

Sweeping Proposals for Reform of Nonprofit Hospitals Released Today

In September of 2006, Sen. Charles Grassley as chairman of the Senate Finance Committee directed that a discussion draft be prepared of potential reforms to ensure an adequate level of charitable care is provided by the nation's nonprofit hospitals. Pursuant to his direction, that discussion draft was to be a bi-partisan staff effort. However, the now minority staff of the Senate Finance Committee (Minority Staff) today released a significant new set of proposals relating to how the business and operations of nonprofit hospitals should be revised, which can be found at the [this link](#). The Minority Staff's discussion draft is described as a means to foster and encourage additional discussion as the Senate Finance Committee considers legislation in this area. The Minority Staff is not optimistic that the reforms it deems necessary with respect to the business and operation of nonprofit hospitals will occur on a voluntary basis. As such, the report suggests that legislative or executive branch action will need to occur.

It is important to note that the majority staff of the Senate Finance Committee, the majority and minority staff of the House Ways and Means Committee, Joint Committee on Taxation and IRS have not, as of yet, published reactions to the proposals submitted by the Minority Staff. However, given the breadth of the proposals by the Minority Staff and their potential impact on shaping the national debate concerning healthcare policy and the tax policy related thereto, we believe a brief overview of the proposals would be beneficial to our clients and friends in the healthcare community. In short, the proposals include, among others:

- Minimum quantitative annual charity care standards
- Sanctions for failure to meet the new standards
- Special rules for joint ventures
- Maximum charges for the medically indigent
- Board composition and executive compensation
- Governance standard
- Transparency and new reporting requirements

In its prelude to the proposals, the Minority Staff indicated that the federal government has for many months been investigating nonprofit hospitals and reviewing the current standards applicable to section 501(c)(3) nonprofit hospitals. Although it is awaiting receipt of the anticipated IRS report on several areas of concern related to the tax exempt status of nonprofit hospitals (which also is scheduled to be released later today), the report by the Minority Staff identifies several areas of concern that in one way or another are all related to the substantial federal and state income tax benefits and subsidies the hospitals receive. The Minority Staff notes that "some nonprofit hospitals are helping pull the wagon when it comes to charity care but far too many nonprofit hospitals are sitting in the wagon - receiving significant tax breaks but providing little to nothing in the way of charity care for those in need in our society."

The Minority Staff suggested various alternatives to consider for possible legislative action by Congress. These are separated into recommendations for hospitals that seek section 501(c)(3) status versus section 501(c)(4) status (*a status not utilized by hospitals today but perhaps a "suggested" alternative by the Minority Staff for certain nonprofit hospitals in the future*). Since the tax benefits for section 501(c)(3) organizations (i.e., tax-exempt financing and deductible contributions) are greater than for section 501(c)(4) organizations, the proposals are more stringent for section 501(c)(3) hospitals. The Minority Staff believes that these proposed changes, although not a "cure-all", would improve the healthcare services for many low-income families by ensuring that the tax benefits provide to nonprofit hospitals would translate into health care for those in need and the community at large. The role of teaching hospitals and whether there are or should be variances to the rules discussed below for them is not addressed.

Proposals for Section 501(c)(3) Hospitals:

(1) Mandatory Charity Care Policy. Each hospital would be required to develop a written charity care policy in plain language that sets forth eligibility requirements, procedures for obtaining free or discounted care, and where a patient can obtain more information. The policy would need to be made publicly available and widely posted in areas that will ensure notice by patients. The Minority Staff recommends that the minimum eligibility threshold for all charity care policies be no less than 100% of the federal poverty level (i.e., free of charge medically necessary in/out patient hospital services (not otherwise covered by Medicaid, etc.) to all individuals at or below the federal poverty level).

