
State of South Carolina
Department of Revenue
301 Gervais Street, P. O. Box 12265, Columbia, South Carolina 29211
Website Address: <http://www.sctax.org>

SC REVENUE RULING #05-18

SUBJECT: Property Tax Exemption for Nonprofit Hospitals
(Property Tax)

EFFECTIVE DATE: Applies to all periods open under the statute.

SUPERSEDES: All previous advisory opinions and any oral directives in conflict herewith.

REFERENCES: S. C. Code Ann. Section 12-37-220(A)(2)(2000)
South Carolina Constitution, Article X, §3(b)(Supp. 2004)

AUTHORITY: S. C. Code Ann. Section 12-4-320(2000)
S. C. Code Ann. Section 1-23-10(4)(Supp. 2004)
SC Revenue Procedure #05-2

SCOPE: The purpose of a Revenue Ruling is to provide guidance to the public and to Department personnel. It is an advisory opinion issued to apply principles of tax law to a set of facts or general category of taxpayers. It is the Department's position until superseded or modified by a change in statute, regulation, court decision, or another Departmental advisory opinion.

Question:

Is every piece or item of property owned by a charitable entity that operates a hospital exempt from ad valorem property taxation under Article X, §3(b), of the South Carolina Constitution and Code Section 12-37-220(A)(2)?

Conclusion:

No. In the opinion of the Department, the property must be devoted to, and necessary for, the functional operation of the hospital in order for the property to be exempt from ad valorem property taxes under the constitutional provision and Code Section 12-37-220(A)(2). While each situation must be examined on a case-by-case basis, examples are provided at the end of this document that provide guidance as to how the principles expressed in this revenue ruling will be applied by the Department. Please note, the examples are fact specific and a change in one fact may result in a different conclusion as to the exempt status of the property.

Discussion:

Article X, Section 3(b) of the South Carolina Constitution provides:

There shall be exempt from ad valorem taxation:

...

(b) all property of all schools, colleges and other institutions of learning and all charitable institutions in the nature of hospitals and institutions caring for the infirmed, the handicapped, the aged, children and indigent persons, except where the profits of such institution are applied to private use.

Code Section 12-37-220(A)(2) provides that:

(A) Pursuant to the provisions of Section 3 of Article X of the State Constitution and subject to the provisions of Section 12-4-720, there is exempt from ad valorem taxation:

...

(2) all property of all schools, colleges, and other institutions of learning and all charitable institutions in the nature of hospitals and institutions caring for the infirmed, the handicapped, the aged, children and indigent persons, except where the profits of such institutions are applied to private use.

While there is no definition of hospital contained in the constitutional provision or Code Section 12-37-220(A)(2), there is a definition of hospital in Chapter 7, Title 44, the State Certification of Need and Health Facilities Licensure Act. This Act is used to determine whether a hospital or an expansion of an existing hospital is needed in a particular geographical area and to govern the licensing of these hospitals. It defines a “hospital” as:

A facility organized and administered to provide overnight medical or surgical care or nursing care of illness, injury, or infirmity and may provide obstetrical care, and in which all diagnoses, treatment or care is administered by, or under the direction of persons, currently licensed to practice medicine, surgery, or osteopathy.

See SC Code Section 44-7-130.

The Department of Health and Environmental Control regulations that are associated with the State Certification of Need and Health Facilities Licensure Act further define “hospital” as:

A facility organized and administered to provide services to accommodate two or more non-related persons for the diagnosis, treatment, and care of such persons over a period exceeding 24 hours and provides medical or surgical care or nursing care of illness, injury, or infirmity and may provide obstetrical care, and in which all diagnoses, treatment, or care is administered by or under the direction of persons currently licensed to practice medicine, surgery, or osteopathy.

SC Reg. 61-15, Section 103, amended by State Register Volume 17, Issue No. 6, effective June 25, 1993.

Reviewing the constitutional provision and Code Section 12-37-220(A)(2), it might be argued that the term “all property” seems to allow an exemption for all property owned by an entity that owns a hospital so long as the profits are not used for private purposes. However, the case law and the rules of statutory construction require that the term “all property” be construed more narrowly so that the interpretation of this term does not produce an absurd result.

"However plain the ordinary meaning of the words used in a statute may be, the courts will reject that meaning when to accept it would lead to a result so plainly absurd that it could not possibly have been intended by the legislature or would defeat the plain legislative intention." Kiriakides v. United Artist Commun., Inc., 312 S.C. 271, 275, 440 S.E.2d 364, 366 (1994) (quoted in Conner v. City of Forest Acres, 363 S.C. 460, 611 S.E.2d 905, 909 (2005)). If possible, the statute will be construed in a manner that escapes the absurdity and carries the legislative intention into effect. Id.

