



# *South Dakota Legislative Research Council*

## *Issue Memorandum 97-24*

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### **CONGREGATE HOUSING-- HEALTH CARE RELATED AND EXEMPT FROM TAXATION**

#### **Introduction**

In order to understand the elderly housing industry, you must be familiar with the differences between congregate housing and assisted living. Congregate housing and assisted living are not interchangeable terms as used in South Dakota statutes. In fact, the term “congregate housing” is rarely used in statute.

Congregate housing is a place which provides a safe living environment for the elderly who need limited assistance with the activities of daily living but do not need twenty-four hour supervision.

A congregate housing facility is not a licensed health care facility. Congregate housing is considered health care related pursuant to SDCL 10-4-9.3 if it is an assisted, independent group-living environment for elderly or disabled persons and is owned and operated by a health care facility licensed under chapter 34-12. An assisted living center is a licensed health care facility pursuant to chapter 34-12 and the center might own and operate a congregate housing facility which is classified as tax-exempt property pursuant to SDCL 10-4-9.3.

The criteria for exempting health care facilities from property taxation were initially developed by the 1985 Interim

Taxation Committee, which studied tax-exempt property with special emphasis on establishing definitions for tax-exempt property to provide guidance to local governments. The 1986 Legislature passed HB 1017, which included a section defining the criteria for exempting property used primarily for human health care and health care related purposes. This language was further amended by HB 1311 in 1988, most likely in response to a 1987 case before the State Board of Equalization when the Board refused to accept congregate housing as health care related without a change in the law. It is important to understand the property tax exemption provided to health care facilities before examining the exemption extended to certain congregate housing facilities.

Some of the commonly accepted reasons for providing tax exemptions to certain nonprofit properties are:

1. The services provided lessen a government burden, thereby partially or fully offsetting any tax subsidy.
2. Resources are devoted to the relief of the poor, distressed, or underprivileged.
3. A majority of the revenue is received from donations, public funds, membership fees, or program fees generated solely to cover operating

- expenses.
4. Services are offered to people regardless of their ability to pay.

### **Health Care Facilities**

The Legislature is empowered by the South Dakota Constitution to enact legislation exempting certain property from taxation such as property used for health care purposes. The constitutional language concerning this issue is:

*"Article XI, § 2. . . .the Legislature is empowered to divide all property including moneys and credits as well as physical property into classes and to determine what class or classes of property shall be subject to taxation and what property, if any, shall not be subject to taxation."*

*"Article XI, § 6. The Legislature shall, by general law, exempt from taxation, property used exclusively for agricultural and horticultural societies, for school, religious, cemetery and charitable purposes, property acquired and used exclusively for public highway purposes, and personal property to any amount not exceeding in value two hundred dollars for each individual liable to taxation."*

The Legislature enacted SDCL 10-4-9.3, which requires a health care facility to be designated by the Internal Revenue Service as a § 501(c)(3) nonprofit organization before the property may be classified as tax exempt. The last sentence of SDCL 10-4-9.3 also requires these facilities to meet this standard, *"Such health care facility must admit all persons for treatment consistent with the facility's ability to provide medical services required by the patient until such facility is filled to its ordinary capacity and must*

*conform to all regulations of and permit inspections by the South Dakota Department of Health."* The Attorney General issued an opinion in 1988 stating that this sentence does not apply to congregate housing facilities which are not licensed health care facilities, but are only considered health care related facilities.

The Legislature treats health care facilities similar to property owned by charitable and benevolent organizations by requiring a § 501(c)(3) designation and requiring that the facility generally admit all persons for treatment. Health care facilities are required to admit all persons for treatment consistent with their health care capabilities, which implies that ability to pay for care is not an admission factor. If a person is indigent, the counties, i.e. the taxpayers, reimburse the facility for certain treatment expenses pursuant to SDCL 28-13. But like many other businesses, health care facilities do face nonpayment of certain accounts.

Health care is a fast growing and expanding industry, and with this growth there are new and expanded facilities. The tax exemption provided to health care facilities aids those entities in constructing new or expanded facilities, while also increasing the demand for infrastructure services provided by local governments. The inability of local governments to generate tax revenue from these facilities does shift the tax burden onto other property. However, if local governments were allowed to levy a tax or additional fees on health care facilities, it may inhibit the organization's ability to invest any capital into new services or upgrading facilities.

