



# Friday Focus -- Nonprofit Health Care

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# Presenters



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## Déjà Vu All Over Again?

- Challenges in late 1980's and early 1990's to state real estate and sales tax exemption
- PILOTS – payments on lieu of taxes in numerous states
  - Common in Pennsylvania
- Some states mandated charity care policies
- Debate over community benefit standard and quantifying charity care
  - Lack of consensus over what qualifies





## What Is It Really About?

- Reforming the healthcare system? The entire nonprofit sector?
- Protecting the uninsured or other beneficiaries of “charity?”
- Raising revenue at local, state, federal levels?
- Concern over the use/abuse of charitable assets?
- Money for the class action bar?



## Recent Tax-Exemption and Tax Enforcement Developments





## IRS Good Governance Practices 7

- Good Governance Practices for 501(c)(3) Organizations
  - Discussion Draft released February 2007
    - “While adopting a particular practice is not a requirement for exemption, we believe that an organization that adopts some or all of these practices is more likely to be successful in pursuing its exempt purposes and earning public support”



## IRS Good Governance Practices (cont'd) 8

- Mission Statement: “A well-written mission statement shows why the charity exists, what it hopes to accomplish, and what activities it will undertake, where, and for whom”
- Code of Ethics and Whistleblower Policies: Partially SOX-based
- Due Diligence Responsibilities of Directors: Directors should assure that procedures are in place, and information is provided by management, sufficient and appropriate to allow them to oversee and set policy for the organization



## IRS Good Governance Practices (cont'd)

- Duty of Loyalty by Directors: Includes adoption of conflict of interest policy
- Transparency: Public disclosure of financial and operational information
- Fundraising Policy: An aspect of “transparency,” plus there are specialized laws and registration requirements



## IRS Good Governance Practices (cont'd)

- Financial Audits: SOX-driven, at least for large charities. Suggested practices include appointment of separate audit committee to select and oversee outside auditors, and rotation of auditors. Alternative, less costly “best practices” are suggested for smaller organizations
- Compensation Practices: Use Section 4958 “rebuttable presumption” procedures for executive compensation. “Charities should generally not compensate persons for service on the board of directors except to reimburse direct expenses of such service
- Document Retention Policy: “[A]dopt a written policy establishing standard for document integrity, retention, and destruction. The document retention policy should include guidelines for handling electronic files”



## IRS Executive Compensation Compliance Project

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### ■ March 2007 Report

- Exempt organization compensation project begun in 2004 – partly impelled by Senate Finance Committee investigation of the nonprofit sector
- Intention was to discover
  - Whether excessive compensation was being paid to nonprofit executives, and
  - Whether reporting requirements were being followed
- Letters sent to 1,826 organizations: 1,428 public charities and 398 private foundations. 782 actual audits followed, of varying degrees of intensity and involving charities of all sizes.
  - No breakdown of how many public charities were hospitals or other healthcare organizations, though some certainly were.



## IRS Executive Compensation Compliance Project (cont'd)

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- Many amended 990's filed as a result of IRS contacts
- “The Project shows mixed results...”
  - The project uncovered significant reporting errors. Of 50 public charities reporting payment of more than \$250,000 in annual executive compensation, none had properly reported the compensation on Form 990
  - On the other hand, organizations selected for audit were generally determined not to be paying excessive compensation when tested by an arm's length, “reasonableness” standard. But sample size precludes making general conclusions about nonprofit sector as a whole.
  - Some problems were found. Excise taxes of over \$21 million based on excessive compensation have been asserted, against both public charities and private foundation. Loans to officers and directors were a specific problem area. (Compare SOX prohibition)



## IRS Executive Compensation Compliance Project (cont'd)

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### ■ Follow-up

- Logistical problems in the enforcement initiative. Probably won't see the "send thousands of letters" approach again
- Form 990 compensation reporting needs to be revised
- IRS to educate charity sector on reporting, and on rebuttable presumption procedure for determining executive compensation
- "[C]ontinue to review compensation issues in more focused projects..."



