

Examining Community Benefit: The IRS' Shifting Standards for Tax-Exempt Hospitals

Executive Summary

Our **Nonprofit Organizations** group navigates the rules and regulations governing tax-exempt hospitals' tax-exemption, as well as the regulations created by the Patient Protection and Affordable Care Act (the "ACA"), and can help your organization perform a self-audit of its existing policies and procedures, as well as assist in the event of an IRS examination.

- Tax-exempt hospital's compliance with the community benefit standard, as well as the Internal Revenue Code Section 501(r) and its related Regulations, will be the subject of Internal Revenue Service focus and examinations.
- Including the community benefit standard in its compliance program indicates the IRS has concerns about whether tax-exempt hospitals are operating in a manner consistent with their tax-exempt status.

Background

On Monday, March 18, the IRS' Tax-Exempt and Government Entities division ("TE/GE") updated its compliance strategies to the Exempt Organization compliance program and priorities website for 2024. A new focus area is tax-exempt hospital's compliance with the Patient Protection and Affordable Care Act ("ACA"). The TE/GE will examine whether tax-exempt hospitals are complying with "statutory obligations under Internal Revenue Code ("Code") Section 501(c)(3), including the community benefit standard, and Section 501(r)." Not only does this update serve as a sign for tax-exempt hospitals to review their financial assistance policies and procedures, but the update may imply the IRS believes some tax-exempt hospitals are not satisfying the operational test for tax exemption.

Tax Exemption Generally

A hospital organization must be organized and operated exclusively for one or more exempt purposes to qualify for tax exemption under Code Section 501(c)(3). In addition to the requirements for all 501(c)(3) tax-exempt organizations, a hospital must also comply with the community benefit standard of Revenue Ruling 69-545. This standard sets forth requirements to meet the operational test of promoting health for the benefit of its community. Aside from

providing health benefits and services to a broad portion of the community and operating to serve a public interest, the IRS considers, among other factors, whether the hospital has an emergency room open to all, has a board of directors that represents the community, maintains an open medical staff policy, or provides care to all, regardless of ability to pay.

Section 501(r) codified the requirements of the ACA, which implemented additional technical requirements for tax-exempt hospitals. Every three years, the hospital must perform a community health needs assessment that analyzes the community the hospital serves, the processes and methods used to conduct the assessment, and the external impact the community has on the hospital, including a prioritized description of the significant health needs of the community, and describes the resources available to address the needs. Code Section 501(r) also requires the hospital to implement a financial assistance policy, limits the amount charged for emergency or medically necessary care, and prohibits the hospital from engaging in extraordinary collection actions.

Implications

The ACA required the IRS to review each tax-exempt hospital's compliance with these policies once every three years. While the frequency and depth of these reviews during COVID-19 and the IRS's staffing shortage are unclear, it appears the service is ready to re-start examinations in earnest. By emphasizing compliance with the community benefit standard and Code Section 501(r), the IRS could be implying a change to how it analyzes a hospital satisfying the operational test for exempt organizations, as well as combining an overall review of a hospital's operations into the three-year review cycle. Since Code Section 501(r) was enacted, the requirements under 501(r) and the community benefit standard have been seen as two separate requirements to be met, despite some overlap in the factors and requirements. Historically, the community benefit standard has been a qualitative evaluation, focusing on the activities the hospital engages in within the community. The evaluation considers but is not limited to, the factors discussed in Revenue Ruling 69-545.

Including both sections in their examination plan potentially signals a merging of the two concepts into a broader organizational test and may imply the IRS will add a quantitative approach to the community benefit standard. IRS Form 990 Schedule H requires hospitals to report the amount of community benefits and financial assistance provided. Using Code Section 501(r) to interpret the community benefit standard implies Form 990 Schedule H could be used to determine if a hospital's activities meet the requirements for tax exemption. Under this approach, the IRS would determine that if a hospital is not complying with the technical requirements in Code Section 501(r), they are not complying with the community benefit standard. At a minimum, the updated compliance program signals an intent from the IRS to increase its audit activity and more thoroughly examine hospitals' policies and implementation of those policies for compliance with the ACA, 501(r), and the community benefit standard.

Federal and state legislative efforts indicate a desire to move toward a more quantitative standard to determine a hospital's tax-exempt status. In 2023, the Senate Committee on Health, Education, Labor, & Pensions issued a report comparing charity care to chief executives' salaries at a number of systems. At the state level, some states, such as Illinois and Texas, base a charitable hospital's property tax exemption on the amount of charity care the hospital provides. In 2020, Florida proposed that the amount of charity care provided by a hospital in a county be compared to the tax value of the hospital's exemption in the county. If the value of charity care is less than the value of the tax exemption, the exemption on each parcel would be reduced based on this ratio. While this bill did not pass in Florida, the federal and state trends are to put a numerical value to the benefits received from tax exemption. As such, any attempt

from the IRS to quantify the community benefit standard would follow the trend of bipartisan federal and state initiatives.

Takeaways

The update to the Exempt Organization compliance program is recent and the extent to which the TE/GE will examine exempt hospitals is still unknown. In the meantime, however, we recommend the following:

- Ensure the system and its hospitals are capturing all community benefit and investment activities and expenses, and reporting those on Form 990, Schedule H.
- Review and refresh financial assistance and debt collection policies and procedures.
- Train and refresh employees in areas that impact compliance, such as revenue cycle, on your organization's policies and procedures.
- Self-audit newly acquired facilities to ensure they are compliant with your system's policies and procedures.

For more information, please contact Michael Kuczynski at MKuczynski@Polsinelli.com or (404) 253-6036, Lisa Schultes at LSchultes@Polsinelli.com or (816) 360-4114, or Toni Ruo at TRuo@Polsinelli.com or (816) 360-4152.