Medical Foundation as the recipient of charitable contributions, yet provide no explanation of how those donations are used to support the work of UMPHysicians. They argue only that MMF is the primary foundation that raises money for various University programs. As a result, neither the claimed salary support from the University nor donations to MMF are relevant to whether UMPHysicians is a charitable entity.

Relators also assert that the Tax Court erred by not considering faculty and staff grants and research projects. The grants received, however, are for specific projects, not patient care. They are in essence a contract for research or other services. The grants are not given to support the patient care provided by the clinic as was the case in *Cook Area Health Services v. County of St. Louis*, 2001

WL 428623 (Minn. Tax). As a result, the grants received cannot be considered a form of charitable contribution.

**2. UMPHysicians does not meet the third *North Star* criteria.**

The next *North Star* factor UMPHysicians fails to meet is the third, which requires UMPHysicians to show that it provides charitable services for its patients. To satisfy this factor, UMPHysicians must prove that its patients at the subject property receive services free of charge or at considerably reduced rates. The Tax Court properly ruled, based on *Allina Medical Clinics v. County of Meeker*, 2005 WL 473908 (Minn. Tax), that this factor is not met because the majority of patients pay for services and all patients, if unable to pay, must exhaust all other avenues of payment.

All patients are billed for and asked to pay for the services provided. All medical insurance plans are accepted. Patients without insurance are assisted in applying for coverage for which they might qualify. Community Care is provided with sliding scale fees based on federal poverty guidelines for qualifying individuals who have been unable to obtain any insurance or other coverage. Community Care is provided only after all other financial means to pay for services, whether private insurance or governmental benefits, have been explored. (App. at 24; Stip. 120; Ex. 89; Wendy Nickerson Deposition pp. 7-9). Community Care accounted for less than 1% of gross charges for 2003 and 2004 (.1% - .15%), and represented fewer than 369 visits to the clinic. (*Id.* Exhibit 6). With respect to the small number of patients who do receive Community Care, Relators have

never established that those patients pay anything less than rates negotiated with third party carriers.

As noted above with respect to HealthEast, these business practices are no different than those of the petitioner in *Chisago Health Services v. Commr. of Revenue*, 462 N.W.2d 386 (Minn. 1990). In *Chisago Health Services* this Court found that similar business practices were no different than those of any other health care provider and that factor three was not satisfied. *Id.* at 391. The same analysis applies here.

Relators argue that this Court should abandon its long standing ruling in *Chisago Health Services* and apply the analysis set out by the Michigan Supreme Court in *Wexford Medical Group v. City of Cadillac*, 713 N.W.2d 734 (Mich. 2006). Michigan law with respect to exemptions from property tax is different from the established law in Minnesota. Michigan does not have a test similar to that set out in *North Star* and appears to have a lower threshold for obtaining exempt status. As a result, this Court should not depart from its previous rulings and adopt the analysis of a different state.

### **3. UMPHysicians does not meet the fourth *North Star* criteria.**

Factor four asks whether the income received from gifts and donations and charges to users produces a profit to the charitable institution. The Tax Court found that UMPHysicians had profits ranging from almost \$3 million to \$4.5 million in the relevant years. (App. at 74). Relators do not attempt to dispute these numbers but again switch gears and argue that they are not precluded from

making a profit, so long as it stays within the clinic for future uses. Relators again cite the non-controlling Michigan case along with *American Association of Cereal Chemists v. County of Dakota*, 454 N.W.2d 912, 915 (Minn. 1990), to support their position.

As noted above, *American Association of Cereal Chemists* only says that realization of a profit is not decisive; it does not state that profits can be realized if they are retained. All non-profits are required to retain earnings until dissolution. The inquiry is into the use of funds received from donations and charges for services. In this case UMPHysicians receives no donations and all of its profits are derived from charges to patients. As noted by the Tax Court, “UMPHysicians staff is well compensated regardless of their patients’ ability to compensate them.” (App. at 24).

