

**eHealth Initiative's Third Health  
Information Technology Summit  
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**Securing Tax-Exempt Status for  
Your Health Information  
Organization**

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# Overview – Why Be Exempt?

- **Tax-Exempt vs. Taxable Entities**
  - **Tax-exempt entities do not pay federal (or state) income tax**
  - **Taxable Entities are subject to both state and federal income tax**

# Overview – Why Be Exempt?

- **Why be Exempt Under Section 501(c)(3)?**
  - **Advantages**
    - **Exemption from income tax (Except UBI)**
    - **Contributions are deductible to the donor**
    - **Public image – exemption is “good”**
    - **Potential exemption from state sales and use taxes on purchases by organization**

# Overview – Why Be Exempt?

- **Why be Exempt Under Section 501(c)(3)?**
  - **Disadvantages**
    - **Limitations on activities**
      - Prohibitions on inurement and unwarranted private benefit
      - Prohibition on political campaign activity
      - Limits on lobbying
      - Must be primarily operated for exempt purposes and not be controlled by private parties for their benefit
    - **Application and reporting requirements**

# Applying for Exempt Status

- **Forming a Nonprofit**
- **Applying with the Internal Revenue Service**
- **Forms Required**
- **Exemption Process**

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# Inurement and Private Benefit

- **Inurement.** The net earnings of a Section 501(c)(3) organization may not “inure in whole or in part to the benefit of private shareholders or individual.” Unlike private benefit, there is no de minimis exception to the inurement proscription
  - **Insiders.** The inurement proscription is applied to “insiders” who have a personal and private interest in the organization’s activities and could cause the organization to confer a prohibited private benefit

# Inurement and Private Benefit

- **Insiders (cont'd)**
  - **The IRS focuses on whether an individual possesses control over the organization to determine whether that individual is an “insider”**

# Inurement and Private Benefit

- **Medical Staff Physicians.** Originally, the IRS took the position that physicians on the medical staff of an exempt health care facility are presumptively “insiders” for purposes of the private inurement proscription.
- **Payors**

# Inurement and Private Benefit

- **Per se Inurement.**
- **Facts and Circumstances Inurement**
  - **Payment of unreasonable compensation to insiders**
  - **Providing benefits (e.g. benefits, or use of organization property) that is not treated as compensation to the insider**
  - **Paying compensation calculated in such a way as to mimic an equity interest or give inappropriate incentives**

# Inurement and Private Benefit

- **Private Benefit.** A Section 501(c)(3) organization must serve public rather than private interests
  - However, the organization may serve private interests as long as the private benefit is incidental to the organization's exempt purpose.

# Inurement and Private Benefit

- **Private Benefit (cont'd)**
  - **The IRS has explained that private benefit is “incidental” if it is:**
    - **“Indirect,” “unintentional” or a “necessary concomitant” of the public activity; and**
    - **Insubstantial in relation to the public benefit resulting from the activity**

# Inurement and Private Benefit

- **Private Benefit (cont'd)**
  - **For example, a Section 501(c)(3) hospital may benefit a physician who is employed by the hospital after the hospital acquires the physician's practice, as long as that private benefit is incidental when balanced against the public benefit provided by the hospital's activities**
  - **Payment of unreasonable compensation, or other widespread transactions not at fair market value, can create unwarranted private benefit**

# Community Benefit Standard

## The Basic Exemption Argument

- Charitable organizations qualify for exemption under IRC 501(c)(3)
- The term “charity” is used in its “generally accepted legal sense” (Treas. Regs. Section 1.501(c)(3)-1(d)(2))

# Community Benefit Standard

## The Basic Exemption Argument

- The generally accepted legal sense includes the “promotion of health” (Rev. Rul. 69-545)
  - However, not all health-related activities are charitable.
  - To be charitable, healthcare activities must serve “public rather than private interests” (Treas. Regs. 1.501(c)(3)-1(d)(1)(ii)).
  - This has come to be known as the **Community Benefit Standard**

# Community Benefit Standard

## IRS Articulation of the Community Benefit Standard

- **Rev. Rul. 69-545**
- **Rev. Rul. 83-157**
- **1997 EO CPE Text (“Community Board and Conflicts of Interest Policy”)**
- **2004 EO CPE Text (“Healthcare Provider Reference Guide”)**

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# Community Benefit Standard

## Community Benefit: Good Factors

- **Community board**
- **Open medical staff**
- **ER available to all regardless of ability to pay**
- **Participate in Medicare/Medicaid**
- **Special or unique services (cancer hospital, children's hospital)**
- **Research and education**
- **Charity care**
- **Excess funds devoted to charitable purposes**

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# Community Benefit Standard

## Community Benefit: Factors Receiving Scrutiny

- Transactions with physicians and other insiders
- Compensation
- Joint ventures with for-profit partners

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# Community Benefit Standard

## Application to HIE/HIT

- **Fundamental Problem: CB standard was created for healthcare providers and RHIOs are not providers**

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# Community Benefit Standard

## Application to HIE/HIT

- **Solution:**
  - **The CB standard is the result of the application of the private benefit rule (must serve public rather than private interests) to nonprofit hospital industry.**
  - **IE, RHIOs must argue they serve public rather than private interests**

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# Community Benefit Standard

## Serving Public versus Private Interest

- **Community board (multi-stakeholder approach that is prevalent with RHIOs)**
- **Conflicts of Interest Policy**
- **Open to all providers who want to participate (hospitals, physicians, labs, diagnostic imaging, pharmacies, etc.)**

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# Community Benefit Standard

## Serving Public versus Private Interest

- **Open to all individuals in the community**
  - **69-545 does not require that services benefit everyone in the community nor that services be provided to the indigent**
  - **However, must establish that sufficiently large class is served (i.e., not patients of one hospital or one large medical group)**

