

Tax Exemption Challenges

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Presented By:

**Daniel R. Roach
V.P. Compliance & Audit
Catholic Healthcare West
San Francisco, CA**

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Overview

“...[S]ome NFPs do just the opposite: Charging their uninsured patients significantly more than those who have insurance; [p]ursuing the poor or uninsured relentlessly by aggressive and humiliating collection techniques; [r]ampantly violating federal and state prohibition [sic] against profiteering by ‘private interests,’ ...”

Taken from www.nfplitigation.com website 2/24/05

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	Who
	<ul style="list-style-type: none"> • House Energy and Commerce Committee • House Ways and Means Committee • Senate Finance Committee • Government Accountability Office • Class Action Lawsuits • IRS Executive Compensation Audits • Advocacy Groups (K.B. Forbes, SEIU, etc.) • State Attorney Generals • State and Local Politicians

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	What
	<ul style="list-style-type: none"> • Charity Care • Pricing • Balance Sheet • Ventures with For-Profits • Community Benefit • Billing/Collection • Executive Compensation

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	Federal Law – Current Requirements
<p data-bbox="418 394 1182 520">IRC § 501(c)(3): entity must be organized and operated for a charitable or other specified purpose</p> <ul data-bbox="418 552 1182 835" style="list-style-type: none"> <li data-bbox="418 552 1182 636">• Organizational test – organized to promote health is a charitable purpose <li data-bbox="418 657 1182 835">• Operational test – must actually operate in furtherance of that purpose in a manner that benefits members of the community (“<u>community benefit</u>”) 	

	Federal Law (con't)
<p data-bbox="418 1264 1052 1306">IRC § 501(c)(3): General Prohibitions.</p> <p data-bbox="418 1337 548 1369">Cannot:</p> <ul data-bbox="459 1390 1166 1705" style="list-style-type: none"> <li data-bbox="459 1390 1166 1516">– Undertake (other than incidentally) activities that do not further exempt purpose <li data-bbox="459 1537 1166 1568">– Serve private rather than public interests <li data-bbox="459 1589 1166 1705">– Permit organization’s income to inure to the benefit of insiders (directors, officers, key employees & physicians) <ul data-bbox="508 1726 1052 1757" style="list-style-type: none"> <li data-bbox="508 1726 1052 1757">• Note: This is an absolute prohibition 	

	Federal Law (con't)
<p data-bbox="418 401 1175 470">Rev. Rul. 69-545: Hospital demonstrated “community benefit” by:</p> <ul data-bbox="435 499 1159 793" style="list-style-type: none"> <li data-bbox="435 499 716 533">• Promoting health <li data-bbox="435 554 737 701">• Using surplus for quality of care, facilities, research, and education <li data-bbox="435 722 716 793">• Emergency room open to all <li data-bbox="813 499 1159 604">• Care for all who can afford to pay including M/M <li data-bbox="813 632 1110 665">• Open medical staff <li data-bbox="813 686 1159 793">• Community board comprised of persons w/o financial interest <p data-bbox="428 835 1078 863">Note: Not every element must be met to qualify for exemption</p>	
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	Federal Law (con't)
<ul data-bbox="412 1255 1159 1703" style="list-style-type: none"> <li data-bbox="412 1255 1057 1297">• IRS 2001 Field Service Advisory <ul data-bbox="461 1318 1159 1703" style="list-style-type: none"> <li data-bbox="461 1318 1013 1352">– Free or discounted care policy? <li data-bbox="461 1373 1045 1407">– Policy communicated to patients? <li data-bbox="461 1428 997 1461">– Emergency Room open to all? <li data-bbox="461 1482 1127 1516">– Admission policy on indigent patients? <li data-bbox="461 1537 1159 1608">– Number of indigent patients who actually received free or discounted care? <li data-bbox="461 1629 1159 1703">– Account for bad debt separate from free care? 	
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	Federal Law (con't)
<ul style="list-style-type: none">• Legal theory of Scruggs federal lawsuits<ul style="list-style-type: none">– Uninsured patients are third party beneficiaries of an implied contract between federal government and hospital arising out of hospital's tax exempt status– Duty of Good Faith and Fair Dealing– Breach of Implied Public Trust– Unjust Enrichment– EMTALA	
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	State Law
<ul style="list-style-type: none">• Qualification for tax exemption generally the same as federal law• More explicit criteria (charity care, community benefits, etc.)• AGs frequently have broad powers• Special rules may apply to facilities which are financed by tax-exempt bonds	
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	State Law (con't)
	<ul style="list-style-type: none">• Scruggs State lawsuits<ul style="list-style-type: none">– Breach of Contract– Breach of Implied Warranty of Good Faith and Fair Dealing– Consumer Fraud Act– Uniform Deceptive Trade Practices Act– Unjust Enrichment/ Constructive Trust– Unfair Business Practices– Non-profit Corporations Act <p data-bbox="1193 924 1289 970" style="text-align: right;">11</p>

