Tax Exemption Challenges

Improving Governance Practices
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“…[S]ome NFPs do just the opposite: Charging their uninsured patients significantly more than those who have insurance; [p]ursuing the poor or uninsured relentlessly by aggressive and humiliating collection techniques; [r]ampantly violating federal and state prohibition [sic] against profiteering by ‘private interests,’…”

Taken from www.nfplitigation.com website 2/24/05
Who

- House Energy and Commerce Committee
- House Ways and Means Committee
- Senate Finance Committee
- Government Accountability Office
- Class Action Lawsuits
- IRS Executive Compensation Audits
- Advocacy Groups (K.B. Forbes, SEIU, etc.)
- State Attorney Generals
- State and Local Politicians
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IRC § 501(c)(3): entity must be organized and operated for a charitable or other specified purpose

- Organizational test – organized to promote health is a charitable purpose
- Operational test – must actually operate in furtherance of that purpose in a manner that benefits members of the community ("community benefit")
IRC § 501(c)(3): General Prohibitions.

Cannot:

- Undertake (other than incidentally) activities that do not further exempt purpose
- Serve private rather than public interests
- Permit organization’s income to inure to the benefit of insiders (directors, officers, key employees & physicians)
  - Note: This is an absolute prohibition
Rev. Rul. 69-545: Hospital demonstrated “community benefit” by:

- Promoting health
- Using surplus for quality of care, facilities, research, and education
- Emergency room open to all
- Care for all who can afford to pay including M/M
- Open medical staff
- Community board comprised of persons w/o financial interest

Note: Not every element must be met to qualify for exemption
• IRS 2001 Field Service Advisory
  – Free or discounted care policy?
  – Policy communicated to patients?
  – Emergency Room open to all?
  – Admission policy on indigent patients?
  – Number of indigent patients who actually received free or discounted care?
  – Account for bad debt separate from free care?
Legal theory of Scruggs federal lawsuits
- Uninsured patients are third party beneficiaries of an implied contract between federal government and hospital arising out of hospital’s tax exempt status
- Duty of Good Faith and Fair Dealing
- Breach of Implied Public Trust
- Unjust Enrichment
- EMTALA
• Qualification for tax exemption generally the same as federal law
• More explicit criteria (charity care, community benefits, etc.)
• AGs frequently have broad powers
• Special rules may apply to facilities which are financed by tax-exempt bonds
• Scruggs State lawsuits
  – Breach of Contract
  – Breach of Implied Warranty of Good Faith and Fair Dealing
  – Consumer Fraud Act
  – Uniform Deceptive Trade Practices Act
  – Unjust Enrichment/ Constructive Trust
  – Unfair Business Practices
  – Non-profit Corporations Act
• Status of State lawsuits
  – Dozens of lawsuits filed, many were dismissed but roughly $\frac{1}{2}$ allowed to continue in some form
  – Discovery
  – Class Certification
  – Settled: Providence, Sutter, CHW, Legacy, ??
State Initiatives

• Minnesota – Agreement with AG
  – Collection Practices
  – Discount for Uninsured/ Underinsured
  – Training to staff on financial assistance
  – Communication of policies to patients
  – Internal audit and report to Board

• Wisconsin Attorney General
  – Sued 2 hospitals for unfair trade practices
  – Alleging they charged uninsured patients “sticker” prices, far in excess of the steeply discounted prices paid by the vast majority of patients
State Initiatives

• Ohio Attorney General
  – Conflicts of interest
  – “Excessive” compensation
  – Community benefit
  – Billing and debt collection practices
• IL AG Legislative Proposals
  – Tax-Exempt Hospital Responsibility Act
    • Free care at or below 150% of FPL
    • Discounts from cost at or below 250% of FPL
    • 8% of total operating costs must be spent on community benefit
  – Hospital Fair Billing and Collection Practices Act
    • Communicate free or discounted care to patients
    • Restraints on collection techniques
    • Additional procedures before pursuing litigation or enforcing judgments through lien foreclosures or garnishments
1. **Charity Care Policy**
   - Is it reasonable?
     - Scope of services
     - Community need
     - Organization’s resources
     - Financial impact
       - Bad debt vs. charity care
         » Reporting to State Agencies
         » HFMA Principals and Practices Board Statement Number 15
   - Discounts from costs or charges?
   - Are policies effectively communicated?
     - To patients and staff
Charity Care Policy (con’t)

