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RQ-0547-JC

May 7, 2002

FILE # ML-42103-02
I.D. # 42103

Hon. John Cornyn
Attorney General
PO Box 12548
Austin, Texas 78711-2548

Re: Request for opinion concerning: (1) whether the property of a municipal hospital authority is held to the exclusive use requirement of the Texas Constitution when it is not owned by a county, city, or town; (2) whether the exclusive use requirement is deemed satisfied based on the language of the Texas Municipal Hospital Authority Act or can be determined to be satisfied based on the use of the property for the public purpose of providing long term care; and (3) whether the municipal hospital authority retains any tax liability or risks losing its tax exempt status when it leases space to a third- party, for-profit business enterprise.

Dear General Cornyn:

I am requesting an opinion from your office on behalf of the Tomball Hospital Authority (the "Authority"). The Authority is a governmental entity organized under the Texas Municipal Hospital Authority Act. TEX. HEALTH & SAFETY CODE ANN. Sec. 262.001, *et seq.* (Vernon, 2001) (the "Act"). The Authority was created in 1981 by a city ordinance adopted by the City of Tomball, in Harris County, Texas, and operates a hospital known as Tomball Regional Hospital (the "Hospital").

Background:

The Authority operates the Hospital as a licensed general hospital. The Authority is currently expanding its Hospital facilities by constructing a new patient tower (the "New Tower") adjacent to the existing Hospital building on the Authority's land. The New Tower will be owned and operated by the Authority for the public purpose of caring for Hospital patients.

The Act allows a municipal hospital authority to lease part of its hospital facilities to a tenant for operation by a tenant as a hospital if the governing board (the "Board") of the Authority approves. The Tomball Regional Hospital Authority desires to lease two floors in the New Tower to a long-term care hospital company in order to have long-term care access readily available for the convenience of its patients.

Under Texas law, a long-term care hospital cannot be operated as part of a general hospital; rather, it must be operated as a separately licensed "specialty" hospital. Although the Authority might be able to construct and obtain a license for the operation of a long-term care hospital, the Board is concerned that dual ownership of both a general hospital and a specialty hospital may create a potential pay source conflict of interest. To avoid any allegations of a pay source conflict of interest, the Authority would like to enter into an arm's length arrangement, allowing a third-party, long-term care hospital business enterprise to operate a long-term care hospital as a "hospital-within-a-hospital" on two of the ten floors of the new tower.

A pay source conflict of interest arises when a patient is discharged from a general hospital and contemporaneously admitted to a long-term care hospital. In the past, ownership of both facilities by a single entity has resulted in allegations by the Department of Justice that the owner was attempting to maximize its Medicare reimbursement. The medical care provided to most insured patients in general hospitals, including Medicare patients, is reimbursed based on each patient's diagnosis, known in the health care industry as a Diagnosis Related Group ("DRG"). Reimbursement for Medicare patients admitted to long-term care hospitals is based upon a different payment methodology. According to the Department of Justice, a joint-owner of both a general hospital and a specialty care hospital may be motivated to shorten the patient's length of stay in the general hospital after receiving the DRG-based reimbursement by admitting the patient to the long-term care hospital. By leasing space in its New Tower to an unrelated long-term care provider, the Authority seeks to avoid the appearance of impropriety related to patient care decisions or the movement of patients between the general and specialty care hospitals.

Property tax questions:

The current tax-exempt status of the Authority's property is not in dispute. The records of the Harris County Appraisal District currently reflect that the Hospital and the property where the New Tower is to be constructed are owned by the Authority and are tax-exempt. The Texas Constitution provides that all real property shall be taxed according to its value, unless such property is exempt from taxation. TEX. CONST. Art. VIII, Sec. 1. A constitutional exemption is provided for real property owned by counties, cities, and towns and held only for public purposes, and all other property owned by counties, cities, and towns and devoted exclusively to the use and benefit of the public. TEX. CONST. Art. XI, Sec. 9.

