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IRS Issues Interim Report on Community Benefit and Sen. Grassley Releases Draft Reforms for Nonprofit Hospitals

The lack of a requirement for tax-exempt hospitals to provide charity care, as well as billing practices of certain tax-exempt hospitals (e.g., billing uninsured patients higher rates than those with insurance), have caused federal legislative and IRS scrutiny of the industry. The IRS conducted a community benefit compliance project studying charity care and community benefits provided by tax-exempt hospitals, and last month, released its interim report. Concurrently with the release of the IRS report, Senator Charles Grassley (R-Iowa) released a draft of proposed reforms for nonprofit hospitals containing provisions addressing charity care, community benefits, billing practices, joint ventures and penalties. It appears that charity care or additional community benefit requirements and billing reforms may soon be required for hospitals to obtain or maintain tax-exempt status.

The IRS interim report summarized the data received from its community benefit compliance initiative. This initiative requested of 544 tax-exempt hospitals information including the amount of uncompensated care provided, the compensation of hospital executives, and if services were denied to any individuals with private insurance, Medicare, Medicaid or no insurance. The report noted a lack of uniformity in the definition of uncompensated care and its reporting and called for hospitals to report charity care and community benefit on a separate schedule on the annual return filed by tax-exempt organizations (Form 990). As a result, the recently released discussion draft of the Form 990 includes a new Schedule H, where hospitals will report how they provide community benefit and charity care.

The staff document of the Senate Committee on Finance – Minority ("Discussion Draft") released by Senator Grassley proposed new requirements for hospitals seeking exempt

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status under Internal Revenue Code ("Code") section 501(c)(3) and (c)(4), requirements for government hospitals and penalties. The document, which is a discussion draft and not legislation, proposes reforms for Code section 501(c)(3) hospitals consisting generally of the following:

- Establishing a publicized plain language charity care policy with a minimum eligibility threshold of no less than 100% of the federal poverty level ("FPL").
- Requiring the provision of a quantitative amount of charity care annually in an amount equal to the greater of 5% of annual patient operating expenses or revenues. The value of the care is a rate that equals the lower of: (i) the lowest rate that would be paid by Medicare/Medicaid or (ii) the actual unreimbursed cost to the hospital for such service. Charity care would not include bad debt. Critical access hospitals would be exempt from the 5% standard.
- For joint ventures with taxable entities, requiring: (i) the joint venture to have its own charity care policy, (ii) in the context of a "whole hospital joint venture", the joint venture's board be controlled by the tax-exempt hospital and the joint venture satisfies the mandatory charity care requirement (detailed above), and (iii) in the context of an "ancillary joint venture", the tax-exempt hospital controls the joint venture's charity care policy (i.e., no decision may be made affecting the joint venture without the approval of the tax-exempt hospital) and have at least one voting member on the joint venture's board.
- Compelling the performance of a community needs assessment every three years with emphasis on vulnerable populations.
- Limiting tax-exempt hospital charges to medically indigent who are uninsured or under-insured to the lower of the amount paid by the government or the actual hospital cost. This requirement applies to Code section 501(c)(4) hospitals as well.
- Requiring tax-exempt hospitals (including Code section 501(c)(4) hospitals) to abide by governance rules including: (i) having a board of directors controlled by members representing the broad interests of the public (such as public officials, persons with expertise in community health care, community leaders, advocates of those benefiting from charity or discounted care) and not comprised of more than 25% of persons employed by the hospital, management, physicians or those that would benefit financially directly or indirectly from the hospital, (ii)

having a detailed conflict of interest policy, (iii) having the board of directors set the criteria, determine eligibility and determine required verification for charity care and discounts for low-income or uninsured, and (iv) having the board of directors review Form 990 and approve the community needs assessment.

- Mandating annual reporting to the IRS and the public of information such as composition of board of directors, patient operating expenses and revenues, details associated with charity care and community benefit, offsetting funding, and details associated with joint ventures. Per the Discussion Draft, much of this information could be reported on Schedule H of the proposed Form 990. This requirement applies to Code section 501(c)(4) and government hospitals as well.
- Requiring that all tax-exempt hospitals (including Code section 501(c)(4) and government) comply with the Federal Debt Collection Practices Act ("FDCPA") by having the provisions of the FDCPA be expanded to apply to internal hospital billing and collection practices.

In addition to the requirements noted above, the Discussion Draft requires that Code section 501(c)(4) hospitals conduct a community needs assessment every three years and dedicate a minimum of 5% of annual patient operating expenses or revenues to community benefits. Community benefits would include charity care, an emergency room open to all regardless of ability to pay, burn units, trauma centers, health professional education and training programs, health research, and activities in response to issues raised by a community needs assessment.

Additionally, the Discussion Draft recommends penalty provisions including:

- Imposing a termination tax on the conversion of assets from tax-exempt to taxable.
- Subjecting a tax-exempt hospital to excise tax for failing to meet the charity care or community benefit requirement in an amount equal to twice the hospital's shortfall.
- Eliminating the initial contract exception and the rebuttable presumption of reasonableness for Code section 4958 excess benefit transactions with respect to joint ventures between tax-exempt and taxable hospitals. Additionally, for joint ventures the definition of disqualified person is expanded to include any

person participating in the joint venture where the person receives excess financial benefit or the tax-exempt hospital receives a disproportionate financial detriment.

- Imposing an excise tax in an amount of 25% of the excess benefit on any tax-exempt hospital manager who knowingly participates or authorizes an excess benefit transaction. Additionally, the Discussion Draft addresses executive compensation recommending a disallowance of payment of country club fees, spousal travel, private air transport, loans to executives and limiting first class travel. It also recommends elimination of the initial contract exception of Code section 4958 for employment contracts.
- Revoking tax-exempt status when the tax-exempt hospital fails to meet any applicable requirements and a recapture of prior tax benefits.

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