### **Assisted Living Facility**

Before 1991 the term “supervised personal care facility” was used to describe what is now called an assisted living center. An assisted living center is defined as follows in subdivision (2) of SDCL 34-12-1.1:

*“‘Assisted living center,’ any institution, rest home, boarding home, place, building, or agency which is maintained and operated to provide personal care and services which meet some need beyond basic provision of food, shelter, and laundry in a free-standing, physically separate facility which is not otherwise required to be licensed under this chapter.”*

An assisted living center is a facility which provides twenty-four hour supervision and assistance with the activities of daily living. There are 81 licensed assisted living centers in 43 cities which have 1,419 beds. An assisted living center may be organized as a forprofit or nonprofit entity. Only the nonprofit centers may receive a tax exemption, otherwise all assisted living centers are licensed and operated in similar fashion pursuant to SDCL 34-12 and ARSD Article 44:04, which establish the regulations regarding health care facilities.

### **Congregate Housing**

Congregate housing is defined by the South Dakota Housing Development Authority as follows in subdivision (9) of ARSD 20:09:01:01: *“‘Congregate housing,’ housing units which provide a semi-independent living environment which offers residential accommodations, central dining facilities (where at least one meal is provided 7 days a week), related facilities, and supporting staff and services to persons of at least 62 years of age or with disabilities.”* The Housing Development Authority estimated that were 7,200 congregate and individual housing

units available in 1996 and that there may be a demand for as many as 3,000 more. The Housing Development Authority also cautioned that the industry needs to be careful not to overbuild the market to meet this demand like nursing home beds were over built in the past.

Only nonprofit congregate housing facilities owned and operated by health care facilities licensed under chapter 34-12 are tax exempt pursuant to SDCL 10-4-9.3. A congregate housing facility operated by any other kind of entity is not permitted to be classified as tax exempt unless the facility is owned and operated by a unit of government.

The Attorney General was asked by the Department of Revenue in 1988 to provide clarification and guidance on how to interpret the exemption language found in SDCL 10-4-9.3 concerning congregate housing. This section was enacted in 1986 and amended during the 1988 session. This opinion does clarify several issues concerning how supporting services might be interpreted and the application of the last sentence of this section. As mentioned previously, it was stated in the opinion that the last sentence of SDCL 10-4-9.3 does not apply to congregate housing.

Some form of health care must be provided in each congregate housing facility classified as tax exempt pursuant to SDCL 10-4-9.3. It was stated in the opinion that an electronic call device is not sufficient to satisfy the health care requirement. The operator of the facility should offer a range of health care services, like independent home health care or some similar service, to meet the requirements of SDCL 10-4-9.3. There is a delicate balance to maintain in meeting these requirements because if a doctor or nurse is

employed as a full-time staff member of a congregate housing facility, the facility may be subject to licensure requirements pursuant to chapter 34-12.

A balanced nutrition program must be offered at each congregate housing facility. It is not required that the facility have a kitchen or a nutritionist on staff, according to the opinion. Most congregate housing facilities offer at least one regularly prepared meal per day and some facilities do offer additional meals. How each facility satisfies the balanced nutrition program is a question of fact which must be determined in each instance. There are several congregate housing facilities that have an additional charge for the basic meal service as well as charges for additional meals. It was also stated in the opinion that the mere presence of cooking facilities in each individual residence did not constitute a balanced nutrition program.

The tie between the health care facility and the congregate housing may help in providing certain health care services and a balanced nutrition program to its inhabitants. However, the services need not necessarily be defined by the relationship but may be facilitated by the relationship.

### **Tax Exemption**

The Legislature does have the authority to control or limit tax exemptions provided to nonpublicly owned property by developing more definitive criteria. The Legislature defined the exemption for congregate housing facilities in 1986, which was the same time the Legislature substantially revised SDCL 34-12 concerning health care facilities. The enactment of legislation encouraging construction of alternative

living facilities for the elderly such as congregate housing facilities by offering a tax exemption may have been a prelude to the legislation that was passed two years later placing a moratorium on the number of beds in nursing homes and assisted living centers.

