



American Hospital  
Association

# Regulatory Advisory

*A service to members, advisories are produced whenever there is a significant development that affects the job you do in your community. Call (202) 626-4629 if you do not receive the total of four pages.*

## IRS ISSUES GUIDELINES AFFECTING TAX-EXEMPT HOSPITALS, HEALTH CARE ORGANIZATIONS

A Message to AHA Members:

The Internal Revenue Service (IRS) has issued guidance and proposed regulations that could affect your hospital's operations. They include guidelines for tax-exempt organizations, a proposed regulation regarding excess benefit transactions, and proposed changes to Form 990 – the federal tax return for tax-exempt organizations.

Specifically the IRS will examine how hospitals determine executive compensation and how not-for-profit hospitals meet the community benefit standard in qualifying as a 501(c)(3) organization. The agency also issued proposed regulations regarding excess benefit transactions in which a tax-exempt organization provides compensation that exceeds the value of goods or services received.

Please review the attached advisory for details on these IRS activities. Share the advisory with your chief financial officer and other senior management to determine what action your organization should take.

Because of the increased scrutiny that hospitals are facing regarding executive compensation and other financial activity, hospitals and health systems should put the following items on their “to do” list.

- Conduct compensation reviews for all management compensation, including deferred compensation, fringe benefits and severance payments. Make sure that everything is being properly reported to avoid automatic excess benefit transactions penalties.
- Conduct community benefit reviews and make sure to:
  - Review community benefit standards under Section 501(c)(3). In assessing the charity care component of the community benefit standard, the AHA recommends that hospitals use the guidance developed by the Catholic Health Association of the U.S. (CHA) and VHA, available at:  
<http://www.chausa.org/NR/rdonlyres/1E9B545E-BD93-4F46-B6F2-3FE18578CB41/0/commbenguidelines.pdf>.
  - Audit the activities of the hospital and/or the system to determine how it addresses the community benefit standard using the guidance of CHA and VHA.

- Document the results of the audit to show how the hospital and/or system is addressing or meeting the community benefit standards.

We'll continue to work with the IRS to ensure that regulations do not impede your ability to care for the patients in your community. If you have questions about this issue, please contact the AHA's Mike Rock, senior director of federal affairs, at [mrock@aha.org](mailto:mrock@aha.org), or (202) 262-2325.

Sincerely,

Rick Pollack  
Executive Vice President

November 22, 2005



American Hospital  
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# *Regulatory Advisory*

November 22, 2005

## **IRS ISSUES GUIDELINES AFFECTING TAX-EXEMPT HOSPITALS, HEALTH CARE ORGANIZATIONS**

### **Background**

The Internal Revenue Service (IRS) has issued guidelines for tax-exempt organizations, a proposed regulation regarding excess benefit transactions, and proposed changes to the Form 990 – the federal tax return for tax-exempt organizations. This Regulatory Advisory summarizes the activity and what actions hospitals may need to take.

### **Executive Compensation**

The IRS on October 25 released its Fiscal Year (FY) 2006 “Implementing Guidelines” for tax-exempt organizations. Under one of the guidelines, the IRS will examine “how hospitals determine and pay executive compensation,” and “how hospitals meet the community benefit standards for purposes of Section 501(c)(3).”

The American Hospital Association (AHA) has been working with the agency on the executive compensation issue and will provide additional information soon so hospitals can adequately address IRS inquiries. In its guidance, the IRS noted that it will contact “a significant number of hospitals asking them to answer certain questions regarding these and potentially other issues.” The IRS, however, has not defined a “significant number” nor indicated what other issues concern the agency.

The IRS Implementing Guidelines also address other IRS initiatives. For example, the IRS is finishing Phase I of its 2005 compensation survey, and states in the October 25 guidelines that the “Tax Exempt Compensation Enforcement Project was established to address the potential issue of excessive compensation being paid to insiders of charities and private foundations. ... During FY 2006, we will complete these examinations and issue a report on our initial findings. Based on our findings, we will target additional examinations and compliance checks.” This makes it clear that the IRS compensation review is not yet completed.

### **Additional IRS Activity**

Under the Intermediate Sanctions rules, the IRS on September 9 issued proposed regulations dealing with tax-exempt status and excess benefit transactions, which occur when compensation given to an individual exceeds the value of goods or services received in return by the tax-exempt organization. Among other items, the proposed regulation would set a minimum threshold of \$2,500 to automatically trigger enforcement of the excess benefits transactions rule.

The proposed rule would conclude that such compensation is an excess benefit transaction because it was not reported as income to the chief financial officer (CFO) of the tax-exempt organization, and could constitute personal liability (excise taxes) on the CFO and the management of the organization that approved the transaction. Comments on the proposed regulation are due December 8. The AHA is concerned about the effects of the proposed regulation and will submit comments.

On October 26, the IRS issued proposed changes to the Form 990, the federal tax return for tax-exempt organizations, with comments due November 28. The AHA is in the process of analyzing the proposed rule and will submit comments by the deadline.

The AHA will continue to work with the IRS to ensure that regulations do not impede a hospital's ability to fulfill its mission to the community. If you have questions, please contact the AHA's Mike Rock, senior associate director of federal affairs, at [mrock@aha.org](mailto:mrock@aha.org), or at (202) 626-2325.