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News

Hospitals

Grassley Asks Two Nonprofit Hospitals For Data Related to Their Tax-Exempt Status

Senate Finance Committee ranking member Chuck Grassley (R-Iowa) has asked two nonprofit hospitals to detail their tax-exempt status given recent media reports the providers have attempted to deny care to patients and sought payment from a patient prior to beginning cancer treatment.

"I keep hearing that tax-exempt hospitals are changing their ways," Grassley said in a statement released Sept. 2. "At the roundtable I convened last year, the hospital community told me to wait and see before legislating, that the new [Internal Revenue Service] 990 Schedule H would not only provide data to make informed decisions but also would change behavior.

"It's troubling then to hear about two world-renowned hospitals engaging in questionable practices," Grassley said. "One made it into the limelight for reportedly requiring a critically ill patient to come up with exorbitant amounts of cash upfront and badgering her for cash during medical treatment. Another appears to be culling the least profitable patients from its emergency room."

In a July 23 letter to the University of Texas M.D. Anderson Cancer Center in Houston, Grassley asked the hospital to answer numerous questions related to its legal and financial status, the financial assistance it provides to patients, the level of uncompensated care it provides, its fund-raising activities, and compensation for top officials.

Grassley said the hospital came to his attention following a media report and later committee testimony that the facility instructed a leukemia patient to bring a cashier's check for \$45,000 to her first appointment because the hospital would not honor her insurance policy.

Grassley in an Aug. 29 letter sought similar information from the University of Chicago Medical Center. He said a media report indicated the hospital has attempted to direct under-insured and uninsured patients away from it to clinics.

Grassley asked both institutions to reply to his letter by Sept. 30.

"The answers to the questions I'm asking are critical to understanding whether these hospitals are setting standards for their peers," Grassley added. "Those standards might include losing sight of the public service that comes with tax-exempt status."

A spokesman for the University of Chicago Medical Center had no immediate comment on the letter Sept. 2. An official from the M.D. Anderson Cancer Center could not be reached for comment.

The University of Texas letter is available at <http://op.bna.com/hl.nsf/r?Open=sfak-7j4qsk>. The University of Chicago letter is available at <http://op.bna.com/hl.nsf/r?Open=sfak-7j4qst>.

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News

Taxation

IRS Close to Deciding on Exemption Status Of Regional Health Information Organizations

The Internal Revenue Service is currently reviewing a number of tax code Section 501(c)(3) exemption applications from regional health information organizations (RHIOs), a new type of entity, and expects to make a determination on whether they will qualify "in the very near future," Steven Grodnitzky, a manager in the IRS exempt organizations division, said Sept. 10.

Speaking at the American Health Lawyers Association tax conference, Grodnitzky said these organizations operate a regional network for exchanging patient health care records and other health care-related data. Most often the RHIOs charge fees to users to access the network.

IRS is spending a great deal of time reviewing the organizations and how current legal precedent applies in this new field, Grodnitzky said. Issues include:

- whether such organizations promote health within the meaning of Section 501(c)(3),
- whether such organizations further education as a tax-exempt purpose, and
- whether there is some kind of government or state involvement such that these organizations would provide systems that lessen the burden of government.

IRS put out a directive on RHIOs in May 2007, assuring exempt organizations that medical records shared electronically with hospitals will not be treated as private benefit or inurement.

IRS Director of Exempt Organizations Lois Lerner said at the time that tax-exempt hospitals were worried they would lose their exemption if they provided the software to doctors--which could be considered a benefit--at less than cost. IRS rules prohibit inurement of benefits to any one party involved in exempt organizations.

Some practitioners questioned Grodnitzky on why Health and Human Services rules require physicians to pay at least 15 percent of a hospital's cost of providing the electronic health records software or services, rather than hospitals requiring nothing of physicians.

He responded, "Hospitals wanted to make sure, and IRS as well, that physicians had some incentive to get involved in putting together the electronic health records system, and if there was no financial burden on the doctors, they may not get involved." He also said that, from the hospital's perspective, if all the doctors were not involved in a particular system, there was a fear that ultimately it would not work.

Advance Rulings Streamlined

Grodnitzky also elaborated on IRS's just-announced streamlining of the advance ruling process for organizations seeking exemption as publicly supported charities. The announcement was made Sept. 8.

IRS will automatically classify a new 501(c)(3) organization as a public charity for its first five years if it can show in its exemption application that it can reasonably be expected to be publicly supported. "What this means, practically speaking for you, is that at the end of the five-year advance ruling period organizations will no longer need to file Form 8734. We are going to make that determination right up front," Grodnitzky said.

Tax-exempt hospitals will still have to file an annual Form 990 return and, beginning with the organization's sixth taxable year and for all succeeding years, it must establish that it meets the public support test by showing that information on Schedule A of Form 990. The new procedures also provide that public support is based on a five-year computation period that consists of the current year and the four years immediately preceding the current year, Grodnitzky said.

Perhaps the best news for the sector is that the new rules will apply to all organizations with applications that are pending before the service, he added, regardless of when the organization submitted the Form 1023 application for exemption.

Hospital Questionnaire

IRS's final report on the responses to a tax-exempt hospital questionnaire sent to almost 500 institutions, trying to determine how the hospitals meet the community benefit standard under 501(c)(3) and how tax-exempt hospitals set and pay compensation to their executives, is expected to be completed in the very near future, Grodnitzky said.

