

SALES AND USE TAX EXEMPTIONS: HOSPITAL CONSTRUCTION

House Bill 4742 (Substitute H-2)
House Bill 5053 (Substitute H-1)
First Analysis (11-12-97)

Sponsor: Rep. Kirk A. Profit
Committee: Tax Policy

THE APPARENT PROBLEM:

The General Sales Tax Act and the Use Tax Act each contains an exemption for sales to contractors who are constructing, altering, repairing, or improving real estate affixed to and made a structural part of the real estate of a nonprofit hospital (or certain nonprofit housing). This is a longstanding exemption and it survived even when exemptions that applied to contractors working for other kinds of nonprofit entities were repealed in 1970, reportedly because they were subject to abuse. According to representatives of Bronson Methodist Hospital, a dispute has arisen between the hospital and the Department of Treasury over the application of the exemption. At issue is what constitutes a nonprofit hospital under the tax statutes. Hospital representatives say that beginning in 1991, they hired a construction company to work on 15 health-related projects for them, the two largest of which were the West Michigan Cancer Center and the University Medical and Health Services Center (for graduate medical education). A treasury department audit of the construction company concluded that use taxes ought to be paid on the projects because they were not hospitals. This was based, say hospital representatives, on the fact that the facilities did not offer overnight accommodations. Reportedly, this matter has not been finally settled between the hospital and the department.

Further, hospital representatives say that while the department historically focused on the use or purpose of a building to determine if it was a hospital, it later began to apply the sales and use tax exemptions more narrowly to facilities under the same roof, thus attempting to exclude such buildings as adjacent diagnostic facilities (for magnetic resonance imaging). A Michigan Court of Appeals decision in 1996, Canterbury Health Care and Granger Construction Company v Department of Treasury, caused a different problem. That decision, say hospital representatives, invites the department to limit the contractor's exemption based on the direct ownership of a facility by a hospital. (See Background Information.) This, they say, does not take into account the modern reality that hospital operations use a multiple entity

structure for business purposes and engage in joint ventures with other hospitals. They say that legislation is needed to provide a definition of "hospital" that reflects the organizational structures used by hospitals today and to reflect the use of multiple facilities and decentralized facilities to carry out hospital purposes.

THE CONTENT OF THE BILLS:

The bills would place in the General Sales Tax Act and the Use Tax Act a definition of the term "hospital" for the purpose of the provisions which provide exemptions from the taxes for the sale of property to contractors doing certain construction work for hospitals.

For taxes levied after December 31, 1991, the term "hospital" would mean a separately organized entity, or a group of entities sufficiently related to be considered a single employer for purposes of Section 414 of the Internal Revenue Code, the primary purpose of which is to provide medical, obstetrical, psychiatric, or surgical care or nursing. Under the definition, nursing includes care provided by skilled nurses in a long-term care facility.

The bills would require that at the time of the transfer of tangible personal property for which an exemption was claimed, the transferee would have to sign an affidavit, in a form approved by the Department of Treasury, attesting to the fact that the property is eligible to be excluded from taxation.

House Bill 4742 would amend the Use Tax Act (MCL 205.94m). House Bill 5053 would amend the General Sales Tax Act (MCL 205.51). The two bills are tie-barred.

BACKGROUND INFORMATION:

Sales of tangible personal property to nonprofit hospitals are themselves exempt from the sales and use taxes. There is a rule that defines a hospital for the purpose of

applying that exemption. The state appeals court relied on this definition in deciding the Canterbury case cited earlier, which was a case in which the department denied the contractor's exemption for the construction of a nonprofit nursing care and retirement facility. The court agreed with the department that such a facility was not a hospital. The rule, known as Rule 37, defines a hospital as " a separately organized institution or establishment, the primary purpose of which is to provide medical, obstetrical, psychiatric, or surgical attention and nursing to persons requiring the same."

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, preliminary estimates suggest that the fiscal impact of the bills would be a decrease of \$1 million to \$2 million per year in gross sales and use tax revenue. (11-12-97)

ARGUMENTS:

For:

By putting a definition of "hospital" into sales and use tax statutes, the bills clarify how to apply the exemptions that already exist for contractors doing work on hospital buildings. The aim of the definition is to allow more flexibility than currently allowed by the Department of Treasury in applying the exemptions to facilities owned by today's more complex organizational entities and to facilities not under the same roof as the sponsoring hospital or hospitals.

Response:

Department of Treasury officials have said that this is a complicated matter and is part of a much broader issue. The department has said it would like to arrive at a better definition of "hospital" than currently exists. Further, there are concerns by people who support the concept of the bill about the extent of the exemption permitted by the bill; whether, for example, it applies to the construction of facilities owned by a nonprofit hospital but leased to profit-making entities.

POSITIONS:

The Michigan Health and Hospital Association has indicated support for the bills. (11-5-97)

Representatives of Bronson Methodist Hospital testified in support of the bills. (11-5-97)

The Department of Treasury has no position on the bills. (11-5-97)

The Michigan Education Association has indicated opposition to the bills. (11-5-97)

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.

