National Audioconference
Hospital and Health System Governance Strategies for Meeting Community Benefit Responsibilities
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The Legal Context of Nonprofit Hospitals' Community Benefit Obligation

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Topics To Cover

Focus on 501(c)(3) Tax Exempt Health Care Organizations

- **Community Benefit Standard - Federal**
  - Criteria
  - Evolution
- **Is the Standard Changing: Charity Care v. Community Benefit**
- **Not Covering Collateral Issues Affecting Compliance with Federal Community Benefit Standard**
  - Not-For-Profit Governance – Independence and Conflicts of Interest
  - Executive Compensation

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The 501(c)(3) Community Benefit Standard

- Revenue Ruling 56-185
  - NFP organization operating hospital for care of sick
  - Operated for those unable to pay (within hospital's financial ability)
  - Not operated exclusively for those able and expected to pay
  - Use of facilities not restricted to particular group of physicians
  - No private inurement

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The 501(c)(3) Community Benefit Standard

- Revenue Ruling 69-545
  - Promoting the health of a class of persons broad enough to benefit the community as a whole, even though not benefiting all persons directly, is sufficient to support charitable status
  - Criteria:
    - ER Open to all without regard to ability to pay
    - Governed by a Community Board
    - Open Medical Staff
    - Medicare and Medicaid non-discrimination
    - Surplus Used for Additional Services or Facilities

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Ancillary Joint Ventures

- General Counsel Memorandum
  - GCM 39862 – "True Community Benefit" v. Financial Benefit to Hospital
  - Indicia – Improved Cost, Quality and Access
    - Creation of new provider
    - Expansion of services
    - Provision of new services
    - Improved treatment modalities
    - Reduction in cost

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Expanded Community Benefit Theory

- Context: 501(c)(3) Determination Letters re: Integrated Delivery Systems
- Increased emphasis on:
  - Community board and conflicts of interest policy
  - Direct provision of health care services
  - Charity Care
  - Medical education and research activities

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IRS 2001 Field Service Advice

- Issued February 2001 (FSA 200110030)
- Internal Advice from IRS Assistant Chief Counsel to IRS Field Attorneys
- Factual Criteria Revenue Agents Should Consider in Examining 501(c)(3) Status under 501(c)(3) Community Benefit Standard
  - Stated policy on care for those unable to pay
  - Actual practices result in delivery of significant health care services to the indigent
  - Documentation of **ACTUAL** practices

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IRS 2001 Field Service Advice

- 14 Questions to Consider
  - Specific written policy on free/discounted care to the indigent?
  - Deviations from the written policy?
  - Broadcasting the policy to the public?
  - ER open to all regardless of ability to pay?
  - Directions to ambulance services about bringing indigent to ER?
  - What non-emergency care is provided to indigent for free/discount?
  - Denial of care to poor or indigent?

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IRS 2001 Field Service Advice

- 14 Questions to Consider (continued)
  - Expectations of full payment from all persons?
  - Means of ascertaining ability to pay?
  - Documents/agreements needed to qualify for free/discounted care?
  - Details of Policy on admitting indigent?
  - Referral of indigent to other area hospitals?
  - Separate detailed records on the number of times/circumstances free/discounted care is provided?
  - Separate account segregating costs of free/discounted care? Does it include write-offs for other than indigents?

IRS FY 2002 CPE Text

- Confirms ER is not required, especially for non-hospital providers
  - Revenue Ruling 83-157
  - Examples
    - Mobile medical unit
    - Free dental clinic
- Charity Care not discussed as an element of the Community Benefit Standard

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Miscellaneous IRS Rulings – 1998 to 2002

- Charity Care as an Indicia of Community Benefit
  - Adoption of Charity Care policy and communication of it to employees and public
  - Charity care policy applicable to all persons regardless of race, socioeconomic status
  - Income and asset guidelines tied to the federal poverty level
  - Actually providing meaningful Charity Care

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"Whole Hospital" Joint Ventures

- Charity Care as One Indicia of Promotion of Health/Community Benefit
  - Redlands-Loss of Exemption
    - No Charity Care
    - Less than 1% of total procedures were reimbursed by Medicaid
    - No communication to public of availability of Charity Care
    - No waiver of fees in excess of Medicare reimbursed amount
  - St. David's-Exemption Holds
    - Over $90 million in uncompensated care for 1997 -1998
    - IRS alleged Charity Care was insufficient and relied on 56-185
    - Court rejected IRS arguments
      - Finds hospital conduct consistent with charitable purpose
      - Percentage of revenue fee for proprietary joint/venture partner and manager provides disincentive to serve the indigent
      - Uncompensated care can be true Charity Care even if the hospital attempted to collect payment first