Almost 100 percent of the hospitals have complied with the "voluntary" questionnaire, he noted, pointing out the ones that did not reply have been referred to IRS's review of operations unit.

The study, when final, will provide further analysis on demographics and reported community benefit expenditures from the hospitals studied. It will also address executive compensation at these institutions.

Globalization of Health Care

Grodnitzky also said a burgeoning area for the tax-exempt world is the globalization of U.S. health care systems.

Some U.S. systems are providing advisory services to foreign governments, mostly in the Middle East, to help them construct, establish, and operate new state-of-the-art hospitals and health care facilities, he said.

Some of these health care systems have created subsidiaries to provide these services but the organization does not own, operate, or control the foreign organizations. The goal is strictly to get them up and running, he said.

Once again, the issues will be whether they are really charitable and if they are promoting educational purposes. "This is an area we are starting to see and hear about," he said.

Public Nature of Proposed Denials

Grodnitzky also clarified that the review process for denials of applications for exemption are handled differently, depending on whether they are coming from the Washington office or from the Cincinnati field office.

If an organization applying for exemption does not meet the requirements of the tax code, it is issued a final denial and that organization's proposed denial is published in redacted form.

In the Washington office, once an organization is issued a proposed denial and IRS determines the organization still does not meet the requirements for tax exemption, the entire case file goes to the Office of Chief Counsel, he said.

In the Cincinnati office, attorneys in the appeals office do a review of the case, not the Office of Chief Counsel. If the field office denies the application, a final adverse letter is issued and the denial is made public.

Grodnitzky said some taxpayers and attorneys are treating proposed denials as though they were formal guidance, "almost like a court decision," with the taxpayer arguing the merits of a proposed denial in another

case. A denial is issued to one taxpayer, in one case, on a specific set of facts only, he said. The document does not have a precedential effect on other taxpayers.

EO Troops Coming

Taxpayers have complained private letter ruling requests are taking too long to process, he said. Retirement is costing the service a number of resources.

But the exempt organizations unit at IRS has hired seven new tax law specialists, he said, two of whom work on health care and other exempt organizations issues. IRS also gave offers to a group of new lawyers, one of whom just started two weeks ago. Grodnitzky said he may have authority to hire a few more.

He said the backlog of exemption applications is also being addressed to decrease the processing time. For applications that are processed immediately, based on information submitted requiring minor additional information, the taxpayer or the attorney will receive a determination letter or request for additional information in about 60 days from the date the application was submitted.

"What this means is that we are doing more and more up front to make that determination," he said.

Litigation: VSP and FICA Cases

In a separate presentation to the conference, Don Spellmann, senior counsel with the IRS Office of Chief Counsel Tax Exempt & Government Entities, said the litigation focus of the IRS in the health care arena remains on the Vision Services Plan (VSP) and medical resident FICA tax withholding cases that continue to be waged in various federal courts throughout the country.

A recent appeals court decision in one of the VSP cases is the subject of a pending petition for U.S. Supreme Court review, he noted. And while the petition argues that the underlying ruling by the U.S. Court of Appeals for the Ninth Circuit threatens to jeopardize the exemptions of all nonprofit health plans and providers, Spellmann dismissed that contention.

"The Ninth Circuit's decision has no conceivable implications for exempt hospitals, nursing homes, or other providers," he said. Although the court's reasoning could be applied to strip certain health maintenance organizations of their exemptions, the fact is that this has been done under appropriate circumstances by courts in the past so the reasoning should not be a surprise to most people.

"If you understand the facts, the Ninth Circuit's decision makes sense," Spellmann said. "The VSP board was controlled by providers, served only larger employers, and did not promote the health and welfare of the community as a whole," he noted.

Exempt HMOs have little to worry about as long as they are open to individuals, provide equally affordable services, engage in programs that benefit their communities, and help expand access to a broad swath of the community's members, he said.


With respect to pending FICA cases--which concern whether medical residents are "students" exempt from withholding or "employees" subject to tax under the Federal Insurance Contributions Act--Spellmann said he did not foresee the IRS embarking on any broad-based settlement initiatives. The service is defending its regulations that say medical residents are not exempt under the FICA student exemption and is litigating in many courts the relevant issues that arise differently in different health care institutions. While the service is always willing to discuss settlements in specific cases, no settlement program is currently being considered, he said.

Gerald M. Griffith, with Jones Day in Chicago, said the government's position on settling medical resident FICA cases "is not surprising given the millions of dollars at stake here and the array of pending cases being litigated nationwide."

"On the VSP case it was helpful to hear that at least one IRS official does not see the case as having any effect on hospital or nursing home exemption," Griffith said. "I agree as it stands right now, but if the U.S. Supreme Court decides to hear the case there is always the real possibility the outcome could be worse for everyone," he

added.

"For example, the Supreme Court could use broad language to adopt a community board standard or percentage of expenditures for charity test that focuses on what is 'charitable' instead of just what is 501(c)(4) social welfare activity generally," Griffith continued. "As for HMOs generally, I think many now are factually distinguishable from VSP but any that are not may have reason for concern," he said.

T.J. Sullivan, with Drinker Biddle & Reath, Washington, agreed and said although the case is not ripe for cert, it would have been preferable had the VSP courts below expressly addressed the issue of VSP's provider controlled board and how that affected the private interests VSP serves. 

By Diane Freda and Peyton Sturges

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