

Healthcare Reform: Implications for Tax-exempt Hospitals

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The Patient Protection and Affordable Care Act of 2010 includes a set of sweeping changes applicable to charitable hospitals exempt under Section 501(c)(3) of the Internal Revenue Code. The Act (a) imposes new eligibility requirements for 501(c)(3) hospitals, coupled with an excise tax for failures to meet certain of those requirements; (b) requires mandatory IRS review of the hospitals' entitlement to exemption; (c) sets forth new reporting requirements on the hospitals involving community health needs assessments and audited financial statements; and (d) imposes further reporting requirements on the Secretary of the Treasury regarding charity care levels. Most of the changes in the Act are scheduled to go into effect for tax years beginning after March 23, 2010, the date of enactment.

Eligibility Requirements. Charitable hospitals will now need to comply with four new requirements in order to maintain their exemption under 501(c)(3). These requirements are set forth in a new Code Section 501(r). In multi-hospital systems, each hospital must meet these requirements in order to retain that hospital's exempt status.

- *Community Health Needs Assessment.* Hospitals must conduct a community health needs assessment at least once every three years. These assessments must include input from persons representing the broad interests of the community served by the hospital, including those with special knowledge or expertise in public health, and the hospital must then make the needs assessment “widely available to the public.” A hospital can satisfy this requirement if it has conducted the assessment during the tax year at issue or in either of the two immediately preceding tax years. Hospitals must adopt an implementation strategy to meet the community health needs identified through their assessments. Hospitals that fail to meet these requirements in any given year will be subject to an excise tax in the amount of \$50,000.
- *Financial Assistance Policy.* Tax-exempt hospitals will now be required to establish written policies on financial assistance and emergency medical care. The financial assistance policy must include eligibility criteria, the basis for calculating charges, the method for applying for financial assistance, and (unless the hospital has a separate billing and collections policy) the actions the organization may take in the event of nonpayment, including collection actions and reporting to credit agencies. The financial assistance policy must also specify how the policy is to be publicized in the community, such as via hospital website. The emergency medical care policy must require the organization to provide, without discrimination, care for certain emergency medical conditions regardless of an individual’s eligibility under the financial assistance policy described above.
- *Limitation on Charges.* To maintain exemption, hospitals will now be required to limit the amounts charged for emergency or other medically necessary care provided to individuals eligible for assistance under the financial assistance policy described above. Hospitals may not charge more than “the amount generally billed” to hospital patients who have commercial insurance coverage. In addition, the organization may not bill assistance-eligible individuals using gross charges.
- *Billing and Collection Requirements.* To maintain exemption under Section 501(c)(3), hospitals must refrain from “extraordinary collection efforts” such as collection actions unless the organization has made reasonable efforts to determine whether the individual is eligible for assistance under the organization’s financial assistance policy.

Mandatory Review of Exemption. The Act requires the Secretary of the Treasury to review the community benefit activities of each exempt hospital at least once every three years.

New Reporting Requirements. As noted previously, the Act imposes new reporting requirements on exempt hospitals and on the Secretary of the Treasury. Exempt hospitals will be required to report as follows:

- *Community Health Needs Assessments.* Each hospital will be required to report on how it is addressing the needs identified in the community health needs assessments, provide a description of any needs that are not being addressed, and explain why those needs are not being addressed. This information will be included in the hospital’s annual information return filed with the IRS (Form 990).
- *Audited Financial Statements.* Exempt hospitals will be required to provide copies of audited financial statements for the organization or consolidated financial statements for organizations that prepare financials on a consolidated basis.

The Secretary of the Treasury will be required to report as follows:

- *Charity Care.* On an annual basis, the Secretary of the Treasury, in consultation with the Secretary of Health and Human Services, will be required to report to Congress on levels of charity care, bad debt expenses, unreimbursed costs for services provided with respect to means-tested government programs, and unreimbursed costs for services provided with respect to nonmeans tested government programs. The preceding reports must be provided with respect to private tax-exempt, taxable, and government-owned hospitals. In addition, for private tax-exempt hospitals only, the Secretary will be required to report on costs incurred for community benefit activities.
- *Trends.* In addition to the annual reports set forth above, the Secretary of the Treasury will be required to report back to Congress in five years regarding trends it has observed in the various levels of charity care included in those annual reports.

Effective Dates. For the most part, changes affecting tax-exempt hospitals will apply to taxable years beginning after the date of enactment (March 23). Requirements relating to community health needs assessments will become effective for taxable years beginning after March 23, 2012, while other requirements are effective for taxable years beginning after March 23, 2010.

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The Act's provisions affecting 501(c)(3) status represent the latest chapter – if not the culmination – of a long series of tax exemption reform efforts in Congress spearheaded principally by Senator Charles Grassley and Congressman Max Baucus. For example, legislation was introduced in the House of Representatives back in 2006 (H.R. 6420, the Tax Exempt Hospitals Responsibility Act of 2006) that would have required hospitals to provide mandated amounts of charity care and to publicize charity care policies. In July 2007, Senator Grassley released a discussion draft of proposed non-profit hospital reforms that included requirements for written charity care policies; publication of charity care eligibility criteria; minimum actual annual amounts of charity care (at the greater of 5% of hospital's annual patient operating expenses or revenues); community needs assessments every three years; community wellness/outreach services for vulnerable populations; caps on charges to the medically indigent; board governance restrictions; standards for billing and collection practices; and reporting and transparency requirements.

The new healthcare reform legislation contains many features from previous exemption reform proposals, but still falls short of mandating specific levels of charity care. The IRS will now be digesting extensive community benefit information contained in hospital filings using the newly-revised Form 990. Senator Grassley and his like-minded colleagues in Washington undoubtedly will be watching for the results of that analysis, and if they remain unsatisfied, we may not have heard the last word on exemption reform.

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