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IHC Health Plans v. Commissioner

- 10th Circuit Court of Appeals 2003
- Factors considered – the "Plus Test"
  - Makes services available to ALL in the community, AND
  - Provides additional community/public benefit sufficient to support strong inference that public benefit is primary purpose

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IRS FY 2004 CPE Text

- Healthcare Provider Reference Guide
  - http://www.irs.gov/pub/irs-tege/etopicc04.pdf
- Review of Community Benefit standard generally consistent with 69-545
- But, picks up on Expanded Community Benefit Standard for application to hospitals
  - "Does hospital serve a broad cross section of the community through research or Charity Care (as defined in Rev. Rul. 56-185)?"
- Follows 2001 FSA as to factors Field Service Agents should consider
- Standard for Charity Care Policy
  - Free or reduced-cost care, often using a sliding scale based on ability to pay
  - NOT bad debt

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IRS FY 2004 CPE Text

- Charity Care is one basis for claiming Community Benefit standard is met
- Others mentioned:
  - Medical training and research
  - Free health education and seminars
  - Community health fairs

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Monitoring and Reporting of Community Benefit

- IRS Conflict of Interest Policy
  - Calls for periodic review of activities for consistency with charitable purposes
- IRS Audit Guidelines
  - Tells IRS agents to review hospital newsletters, press releases and calendars of events
- Form 990
  - Statement of program accomplishments related to charitable purposes
    - Number of patients served
    - Days of care
    - Immeasurable achievements
  - Explanation of how income-producing activities contribute to charitable purpose

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Summary: Federal Community Benefit Standard Legal Precedents

- A Hospital must demonstrate appropriate facts with regard to serving its community
  - Operates full-time ER providing treatment regardless of ability to pay
  - Provides non-emergency services to people who are able to pay including Medicare and Medicaid beneficiaries
  - Open medical staff
  - Board of directors of independent civic leaders from the community
  - Uses operational surplus to further exempt purposes – improving quality of care, medical training, research

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Federal Community Benefit Standard Summary
Legal Precedents

- Additional factors (not exhaustive)
  - Creating new healthcare provider
  - Expanding community health resources
  - Improving treatment modalities
  - Reducing healthcare costs
  - Improving patient convenience, access to physicians
  - NOTE: No Charity Care requirement except for ER services

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Summary: Federal Community Benefit Standard Advice to Field Service Agents

- Actually provides Charity Care specific written plan, policy in place
  - deviations from policy follow explainable circumstances
  - directions provided to ambulance services document that ER is open to indigent patients
  - documents/agreements to be signed by indigent patients before receiving care are not overly burdensome
  - No obstacles to the provision of necessary care

Is the Standard Changing? Charity Care vs. Community Benefit

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Who are the Change Agents?

- IRS
- U.S. Congress (House and Senate)
- State Legislatures
- State and Local Taxing Authorities
- State Attorneys General
- Class Action Plaintiff Lawyers
- Labor Unions
- Press and The Public
- Auditors
- Bond Rating Agencies

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Emerging Themes, Public Policy Issues and Reform Proposals

- You have to *EARN* your tax-exempt status!
- Be prepared to demonstrate how your tax-exempt, not-for-profit organization differs from a for-profit organization?
- The Board has primary responsibility for meeting not-for-profit and tax-exemption standards
- Greater transparency through more rigorous reporting and government oversight is needed to hold not-for-profit, tax-exempt organization Boards accountable.
- NFPs should swiftly adopt and implement Sarbanes-Oxley (SOX) standards of independence and financial reporting.

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PricewaterhouseCoopers 2005 Charity Care Survey

State Legislative Initiatives

- 31 states have introduced or passed legislation related to Charity Care in 2004 and 2005
- 16 in 2004, with legislation adopted in 9
- 15 in 2005, as of late May 2005
- Topics addressed:
  - Prices charged and discounts offered to self pay
  - Policy and procedure requirements relating to patients' ability to pay
  - Communication of Charity Care policies
  - Funding to assist hospitals in providing care to insured and underinsured (New Jersey & Massachusetts)
  - Collection practices
  - Reporting of number of insured and uninsured treated

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Property Tax Challenges
"Failure of Charity" Theory

- Major Themes
  - Shift in focus from the charitable use of the property to the charitable nature of the organization
  - Evolving interpretations and requirements of "charitable" standard
  - Increasing focus on Charity Care programs and quantifications
  - Unclear how much Community Benefit is enough
  - Isolating Charity Care from Community Benefit as the tax-exemption standard