## IRS Form 990 Compensation Reporting

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- 2005 Form 990 contained controversial Question 75c, arguably mandating disclosure of compensation paid by unrelated for-profit entities to the exempt organization's officers and directors
- 2006 Form 990 has backed off, but uncertainties remain. It remains unclear just what related entity compensation the IRS wants to capture
- 2006 Form 990 also has new questions 25a and 25b, requiring separate reporting of compensation and benefits paid to current officers/directors versus former officers/directors





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## Nonprofits & Washington: What's the Temperature?



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## Recap of 109<sup>th</sup> Congress...

- Former Chairman of House Ways & Means Bill Thomas (R-CA)
  - Concerns over Nonprofit Hospitals
  - Hearings in 2005 and 2006
  - CBO Reports issued in December 2006
  - Last Bill introduced...”as a guide to future Congressional and IRS action...”



## Release of CBO Reports December 2006

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### ■ *“Nonprofit Hospitals & Community Benefits”*

- Nonprofit hospitals provide higher levels of uncompensated care than for-profits
- Wide variance in provision of uncompensated care among nonprofits
- Provided more specialty care
- Provided care to fewer Medicaid-covered patients per total patient population

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## Release of CBO Reports December 2006 (cont'd)

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### ■ *“Nonprofit Hospitals and Tax Arbitrage”*

- Federal subsidy through tax-exempt bonds lowered cost of capital for nonprofit hospitals
- Incentive for nonprofit hospitals to use tax-exempt bonds rather than spending their own funds/investment assets for capital projects

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## H.R. 6420 “Tax-Exempt Hospital Responsibility Act”

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- To amend the Internal Revenue Code to:
  - Deny a tax exemption to nonprofit hospitals (charitable or teaching) that fail to adopt and carry out policies for providing care to low-income individuals without health insurance
  - Deny a tax deduction for contributions to such providers; and
  - Impose excise tax penalties for failing to provide care to low-income uninsured individuals, for overcharging for such care, and for failing to make certain disclosures to patients and the public relating to availability of medical care and pricing of care

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## The More Things Change...

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- Former Chairman of Senate Finance Committee Charles Grassley (R-IA)
  - Concerns over Charities & Foundations... *all* charitable organizations
  - Began charitable oversight in 2004...
  - Ongoing to this day...
    - Amendment to Budget Act offered 03/21/07
    - Cuts Executive Compensation of Smithsonian Director

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## Grassley Efforts on Nonprofit Hospitals

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- Nonprofits generally...
  - Senate Finance Committee white paper – June 2004
  - Hearings 2005, 2006
  
- Nonprofit hospitals in particular...
  - Survey and investigation of 10 nonprofit hospitals
  - Results of survey September 2006



## Grassley Efforts on Nonprofit Hospitals – September 2006

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- Investigators during 15-month period reviewed the charitable activities and billing practices of 10 nonprofit hospitals across the nation
- Examined cases of alleged abuse, interviewed community groups and reviewed studies by health care economists
- Routinely overcharge or deny care to low-income, uninsured patients
- Offer some no-cost services, but provide little aid to lowest-income persons
- Fail to inform patients that free care is available
- Hospital officials receive perks, such as paid country club memberships and expensive hotel stays
- Some for-profit hospitals provide “as much if not more charity care” than some nonprofit hospitals



## Grassley Response to Nonprofit Hospital Report Findings...

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- Letter to IRS Commissioner and chief Counsel
  
- Directions to IRS to review:
  - Definition of charity care
  - Requisite level of charity care
  - Definition and level of community benefit
  - Definition of joint ventures, joint ventures involving nonprofit hospitals
  - Payment of excessive compensation
  - Use of tax-exempt bond process

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## IRS Response and Actions...

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- IRS details employees to Senate Finance Committee
  
- Exempt Organizations Division stepped up activities and enforcement
  
- May 2006 – IRS Form 13790 sent to 600 nonprofit hospitals
  
- August 2006 – IRS issued Guidelines for Exempt Status for 501(c)(3) healthcare providers

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## The 110<sup>th</sup> Congress...

