House
Legislative
Analysis
Section

Romney Building, 10th Floor
Lansing, Michigan 48909
Phone: 517/373-6466

SALES AND USE TAX EXEMPTIONS: HOSPITAL CONSTRUCTION

House Bills 4742 and 5053 as enrolled
Public Acts 452 and 451 of 1998
Second Analysis (1-12-99)

Sponsor: Rep. Kirk A. Profit
House Committee: Tax Policy
Senate Committee: Finance

THE APPARENT PROBLEM:

The General Sales Tax Act and the Use Tax Act each contain 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and it survived even when exemptions that applied to contractors working for other kinds of nonprofit entities were repealed in 1970, reportedly because they were subject to abuse.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.

The bills specify that, for taxes levied after 1990 and before 1996, the term "hospital" would include, but not be limited to, an entity which:

-- was a separately organized entity, or 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 was to provide medical, obstetrical, psychiatric, or surgical care or nursing (with nursing to include care provided by skilled nurses in a long-term care facility); and

-- had, prior to 1996, initiated an appeal of taxes assessed on tangible personal property that was used to construct a facility after 1990 and before 1996, whose primary purpose was to provide medical, obstetrical, psychiatric, or surgical care or nursing.

House Bill 4742 would amend the Use Tax Act (MCL 205.94). 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:

The Senate Fiscal Agency cites information from representatives of Bronson Methodist Hospital that the bills would retroactively eliminate a sales and use tax liability of less than $250,000. (SFA floor analyses dated 12-4-98)

ARGUMENTS:

For:

The bills address a specific dispute between the Department of Treasury and a hospital corporation in Western Michigan over whether sales and use taxes should have been paid by contractors who built medical-related facilities for the corporation; the dispute revolved around different interpretations of the term "hospital" as used in the tax statutes. The bill is limited to the 1990-96 time period. Department of Treasury officials said during the hearings on these bills, when they were more broadly drawn, that this is a complicated matter and is part of a much larger issue.

Analyst: C. Couch

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