(2) Annual Charity Care Quantitative Requirement. Each 501(c)(3) hospital would be required to dedicate a minimum of 5 percent of its annual patient operating expenses or revenues (whichever is greater) to "charity care." Charity care would be defined as: (a) medically necessary in/out patient hospital services provided without expectation of payment from or on behalf of the individual receiving the hospital services; (b) the amount of revenue, less any payments received for patient care, which is expected to be written off as a result of a designation (*prior to billing*) that the patient is unable to pay for the services; and (c) providing medical care through free clinics, community medical clinics and other means of providing free medical care to vulnerable populations. The value of charity care provided would be determined based on a rate equal to the lower of: (i) the lowest rate that would be paid by Medicare/Medicaid or (ii) the actual unreimbursed cost to the hospital for such service. Charity care would not include bad debt expense. Critical access hospitals would be exempt from this requirement.

(3) Special Rules for Joint Ventures with For-Profit Entities. Any patient care services that are provided through a joint venture with a for-profit entity would need to adopt its own charity care policy. Whole hospital joint ventures would need to satisfy the charity care requirements described above, and the joint venture's board must be "*controlled*" by the nonprofit hospital. The tax-exempt hospital in ancillary joint ventures (*i.e., surgery centers, etc.*) would be required to control the joint venture's charity care policy. Moreover, no decision could be made by the joint venture board that affects charity care policy without approval by the nonprofit hospital. The nonprofit hospital(s) would be credited with their proportionate share, relative to the other nonprofit hospitals involved, of the charity care provided by the joint venture.

Proposals for Section 501(c)(4) Hospitals

Quantitative Community Benefit

The hospital must dedicate a minimum of 5 percent of its annual patient operating expenses or revenues to community benefits. Critical access hospitals would be exempt from this requirement. The following would be deemed *per se* "community benefits": (i) charity care (as defined above); (ii) an emergency room open to all, regardless of ability to pay; (iii) burn units; (iv) trauma centers; (v) health profession education and training programs; (vi) health research; and (vii) activities conducted in response to issues raised by a community needs assessment.

Proposals Applicable To Both Section 501(c)(3) and 501(c)(4) Hospitals

Community Needs Assessment. The hospital would be required to conduct a community needs assessment every three years with a particular emphasis on vulnerable populations.

Charges. Any charges to the medically indigent who are uninsured or under-insured would not exceed the lower of: (i) the amount paid by the government, or (ii) the actual hospital cost.

Governance. The hospital would be required to be governed by a board of directors that is controlled by members who represent the broad interests of the public and not more than 25 percent of the voting power of the board would be vested in persons who are employed by the hospital or who will benefit financially from the organization's activities. Physicians and management would not comprise more than 25 percent of the board, except for those committees responsible for quality care, credentialing, determining medical staff privileges, etc.

Conversions. The Minority Staff recommends a termination tax on nonprofit hospitals that convert all or a significant portion of their assets to for-profit entities.

Sanctions. A hospital that would fail to satisfy its annual charity care requirement or community benefit requirement would be subject to excise taxes in an amount equal to an amount at least twice the shortfall. Additionally, the IRS would have discretion to reduce the excise tax to no less than the amount of the hospital's shortfall, if the hospital demonstrates it has met the requirements for several years and the shortfall was due to a lack of charity care demand. The Treasury is asked to issue regulations providing for some flexibility in determining compliance, perhaps an average over a three-year period. The IRS would retain authority to revoke the exempt status if a hospital fails to meet any applicable requirements and could result in the disqualification as a Medicare provider.

Transparency and Reporting Requirements. The Minority Staff would require all nonprofit and governmental hospitals to annually report to the IRS and the public their activities and make publicly available the comparables survey on which it relied to establish salaries of executives.

Unfair Billings and Collection Practices. The Minority Staff also has recommended that the provisions of the Federal Debt Collection Practices Act be expended to apply to internal hospital billing and collection practices.

These recommendations should generate heated discussion. The Minority Staff is attempting to require section 501(c)(3) hospitals to "pay" for their federal, state and local tax benefits with primarily charity care with little consideration for other aspects of community benefit or for providing a needed community service (for example, a burn unit or trauma center that is not financially justified but needed in the community). The fixation on charity care for non-critical access hospitals classified as 501(c)(3) organizations is also irreconcilable with any implementation of universal health coverage.