To read the constitutional provision and the statute as allowing all property of a charitable entity that owns and runs a hospital to qualify as exempt from tax would lead to an absurd result as property that was totally unrelated to the functioning of the hospital would be exempt. The unintended result of allowing a broad interpretation of the statute would be that property such as shopping centers, vacant land, or even a manufacturing plant would be exempt from ad valorem taxes so long as it is owned by an entity that also owns and operates a hospital.

It is unlikely that the intent of the constitutional provision or the statute was to confer a property tax exemption based on ownership alone. Exemptions based solely on ownership status fell into disfavor after the railroad industry “obtained a virtual exemption from taxation” in the 1800s. Town of Morristown v. Woman’s Club of Morristown, 124 N.J. 605, 612, 592 A.2d 216, 220 (1991). Typical of such exemptions was language providing that “all the property and effects of [the railroad] company shall be exempt from taxation [for a certain period].” Ford v. Delta & Pine Land Co., 164 U.S. 662, 665 (1897) (considering this language, but holding that, because of intervening facts, it did not control the issue).

In Ford v. Delta & Pine Land Co., the United States Supreme Court rejected the idea of a property tax exemption based solely on ownership alone, instead noting that it had been frequently decided that a general property tax exemption for the property of a corporation is construed as referring only to the property that is necessary for the entity to conduct its business. This approach was “founded in the wisest reasons of public policy.” Id. at 667. As the Supreme Court consistently recognized, a contrary construction would have produced an absurd result:

It would lead to infinite mischief if a corporation, simply by investing its funds in property not required for the purpose of its creation, could extend its immunity from taxation, and thus escape the common burden of the government.

Id.

Tax exemption statutes are strictly construed against the taxpayer. Westview Baptist Church v. Rembert, 286 S.C. 30, 331 S.E.2d 382 (Ct. App. 1985) (citing Hibernian Society v. Thomas, 282 S.C. 465, 319 S.E.2d 339 (Ct. App. 1984)). Construing the exemption set forth in Section 12-37-220(A)(2) as applying only to property that is devoted to, and necessary for, the functional operation of the hospital avoids an absurd consequence and carries the constitutional and legislative intent into effect.

While the exemption is limited to property that is devoted to, and necessary for, the functional operation of the hospital, the question arises as to how to determine what property is devoted to, and necessary for, the functional operation of the hospital. For example, would property that contributes to the comfort of the staff of the hospital or that contributes to the economic health of the hospital be considered devoted to, and necessary for, the functional operation of the hospital? This issue was taken up in Chisago Health Services v. Commissioner of Revenue, 462 N.W. 2d 386 (1990), a property tax exemption case decided by the Minnesota Supreme Court. In that case, the court considered whether ambulatory care facilities operated by a hospital (but not part of the hospital's emergency room services) and a hospital annex which housed: (a) a business office that handled the hospital's business matters and (b) physician's offices, was "reasonably necessary" for the accomplishment of "public hospital purposes" and therefore, exempt from ad valorem property taxes. The court held that in order to qualify for the property tax exemption for public hospitals, the property must be devoted to, and necessary for, the functional operation of the hospital, *i.e.*, the property must be necessary to provide those services traditionally provided by a hospital. The court held that although the auxiliary facilities and the hospital annex contributed to the economic wellbeing of the hospital, the majority of the property was not necessary for the functional operation of the hospital.¹

In reaching its conclusion, the Minnesota Supreme Court noted that:

The difficulty with granting tax exemptions to auxiliary properties which help an exempt institution to survive or to prosper financially is two-fold. First, it is difficult to know where to draw the line: almost any auxiliary facility can be found to improve the financial well-being of a hospital. Secondly, these exemptions, because they are exceptions to the requirement of uniform taxation, tend to give an unfair competitive advantage to the exempted facility over similar facilities privately operated.

In conclusion, the rules of statutory construction require that we read the tax exemption allowed under Article X, §3(b) of the South Carolina Constitution and Code Section 12-37-220(A)(2) with a view towards a reasonable interpretation that will not result in unintended consequences or an unwarranted expansion of the exemption. Accordingly, the Department of Revenue will

¹ The court did recognize that the portion of the hospital annex that served as the business office for the hospital as well as the company's emergency centers, would qualify as reasonably necessary to the functional operation of the hospital, however, since that area had not been separately identified at the trial court level, the court did not address the issue further.

construe the tax exemption under the constitutional provision and Code Section 12-37-220(A)(2) as requiring that the property be devoted to, and necessary for, the functional operation of the hospital in order to qualify for the exemption.

The following examples may help to illustrate the principles discussed above.

