Not-For-Profit Hospital Status Under Heightened Government Scrutiny
Latest Strategies for Protecting Tax-Exempt Status

A Live 90-Minute Teleconference/Webinar with Interactive Q&A

Today's panel features:

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James R. King, Partner, Jones Day, Columbus, Ohio
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Wednesday, May 19, 2010

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1 pm Eastern
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NFP Hospitals Under Scrutiny

New Federal Law Requirements After PPACA for Tax-Exempt Hospitals

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May 19, 2010
Healthcare Reform - Health Care and Education Reconciliation Act of 2010 / Patient Protection and Affordable Care Act

- New requirements for hospitals to maintain exemption from federal income tax under IRC section 501(c)(3)
- If organization operates multiple hospitals, each hospital facility must separately meet these requirements
- Requirements generally effective for tax years beginning after March 23, 2010
- Requires IRS to review at least once every three years the community benefit activities of each hospital
- Required annual reporting by Secretary of Treasury on information with respect to private tax-exempt, taxable, and government owned hospitals (and trend reporting by 5 years)
Healthcare Reform - Health Care and Education Reconciliation Act of 2010 / Patient Protection and Affordable Care Act

- New exemption requirements for hospitals-Sec. 501(r)
  - Community health needs assessment every three years
  - Sec. 4959--excise tax penalty of $50,000 for failure to comply

- Financial assistance policy requirements
  - Must have written plan; publicize widely
  - Separate written policy on emergency care
Healthcare Reform - Health Care and Education Reconciliation Act of 2010 / Patient Protection and Affordable Care Act

• Limitations on patient charges
  • Can’t charge patients qualifying for financial assistance more than amounts generally billed to individual patients who have insurance
  • Hospital must prohibit use of gross charges
• No extraordinary collection efforts before making reasonable efforts to determine eligibility
Healthcare Reform - Health Care and Education Reconciliation Act of 2010 / Patient Protection and Affordable Care Act

• New reporting and disclosure requirements with Form 990
  • How organization meets the needs of its community health needs assessment
  • Audited financial statements
Healthcare Reform – Additional Tax Provisions

- Premium tax on health plans. Tax-exempts at 50% of applicable rate
- Employer penalties relating to coverage requirements
- Excise tax on high-value “Cadillac” health plans
- Expansion of information reporting requirements
- Disclosure of value of employer-provided health insurance to employees on Form W-2
- Medical device excise tax
- Additional hospital insurance tax on high-income taxpayers and new tax on unearned income
Rejected Proposals

– Grassley proposed amendments to health reform bill:
  • Amend the Internal Revenue Code to require the reporting of governance and management information to the IRS
  • Remove the rebuttable presumption of reasonableness from intermediate sanctions
– Will IRS reconsider initial contract exception?
Role of Nonprofit Health Care under the PPACA (New Disclosure Requirements, Studies, and Reports to Congress)

James R. King, Jones Day, Columbus, Ohio
May 19, 2010
Role of Nonprofit Health Care under the PPACA

- 1 – Goals of PPACA
- 2 -- New Individual Coverage Mandate Compared to Current Charity Care Policies
- 3 -- New Mandated Studies and Reports
- 4 -- Role of Exempt Organization Provisions in Overall Reform
Goals of PPACA

• 1 - Increase number of Americans with health insurance coverage and thus increase access to care
• 2 - Ensure that coverage satisfies minimum thresholds and thus ensure a minimum level of quality care
• 3 - Bend that cost curve down
Charity Care v. Medicaid Expansion and the Individual Mandate

- Today’s Charity Care Policies
  - Sliding scale
    - Free to 200% FPL [$81,586]
    - Discounted to 400% FPL [$163,172]
  - Medical indigence
- Expand Medicaid to 133% FPL [$54,417]
- Individual Mandate -- Buy insurance or pay income tax penalty [IRC 5000A(b)]
  - Begins 2014 -$696/year per person, indexed to inflation
  - No penalty below 100% FPL [$40,793]
  - Between 100% and 400% FPL
    - Premium tax credit [IRC 36B], and
    - Cost-sharing subsidy [HR 3509 section 1402]
Reviews and Reports on Community Benefit

- IRS to review community benefit activities at least every three years
- Hospital Organization must describe in Form 990
  - How addressing needs identified in assessment
  - Any needs not being addressed and why
  - Any IRC 4959 excise taxes paid
  - A copy of audited financials for the organization
Comparative Reports and Studies on Trends

- Compare 501(c)(3) [60%] to for profit [20%] and government [20%]
  - Levels of charity care
  - Bad debt expenses
  - Unreimbursed costs for means-tested government programs
  - Unreimbursed costs for non-means-tested government programs
- Information on 501(c)(3) costs for community benefit activities
- Not later than 04-22-15, HHS/IRS report to
  - HWM, Ed & Labor, Energy & Commerce, and
  - SFC and Health, Ed, Labor, & Pensions
PPACA’s Impact – CMS Office of the Actuary
April 22, 2010

• Reduces but doesn’t eliminate uninsured
  • From 57 million to 24 million
  • 5 million undocumented aliens cannot use Medicaid or new exchanges
  • Loss of employer coverage
  • Cost of exchange coverage

• Creates access issues for Medicare and Medicaid
  • Reimbursement shortfalls
  • Expansion Medicaid to 133% of FPL

• CDC National Center Health Statistics
  • Medicaid now 25.5% of ER visits versus 17.4% for uninsured
  • Medicaid ER visit rate higher
    – 82/100 Medicaid patients
    – 48/100 uninsured patients
What Role for Nonprofit Health Care under PPACA?

