

A horizontal banner image divided into several rectangular panels. The panels contain various legal and professional symbols: a pair of scales of justice, a gavel, a computer keyboard, and open books. Overlaid on this banner is the text "JONES DAY" in a smaller font and "COMMENTARY" in a large, bold, white sans-serif font.

## JONES DAY COMMENTARY

### HEALTH CARE

# IRS TO SEND COMMUNITY BENEFIT QUESTIONNAIRES TO 600 HOSPITALS NATIONWIDE

## 2006 IRS WORK PLAN TARGETS COMMUNITY BENEFIT

As part of its 2006 Work Plan, the IRS announced that its Exempt Organizations Compliance Unit would send questionnaires to a "significant number of hospitals asking them to provide information on . . . how they meet the community benefit standards for purposes of section 501(c)(3)." Since that time, the IRS has been staffing up and training its agents for this undertaking, and it is our understanding that between now and the end of September 2006, the IRS anticipates sending out approximately 600 of these questionnaires to hospitals and hospital systems of various sizes and in various locations.

As a result, many hospitals will soon be faced with demonstrating how they satisfy the community benefit standard. To do so, these hospitals will be required

to show how they determine what community benefits they provide, how they allocate resources to those benefits, how much community benefit they deliver, and why what they do and how they do it satisfy the community benefit standard.

## DEMONSTRATE BOARD INVOLVEMENT IN COMMUNITY NEED ASSESSMENTS

The community benefit standard is premised on the notion that boards will be actively involved in determining what needs exist in the community and how the institution can best serve those needs, given its financial resources and charitable mission orientation. In this regard, all nonprofit hospitals operate with finite resources; under the community benefit standard, they are empowered to allocate these resources in a manner that, in their judgment, best suits the needs of

the communities they serve. In many instances, this means a substantial dollar commitment to charity care spending and to other activities that further the organization's charitable mission.

In his May 26, 2005, testimony before the House Committee on Ways and Means, IRS Commissioner Mark W. Everson noted that the health care industry has changed dramatically since the community benefit standard was first set forth in Revenue Ruling 69-545, and he further noted that several of the factors set forth in that Revenue Ruling no longer serve as meaningful standards for distinguishing between tax-exempt and for-profit hospitals. As a result, Commissioner Everson stated, *"More and more, the IRS looks to the independent board exercising its fiduciary duty to operate for the benefit of the community to differentiate the tax-exempt hospital from a for-profit operation."* As a result, whether or not your hospital receives one of the approximately 600 IRS community benefit compliance questionnaires, it is important to involve your board actively in the process of determining and quantifying community needs.

## HOW AND WHAT TO QUANTIFY TO DEMONSTRATE COMMUNITY BENEFIT

While community benefit likely has both a qualitative and a quantitative aspect, the IRS questionnaires can be expected to focus primarily on the quantitative aspects of community benefit. In this regard, the generally accepted approach to identifying and quantifying the net cost of community benefits is to assess the nature and scope of the health care, education, and research provided by the organization as well as the overall economic benefit resulting from its operation.

This means that typically, though not exclusively, at least the following categories of community benefit are measured:

- Health care organizations offer charity care to meet community needs by providing health services at a full or partial discount to patients who cannot afford to pay.
- Health care organizations serve low-income Medicaid and other public-program patients, and incur associated costs that exceed public program reimbursement. This "Medicaid or public-payer shortfall" is created when hospitals and physicians receive payment below the cost of treating Medicaid recipients.
- Health care organizations provide subsidized health services, which generate a bill for reimbursement, but they are provided at a negative margin because they are needed in the community. The community would be at risk of losing the services if the health care organization did not provide them—or responsibility for the programs would fall to an alternative governmental or not-for-profit entity.
- Health care organizations provide and/or fund specific community outreach programs to meet community needs or because they are considered to improve community health overall. These types of community outreach programs do not result in a bill for reimbursement from third-party payers, and they include initiatives such as health screenings and cash and in-kind donations not conducted for marketing purposes but to meet identified community needs.
- Hospitals educate and train health professionals to ensure a high-quality, adequate supply of future generations of physicians, nurses, pharmacists, and other allied health professionals. It has long been recognized that education activities serve charitable purposes.
- At hospitals, the primary purpose of medical research is to advance clinical protocols and to develop technologies that will save and improve lives. The results of such research are published and communicated to other academic and health professions to be used for the public benefit. Many hospitals use internal or clinical funds to subsidize research endeavors.

- Tax-exempt health care organizations also benefit their communities by contributing to overall economic development and by attracting philanthropic contributions that support the charitable mission, or by subsidizing community volunteers (e.g., paying staff while they are engaged in various community service activities).

## JONES DAY'S EXPERIENCE WITH QUANTIFICATION OF COMMUNITY BENEFIT

We have assisted a number of clients in the process of cataloging and quantifying community benefit in a number of contexts, from preparation for IRS examinations to defense of exemption in state tax litigation, and in responding to legislative inquiries on the topic. We would be glad to talk with you regarding how your organization addresses this important matter.

## LAWYER CONTACTS

If we can be of assistance, please contact your principal Firm representative or any of the lawyers listed below. General e-mail messages may be sent using our "Contact Us" form, which can be found at [www.jonesday.com](http://www.jonesday.com).

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