While the constitutional exemption found at Article XI, Section 9, specifically identifies the "property of counties, cities, and town," the Texas Supreme Court has held that the exemption extends to the property of any government agency. See *Lower Colorado River Authority v. Chemical Bank and Trust Company*, 190 SW2d 48 (Tex. 1945). The Texas

Constitution also empowers the Legislature to enact general laws that exempt from taxation public property used for public purposes. TEX. CONST. Art. VIII, Sec. 2(a). The Legislature has enacted Section 11.11 of the Texas Tax Code, which provides a tax exemption for property owned by the state or a political subdivision if the property is used for public purposes. TEX. TAX CODE ANN. Sec. 11.11(a) (Vernon 2001). In addition, the Act contains an exemption for "[t]he authority's property...*because it is held for public purposes only and devoted exclusively to the use and benefit of the public*." TEX. HEALTH & SAFETY CODE ANN. Sec. 262.004 (Vernon 2001) (emphasis added).

Although Article VIII, Section 2(a) and Section 11.11 of the Tax Code do not, by their terms, require a political subdivision to use its property for *exclusive* public use in order to maintain its tax-exempt status, the relevant case law articulates a single standard derived from the language of Article XI, Section 9. The Texas Supreme Court decisions hold that to be tax-exempt, property must be held only for public purposes and be devoted exclusively to the use and benefit of the public. See *Grand Prairie Hosp. Auth. v. Dallas County Appraisal Dist.* 730 SW2d, 849, 851 (Tex. App.--Dallas, 1987, writ ref'd n.r.e.) *Grand Prairie Hosp. Auth. v. Tarrant Appraisal Dist.*, 707 SW2d 281, 184 (Tex. app.--Fort Worth 1986, writ ref'd n.r.e.). Opinions from the office of the Attorney General have also articulated a single standard. Tex. Att'y Gen. Op. Nos. DM-436 (1997); DM-188 (1992); DM-78 (1992), JM-523 (1986).

It is important to note, however, that even public property put to private use does not necessarily lose its tax exempt status. Attorney General Opinion DM-188 (1992) at 8, citing Texas Attorney General Op. Nos. JM-1049 (1989) and JM-405 (1985), concluded that "public property put to a private use will remain tax-exempt where the private use can either be characterized as a public purpose or in direct support of a public purpose of the political subdivision. Case law also instructs that a "public purpose" does not require that the governmental unit itself use the property, but requires that the property be used exclusively for the health, comfort, and/or welfare of the public. *Lower Colorado River Authority v. Chemical Bank and Trust Company*, 190 SW2d 48 (Tex. 1945) The Authority asserts that the operation of a long-term care facility on the Authority's property through the lease arrangement described above is exclusively for the "health, comfort, and/or welfare" of the patients in the Authority's service area.

While the Texas Tax Code provides that leaseholds on tax-exempt property can, in certain circumstances, become taxable, the Code is silent as to the tax-exempt status of the rest of the property. The Authority proposes that the leasehold will be listed in the name of the owner of the possessory interest if the duration of the interest is at least one year as required by the Texas Tax Code in Section 25.07. While Section 25.07 does not purport to impose tax liability, the Dallas Court of Appeals has held that "listing" has the effect of imposing tax liability. *County of Dallas Tax Collector v. Roman Catholic Diocese of Dallas,* 41 SW3rd 739, 744-45 (Tex. App.--Dallas 201, no writ history). It would appear that a tenant would be responsible for any taxes that would be imposed on the leased space, and the "listing" of the leasehold interest would not otherwise affect the tax-exempt status other property owned by the Authority.

The Authority seeks first to determine whether they are subject to the "exclusive use" requirement of Article XI, Section 9 of the Texas Constitution. If so, then is the exclusive use requirement deemed satisfied because the specific tax-exempt provision for Authority property states that the "property is exempt...*because* it is held for public purpose only" and does not include the qualifying word *"if"* or, in the alternative, can it be deemed satisfied because the lease is in direct support of the Authority's use of the property for public purposes?

If a lease on tax-exempt property does not satisfy the public purpose requirement to remain tax-exempt, does the Authority retain any tax liability for the leased space or do they risk losing the tax-exempt status of the entire building or any of its other property?

I appreciate your usual prompt attention to this request so that the Authority may fully consider all implications of any lease arrangement. As an interested party, they may wish to furnish additional briefing, and may be contacted through their counsel as set out below.

Sincerely,

Patricia Gray, Chair
House Committee on Public Health

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