STATE OF CALIFORNIA

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October 19, 1987

[illegible] Boulevard
Torrance, Ca. 5

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This is in response to your inquiry concerning the recent staff findings to the effect that that portion of the Hospital's property leased to Health Access System as well as to other for-profit corporations owned in part or entirely by for-profit corporations in a similar manner, if any, should not receive the welfare exemption from property taxation. Staff's reasoning in this regard follows.

Per the Outpatient Diagnostic Center Agreement between the Hospital and Health Access System, in part:

"RECITALS

"A. The Hospital owns that certain facility located at 3330 Lomita Boulevard, Torrance, California....The Hospital also owns the furniture, fixtures and equipment....

"B. Hospital desires to furnish, for the non-exclusive use of Lessee, the Equipment and the Premises for use as the Hospital's outpatient diagnostic center (including outpatient CT scans, ultrasound, and non-cardiac nuclear medicine) (the "Department") for the purpose of treating outpatients of the Department....

"C. The Hospital and the Lessee desire to enter into this Agreement pursuant to which the Lessee will obtain the non-exclusive right to use the Premises and Equipment of the Hospital....

"1. The Use Agreement.

"1.1 Premises and the Equipment.

"The Hospital hereby grants to Lessee and Lessee receives from Hospital...(i) the Premises, and (ii) the

Equipment....The Hospital also grants to Lessee a non-exclusive right in common with the Hospital to use the common areas and services of the Facility....

"1.2 Term. The term of this Use Agreement shall be for twenty (20) years, commencing on the 1st day of January, 1985....

"1.3 Utilization Fee.

"1.3.1 Monthly Utilization Fee. Lessee shall cause the Hospital to be paid, as a utilization fee for the Equipment and Premises, a monthly utilization fee in the amount of One Dollar ($1.00)....

* * *

"1.3.3 One Time Supplemental Utilization Fee Request. In addition to the payments set forth..., Lessee shall make a one time non-refundable payment to the Hospital in the amount of...($346,105)....Such one time supplemental utilization fee payment shall be a fee for the non-exclusive right to operate an outpatient diagnostic center.

* * *

"1.4 Use.

"1.4.1 Use. The Premises and the Equipment shall be used and occupied by the Lessee only as the Hospital's outpatient diagnostic center and uses incidental thereto and for no other purposes. Lessee shall not use the Premises or the Equipment for any other purposes. The Equipment shall not be removed from the Premises without the Hospital's express prior written consent....

* * *

"1.4.4 Ownership and Inspection. The Equipment and the Premises shall at all times remain the property of the Hospital....

* * *

1.7 "Real and Personal Property Taxes.

"1.7.1 Payment of Real Property Taxes. Hospital shall pay, in addition to all other payments under this Use Agreement, all real property taxes, if any, applicable to the

Lessee's use of the Premises and the Equipment during the term of this Use Agreement.

* * *

"1.8.3 Change in Ownership. Lessee intends to offer its shares of stock in an offering during the first six months of 1985 (the "Offering"), following which Offering the shares of Lessee will be owned fifty percent (50%) by Torrance Health Association, Inc., a California nonprofit corporation, and fifty percent (50%) by certain members of the medical staff of the hospital operated by the Hospital, or the related professional corporations or pension trusts of such medical staff members (collectively the "Original Shareholders")....

* * *

"1.10.8 Construction of the Use Agreement as a Lease. The parties agree that, notwithstanding the fact that Lessee does not have sole and exclusive right to possession and use of the premises and the Equipment, the Use Agreement set forth in this Section 1 shall be construed as a lease under California law....

"2. Services.

"2.1 Services Provided by the Hospital. The Hospital shall, by itself or through agents or independent contractors, provide the following services in connection with Lessee's use of the Premises and Equipment:

* * *

"3. Billings and Division of Revenue.

"3.1 Division of Hospital Charges. The non-professional billings for the Department shall be divided between the Hospital and Lessee....

* * *

"3.4 Books and Records. In order to verify the expenses, deductions, and allowances, as defined in Exhibit "C" hereto, the Hospital shall maintain and keep books of account covering the expenses, charges and other costs incurred by it in connection with the provision of services set forth in Section 1 and 2.1 of hereof....

* * *

"4.2 Operating as a Department of the Hospital. The parties hereto intend that the Premises shall be operated as and shall be considered to be an outpatient department of the Hospital. Accordingly, in providing the services set forth in Section 2.1 hereof, the Hospital shall have the authority to take and may take such actions as are necessary to operate the Premises as an integral and subordinate part of the Hospital....

* * *"

The Hospital's June 4, 1987, letter to the Los Angeles County Assessor's Office sets forth the circumstances which led to the Agreement and summarizes the situation as follows:

> "The hospital continues to own and operate these facilities. The facilities are all within the hospital building and are still under the license of the hospital. All the related billings use hospital provider numbers as the patients are still hospital patients. Health Access Systems has no license or provider number of its own.
>
> "The substance of this transaction is that Health Access Systems is entitled to the revenue stream from the outpatient portion of these facilities. There is no other entitlement by Health Access Systems to own or operate the facilities."

At first blush, applicable is Revenue and Taxation Code section 214.7, which states:

> "In the case of a hospital, neither the use of hospital property nor the receipt of fees or other lawful compensation by a licensed physician for the practice of his profession therein, shall be grounds for denial of the exemption provided by Sections 214 and 254.5. This section does not apply to such portions of a hospital as may be leased or rented to a physician for his office for the general practice of medicine."

Thus, determinative in section 214.7 matters has been whether physicians have used hospital property for hospital purposes or whether they have leased or rented hospital property for offices for the general practice of medicine.

In this instance, however, it is not the physical use of the portion of the Hospital's property by Health Access System or its member/employee doctors which is at issue but rather, it is the use thereof to derive and the division of revenues between the Hospital and Health Access System, a for-profit corporation owned 50 percent by certain members of the medical staff of the

hospital (sections 3 and 1.8.3 of the Agreement and the June 4, 1987, letter). In return for the nominal monthly utilization fees and the one-time supplemental utilization fee (sections 1.3 and 1.3.3 of the Agreement), Health Access System and its individual owners, anticipating, no doubt, revenues from non-professional billings well in excess of such fees and supplemental fee, are entitled to share in the revenues, pursuant to the provisions of the Agreement.

This Agreement or "arrangement" runs afoul of the requirements of Revenue and Taxation Code section 214(a) that property be used exclusively for hospital purposes by nonprofit corporations organized and operated for hospital or charitable purposes and that:

"* * *

"(2) No part of the net earnings of the owner inures to the benefit of any private shareholder or individual.

* * *

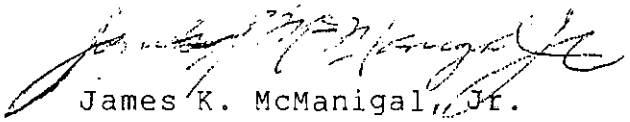
"(4) The property is not used or operated by the owner or by any other person so as to benefit any officer, trustee, director, shareholder, member, employee, contributor, or bondholder of the owner or operator, or any other person, through the distribution of profits, payment of excessive charges or compensations or the more advantageous pursuit of their business or profession.

* * *"

Thus, that portion of the Hospital's property leased to Health Access System, as well as portions leased to other for-profit corporations in a similar manner, if any, do not receive the exemption.

As I indicated, copies of the findings will be resent directly to you. Meanwhile, enclosed for your information is a copy of property tax Rule No. 136, Welfare Exemption Claim Review Procedure.

Very truly yours,



James K. McManigal, Jr.
Tax Counsel

JKM/rz