

Winds of Change



Grayson Walker looks at the changes afoot for nonprofits' tax exempt status.

There definitely is a breeze blowing through the halls of non-profit hospitals in the wake of an IRS inquiry into the community benefit standard. What remains to be seen is whether that wind is a breath of fresh air resulting from a new openness about the good works that tax-exempt hospitals do in their communities or the precursor to a storm of heightened scrutiny by a feared federal agency.

The issue gained prominence in May when the Internal Revenue Service sent a survey with 80-plus questions to 550 of the nation's largest nonprofit hospitals, asking about uncompensated care, billing practices for the uninsured, emergency department policies, and salaries of top executives. Hospitals were given a month to complete the survey, but many asked for an extension because of its complex nature, said Melinda Hatton, chief Washington counsel for the American Hospital Association.

"We're taking the IRS at its word that it's updating the 990 form to capture more information about community benefits," Hatton said of the Return of Organization Exempt From Income Tax that nonprofits file yearly. "We understand that since the statute was altered in 1969 to include more than charity care to the community, there's only been anecdotal evidence on what's a community benefit. We believe it's an information-gathering exercise by the IRS to update the 990 form."

But why would a request for information be coupled with a new financial investigations unit to focus on complex issues, wondered Alvin Brown, a tax

attorney and founder of the IRS Forum, a nonprofit that aims to bring transparency into how the agency deals with taxpayers.

"It seems to me they're ramping up to do battle with the whole industry," said Brown, who worked for the IRS for 27 years and believes the agency is not fulfilling its mission. "I regret to say this, but I don't think the agency is living up to its mandate of integrity and fairness."

Brown said complying with an IRS request for activities related to a nonprofit's tax-exempt status is not as easy as turning over a few pieces of paper. If examining a hospital, the IRS would look at the governing body of the organization, the privileges of the medical staff, the qualifications of physicians, emergency department practices, policies surrounding the acceptance of patients, any indirect benefit to employees, and other practices.

And since audit questions are open to interpretation, "Examiners can be expected to raise lots of issues and take aggressive positions on those issues," Brown said. "Strong advocacy is important because many of the issues are judgment issues. Just because the IRS says something, that doesn't mean you can't oppose them."

If a hospital doesn't have an attorney with IRS-specific experience, one should be retained, Brown advised. He created the IRS Forum so taxpayers can share their stories, bringing transparency to dealings with the federal agency.

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Brown said. "They're unbridled about what they do. They can't do the bad things they do in the sunshine. I think it's probably a good idea for the industry to close ranks and have a central place to report problems and share information."

Meeting the mission

While a nonprofit enjoys tax advantages that a for-profit hospital doesn't, part of a nonprofit's burden is investing the time necessary to ensure that the facility meets the letter of the law, said Bill Rucci, a CPA and partner in the 30-person CPA/business advisory firm Rucci, Bardaro & Barrett in Malden, MA. Rucci also sits on the board of Hallmark Health System, which serves the northern Boston suburbs with two acute-care facilities.

"It comes down to a nonprofit entity meeting its mission," Rucci said. "The IRS is the body that determines whether a hospital is doing that."

When asked whether he thought nonprofits were fulfilling the community benefit provision of the tax code, Rucci said he believed that most hospitals have become sensitive to the issue because of the past transgressions of a few facilities that have been publicized. Past issues included overpaying for physicians' practices, paying more than fair value to physicians for their services, and using tax-exempt bonds in an inappropriate fashion.

Sixteen states already have some type of community benefit provision, according to the Association for Community Health Improvement, founded in 2002 as a successor to three other community health initiatives. The association offers a wealth of community benefit resources to hospitals, including planning guides, IRS guidelines, financial questionnaires, and sample reports.

Hospitals, especially those that already are reporting community benefit information to state agencies, should have few worries if an audit is conducted, said Rucci.

Brown said the current attention on community benefits for tax-exempt hospitals can be attributed to US Sen. Chuck Grassley (R-IA), chairman of the Senate Committee on Finance, the group responsible for tax legislation and oversight. The tax-exempt status of nonprofit hospitals also was the focus of testimony last May before the US House Ways and Means Committee.

A Government Accountability Office study presented at the hearing found that government hospitals generally devoted "substantially larger" shares of patient operating expenses to uncompensated care than did nonprofit and for-profit hospitals. While the nonprofit groups' share was higher than that of the for-profit groups in four of the five states studied, the difference was small relative to the difference compared with the government hospital group, the GAO found.

IRS records list about 7,000 nonprofit hospitals and healthcare organizations. In the past decade, it has audited 375 of them, a figure that IRS Commissioner Mark Everson called too low.

"The more hospitals use (the questionnaire) to elaborate on community health, the greater understanding the IRS and the public will have, and that's a good thing for everybody," said AHA's Hatton.

Tax attorney Brown from IRS Forum has a very different interpretation of IRS motives. "I think this is a wake-up call to every organization that provides tax-exempt care," said Brown.

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