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IRS Community Benefit Hospital Survey

- In mid-May 2006 the IRS sent a "voluntary" questionnaire to 545 tax-exempt hospitals.
- Questionnaire was a compliance check, rather than an examination.
- Questionnaire covers following areas:
  - Board membership
  - Community benefit
  - Charity care
  - Billing practices
  - Medical research
  - Medical education and training
  - Executive compensation
- Findings: All respondents provide community benefit, No uniformity in approach or data, Wide variability in amounts and types

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Extreme Makeover of Form 990

- IRS released in June a draft of revamped Form 990 for public comment
- New 990 would apply beginning in FY 2008 (returns filed in 2009 for FYs beginning in 2008)
  - For calendar year organizations, new Form is operational now!
- Structure of the Form
  - 11-page core form
  - 16 separate schedules
- Public comment period expired September 14
- Instructions just issued in Spring 2008 and expected to be final by end of Summer 2008

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Extreme Makeover of Form 990

- New hospital schedule for detailed disclosure of charity care and community benefit
  - Adopts CHA/VHA approach to community benefit and bad debt, but permits separate report and explanation of these
  - Disclosure of community benefit expenses
  - Description of charity care policy
  - Activities and programs conducted at each facility
  - 2009 effective date for all but facilities report

Extreme Makeover of Form 990

Program Service Accomplishments

- Moved up to page two of core form
- Statement of program service accomplishments must include separate description of significant changes and of most important accomplishment for the year
- Electronic filers will have little room to "tell their story," because new Schedule O has two-page limit per item
- Hospitals will be less pressured to explain community benefit and charity care here, because Schedule H will require disclosure and narratives

Extreme Makeover of Form 990

Schedule H: Hospitals

- Most of form delayed one year; reporting on facilities required for 2008
- Hospital defined by state licensure/certification for now – all reporting on entity-by-entity basis
- More detailed questions on charity care and community benefits – charity care policy, eligibility criteria, annual report
- Provide detailed figures on charity care
  - Charity care at cost
  - Unreimbursed Medicaid costs
  - Unreimbursed costs under other government programs
  - No unreimbursed Medicare cost or bad debt

Extreme Makeover of Form 990

Schedule H: Hospitals

- Provide detailed figures on specified categories of community benefit
  - Community health improvement programs (express purpose of improving community health – no patient billing)
  - Health professions education (negative margin starting with cost), including scholarships for health professional education
  - Subsidized health services (clinical services with negative margin after removing charity care and Medicaid shortfalls)
  - Research (unsponsored direct and indirect costs)
  - Cash and in-kind contributions to community groups (to improve health of community)
- For all these, report number of programs, persons served, total expense, offsetting revenue and percentage of net expense to total expense

Extreme Makeover of Form 990

Schedule H: Hospitals

- Separate section on community building activities (same financial data as for charity care and community benefit)
  - Physical improvements and housing
  - Economic development
  - Community support
  - Environmental improvements
  - Leadership development and training
  - Coalition building
  - Community health improvement advocacy
  - Workforce development
  - Other

Schedule H: Hospitals

- New Section for disclosing bad debt, Medicare shortfall and collection practices – note narrative explanations required: why should these be considered community benefit?
- Draft table on billing data by patient category eliminated
- Describe management companies and joint ventures owned jointly with officers, directors, trustees, key employees and physicians, and disclose ownership percentages – aggregate ownership threshold of 10% (raised from 5% in draft)

Schedule H: Hospitals

- New section requiring narratives
  - Income criteria for free/discounted care
  - Bad debt, Medicare shortfall and collection practices
  - Community healthcare needs assessment
  - Patient education of eligibility for assistance
  - Description of community served
  - Community-building activities (promoting health)
  - Other promotion of community health
  - Roles of entity and affiliates in community health promotion
  - States in which community benefit report filed

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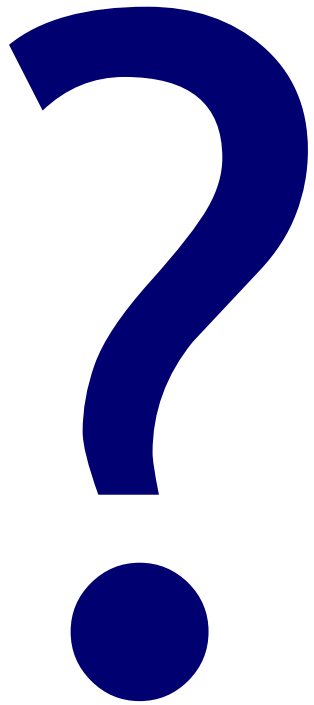

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