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Recent Legislative Changes Affecting Tax-Exempt Hospitals

By David Kahn, Ursula H. Hyman, Daniel Settelmayer, Paul DeMuro, and Gerald Peters

The recently enacted Patient Protection and Affordable Care Act (H.R. 3590), as amended by the Healthcare and Education Reconciliation Act (H.R. 4872), signed into law by President Barack Obama (together, the Health Care Reform Law), amends the Internal Revenue Code to impose several significant new requirements on tax-exempt hospitals.

These requirements refine the community benefit standard and impose specific charity care obligations for nonprofit hospitals, including new rules governing community health needs assessments, charity care policies, charge limitations, billing of charity patients, 990 reporting, disclosure and publicity. Most of the rules take effect immediately and will require adjustment of current policies and procedures in these areas.

These changes will apply to any organization exempt from federal income tax under Internal Revenue Code Section 501(c)(3) and those operating any facility required to be licensed or registered as a hospital by any state, or any other organization that the Internal Revenue Service (in consultation with the US Dept. of Health and Human Services) determines has the provision of hospital care as its principal function or purpose constituting the basis for its tax-exempt status.

In addition to the requirements already imposed on such entities under the Internal Revenue Code, the Healthcare Reform Law requires tax-exempt hospitals to prepare certain specified "community health needs assessments" on a periodic basis; adopt or maintain a "financial assistance policy" meeting the requirements of the new law; limit amounts charged to certain low income service recipients for necessary services; comply with new rules regarding the use of certain billing and collection procedures; and comply with certain enhanced information reporting requirements to be implemented through changes in the Form 990.

Tax-exempt organizations operating more than one hospital facility must meet these requirements separately with respect to each such facility.

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Each tax-exempt hospital must conduct a "community health needs assessment" at least once every three taxable years, and must adopt an "implementation strategy" to meet the community health needs identified in the "community health needs assessment." This must take into account input from persons who represent the broad interests of the community served by the hospital facility at issue, including those with special knowledge of or expertise in public health, and it must be made widely available to the public. The "community health needs assessment" may be based on current information collected by a public health agency or nonprofit organization, and it may be conducted together with one or more other organizations, including related organizations.

Hospitals must disclose on their Forms 990 how they are addressing the needs identified in the "community health needs assessment" and, if all identified needs are not being addressed, the reasons why (*e.g.*, insufficient financial or human resources). Failure to comply with these requirements during any three-year period can result in the imposition of a penalty of up to $50,000 and/or existing penalties applicable to incomplete information returns under Internal Revenue Code Section 6652.

Hospital facilities must also adopt, implement and widely publicize a written financial assistance policy, which must set forth:

The eligibility criteria for financial assistance and whether such assistance includes free or discounted care; the basis for calculating amounts charged to patients; the method for applying for financial assistance; if the organization does not have a separate billing and collections policy, the actions (including collections efforts and credit agency reporting) the organization may take in the event of nonpayment; and measures the organization will take to publicize the policy widely within the community to be served.

In addition, each hospital facility is required to adopt and implement a policy to provide care for "emergency medical conditions" within the meaning of Section 1867 of the Social Security Act (42 USC 1395dd). This policy must prevent discrimination in the provision of such treatment, including denial of service, regardless of the recipient's eligibility for financial assistance under the facility's financial assistance policy.

Tax-exempt hospitals are required to limit the amount charged for emergency or other medically necessary care to individuals eligible for assistance under the hospital's financial assistance policy to an amount that does not exceed the amount generally billed to individuals who have insurance covering such care. In addition, the use of "gross charges" (*e.g.*, "chargemaster rates") is prohibited when billing individuals who qualify for financial assistance. Legislative history accompanying the Healthcare Reform Law indicates that "[i]t is intended that amounts billed to those who qualify for financial assistance may be based on either the best, or an average of the three best, negotiated commercial rates, or Medicare rates."

The Healthcare Reform Law requires that tax-exempt hospitals refrain from engaging in "extraordinary collection actions" (even if otherwise permitted by law) before making "reasonable efforts" to determine whether an individual is eligible for assistance under the hospital's financial assistance policy. Such extraordinary collection efforts include lawsuits, liens on residences, arrests, body attachments or other similar collection procedures. Further, the IRS is directed to issue guidance concerning what constitutes "reasonable efforts to determine eligibility" under an organization's financial assistance policy, including specifically patient notification of the hospital's financial assistance policy upon admission and in written and oral communications regarding the patient's bill.

Tax-exempt hospitals are required to include copies of the organization's audited separate or consolidated financial statements and provide certain additional information on their annual information return (Form 990) filed with the IRS.

Further, the legislation requires the IRS to review information regarding hospital community benefit activities at least once every three years. The IRS is required to submit a report to Congress annually summarizing the levels of charity care, bad debt expenses, unreimbursed costs of means-tested government programs, and unreimbursed costs of non-means tested government programs incurred by private tax-exempt, taxable and government hospitals, as well as the costs incurred by private tax-exempt hospitals for community benefit activities. On or before March 23, 2015, the IRS must conduct and submit to Congress a study of the trends in these amounts.

Under the Healthcare Reform Law, obligations of tax-exempt hospitals relating to the conduct of a "community health needs assessment" are effective starting in taxable years after March 23, 2012. All other requirements imposed under the Healthcare Reform Law, including the excise tax relating to the "community health needs assessment", are effective for taxable years beginning after March 23, 2010 (the date of enactment).

The Healthcare Reform Law results in a number of potentially significant changes in the manner in which nonprofit hospitals are required to conduct business and report information to the IRS, patients and the public. Additional changes are likely as the IRS follows the legislation's mandate to issue implementing Treasury regulations and make additional changes to the Form 990.

These new community benefit and charity care requirements for nonprofit hospitals continue the trend of enhanced accountability and focus on specific exactions from nonprofit hospitals for the benefit of tax-exempt status. If health care reform takes hold in the coming years as envisioned, and the promise of dramatically reduced uninsured populations are realized, the basis for nonprofit hospital tax-exemption and the contours of community benefit are likely to be a constant focus of government and the industry.

David Kahn is a partner in the Los Angeles and San Diego offices of Latham & Watkins, is a member of the firm's Finance Committee, and is chair of the Los Angeles office Tax Department.

Ursula H. Hyman is a partner in Latham & Watkins' Los Angeles office and currently leads the firm's Public and Tax-Exempt Financing practice.

Daniel Settelmayer is a partner in the Los Angeles office of Latham & Watkins and is a co-chair of the firm's global health care practice group.

Paul DeMuro is a corporate partner in the Los Angeles and San Francisco offices of Latham & Watkins.

Gerald Peters is a partner in the San Francisco office of Latham & Watkins and served as Chairman of Latham's National Health Care Practice Group from 1997-2005.