

What's News

TAX EXEMPT HOSPITALS: HOW TO SURVIVE IN A HOSTILE ENVIRONMENT

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In our previous article entitled, *TAX EXEMPT HOSPITALS: IN THE FIRE AND UNDER THE GUN*, we examined the recent events that have brought intense scrutiny and increased regulatory oversight to tax-exempt hospitals' charity care and collections practices, among other activities. As the pressure from lawsuits, state attorneys general, and the Congress continues to build, tax-exempt hospitals are, or should be, in the process of creating, or reviewing and evaluating, charity care and debt collections policies and procedures, and other policies related to their tax-exempt status.

Charity Care

Where does a tax-exempt hospital's charity care obligation come from? There is no requirement in Section 501 of the Internal Revenue Code or any subsequent Internal Revenue Service ("IRS") regulation that a hospital must provide charity care to obtain or maintain tax-exempt status. In 1969, the IRS issued a revenue ruling that set forth the "community benefit standard" as the bedrock for tax-exempt status for non-profit hospitals. Rev. Rul. 69-545, 1969-2 C.B. 117. The community benefit standard requires all tax-exempt hospitals to utilize their resources to benefit the community. The IRS indicated that by operating an emergency room open to all persons and providing hospital care for all those persons in the community

able to pay the cost thereof either directly or indirectly through third party reimbursement, a hospital is promoting the health of a broad enough class of persons to benefit the community as a whole. The revenue ruling specifically indicated that it modified an earlier ruling that required tax-exempt hospitals to provide healthcare without charge or at rates below cost.

While charity care may not specifically be required, it is an element of the community benefit standard and can be a significant indicator to the courts and the IRS that a hospital promotes the health for the benefit of the community.

Every tax-exempt hospital should have a charity care policy that articulates the financial criteria used by the hospital to determine whether a low-income patient is eligible for financial assistance. The policy should also describe the process by which the hospital reviews eligibility decisions and communicates the criteria and process to the patients.

The financial criteria are generally based upon the federal poverty level. The patient must be able to provide accurate documentation of his or her income by providing a copy of an income tax return, a W-2 or a recent pay stub (which may be a more accurate, up-to-date snapshot of the patient's financial status).

In addition to straight charity care, the policy could provide alternative options for different classes of low-

income patients, such as a sliding scale, charges equal to Medicare or Medicaid reimbursement rates, or an interest-free extended payment plan, or other options for paying the hospital's charges to the extent of the patient's financial ability.

Additionally, eligibility for charity care and alternative payment plans should be re-determined on an ongoing basis, so that if a patient's financial conditions worsens or improves, the patient's financial assistance can be reassessed periodically to accurately reflect his or her financial condition. Effective charity care policies should be flexible enough to evolve with the community and its citizens.

However, just having a charity care policy is not enough. In a field service advisory, which the IRS National Office issues to field offices, the IRS stated a hospital will not qualify for exemption under the community benefit standard merely by stating in its policies that it will provide charity care. See FSA 200110030 (Feb. 5, 2001). The IRS cited numerous cases in which the record contained no evidence that an organization actually provided significant health care services to the indigent. Additionally, the IRS noted that while an organization may have a charity care policy, it is of no use unless the policy is communicated to its patients and the organization abides by the policy.

Therefore, a tax-exempt hospital must make its charity care policy known to the admissions and other

appropriate staff in order to implement the policy and benefit the patients who qualify for it. The hospital could also post notices of the availability of financial assistance visibly in high traffic areas, such as the Emergency Department, inpatient and outpatient admissions/registration, and billing offices.

The benefits a tax-exempt hospital provides to the community should be advertised in the community, so the hospital builds and reinforces a positive reputation in the community. Hospitals should inform the community of their charity care policy and willingness to work with patients to help create payment plans that fit within their budget.

Further, all forms of charity care should be calculated and documented. While no hospital wants to be faced with a lawsuit or governmental audit questioning its charity care, a hospital can attempt to insulate itself from such types of claims by establishing a record that demonstrates and supports the hospital's actual charity care practices. This information can also be shared with the community to further bolster a hospital's image and perception as meeting the community's healthcare needs.

Debt Collection

Hospitals must be careful to use consistent, prudent and lawful collections measures. While the use of collection agencies to collect unpaid debts is a common practice in any business, tax-exempt hospitals need to be especially cautious when using collection agencies to ensure the agency does not utilize overzealous means to collect unpaid debts. This is especially important in this current environment in which tax exempt hospitals'

debt collections practices are being questioned and scrutinized in some of the uninsured lawsuits.

Tax-exempt hospitals should create their own debt collection standards, or revisit their existing ones. For example, the hospital should attempt to determine whether the patient is eligible for financial assistance under the hospital's charity care policy before referring an unpaid balance to a collection agency. Additionally, a debt collection policy could state that the hospital will not use liens on homes to collect unpaid bills, or will not refer to collection agencies, as long as the patient is cooperating to settle the bill. In addition, we recommend that when hospitals use collection agents or attorneys, they should be familiar with the collection agent's or attorney's methods and policies to ensure that their actions will be consistent with the hospital's tax exempt purpose.

Additionally, the hospital's collection efforts should be well documented. As with its charity care practices, a hospital faced with a lawsuit or governmental audit regarding its collection efforts is much better equipped to defend itself with a complete record of its compliant collection actions.

Future Legislation

It is particularly crucial that tax-exempt hospitals begin the process of reviewing or creating charity care and debt collection policies and other procedures, and putting them into practice now, if they have not already begun to do so. It is not a matter of if, but rather when, tax-exempt organization reform legislation will be passed at the federal and possibly the state level. Such legislation is likely to be broadly based covering tax-exempt

organizations' governance and operations, which would include community benefit, charity care, charges to the uninsured, and debt collection practices.

Senate Finance Committee staffers have indicated that it is only the recent national disasters-Hurricanes Katrina and Rita-that have diverted Congress' attention and that tax-exempt organization reform legislation is likely next year. However, tax-exempt hospitals should not wait for such legislative reforms and should begin the process of assessing its current practices and implementing improvements to its charity care billing and collections processes now.

This article provides a general overview and commentary and is not intended to be legal advice regarding a particular tax-exempt hospital's situation. The laws and regulations governing tax-exempt hospitals and the related issues are extremely complex and this article is not intended to be an in-depth analysis of the same. If you would like more information or have a specific question, please contact us.

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