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## Health Law Weekly

# Significant New Congressional Focus on Hospital Tax-Exempt Status

 April 28, 2023**Michael W. Peregrine**, McDermott Will & Emery LLP

The April 26 hearing of the Subcommittee on Oversight of the House Ways and Means Committee (Hearing) is the latest development in the re-examination of decades-old standards for federal tax-exempt status of not-for-profit hospitals. The Hearing particularly focused on the community benefits

provided by not-for-profit hospitals and how those benefits are reported to the Internal Revenue Service (IRS) and the greater public.

As this critical focus is likely to continue for the near future at least, hospital/health system leadership should monitor the potential for possible legislative changes given congressional concerns toward the sector. In particular, leadership should reconsider how they are currently reporting their community benefits, since the industry as a whole is perceived as doing a poor job in communicating on this point. The Hearing serves as excellent guidance regarding how tax-exempt hospitals could better convey the scope of their community benefits to the public. Depending upon the scope of any upcoming legislation, community benefit reporting could evolve as an enterprise-level risk for not-for-profit hospitals. The chief legal officer, teaming with the chief compliance officer, is perhaps the most appropriate corporate officer to guide executive and board leadership in developing an appropriate organizational response.

## **Background on Community Benefit Standard**

As most health regulatory lawyers know, the “Community Benefit Standard” is the primary means by which the IRS evaluates whether a hospital (and other medical care providers) is organized and operated for the charitable purpose of “promoting health,” for the purposes of qualifying for tax-exempt status under Section 501(c)(3) of the Internal Revenue Code (Code). Stated simply, the Community Benefit Standard requires that a hospital operate exclusively to promote the health of a class of persons that is broad enough to benefit the community.

Rev. Rul. 69-545 identifies certain specific factors that demonstrate community benefit: (i) operating an emergency room open to all, regardless of ability to pay; (ii) maintaining a board of directors drawn from the community; (iii) maintaining an open medical staff policy; (iv) providing hospital care for all patients able to pay, including those who pay their bills through public programs such as Medicaid and Medicare; (v) using surplus funds to improve facilities, equipment, and patient care; and (vi) using surplus funds to advance medical training, education, and research. This list is not meant to be inclusive of all types of community benefits and the absence of any one of the factors is not sufficient to defeat tax exemption. Importantly, and as expressly recognized at the Hearing, the Community Benefit Standard is an evolving standard that takes into account the changes in community health needs over the years, as well as the different needs of various communities served by hospitals throughout the United States.

The Community Benefit Standard was supplemented by Code Section 501(r), adopted in 2012. Section 501(r) obligates Section 501(c)(3) hospitals to satisfy four additional, specific requirements on a facility-by-facility basis: (i) establish written financial assistance policies that contain certain specified provisions and emergency medical care policies; (ii) limit amounts charged for emergency or other medically necessary care to individuals eligible for assistance under the hospital's financial assistance policy; (iii) make reasonable efforts to determine whether an individual is eligible for assistance under the financial assistance policy before engaging in extraordinary collection actions against the individual; and (iv) conduct a community health needs assessment and adopt an implementation

strategy at least once every three years. Importantly, a meaningful part of the Hearing was spent on whether hospitals currently have too much flexibility in drafting financial assistance policies and applications for financial assistance.

In addition, the tax reform bill passed by Congress in December 2017 contained a series of provisions that were punitive to tax-exempt hospitals and health systems (as well as other types of tax-exempt entities). Other, potentially more onerous proposals were considered by the House and (particularly) Senate tax committees during the legislative process but were not included in the final bill.

## The Wave of Negative Coverage

The potential impact of the Hearing should be considered in the context of the wave of unprecedented, highly negative media coverage and by-lined articles published since last September and singularly focused on not-for-profit hospitals.

Much of this coverage has appeared in mainstream publications ranging from *The New York Times* and *The Wall Street Journal* to *STAT* and *Health Affairs*. The authors have ranged from traditional reporters, to physicians, to academics. The topics for criticism have ranged from poor investment performance to board composition, collection practices, and charity care policies. Collectively, they are best typified by the sensational nature of their allegations; an apparent lack of understanding of how not-for-profit hospitals are organized, operated, and governed; the use of atypical, one-off examples; confusion on the economics of the not-for-profit hospital industry; and an unfamiliarity with how hospitals are regulated.

## The April 26 Hearing

The subject of the Hearing was “tax-exempt hospitals and the community benefit standard.” Particular focus was placed on reporting discrepancies in the Community Benefit Standard and on determining potential solutions for ensuring tax-exempt hospitals are providing sufficient community benefits.

