

A Question for Minnesota Hospitals: Is Your Clinic Space Properly Classified as Tax-Exempt?

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After a recent decision of the Minnesota Supreme Court, Minnesota hospitals should analyze whether hospital-owned clinics and other facilities may now qualify for an exemption from property tax. In its decision in *Perham Hospital District*, the Minnesota Supreme Court recognized that hospital-owned clinics can be an important component of a hospital and necessary to the operation of the hospital. This conclusion and the related decision of the Tax Court may establish a framework for district and nonprofit hospitals to obtain property-tax exemption for clinics and other hospital facilities that have traditionally been treated as taxable properties.

Background

Under Minnesota law, space that is owned by a nonprofit and operated as a public hospital is exempt from property tax. The Minnesota Constitution mandates that public hospitals are exempted from property taxation and this exemption is implemented by Minnesota statute.[1] A public hospital is defined by Minnesota courts as a hospital that is generally open to the public and is operated without private profit.[2] While the statutory language provides that "[a]ll public hospitals are exempt" from property taxation, Minnesota courts have found this exemption "is not limited to buildings actually used as hospitals." [3]

The public hospital exemption also applies to any property which is "devoted to and reasonably necessary for the accomplishment of the purposes of the [hospital] seeking exemption." [4] In this context, the term "necessary" is to be given a reasonable, natural, and practical interpretation considering modern conditions, and the property must be functionally, not just economically necessary. [5]

An additional provision of Minnesota law also provides an exemption from taxation for municipal hospital districts. Under that law, property "acquired, owned, leased, controlled, used, or occupied" by a hospital district, for the purposes of running a hospital, is exempt. [6]

For many years, counties have sought to narrowly define the scope of exemption available to nonprofit and district hospitals. County tax officials, relying on now dated court decisions and sub-regulatory guidance from the Minnesota Department of Revenue, have argued that "clinics are taxable." [7] But Minnesota courts in recent years have rejected a rigid test and now will closely analyze the facts to determine whether a clinic



is entitled to exemption. While they have not overruled the prior precedents, these court decisions suggest a growing recognition that there may be little or nothing that distinguishes modern hospitals from clinics given the overlap in their services and cohesive operations. The reasoning of the recent decisions also suggests that hospital-owned clinics may be "devoted to and reasonably necessary" for the accomplishment of a hospital's purposes within the "functional" sense contemplated by the older precedents.

Perham Hospital District case

This more modern approach is exemplified in the Tax Court's decision in the *Perham Hospital District* case. [8] There, the Tax Court held that the clinics at issue were a part of the hospital, and the hospital operated the clinics as hospital facilities. Of critical note, the court in *Perham Hospital District* found that the evolution in the health care industry has fundamentally changed what hospitals do, as the number of inpatient services in hospitals has drastically declined.[9] Therefore, there is no longer a sharp distinction between hospitals and clinics based on the fact that clinics do not provide inpatient services. The court also found that the clinics were hospital facilities even if they did not offer care at all times.[10] Finally, the Tax Court concluded that the similarity of the clinics' physician compensation structure to traditional hospital-based compensation structures was additional evidence that the clinics should be classified as a hospital and exempt from property tax.[11]

The County appealed the Tax Court decision, which resulted in the Minnesota Supreme Court's first opportunity in many years to consider a hospital's request for property tax-exemption for facilities other than the core hospital.[12] Although the Supreme Court limited its discussion to the exemption for municipal district hospitals, the court's reasoning may require a reexamination of its prior precedents regarding (non-municipal) public hospitals. The Supreme Court recognized that the clinics were necessary to the operation of the Perham hospital.[13] The Supreme Court concluded that the clinics in the *Perham Hospital District* case were used by the hospital to "improve and run" the hospital, and the Supreme Court affirmed the Tax Court's finding that the clinics "helped attract physicians and patients, improved the Hospital's overall operations and service delivery, increased patient follow-up, and provided physical space for use by other Hospital departments." [14]

Applicability to Other Clinics

The clinics in the *Perham Hospital District* case have significant parallels to the clinical operations of many Minnesota nonprofit hospitals. The *Perham Hospital District* case makes it clear that Minnesota courts may no longer routinely exclude clinic space from exemption, and, in fact, clinics can be a necessary component of a successful hospital operation and therefore exempt from property tax under either the standards for public, nonprofit hospitals or district hospitals.



Importantly, the dispute in *Perham Hospital District* was not over whether the clinic space was exempt because it was owned by a district hospital. Instead, the Supreme Court considered whether the clinics were used to "improve and run" the hospitals. After deciding that they were, the Supreme Court concluded the clinic space was exempt from property taxes.

When a space is owned and operated by a Minnesota nonprofit hospital and the space is "devoted to and reasonably necessary for the accomplishment of the purposes" of the hospital, it should be classified as exempt. In the modern health care setting, this should apply to clinic space, as suggested in the *Perham Hospital District* case. But may also be equally applicable to other space owned by a hospital that is used by the hospital to meet its mission. Hospital departments and areas including rehab centers, Chemo/Infusion Clinics, employee-only areas including locker rooms and fitness areas, storage space, and other similar space may all be appropriately classified as exempt space if used to advance the nonprofit mission of the hospital.

Next Steps

Minnesota hospitals wishing to challenge a tax assessment related clinic space, or other space that meets the "devoted to and reasonably necessary for" test, may do so by filing an appeal by petition to the Minnesota Tax Court before April 30 for the year in which the property tax is payable. Another option is for a hospital to consider whether to seek review of a property's proposed assessment and classification by the local and/or County Board of Appeal and Equalization. Such meetings are held between April 1 and May 31 each year.

Lathrop GPM can provide assistance in analyzing this complex area of law and, if appropriate, help clients navigate the process of obtaining exemption for hospital-owned space. Obtaining such an exemption may result in substantial tax savings for Minnesota hospitals.

For more information, please contact Ben Peltier, Wade Hauser, or your regular Lathrop GPM attorney.

[1] Minn. Const. Art. X, Sect. 1; Minn. Stat. § 272.02, subd. 4.

[2] *Village of Hibbing*, 14 N.W.2d 923, 925 (Minn. 1944).

[3] *Chisago Health Servs. v. Comm'r of Revenue*, 462 N.W.2d 386, 388 (Minn. 1990).

[4] *Naeve Health Care Ass'n v. Freeborn Cnty.*, No. C6-92-541, 1993 WL 35164, at *4 (Minn. Tax Feb. 11, 1993) (citing *State v. Fairview Hosp. Ass'n*, 114 N.W.2d 568, 571 (1962)).

[5] *Id.*



[6] Minn. Stat. § 447.31, Subd. 6.

[7] "Hospital and Clinic Properties - Taxation vs. Exemption," Minnesota Department of Revenue, September 2, 2015.

[8] *Perham Hosp. Dist. v. Otter Tail Cnty.*, No. 56-CV-18-1196, 2021 WL 1099500 (Minn. Tax Mar. 18, 2021).

[9] *Id.* at *27.

[10] *Id.*

[11] *Id.*

[12] *Perham Hosp. Dist. v. Cty. of Otter Tail*, 969 N.W.2d 366 (Minn. 2022)

[13] *Id.* at 375.

[14] *Id.*