	State Law (con't)
	<ul style="list-style-type: none">• Status of State lawsuits<ul style="list-style-type: none">– Dozens of lawsuits filed, many were dismissed but roughly ½ allowed to continue in some form– Discovery– Class Certification– Settled: Providence, Sutter, CHW, Legacy, ?? <p data-bbox="1193 1795 1289 1841" style="text-align: right;">12</p>

	State Initiatives
	<ul style="list-style-type: none"> • Minnesota – Agreement with AG <ul style="list-style-type: none"> – Collection Practices – Discount for Uninsured/ Underinsured – Training to staff on financial assistance – Communication of policies to patients – Internal audit and report to Board • Wisconsin Attorney General <ul style="list-style-type: none"> – Sued 2 hospitals for unfair trade practices – Alleging they charged uninsured patients “sticker” prices, far in excess of the steeply discounted prices paid by the vast majority of patients

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	State Initiatives
	<ul style="list-style-type: none"> • Ohio Attorney General <ul style="list-style-type: none"> – Conflicts of interest – “Excessive” compensation – Community benefit – Billing and debt collection practices

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	State Initiatives
	<ul style="list-style-type: none"> • IL AG Legislative Proposals <ul style="list-style-type: none"> – Tax-Exempt Hospital Responsibility Act <ul style="list-style-type: none"> • Free care at or below 150% of FPL • Discounts from cost at or below 250% of FPL • 8% of total operating costs must be spent on community benefit – Hospital Fair Billing and Collection Practices Act <ul style="list-style-type: none"> • Communicate free or discounted care to patients • Restraints on collection techniques • Additional procedures before pursuing litigation or enforcing judgments through lien foreclosures or garnishments

	How Should Hospitals Respond?
	<p>1. <u>Charity Care Policy</u></p> <ul style="list-style-type: none"> – Is it reasonable? <ul style="list-style-type: none"> • Scope of services • Community need • Organization’s resources • Financial impact <ul style="list-style-type: none"> – Bad debt vs. charity care <ul style="list-style-type: none"> » Reporting to State Agencies » HFMA Principals and Practices Board Statement Number 15 – Discounts from costs or charges? – Are policies effectively communicated? <ul style="list-style-type: none"> • To patients and staff

Charity Care Policy (con't)

– Issues/Risks

- Who (citizens, residents, community members) gets free/discounted care (income/assets)
 - Free care: 200% of FPL Discounts: 400% of FPL
- Discounts for the wealthy uninsured? Underinsured?
- Encouraging high-deductible plan selection (HSAs)
- Employers dropping insurance
- Elimination/cutbacks in local government programs
- Patient engagement in process

– Resources

- Redressing Undercompensated Care, Vol. II – Practice Portfolio, The Advisory Board Company (2004)

Charity Care Policy (con't)

– Scruggs Settlement Agreements

- Free care at 200% of FPL
- Discount equal to Providence PPO's discount for all uninsured patients
- Additional sliding scale discount from 200-400% of FPL

– Illinois Legislative Proposal

- Free care at 150% of FPL
- Discount from cost at or below 250% of FPL

– MN AG Agreement

- Discount equal to that provided to “most favored payer” to patients at or below \$125,000 annual household income

How Should Hospitals Respond?

- Communicating the Charity Care Policy
 - Financial Assistance publicized on website
 - Financial Assistance brochure created
 - Posters in waiting areas
 - Attempt to identify uninsured patients during pre-registration and admission process
 - Train all staff on free care policy and uninsured discount
 - Development of charity care eligibility tools to simplify and make process less intrusive

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How Should Hospitals Respond?

- Communicating the Charity Care Policy
 - All collection letters include a reference to the availability of financial assistance, with a phone number and address
 - During any communication regarding bill, business office staff will:
 - Verify that we billed the right person
 - Verify any insurance coverage they might have
 - Offer a reasonable payment plan if bill cannot be paid in one payment
 - Send an application for free care if reason to believe the person would qualify

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How Should Hospitals Respond?

- Impact of Increased Communication
 - Number of applications for free care tripled: from 4,000 in 2003 to 12,000 in 2005 (Allina)
 - 150%+ increase in charity care (CHW)

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How Should Hospitals Respond?

2. Community Benefit

- Definition issues
 - What is promotion of health?
 - Do programs need to be targeted at poor to qualify?