Generally speaking, the tone of the hearing was moderate and balanced, highlighted by a common interest in addressing concerns with respect to hospital tax-exempt status. The witnesses were: (i) Ms. Jessica Lucas-Judy (Director, Strategic Issues, U.S. Government Accountability Office); (ii) Dr. Ge Bai, PhD, CPA (Professor of Accounting and Health Policy, Johns Hopkins University); (iii) Dr. Zachary Levinson, PhD (Project Director, KFF); and (iv) Ms. Melinda (Mindy) Reid Hatton (General Counsel, American Hospital Association).

Highlights of the hearing included the following:

- The importance of defining what aspects of the Community Benefit Standard should be required for hospitals recognized as federally tax-exempt, and how nuances in communities’ needs make this challenging. The emphasis on “transparency” with respect to reporting community benefit offers some suggestions on how hospitals can be more proactive in their reporting on Form 990, Schedule H. The inference is that any legislative response would be “at the margins”; e.g., clarifying the Community Benefit Standard as opposed to replacing, eliminating, or wholly overhauling the Standard.

- Potential mechanisms for Congress to consider in regulating the tax-exempt status of not-for-profit hospitals, including streamlining IRS reporting forms and standardizing the reporting of community benefits. Important in this regard was the apparent consensus among witnesses in maintaining the flexibility of the Community Benefit Standard and avoiding any bright-line or minimum spending requirements.
- The frustration expressed by some Subcommittee members with the compensation payable to CEOs of tax-exempt hospitals.
- Though there was consensus on the need for more transparency and better reporting, there was wide disagreement among the expert witnesses regarding the scope and degree to which tax-exempt hospitals benefit their community and what the actual value of tax-exempt status is for such entities.

## Potential Implications and Possible Strategies

Some comfort can be taken by the moderate and balanced manner in which the Hearing was held. Nevertheless, hospital and health system leadership should expect continued editorial and legislative focus on the Community Benefit Standard for the foreseeable future. This focus may also extend to the broader question of how charitable, tax-exempt hospitals can effectively differentiate themselves from tax-paying, for-profit hospitals which, again, was a topic of debate among the witnesses and Subcommittee members.

Hospital and health system leadership are thus called upon to revisit, confirm, and possibly refine how the organization's mission-related commitments are described to the public and to regulators. In the current environment, traditional "margin supports the mission" arguments—while accurate—may no longer be sufficient to justify tax-exempt status in the minds of the media, the public, and legislators.

For these and other reasons, organizational leadership may wish to consider a variety of responsive strategies, including but not limited to:

- The governing board is encouraged to "lean in" and engage in the internal discussion of the organization's commitment to charitable, not-for-profit status.
- Board governance committees should place greater focus on including, within their nomination criteria, qualified, independent leaders from the communities served by their communities.
- The board should establish an effective process by which it exercises oversight of investments made by the organization in for-profit businesses and other activities not directly associated with the traditional charitable mission.
- Officers and directors should increase their sensitivity to the negative perceptions and reputational concerns that can arise from financial relationships between the organization and members of the leadership team or their business entities.
- Increased resources should be committed to Code Section 501(r) compliance, particularly the requirements of sections 501(r)(4) through (6) relating to financial assistance, limitations on charges, and billing and collections.
- The financial assistance application process and information needed from applicants to support such application should be reviewed and streamlined if possible. More assistance, and less onerous procedures and documentation requirements, should be a goal.
- Executive leadership should approach the development and response to the requisite Community Health Needs Assessment as a strategic, mission-critical imperative, including attention to the

environmental and social needs of communities served.

- The board's executive compensation committee should incorporate incentive compensation goals that recognize demonstrable achievements in preserving the organization's charitable mission and alleviating community health needs.

More broadly, not-for-profit hospitals and health systems are encouraged to develop a coherent, defensible, and broadly disseminated message on how they promote health in the communities they serve, and how this can be distinguished from services provided by for-profit hospitals. This may require the involvement of expert external communications advisors.

## Sources

- IRS, [Charitable Hospitals - General Requirements for Tax-Exemption Under Section 501\(c\)\(3\) | Internal Revenue Service](#)
- IRS, [Requirements for 501\(c\)\(3\) Hospitals Under the Affordable Care Act – Section 501\(r\) | Internal Revenue Service](#)
- Hearing on Tax-Exempt Hospitals and the Community Benefit Standard <https://waysandmeans.house.gov/event/hearing-on-tax-exempt-hospitals-and-the-community-benefit-standard/>
- Hearing on Tax-Exempt Hospitals and the Community Benefit Standard, <https://www.youtube.com/watch?v=AC1zXdPAuFo>

## About the Author

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