

Additional Hospital Tax-Exempt Status Requirements Effective Soon

Email Alert

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Nonprofit hospitals should move quickly to assure compliance with the new supplemental requirements for federal tax-exempt status included in the new healthcare reform act. While most provisions of the act will be effective at later dates, the specific requirements for hospital income tax exemption will be effective very soon.

Section 9007 of the Patient Protection and Affordable Care Act (Act), signed into law by President Barack Obama on March 23, 2010, adds new sections 501(r) and 4959 to the Internal Revenue Code. Section 501(r) includes a series of specific requirements for hospitals to receive and maintain Section 501(c)(3) status. Section 4959 imposes an excise tax on hospitals that fail to meet one of these standards, namely, the community health-needs assessment standard. Most of the new standards are effective for tax years beginning after the date of enactment--which means they could apply to some hospitals as soon as April 1, 2010. Tax-exempt hospitals should thus confirm before the beginning of their next tax year that they have required policies and procedures in place.

Section 9007 is the same provision on this subject as was included in the Senate healthcare reform bill adopted on December 24, 2009. In essence, it codifies and elaborates on certain key aspects of the "community benefit" standard for hospital tax exemption. As such, it reflects a modest but nevertheless important adjustment to current tax-exemption standards.

Further, the excise tax (penalty) provisions and focus on ongoing charity-care trends should prompt hospital governance and management to pay much closer attention to these particular requirements, and the broader distinctions between tax-exempt and for-profit hospitals. It is interesting that these new supplemental requirements to federal hospital tax-exemption standards come at the same time as the March 18, 2010, decision of the Illinois Supreme Court denying property tax-exempt status to Provena Covenant Hospital in Champaign, IL. Access yesterday's [email alert](#) on the Provena Covenant Hospital case. The *Provena* decision has re-energized the concerns of some third parties that nonprofit hospitals are not by their activities sufficiently distinguishable from their for-profit counterparts.

The Act adds four specific additional requirements that hospitals must satisfy in order to qualify for tax-exempt status under Section 501(c)(3). The Act's structure is similar to other situations--for example, child care--in which a separate subsection is added to provide more specificity to the general requirements of Section 501(c)(3). The Act provides that in general the provisions are effective for taxable years beginning after the date of enactment.

Community Health-Needs Assessment

Each hospital must have (1) conducted a community health-needs assessment in the applicable taxable year or in either of the two taxable years immediately preceding such taxable year; and (2) adopted an implementation strategy for meeting the community health needs identified in the assessment. The assessment itself must take into account input from a broad cross section of the community served by the hospital, including those with special knowledge of or expertise in public health, and must be made widely available to the public. This provision is effective for taxable years beginning after the second anniversary of the Act's date of enactment.

Financial Assistance Policy

Each hospital must adopt and make widely available a written financial assistance policy containing two key components:

First, it must incorporate (1) eligibility criteria for financial assistance and whether such assistance includes free or discounted care; (2) the basis for calculating amounts charged to patients; (3) the method for applying for financial assistance; (4) for hospitals that do not have a separate billing and collections policy, a statement of the collection-related actions the hospital may take in connection with non-payment; and (5) how the hospital will widely publicize the policy within the community it serves.

Second, it must commit the hospital to provide non-discriminatory emergency medical care, regardless of whether the individual is eligible for financial assistance under the hospital's financial assistance policy. (It is not clear how this changes a hospital's EMTALA obligations.)

Limitations on Charges

The legislation provides that each hospital must limit the charges for emergency or other medically necessary care provided to patients eligible for financial assistance under its financial assistance policy to not more than the lowest amounts charged to patients who have insurance covering such care. The hospital must also prohibit the use of gross charges.

Billing and Collection Requirements

A hospital may not carry out "extraordinary collection actions" until it has made "reasonable efforts" to determine whether a patient is eligible for assistance under the hospital's financial assistance policy. The definition of "reasonable efforts" is to be determined by subsequent regulation, although presumably the latter would include notification to patients of the written financial policy upon admission, in the bill, and by subsequent telephone calls.

Other provisions of Section 9007 are as follows.

Excise Tax

A new Section 4959 is added by the Act to the Internal Revenue Code imposing an excise tax penalty of \$50,000 for any tax-exempt hospital that fails to satisfy the community health-needs assessment requirement for any taxable year.

Mandatory Review

The U.S. Department of the Treasury Secretary (Treasury Secretary) or its delegate is to review at least once every three years the community benefit activities of each tax-exempt hospital (presumably, the Form 990 - Schedule H material). The Internal Revenue Service has not indicated how it anticipates carrying out this review.

Reporting Requirements

Section 6033(b) of the Internal Revenue Code is amended by adding a new provision requiring tax-exempt hospitals to include in their annual Form 990 two additional items: (1) a report that describes how the hospital is addressing the needs identified in each community needs assessment, together with a summary of any such needs that are not being addressed, and why; and (2) their audited financial statements (or the consolidated financial statements in which they are included).

Agency Reports

The Treasury Secretary, in consultation with the U.S. Department of Health and Human Services Secretary (HHS Secretary) is to submit an annual report to Congress on (1) levels of charity care, bad debt expense, and certain unreimbursed costs of taxable, tax-exempt, and government hospitals; and (2) costs incurred by tax-exempt hospitals for community benefit activities. Treasury and HHS are also to conduct a report on community benefit-related trends which is to be presented within five years after the Act's adoption.

Definition of a Hospital

The Act defines a hospital as a facility required to have a state license as a hospital, and any other organization that the Treasury Secretary determines has the provision of hospital care as its principal function. The first part of this definition is similar to the current definition of organizations that must file Schedule H to Form 990. Because the Treasury Secretary is to review the community benefit activities of each tax-exempt hospital, presumably the definition of "hospital" for Section 501(r) purposes will remain close to the Form 990 definition.

Multi-Hospital Organizations

For tax-exempt hospital organizations that own and operate more than one hospital facility, the new tax-exemption requirements will apply to each individual hospital. The Act's language specifies that if one of the organization's hospitals does not separately meet the requirements, that hospital will not be treated as described in Section 501(c)(3). It does not, however, specify the significance that this would have on the income of the hospital corporation (that is, whether income from that facility would be treated as unrelated business income).

While many tax-exempt hospitals may already be operating in substantial conformance with the new standards, hospitals should quickly review their policies and procedures to make sure that appropriate provisions are in place. Hospitals will also need to be even more vigilant in correctly completing Schedule H of the Form 990 so that accurate information is available to the public and the government.

**We would like to thank Elizabeth Mills, Esquire (Proskauer Rose LLP, Chicago, IL) and Michael Peregrine, Esquire (McDermott Will & Emery LLP, Chicago, IL), for providing this email alert.*

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