• Still the dominate way to deliver care [60% plus of sector]
• New IRC 501(r) -- Govern behavior until new system phased in
• New Data and Reports --
  • Increase IRS oversight in near term
  • Gather data to judge the role nonprofit health care will play in the future
  • Real Question – What will Congress do with the data?
• Remember
  • PPACA will illustrate the law of unintended consequences
  • Rev. Rul 69-545 came into being because of a belief that Medicare and Medicaid would eliminate the need for charity care
Not-For-Profit Hospital Status Under Tight IRS Scrutiny Webinar

The Provena Covenant Case: The Lessons for Tax Exempt Hospitals

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I. The Court Rulings in Provena Covenant
History of Provena Covenant Exemption Litigation
In August 2008, DOR denial of exemption affirmed based on finding:

- Percentage of free care is facially inadequate and inconsistent with claimed charitable purpose.
- “[I]t is unclear to what extent Provena exercises ‘general benevolence’ as opposed to…selling medical services.”
- “…operating income derived almost entirely from contractual charges goes against a charitable identity.”
- “…charity care policy could have posed an obstacle to charity to the needy…an elderly retired person…might have to liquidate his house and the investments upon which he depends for basic survival.”
- “If, despite the patient’s inability to pay, the patient is contractually liable to reimburse Covenant for the medical treatment, Covenant has extended no charity to that patient.”

Provena Covenant Medical Center v. Department of Revenue, 894 N.E. 2d 452 (Ill. App. Ct. 2008)
Illinois Supreme Court Decision
Supreme Court Upholds Denial of Property Tax Exemption

• March 18, 2010 decision upholds Illinois DOR denial of property tax exemption for 2002 tax year.
• Court’s **judgment** was unanimous, with all 5 of the participating Justices agreeing with the result.
• As noted in the dissent, the Court’s **reasoning** as it relates to the issue of “charitable use,” did not get the four votes necessary to constitute the opinion of the Court.
• Plurality decision leaves Illinois law **unchanged**.
• Reaffirmed exemption required proof of both ownership by a charitable institution and use of property exclusively for charitable purposes.

http://www.state.il.us/court/Opinions/SupremeCourt/2010/March/107328.pdf
The Court identified five factors considered to be distinctive characteristics of a charitable institution:

1) it has no capital, capital stock, or shareholders; 2) it earns no profits or dividends but rather derives its funds mainly from private and public charity and holds them in trust for the purposes expressed in the charter; 3) it dispenses charity to all who need it and apply for it; 4) it does not provide gain or profit in a private sense to any person connected with it; and 5) it does not appear to place any obstacles in the way of those who need and would avail themselves of the charitable benefits it dispenses.

(Opinion at 16).

• Covenant held to satisfy (1) and (4) only.

• Covenant failed to satisfy factor (2) because its funds were overwhelmingly derived from fees paid for medical services versus charitable donations.

• Covenant failed to satisfy factors (3) and (5) because the record did not contain adequate information to overturn the DOR conclusion that Covenant was not a charitable institution.
Supreme Court on Charitable Use

• Focus on whether Covenant relieved a burden on state or local government.

“Conditioning charitable status on whether an activity helps relieve burdens on government is appropriate.”

• Taxpayer to show: (1) a “financial burden” that local taxing authorities “would otherwise have been required to bear,” and (2) a reduction in that financial burden due to some activity occurring on the subject property.

• Even where a burden on government is reduced, the taxpayer will not satisfy the charitable use requirement if the activity were provided for a fee.

• Ruling suggests that Covenant’s care for residents of the community--where there is no local government hospital--is not itself sufficient to qualify as charitable use.
Other Supreme Court Findings

The Court addressed a number of points to bolster the conclusion that Covenant failed to carry its burden of proof as to charitable ownership or use. Those points include:

- The amount of charity care was *de minimus*.
- Covenant did not expressly advertise the availability of free care.
- Patients were billed as a matter of course.
- 13.4% of residents below the poverty line, so there must have been more poor, underinsured or uninsured in need of charity.
- Charity discounts still resulted in the hospital receiving more than the cost of its services.
- Cross-subsidies between facilities or medical services diminishes the notion that services offered at a loss are truly charitable.
- Medicare and Medicaid do not count as charitable because they are undertaken for business reasons – that is, to keep a steady and reliable stream of patients and to secure 501(c)(3) standing.
The *Provena* Plurality Opinion -- Blueprint or Aberration?