– Reporting

– Tracking

Resources: Community Benefit Reporting Guidelines and Standards: Definitions for the Community Benefit Inventory for Social Accountability (Catholic Health Association, VHA, Inc., Lyons Software)

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	How Should Hospitals Respond?
	<p data-bbox="412 331 797 373">3. <u>Collection Practices</u></p> <ul style="list-style-type: none"> <li data-bbox="461 386 613 420">– Issues: <ul style="list-style-type: none"> <li data-bbox="505 428 1040 462">• Policies & Procedures – approved by Board <ul style="list-style-type: none"> <li data-bbox="537 466 902 499">– Communication with patients <li data-bbox="537 504 1146 537">– “Reasonable payment plan” and financing options <li data-bbox="537 541 1024 575">– When to refer debt to collection agency <li data-bbox="537 579 980 613">– Limitations on collection techniques <li data-bbox="537 617 1183 680">– Oversight of litigation by in-house counsel or hospital executive <li data-bbox="537 684 919 718">– Handling of patient complaints <li data-bbox="505 722 630 756">• Fairness <li data-bbox="505 760 1170 823">• Training of business office staff, collection agency, and counsel <li data-bbox="505 827 1000 861">• Monitor and Audit to ensure consistency <li data-bbox="505 865 867 898">• Evaluate your Past Practices

	How Should Hospitals Respond?
	<p data-bbox="412 1220 854 1262"><u>Collection Practices (con't)</u></p> <ul style="list-style-type: none"> <li data-bbox="412 1266 1024 1308">• Contracts with Collection Agencies <ul style="list-style-type: none"> <li data-bbox="456 1312 1198 1346">– Payment terms to agency – no contingency bonus <li data-bbox="456 1350 1029 1383">– Communication of Charity Care Policy <li data-bbox="456 1388 751 1421">– Body Attachments <li data-bbox="456 1425 691 1459">– Garnishments <li data-bbox="456 1463 805 1497">– Foreclosures on Liens <li data-bbox="456 1501 724 1535">– Credit Reporting <li data-bbox="456 1539 764 1572">– Return of Accounts <li data-bbox="456 1577 1008 1610">– Tracking and reporting of complaints <li data-bbox="456 1614 1162 1686">– Communication between hospital and collection agency <li data-bbox="456 1690 781 1724">– Settlement Authority

4. Pricing

– Macro

- Market Competition
- Sustainable Margins
- Service/Department

– Micro – CDM Level

- Pricing Methodology
- “Smell” Test
- Maintenance
- Disclosure

5. Balance Sheet – Principal issue is to be able to explain why an organization needs large cash reserves.

– Capital – new and replacement

– Debt covenants

– Credit rating

- Ratios (Moody’s, Fitch, Standard & Poor’s)

– Debt service

– Operating cushion

– Self-funded Insurance Programs

- Professional liability
- Workers’ compensation
- Off-shore captives

	How Should Hospitals Respond?
<p data-bbox="412 342 927 384">6. <u>Ventures with For-Profits</u></p> <ul style="list-style-type: none"> <li data-bbox="461 396 581 428">– Risks <ul style="list-style-type: none"> <li data-bbox="505 443 862 474">• Inurement proscriptions <li data-bbox="505 485 732 516">• “Insider” deals <ul style="list-style-type: none"> <li data-bbox="537 527 716 558">– Physicians <li data-bbox="537 569 789 600">– Board members <li data-bbox="505 611 956 642">• Property/Sales Tax Exemption <li data-bbox="461 653 956 684">– Joint Venture Arrangements <ul style="list-style-type: none"> <li data-bbox="505 699 948 730">• Contributions vs. Distributions <li data-bbox="505 741 764 772">• Bond Covenants <li data-bbox="461 783 956 814">– Management Arrangements <ul style="list-style-type: none"> <li data-bbox="505 829 711 861">• Departments <li data-bbox="505 871 850 903">• Percentage of revenue 	
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	How Should Hospitals Respond?
<p data-bbox="412 1211 932 1253">7. <u>Executive Compensation</u></p> <ul style="list-style-type: none"> <li data-bbox="461 1266 769 1297">– Reasonableness <ul style="list-style-type: none"> <li data-bbox="505 1312 667 1344">• Market data <li data-bbox="505 1354 748 1386">• Defensible metrics <li data-bbox="505 1396 935 1428">• Board approval <u>after full disclosure</u> <li data-bbox="505 1438 989 1470">• Independence – Board and consultants <li data-bbox="461 1480 651 1512">– Reporting <ul style="list-style-type: none"> <li data-bbox="505 1526 1162 1642">• Perks -- Club memberships, travel (hotels, limousines, meals) bonus/incentive compensation, retirement benefits (SERP), tax preparation, estate planning/ financial consulting <li data-bbox="505 1652 711 1684">• Multiple entities <li data-bbox="505 1694 672 1726">• Consistency <li data-bbox="461 1736 716 1768">– GAO Surveys <li data-bbox="461 1778 1089 1810">– IRS Executive Compensation Audits 	
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	Tax Exemption Challenge
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Questions?

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