Health care facilities are exempt from taxation by virtue of their character and recognition as such by the federal government through a § 501(c) designation and meeting certain criteria enacted by the Legislature. SDCL 10-4-9.3 directs counties to look at the use of property as well as ownership in determining the tax-exempt status. The county director of equalization should look at the health care services and nutrition program offered by each congregate housing facility to determine if it meets the statutory requirements. The degree to which these criteria are examined is unknown, and it may be difficult for the directors of equalization to apply these criteria uniformly because of the various alternatives that could be used to meet the statutory language.

SDCL 10-4-15 requires any entity claiming a property tax exemption status pursuant to SDCL 10-4-9 to 10-4-14, inclusive, to apply to the county director of equalization before November 1. If a taxing body would challenge the application for a property tax exemption, the courts are to strictly and narrowly construe the application of the statute in favor of the taxing power if it involves ambiguous statutes granting tax exemptions. This may benefit the county in court, if the county denied a tax exemption to a congregate housing facility for failure to provide sufficient health care services or an adequate balanced nutrition program.

## Discussion

The property tax exemption provided for nonprofit congregate housing owned and operated by health care facilities has been debated for several years. One of the primary reasons for giving a tax exemption to most nonprofits is that nonprofits provide essential services to society which are not normally provided by private industry. It also relieves government from providing these services. The government burden is lessened if there are less costly alternatives for living accommodations other than nursing homes and assisted living facilities where qualified individuals receive government financial assistance. There is, however, no government control or influence on the fees charged or services provided to individuals living in congregate housing. The nonprofit and forprofit assisted living centers and nursing homes are licensed health care facilities and are required to meet certain standards; therefore, the services provided at each classification of facilities should be similar.

Tax-exempt property, for the most part, does not, to any extent, compete with other taxable property. The owners of the forprofit congregate housing facilities, however, contend that tax-exempt congregate housing facilities do compete with their property. Others may question whether some of the more expensive nonprofit facilities warrant a tax exemption; however, the cost per unit is not a factor in determining this tax exemption.

Congregate housing offers an opportunity between a person's home, which requires maintenance and upkeep, and an assisted living center or nursing home. Now local governments and the state face the issue of

encouraging continued development of providing housing for elderly persons and the cost of providing a tax exemption for certain congregate housing facilities. This issue may become even more evident in the near future because the baby boomers are entering the retirement age. As we enter the next century, tax policymakers across the country must deliberate the cost of designing tax relief programs for elderly persons which may have long-range impacts on local government revenue, especially for any community targeting itself as a retirement community. Any change in the tax relief programs designed for elderly people and congregate housing may also have long-range impacts and implications for the people and communities served by such organizations. The balance of providing an incentive to create and operate a beneficial activity must be weighed against the tax burden placed on the other taxpayers and fairness within the industry.

Nonprofit and forprofit congregate housing facilities may be very similar in the services they offer. However, since the facilities are not licensed facilities, they are not required to meet certain minimum standards which may be measured by the services offered or occupancy costs. The forprofits argue that their facilities are similar to the nonprofit facilities, and the nonprofits argue that their facilities offer something more; but neither is meeting the standards of a licensed assisted living center. It is reasonable to expect that when a potential customer is looking to move into a congregate housing facility, the customer weighs the services provided against the costs of the facility. It is also reasonable to expect that forprofits and nonprofits cover the entire spectrum of services which may be reflected in prices charged. Basically, congregate housing

facilities are allowed to charge whatever rate the market will bear for the unit offered. It does not appear that the tax exemption given to nonprofits prevents private investment in the market, but the ability of the forprofit facilities to generate sufficient profit margins and offer comparable services and prices are most likely affected by the exemption granted to nonprofits.

## **Conclusion**

Approximately four percent of Americans were sixty-five or older in 1900. This percentage doubled by 1950. Almost 13 percent of all Americans will be sixty-five or older by the year 2000, and by the year 2030 it is expected that it will be 20 percent. This national trend is reflected in South Dakota. In 1960, 11 percent of all South Dakotans were sixty-five or older, in 1980 it was 13.2 percent, and in 1990 it was 14.7 percent. The baby boomers are now approaching retirement age, so as this country looks to the future, we see that there will be fewer working age taxpayers in relation to the number of elderly people. Therefore, the tax exemption provided to certain congregate housing facilities will most likely continue to be part of future discussions.

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This issue memorandum was written by Fred Baatz, Senior Research Analyst for the Legislative Research Council. It is designed to supply background information on the subject and is not a policy statement made by the Legislative Research Council.

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