Relators further claim that this situation is more like *Cook Area Health Service, Inc. v. County of St. Louis*, 2001 WL 428623 (Minn. Tax), where the court found that factor four was satisfied. In *Cook Area Health Services*, the Tax Court found that “[a] small gain or loss was shown for the past five years. In FY 1999, Petitioner lost \$28,905.” In the present situation, UMPHysicians realized profits ranging from almost \$3 million to \$4.5 million. Thus, these two situations are quite different and Relators have failed to demonstrate how factor four is met.

#### **4. UMPHysicians does not meet the fifth *North Star* criteria.**

The last disputed factor in the *North Star* test asks whether the beneficiaries are restricted and if so, whether the class of persons to whom charity is made

available is one having a reasonable relationship to the charitable objectives. A subfactor is whether the entity “lessens the burden of government”. The Tax Court properly relied on *Allina Medical Clinics* to support the finding that when a clinic requires that all possible types of payment be exhausted, there is no lessened burden on government. (App. at 24-25).

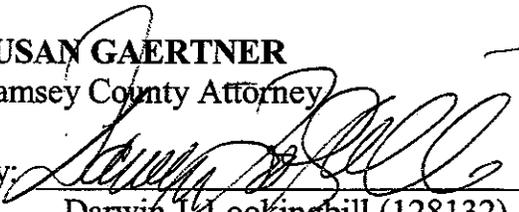
Relators argue that the Bethesda Clinic operated by UMPHysicians is in a medically underserved area and is therefore distinguishable from *Allina*. While the court in *Allina Medical Clinics* did find that Meeker County was not identified as medically underserved, it did not rule that the fifth *North Star* factor would be met by simply showing that the clinic was in a medically underserved area. In *Cook Area Health Services* the court found that the existence of the clinic meant that the government did not have the obligation of maintaining its own hospital and clinic. *Cook Area Health Service, Inc. v. County of St. Louis*, 2001 WL 428623, \*8 (Minn. Tax). Relators have made no attempt to show that the existence of the Bethesda Clinic relieves the government from the obligation of running its own clinic in the area. Thus factor five is not met.

## CONCLUSION

Relators fail in their attempt to show that HealthEast, as a stand-alone corporation, is either a corporation whose property is not taxed in the same manner as other property or that it satisfies the *North Star* test for determining whether the corporation is an institution of purely public charity. Rather, they overlook the legal distinctions between HealthEast and its various subsidiaries in an attempt to satisfy the definition of the type of entity that qualifies under Minn. Stat. § 273.19 which governs when leased property may qualify for exemption from property taxes. Even if HealthEast met the definition of the type of owner covered by the statute, UMPPhysicians is not an institution of purely public charity. As a result the subject property is not entitled to an exemption from property taxes and the Tax Court ruling should be affirmed.

Respectfully submitted,

**SUSAN GAERTNER**  
Ramsey County Attorney

By:   
Darwin J. Lookingbill (128132)

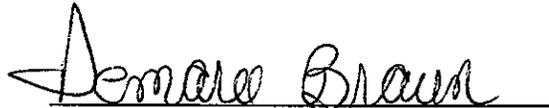
Civil Division Director  
50 West Kellogg Boulevard, Suite 560  
St. Paul, MN 55102-1556  
Telephone: (651) 266-2755

ATTORNEYS FOR RESPONDENT  
COUNTY OF RAMSEY

Dated: 9/12/07

## CERTIFICATE OF COMPLIANCE

I, Demaree Braun, certify that Respondent's Brief complies with the word count limitation of Minn. R. Civ. App. P. 132.01, subd. 3(a). I further certify that, in preparation of this Brief, I used Microsoft Word 2000, and that this word processing program has been applied specifically to include all text, including headings, footnotes, and quotations in the following word count. All text is 13 point Times New Roman. I further certify that the Brief contains 4,777 words.

  
Demaree Braun