

Hospitals face challenges to tax-exempt status

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In recent years, the tax-exempt status of nonprofit hospitals has drawn the attention of federal and state authorities, as well as from plaintiff's attorneys.



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Tax-exempt hospitals are subject to a federal "community benefit standard" to obtain and maintain that status. One element of the standard is providing charity care, which has become a source of controversy for tax-exempt hospitals. Their pricing and debt-collection practices are also being challenged.

Some of the scrutiny comes from Congress. A U.S. House Ways and Means subcommittee held a hearing in June 2004 on the subject.

The U.S. Senate Finance Committee convened a hearing on oversight and reform of tax-exempt organizations in June 2004. The committee released a draft document proposing reforms and best practices for tax-exempt organizations and solicited an outside group to examine the sector's governance, transparency and ethical standards. The panel issued its 116-page report in June.

In May, Finance Committee Chairman Charles Grassley sent letters to 10 hospitals and hospital systems asking

more than 40 questions about charity care, other activities benefiting the community, and billing and collection practices.

Meanwhile, plaintiff's lawyers have brought cases across the country challenging practices of tax-exempt hospitals. Federal-court lawsuits have come primarily through the firm of self-proclaimed "super lawyer" Richard Scruggs, who has reportedly filed 65 lawsuits in 24 states against 60 hospitals since mid-2004.

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These suits alleged, among other things, a violation of the tax code for failure to provide charity care to indigents. The complaints allege patients covered by Medicare, Medicaid and private insurance are charged much lower rates than those without such coverage; consequently, the cost

of medical services disproportionately falls onto those who can least afford it.

Further, the federal lawsuits allege collections practices used by the hospitals violated their charitable mission.

Fortunately for hospitals, many of the federal lawsuits have been dismissed, with judges holding patients have no private right of action as third-party beneficiaries to challenge a hos-

pital's tax-exempt status — only the IRS can do that.

Similar lawsuits alleging hospitals have a two-tiered billing system that puts uninsured individuals at a disadvantage have been filed in N.C. courts. The suits ask the courts to determine a "reasonable" price for hospital services.

Recently, several of these class-action lawsuits were dismissed. The court found the plaintiffs already had claims pending with the defendant hospitals; thus, their claims should be brought as a defense in those lawsuits, not in a class-action lawsuit.

South Carolina has seen more state-court lawsuits related to uninsured patients than any other state, with almost 50 filed.

Tax-exempt hospitals have also caught the attention of state authorities. In February 2004, Provena Covenant Medical Center had its state property tax-exemption revoked by the Illinois Department of Revenue at the recommendation of the Champaign County Board of Review. Public authorities cited problems including Provena's community-benefit report, which primarily consisted of bad-debt write-offs and volunteer work done by hospital employees on their own time. Provena's policies meant those with the least means had to pay the most; no options were provided to help them pay off debts. Provena is appealing the denial of its tax exemption.

Another county board in Illinois recommended in April the state deny property-tax exemptions for five parcels owned by the Carle Foundation, a nonprofit health-care company.

State attorneys general are also focusing their attention on tax-exempt hospitals. A compliance review issued in January by Minn. Attorney General Mike Hatch targeted the charity care, collections and nonprofit governance record of Fairview Health Services of Minneapolis. It concluded Fairview is failing to charge uninsured individuals reasonable rates for care. As a result, in April, Hatch and Fairview Health Services announced the system would expand its charity care by offering greater discounts to low- and middle-income residents and reform its debt-collection practices.

This created a domino effect in Minnesota. On May 5, four other hospital systems made similar, voluntary agreements with the attorney general.

With all this controversy, tax-exempt hospitals should review or create charity-care and debt-collection policies and other procedures related to their charitable mission, and put them into practice now. Tax-exempt hospitals also need to educate patients and the communities they serve about their charitable purposes and activities.

It's not a matter of if, but rather when, tax-reform legislation will be passed at the federal level; states could take action, too. It's only hurricanes Katrina and Rita that have diverted Congress' attention from such legislation; it's likely to come next year.

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