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- Senator Max Baucus (D-MT),  
Chairman of Senate Finance
  - Participated with Senator Grassley in  
Scrutiny of Nonprofit Entities
  - Relationship between Senator Baucus  
and Senator Grassley unusually  
bipartisan

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## House Ways & Means in 110<sup>th</sup> Congress

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- Rep. Charles Rangel (D-NY),  
Chairman of House Ways & Means
  - Closing loopholes...signaled less interest  
in attacking nonprofits
- Relationship between House & Senate  
Committee Chairman
  - Baucus & Grassley
  - Baucus & Rangel

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## IRS... Ongoing Effects of 109<sup>th</sup> Congress

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- Pension Reform Bill amended (not free standing legislation; rather, attached to 'must pass' bill)
- Increased IRS scrutiny and enforcement
- Standardization of capturing and reporting of charity care and 'community benefit'
- Legislation on:
  - Executive compensation
  - Joint ventures
  - Tax-exempt financing

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## External Forces

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- Independent Sector proposed guidelines
  - Governance and board composition
  - Compensation
  - 115 principles
  - Comments due March 30, 2007
- Joel Fleishman & Marcus Owens' proposal for NASD-type self-regulatory body for nonprofit accreditation, rulemaking and enforcement

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## Lots of Activity...

- Be aware and BEWARE!
- Be involved
  - Alliance for Charitable Reform ([www.acreform.org](http://www.acreform.org))
- Comment on proposals...
  - Independent Sector ([www.independentsector.org](http://www.independentsector.org))
  - IRS (Comments requested by April 9 regarding supporting organizations, etc.)
  - IRS requests for information Form 13790

## Federal Court Litigation

- Most cases dismissed in 2004-2005
  - Alleged private cause of action under 501(c)(3) of IRC; breach of contract; breach of covenant of good faith and fair dealing; EMTALA; Civil Rights sec. 1983
- Few have recently survived alleging violations of state unfair trade and deceptive business practices acts
- *Hill v. Sisters of St. Francis Health Services* (USDC, ND Ill 2006) 2006 WL 3783415
  - Motion to dismiss denied
  - Illinois Consumer Fraud Act
  - Unfair billing practices
  - “Hobson’s choice-forego treatment or pay unreasonable charges”

## Federal Court Litigation (cont'd)

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- *Colomar v. Mercy Hospital, Inc. and Catholic Healthcare East, Inc.*, USDC, SD Fla (Nov. 17, 2006)
  - Second Amended Complaint allowed
  - Florida Deceptive and Unfair Trade Practices Act
  - Proceeding under fairness/reasonableness theory, not deceptive practices
  - Enumerated several factors which in aggregate could establish unreasonable pricing
    - Charges in top 13% nationally
    - Top 10% cost-to charge ratio
    - Uninsured charged 450% of Medicare reimbursement

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## Federal Court Litigation (cont'd)

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- *Urquhart v. Manatee Memorial Hospital LLP*, USDC MD Fla. 8:06-cv-1418-T-EAJ (March 13, 2007)
  - Florida Deceptive and Unfair Trade Practices Act
  - Motion to dismiss granted without prejudice because failed to plead damages
  - Agreed with reasoning of *Colomar* court
  - Plaintiff may file amended complaint with facts showing pricing was unfair
  - Plaintiff may file amended complaint showing actual damage
  - Court also dismissed without prejudice breach of contract and unjust enrichment claims

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## State Court Litigation

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- Allegations similar to *Hill, Colomar* and *Urquhart*
- Those that get past Motion to Dismiss based on Unfair Trade Consumer Fraud Act violations
- Many dismissed
- Few have been settled

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## Denial of Property and Sales Tax Exemptions

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- Two recent nursing home cases
  - *Elder Trust of Florida, Inc. v. Epsom*. NH Supreme Court (No. 2005-706 January 18, 2007)
    - “Particularly close case”
    - Nursing home entitled to exemption
    - State law requires home to be established and administered for a charitable purpose
    - Income or profits not used for any purpose other than charity
    - Evidence that patients in need paid substantially below advertised rate was persuasive

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## Denial of Property and Sales Tax Exemptions (cont'd)

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- *Menno Haven, Inc. v. Franklin County Board of Assessment and Tax Revision*, PA Commonwealth Court, No. 1051 CD 2006 (March 7, 2007)
  - SNF failed to qualify for exemption
  - Patients transitioning from assisted living to SNF guaranteed care out of duty to provide continuing care, not charity
  - Not a bona fide effort to serve those who could not afford usual fee