– Issues/Risks
  • Who (citizens, residents, community members) gets free/discounted care (income/assets)
    – Free care: 200% of FPL  Discounts: 400% of FPL
  • Discounts for the wealthy uninsured?  Underinsured?
  • Encouraging high-deductible plan selection (HSAs)
  • Employers dropping insurance
  • Elimination/cutbacks in local government programs
  • Patient engagement in process

– Resources
Charity Care Policy (con’t)

– Scruggs Settlement Agreements
  • Free care at 200% of FPL
  • Discount equal to Providence PPO’s discount for all uninsured patients
  • Additional sliding scale discount from 200-400% of FPL

– Illinois Legislative Proposal
  • Free care at 150% of FPL
  • Discount from cost at or below 250% of FPL

– MN AG Agreement
  • Discount equal to that provided to “most favored payer” to patients at or below $125,000 annual household income
• Communicating the Charity Care Policy
  – Financial Assistance publicized on website
  – Financial Assistance brochure created
  – Posters in waiting areas
  – Attempt to identify uninsured patients during pre-registration and admission process
  – Train all staff on free care policy and uninsured discount
  – Development of charity care eligibility tools to simplify and make process less intrusive
• **Communicating the Charity Care Policy**
  – All collection letters include a reference to the availability of financial assistance, with a phone number and address
  – During any communication regarding bill, business office staff will:
    • Verify that we billed the right person
    • Verify any insurance coverage they might have
    • Offer a reasonable payment plan if bill cannot be paid in one payment
    • Send an application for free care if reason to believe the person would qualify
• **Impact of Increased Communication**
  – Number of applications for free care tripled: from 4,000 in 2003 to 12,000 in 2005 (Allina)
  – 150%+ increase in charity care (CHW)
2. Community Benefit
   - Definition issues
     - What is promotion of health?
     - Do programs need to be targeted at poor to qualify?
   - Reporting
   - Tracking

Resources: Community Benefit Reporting Guidelines and Standards: Definitions for the Community Benefit Inventory for Social Accountability (Catholic Health Association, VHA, Inc., Lyons Software)
3. Collection Practices

- Issues:
  - Policies & Procedures – approved by Board
    - Communication with patients
    - “Reasonable payment plan” and financing options
    - When to refer debt to collection agency
    - Limitations on collection techniques
    - Oversight of litigation by in-house counsel or hospital executive
    - Handling of patient complaints
  - Fairness
  - Training of business office staff, collection agency, and counsel
  - Monitor and Audit to ensure consistency
  - Evaluate your Past Practices
Collection Practices (con’t)

- Contracts with Collection Agencies
  - Payment terms to agency – no contingency bonus
  - Communication of Charity Care Policy
  - Body Attachments
  - Garnishments
  - Foreclosures on Liens
  - Credit Reporting
  - Return of Accounts
  - Tracking and reporting of complaints
  - Communication between hospital and collection agency
  - Settlement Authority
4. **Pricing**
   - **Macro**
     - Market Competition
     - Sustainable Margins
     - Service/Department
   - **Micro – CDM Level**
     - Pricing Methodology
     - “Smell” Test
     - Maintenance
     - Disclosure
5. **Balance Sheet** – Principal issue is to be able to explain why an organization needs large cash reserves.

- Capital – new and replacement
- Debt covenants
- Credit rating
  - Ratios (Moody’s, Fitch, Standard & Poor’s)
- Debt service
- Operating cushion
- Self-funded Insurance Programs
  - Professional liability
  - Workers’ compensation
  - Off-shore captives
6. Ventures with For-Profits

- Risks
  - Inurement proscriptions
  - “Insider” deals
    - Physicians
    - Board members
  - Property/Sales Tax Exemption

- Joint Venture Arrangements
  - Contributions vs. Distributions
  - Bond Covenants

- Management Arrangements
  - Departments
  - Percentage of revenue
7. Executive Compensation

- Reasonableness
  - Market data
  - Defensible metrics
  - Board approval after full disclosure
  - Independence – Board and consultants

- Reporting
  - Perks -- Club memberships, travel (hotels, limousines, meals) bonus/incentive compensation, retirement benefits (SERP), tax preparation, estate planning/financial consulting
  - Multiple entities
  - Consistency

- GAO Surveys
- IRS Executive Compensation Audits
Questions?