# Community Benefit Standard

## Serving Public versus Private Interests

- **Relief of the distressed**
  - **Evidence of serving public interest (Treas. Regs. 1.501(c)(3)-1(d)(2))**
  - **HIE holds promise for chronic disease management, biosurveillance, pandemic surveillance, public health monitoring, backup records in the event of disasters, etc.**

# Community Benefit Standard

## Serving Public versus Private Interests

- **American Health Information Community**
  - “Potential Breakthroughs” as indicia of community benefit
  - <http://www.hhs.gov/healthit/breakthrough.html>

# Community Benefit Standard

**Other non-provider organizations that have been found to promote health**

- **Organizations focused on the “maintenance of conditions conducive to health,” such as gift shops, cafeterias, parking lots, organizations that assist in securing private rooms for patients, and organizations that facilitate visits by families and friends.**

# Community Benefit Standard

**Other non-provider organizations that have been found to promote health**

- **Professional Standards Review Organizations (Rev. Rul. 81-276)**
- **Information retrieval system to facilitate the legal donation of body organs (Rev. Rul. 75-197)**
- **Regional health data systems (Rev. Rul. 76-455)**

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# Other Bases for Exemption

## 501(c)(3)

- **Lessening the burdens of government (Rev. Ruls. 85-1 and 85-2)**
  - **Facts and circumstances test:**
    - **must be an objective manifestation by the government that it considers the activity to be part of its burden**
    - **fact that organization is engaged in activity that is sometimes undertaken by the government is insufficient**

# Other Bases for Exemption

## 501(c)(3)

- **Lessening the burdens of government (Rev. Ruls. 85-1 and 85-2)**
  - **Facts and Circumstances Test**
    - **fact that the government or an official of the government expresses approval of an organization and its activities is insufficient**
    - **working relationship between the government and the organization is strong evidence that the organization is actually "lessening" the burdens of the government**

# Other Bases for Exemption

## 501(c)(3)

- **Lessening the burdens of government (Rev. Ruls. 85-1 and 85-2)**
  - **Application of Facts and Circumstances Test**
    - **Pandemic, biosurveillance, public health benefits of HIE arguably lessen burdens of government in the same way fire departments and ambulances have been deemed to lessen the burdens of government (e.g., see Rev. Rul. 74-361).**

# Other Bases for Exemption

## 501(c)(3)

- **Lessening the burdens of government (Rev. Ruls. 85-1 and 85-2)**
  - **Application of Facts and Circumstances Test**
    - **Government has expressed that HIT activities are part of its burden (executive orders, legislation)**
    - **Most RHIOs are a close collaboration between government and private parties**

# Other Bases for Exemption

## 501(c)(3)

### ▪ Promotion of social welfare (Treas. Regs. 1.501(c)(3)-1(d)(2))

- relief of poor
- relief of distressed
- lessen neighborhood tensions
- eliminate prejudice and discrimination
- defend human and civil rights secured by law
- combat community deterioration and juvenile delinquency

# Other Bases for Exemption

## 501(c)(3)

- **Derivative/Integral Part Exemption (will generally only work if associated with a single IDS)**
- **Supporting organization**
  - **of a single IDS?**
  - **of a community foundation?**
  - **of a city or county or state government?**

# Other Bases for Exemption

- **501(e) Cooperative Hospital Service Organizations**
  - “record center” one of the permitted services
  - can only provide services to member hospitals of RHIO
- **501(c)(4)**
- **501(c)(6)**
- **501(c)\_\_\_\_\_**: maybe Congress needs to create a new class of exemption for RHIOs

# Current IRS Concerns

- **Private benefit**
  - **to physicians and vendors**
  - **private benefit can result in a particular entity being precluded from exemption . . . but not an entire industry**
  - **private benefit to physicians and vendors can be an issue with hospitals, but that doesn't mean that the entire industry is precluded from exemption**
  - **private benefit to health plans**

# Current IRS Concerns

- **Community boards (limit physician and vendor participation)**
- **Stark violations (Rev. Rul. 97-21)**
- **Access fees (Commerciality)**
- **Can't weigh public benefit vs. private benefit because can't quantify public benefits.**

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# Rev. Rul. 200?-??

## Situation 1:

- **Nonprofit corporation under state law**
- **Multi-stakeholder approach to governance—  
including a majority of independent board members**
- **Conflicts of interest policy**
- **Open to all providers in community willing to comply  
with terms and conditions**
- **Open to all individuals in community**
- **Donation of hardware and software, if any, is Stark  
compliant**

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# Rev. Rul. 200?-??

## Situation 1:

- Promotes the health of the community by providing one or more of the services described in the AHIC Breakthroughs
- Provides benefit to one or more classes of the medically underserved (e.g., coordinates electronic records of safety net providers, creates EHR for Medicaid population)
- System is interoperable, can “talk” to other systems and participates in a regional exchange
- Excess funds devoted to charitable purposes

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# Rev. Rul. 200?-??

## Situation 2:

- **Nonprofit corporation under state law**
- **Board consists of executives from one health plan and providers (hospital executives and doctors) that are part of health plan's network**
- **Only health plan's provider physicians and hospitals can access the system**
- **Only patients of the health plan can maintain an EHR**
- **No excess income—designed to break even to hold down costs to doctors and hospitals**

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# Rev. Rul. 200?-??

## Situation 2:

- **Purpose of enterprise is to**
  - **increase market share of health plan**
  - **attract hospitals and doctors to the health plan**
  - **facilitate electronic submission of claims data from provider to health plan**
  - **facilitate clinical interaction among health plan patients and providers**
- **System is not interoperable and does not plan to participate in any regional exchange of information**

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