- Decides only that 43 parcels are not exempt for 2002
- Plurality opinion will likely be used as a blueprint for those in other states who wish to challenge real estate tax exemptions
- Dissenting opinion illustrates the contrary view on the quantum of care metric
- Not clear how well *Provena* plurality will travel to other states
  - Lessening burdens approach is unique
  - Different statutes and constitutional provisions in different states
  - Only two (PA and TX) have quantity metrics, and even there, no absolute minimum amount
  - And, Illinois has yet to decide its own law
State and Local Tax Developments

• In March 2010, Illinois Supreme Court held that Provena Covenant Medical Center did not provide enough charity care to qualify for state property exemption.
  – A plurality opinion, so not binding precedent
  – Ill. Hospitals will likely approach the legislature to clarify
• Senator Grassley (R-IA), Senate Finance Ranking Member, termed ruling yet more evidence that there is “no discernable difference between the operations of taxable and tax-exempt hospitals.”
• Anecdotal evidence that local taxing authorities are demanding PILOTs and challenging exemptions. Modern Healthcare May 3, 2010
Provena In Context

- Two hospital town: Provena, Carle Foundation
- Scruggs lawsuits, SEIU raise controversy
- Low charity care record
- Patients billed full charges, unpaid bills sent to collection
- Body attachments
II. Provena Covenant: The Lessons for Exempt Hospitals
State Tax Exemption Requirements Must Be Understood

- The state requirements for charitable property and other tax exemptions are frequently not understood or considered.
- It is no longer possible to assume your hospital or other exempt parcels are beyond challenge.
- Possible threats should prepare to demonstrate compliance with all exemption criteria, including charitable use and ownership criteria.
- Recognize that all challenges will continue due to ill-defined or outdated state exemption standards.
- Developing best practice is to subject exemption standards to compliance review and validation.
The Charity Program Must Meet Prevailing Standards

- Tax authorities and courts are increasingly hostile to exempt organizations with *de minimis* charity care.
- Common failures to identify and assist charity care patients must be addressed.
- The numbers of free care patients should correlate to local need.
- The number of charity cases accounted for as bad debt must be reduced.
- Hardship provisions should exist in all charity care programs.
- Billing and pricing practices viewed as unfriendly or “unfair” to charity and other patients must end.
- The problems that have resulted in the loss of exemption or challenge must be understood and avoided.
Charity Must Be Effectively Advertised

- Recent and continuing scrutiny supports position that charity care is not being effectively advertised.
- The mission commitment of providing free care to all in need must be widely communicated.
- Advertisements can be used to reaffirm the offer of financial assistance and deter enforcement claims relating to “silent” charity programs.
- Billing statements and mailings should reinforce the offer of charity.
- Applications and charity information should be available and easily accessed by people in need.
- External reviews serve to confirm the charity offer is clear and consistent with local and state requirements.
Charity Should be Considered a *Quid Pro Quo* Matter

- Local and state tax authorities are weighing qualifications for exemption based on the amount of free care being given in return for tax subsidy.
- Develop data and other information showing how charitable contributions reduce burdens otherwise falling on government.
- Identify all contributions that merit consideration as charitable gifts.
- Uncompensated care must be linked as possible to the charitable mission.
- Valuations of exemptions help defend against claims of outsized and undeserved exemption benefits.
The Need for Improved Charitable Reporting

• Community benefit is not necessarily charity under State law and continuing confusion, conflation invites controversy.
• Reporting should make the case for charitable exemption.
• Inconsistent and flawed reporting of charity numbers serves to support challenges to exempt status.
• Presumptive charity and other vehicles are available to buttress the case for charitable exemption.
• Use 990 and similar reporting to tell the quantitative and qualitative stories that demonstrate charitable mission.
• Understand how some charity reporting will be covered by media and evaluated by tax authorities.
Collections and Billing Require Strict Control

• Billing materials should reiterate the available charity options.
• Rack rate pricing and billing charity patients above cost will invites controversy.
• Know how billing and collections information is used to challenge exempt status.
• Consider new and different ways to engage potential charity patients such that the chances of cooperation are increased.
• Carefully consider collections action in cases involving possible charity patients.
• Do not allow courts to issue “body attachment” or similar orders.
• Categorizing even uncooperative patients as charity cases is not going to be challenged by anyone.
Hospitals and related exempt organizations are increasingly viewed as remote, big businesses.

Success in reducing status challenges requires positive relationships with local representatives and tax authorities, as well as hospital critics and patient advocates.

The times and threat demand an editorial board strategy.

Enforcement action and controversial business practices will create pressure for exemption challenge.

It is too late to find friends or supporters once an exemption dispute erupts.
Reinforcement of the Charitable Mission

• Charitable mission must be internally and externally stressed as a priority.

• Senior management and directors should help promote the charitable mission.

• Revisit the extent of finance control over charity and understand the resulting perception.

• Educate and train hospital personnel to serve the charitable mission.