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## Denial of Property Tax Exemptions - Provena Covenant is Not Alone in Illinois

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- Carle Foundation denied exemption by Illinois Department of Revenue on February 23, 2007
- Champaign County
  - Analysis follows Provena Covenant decision closely
  - Relationship of the Carle entities-Foundation, hospital and for-profit clinic was important
    - DOR said separate only on paper

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## Denial of Property Tax Exemptions – Provena Covenant is not alone in Illinois (cont'd)

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- Much made of the amount of free care rather than sum of all benefits conferred on community
  - DOR found that free care amounted to less than .5% of revenues
  - DOR called that *de minimus*
- Richland Memorial Hospital denied exemption by DOR on same day
  - Exemption was recommended by Richland County Board of Review

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## Provena Covenant Decision

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- *Department of Revenue v. Provena Covenant Medical Center* 04-PT-0014
  - Reversed recommendation of ALJ for tax year 2002
  - Six prong guidance from Illinois Supreme Court to determine charitability
    - Director applies guidance and comes to different result than ALJ

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## Provena Covenant Decision (cont'd)

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- “Primary basis for my conclusion is simple”
  - Revenues \$113 million and free care \$831,724 or .7% of total
  - Exemption was worth at least \$1.1 million
- Primary use of property was for “exchange of services for payment”
- Open ER without ability to pay regulatory compliance
- Charity is incidental and at most a secondary use of the property
- Illinois Attorney General Amicus brief stated “hospitals such as the Applicant reap substantial tax benefits while paying only lip service to their charitable obligations”



## Provena Covenant Decision (cont'd)

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- Case on appeal to Circuit Court of Sangamon County, Case No. 2006-MR-000597
  - Where undisputed facts, courts apply law *de novo*
  - Amicus filed by Illinois Hospital Association and American Hospital Association
  - Standard in Illinois is based on Sec. 15-65 of Property Tax Code
    - “...property...exempt when actually and exclusively used for charitable or beneficent purpose not otherwise used with a view to profit”
    - Brief filed by Provena Covenant March 9, 2007
      - Level or quantum of free care no bearing on whether primarily charitable
      - Argues that six prong guidance substantially met



## State Attorneys General

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- Illinois AG introduced two bills in 2006
  - Tax Exempt Hospital Responsibility Act
    - Minimum of 8% of operating costs must be used to care for uninsured or poor patients
    - Did not get out of legislature
    - IHA trying to lead opposition to any bill it does not agree with
  - Hospital Fair Billing and Collection Practices Act
    - Passed

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## State Attorneys General (cont'd)

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- Ohio AG backed off first proposed rules and settled on one-time registration statement
- Kansas AG agreed with Kansas Hospital Association on billing and collection practices
- Wisconsin AG entered into agreement with Mercy Health System Corporation on December 21, 2006
  - Automatic discount to non-insured equivalent to average percentage discount offered to patients with insurance
  - Not less than 20%
  - Plain and concise collection practices
  - Mercy has reporting obligation to AG
- Number of the more active AG's have left office as of January 2007

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## State Legislatures

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### Standards

Community Benefit in most states

Only Texas, Pennsylvania and Utah must meet numeric criteria

### Community Benefit Reporting

- 13 states require reporting (CA, ID, IL, IN, MA, MD, NV, MH, NY, NC, PA, RI, TX)  
Nevada applies to all hospitals
- Reports generally include
  - Report on vulnerable populations including those served by Medicare and Medicaid and shortfalls
  - Report on unreimbursed costs
  - Report on charity and subsidized care
  - Report on other community benefits including education



## Corporate Campaigns

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- SEIU and AFSME behind efforts in Illinois to pressure hospitals to change charity care policies
  - Tactic to unionize work force
  - Unsuccessful
- New approach was to file several class action cases in Chicago, San Antonio, Albany and Memphis alleging a conspiracy to depress nurses wages by participating in wage, benefit and salary surveys
  - Copy cat cases have been filed





## Questions & Answers



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