CAVEAT: THE FOLLOWING EXAMPLES ARE FACT SPECIFIC AND A CHANGE IN ONE FACT MAY RESULT IN A DIFFERENT CONCLUSION AS TO THE EXEMPT STATUS OF THE PROPERTY.

Example 1 - Shopping Center

Hospital C is owned by Corporation C, a 501(c)(3) organization under the Internal Revenue Code. Corporation C operates the hospital which provides both emergency and non-emergency medical services to constituents of County C, 24 hours a day, seven days a week. Hospital C is able to provide these services on both an outpatient and an inpatient basis. Recently, Corporation C received a gift of real property from a donor that consists of a shopping center located in County C. The corporation plans to use the proceeds it receives from the rents of tenants at the shopping center to fund a new wing for the hospital.

Under the facts given above, the shopping center is not devoted to, and necessary for, the functional operation of the hospital and therefore will not qualify for the exemption.

Example 2 – Medical Office Building

Hospital A is owned by Corporation A, a 501(c)(3) organization under the Internal Revenue Code. Corporation A operates the hospital which provides both emergency and non-emergency medical services to constituents of County A, 24 hours a day, seven days a week. Hospital A is able to provide these services on both an outpatient and an inpatient basis. Next to the hospital, Corporation A owns a medical building that houses offices for several doctors, some of whom are employees of the hospital, some of whom have admitting privileges at the hospital, and others who have no affiliation with the hospital. The physicians who are employed by the hospital have their offices in the medical building because there is no room for them in the hospital itself and these offices provide a space where the physicians may review patients' charts, conduct research, and confer with other doctors about patients' conditions and treatment. The medical building also houses several dentists' offices, a bank that is used by hospital employees as well as others, a restaurant, and the offices of pharmaceutical representatives that sell products to the hospital.

Under the facts presented above, those offices that are occupied by the doctors who are employees of the hospital will qualify for the exemption. These doctors' offices are devoted to, and necessary for, the functional operation of the hospital since the doctors are performing the hospital's work in their offices. However, the property associated with the offices of those doctors who merely have admitting privileges at the hospital or who have no affiliation with the hospital, the dentists' offices, the bank, the restaurant, and the pharmaceutical representatives' offices will not qualify for the exemption as they are not

devoted to, and necessary for, the functional operation of the hospital but instead serve a private purpose. The portions of the building that relate to the non-qualifying doctors' offices, the dentists' offices, the bank, the restaurant and the offices of the pharmaceutical representatives will be separately valued and will be subject to ad valorem taxation, unless another exemption applies to these facilities.

Example 3 – Child Care Center

Hospital B is owned by Corporation B, a 501(c)(3) organization under the Internal Revenue Code. Corporation B operates the hospital which provides both emergency and non-emergency medical services to constituents of County B, 24 hours a day, seven days a week. Hospital B is able to provide these services on both an outpatient and an inpatient basis. However, recently Hospital B has found it difficult to attract nursing staff to staff the afternoon and evening shifts at the hospital. In order to attract employees to staff these difficult shifts, the hospital has set up a child care center next door to Hospital B that provides 24 hour care for the children of the hospital staff of Hospital B, including child care for the children of those employees who work the afternoon and evening shift at the hospital. The child care center is owned by the hospital and is run by staff employed by the hospital and all expenses of the child care center are paid from monies received from the hospital's operations.

Under the facts given, the child care center is not eligible for the exemption. The day care is provided for the convenience of the employees of the hospital and is not devoted to, and necessary for, the functional operation of the hospital.

Example 4 – Parking Facility

Hospital D is owned by Charitable Institution D, a 501(c)(3) organization under the Internal Revenue Code. Charitable Institution D operates the hospital which provides both emergency and non-emergency medical services to constituents of County D, 24 hours a day, seven days a week. Hospital D is able to provide these services on both an outpatient and an inpatient basis. In order to serve the hospital's staff and the patients that use the hospital, Charitable Institution D owns a parking facility that is located right next to, and is attached to, the hospital. In addition to patients, visitors and staff parking in the garage, the garage housed ambulances and other hospital vehicles when they are not in use. All expenses of the parking garage are paid from monies received from the hospital's operations.

Under the facts given, the parking garage will qualify for the exemption. It is devoted to, and necessary for, the functional operation of the hospital since it houses the ambulances which are used in transporting patients to the hospital and is also used for employee parking and patient parking.

If in addition to providing parking for patients, employees and the ambulances, the parking garage was also used to provide parking for unrelated businesses or entities, such as doctor's offices for those doctors who are not employees of the hospital, then that portion of the parking garage that is attributable to the unrelated businesses or entities will be valued separately and will be subject to ad valorem taxation unless another exemption applies to these facilities.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/Burnet R. Maybank
Burnet R. Maybank III, Director

December 13, 2005
Columbia, South Carolina