Protecting Tax Exemption Under the ACA

Sponsored by Hospitals and Health Systems (HHS) and
Tax and Finance (TAX) Practice Groups
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Community Benefit in Context: Evolution to ACA §9007

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Overview

- Nonprofit hospital tax exemption: what's at stake?
- Origins of the charitable tax exemption & evolution of the community benefit standard
- General requirements for federal tax exemption
- Community benefit requirements under I.R.C. § 501(r)
- Schedule H Reporting
- How much is enough?
- State community benefit requirements

Nonprofit (tax-exempt) hospitals

- About 2,900* non-government nonprofit community hospitals in the United States

"*Community hospitals are defined as all nonfederal, short-term general, and other special hospitals. Other special hospitals include obstetrics and gynecology; eye, ear, nose, and throat; rehabilitation; orthopedic; and other individually described specialty services. Community hospitals include academic medical centers or other teaching hospitals if they are nonfederal short-term hospitals. Excluded are hospitals not accessible by the general public, such as prison hospitals or college infirmaries.*"

*American Hospital Association (*based on 2010 data)*

http://www.aha.org/research/rc/stat-studies/fast-facts.shtml

Nonprofit hospital tax exemption – what's at stake?

Benefits of federal tax exemption

Federal income tax	$2.5 billion
Tax-exempt debt (bond financing)	$1.8 billion
Deductibility of charitable contributions	$1.8 billion
Total federal benefits	**$6.1 billion**

Congressional Budget Office 2006 (based on 2002 data)

Nonprofit hospital tax exemption – what's at stake? (continued)

Benefits of state tax exemption

State corporate income tax	$ 0.5 billion
State sales tax	$ 2.8 billion
State & local property tax	$ 3.1 billion
Total state & local benefits	**$ 6.4 billion**

Congressional Budget Office 2006 (based on 2002 data)

Nonprofit hospital tax exemption – what's at stake? (continued)

- Benefits of federal tax exemption $6.1 billion
- Benefits of state tax exemption $6.4 billion
- Total benefits of tax exemption $12.6 billion*

*(CBO rounding)

Congressional Budget Office 2006 (based on 2002 data)

Charitable tax exemption - origins and rationale

- Charitable organizations: charitable trust doctrine
- Charitable activities relieve government of responsibilities that would otherwise have to be met at public cost

Charitable tax exemption – U.S. statutes

- 1894: Wilson-Gorham Tariff Act exempted organizations "organized and conducted solely for charitable, religious, or educational purposes"
- 1913: First U.S. income tax code
- Revenue Act of 1954: Internal Revenue Code §501(c)(3)

Charitable organizations – I.R.C. §501(c)(3)

- "Organized and operated exclusively for … **charitable purposes**…."

- NO:
  - Private inurement
  - Substantial lobbying activities
  - Participation in political campaigning for or against candidates for public office

I.R.C. §501(c)(3)

By its terms, §501(c)(3):

- Does not mention hospitals
- Does not expressly recognize health promotion as a charitable purpose

Early IRS interpretation of §501(c)(3)

- Original IRS interpretation of "charitable" purpose: relief of the poor.

- 1956: "financial ability" standard (Rev. Rul. 56-185) Exemption for hospitals that accepts patients without the ability to pay - to the extent of the hospital's financial ability

IRS establishes "community benefit" standard

1969: "community benefit" standard (Rev. Rul. 69-545)

- Recognized **promotion of health** as a charitable purpose under §501(c)(3): "…deemed beneficial to the community as a whole even though the class of beneficiaries eligible to receive a direct benefit… does not include all members of the community … provided that the class is not so small that its relief is not of benefit to the community.
- Not limited to charity or discounted care

2010: The Affordable Care Act (ACA)

- ACA § 9007: "Additional Requirements for Charitable Hospitals"
- Adds I.R.C. §501(r)
  - Community health needs assessment & implementation strategy every 3 years
  - Written financial assistance policy to be "widely publicized"
  - Emergency medical care policy – nondiscriminatory treatment
  - Limitations on hospital charges
  - Billing and Collections limitations – no "extraordinary collection actions before making reasonable efforts to determine eligibility for financial assistance

I.R.C. §501(r)

- Does not establish any community benefit dollar amount or percentage of hospital revenue that must be provided in order to qualify for tax exemption
- IRS determines qualification for exemption by application of “facts and circumstances” test
- Regulations? – not yet

IRS guidance

- IRS Notice 2010-39: "Request for comments regarding additional requirements for tax-exempt hospitals"
  - Except for specific additional requirements of §501(r), "the Affordable Care Act did not otherwise affect the substantive standards for tax exemption that hospitals are required to meet under section 501(c)(3)."
  - Over 200 comments – hospital associations, individual hospitals and hospital systems, advocacy organizations, health department organizations, academics, interested individuals…

IRS guidance (continued)

- IRS Notice 2011-52: "Notice and request for comments regarding the community health needs assessment requirements for tax-exempt hospitals"
  - Describes what Treasury/IRS "intends to provide" in future regulations interpreting §501(r)

- Informational returns – forms and instructions:
  - Form 990, Schedule H revised for 2010 and 2011 tax years to reflect §501(r) requirements

What counts as community benefit under Schedule H?

Hospital costs relating to:

- Financial assistance
- Medicaid shortfall & unreimbursed costs of other means-tested government programs
- Other benefits:
  - Community health improvement services
  - Health professions education
  - Research
  - Subsidized health services
  - Cash & in-kind contributions for community benefit

How much is enough?

- Facts and circumstances
- Community benefit expenditures commensurate with hospital's estimated non-exempt tax liability?
- Catholic Health Association:* when setting level of community benefit hospital should budget, consider:
  - Responsiveness to community needs (hospital's "fair share")
  - Hospital's financial capacity
  - State regulatory requirements
  - Value of tax exemption

*Catholic Health Association, *A Guide for Planning and Reporting Community Benefit (2008)*

State community benefit requirements

- State income, property, sales tax – value of state exemption may be more substantial than federal
- A handful of states have set community benefit minimums for tax exemption
- State legislative activity increasing

Closing Thoughts & Tips…

Encourage nonprofit hospital clients to:

- Take their community benefit responsibilities seriously
- Involve the community, local public health, and public health experts in needs assessment and community benefit planning
- Involve hospital's governing body – IRS expects formal adoption of community benefit implementation strategy (IRS Notice 2011-52)
- Budget for needs assessment, planning, and implementation
- Evaluate community benefit activities - find out what works to improve health in community the hospital serves
- View community benefit as an opportunity to fulfill the hospital's health mission by contributing to improved community health

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About The Hilltop Institute and Hilltop's Hospital Community Benefits Program

The Hilltop Institute at UMBC *is a non-partisan health research organization dedicated to improving the health and wellbeing of vulnerable populations. It conducts research, analysis, and evaluations on behalf of government agencies, foundations, and nonprofit organizations. For more information, go to www.hilltopinstitute.org.*

Hilltop's Hospital Community Benefit Program *is funded by the Kresge Foundation and the Robert Wood Johnson Foundation as the central resource created specifically for state and local policymakers who seek to ensure that tax-exempt hospital community benefit activities are responsive to pressing community health needs.*