

May 30, 2006

IRS ISSUES COMPLIANCE CHECK QUESTIONNAIRE

AT A GLANCE

The Issue:

The Internal Revenue Service (IRS) recently began sending a nine-page “Compliance Check Questionnaire” to as many as 600 tax-exempt hospitals asking a series of detailed questions regarding hospital operations. In the cover letter, the IRS describes the contact as “a compliance check of your organization as part of our ongoing efforts to increase voluntary compliance by tax-exempt organizations.”

The questionnaire is part of a previously announced effort by the IRS to study the compliance of tax-exempt hospitals with Section 501 (c)(3) of the tax code. During a recent teleconference on Compensation Issues for Exempt Organizations, the IRS noted that 800 audits resulted from contact with 1,800 organizations in connection with the IRS’ year-long look at executive compensation in charitable organizations. The questions largely focus on the areas of operation that the IRS has said in its revenue rulings are indications that a hospital meets the community benefit standard. These include: the operation of an emergency room, composition of the board of directors, medical staff privileges, education, research, medical training and community programs. There are also a series of questions on uncompensated care, billing practices and compensation.

IRS procedures provide for an automatic 14-day extension upon request, and the agency typically will grant a 30-day extension if asked. Longer extensions also may be available.

Our Take:

The AHA will continue to work with the IRS to ensure that its various compliance initiatives do not impede a hospital’s ability to fulfill its mission to the community.

What You Can Do:

Please review this advisory for details on the compliance check and share it with your senior management and counsel to determine what actions to take. Among other things, you will want to: determine whether you need an extension to complete the compliance check and promptly request one by contacting the listed IRS contact and follow up with a written request; and identify and work with senior staff and legal counsel familiar with tax-exempt issues in formulating a plan to respond to the compliance check.

We recommend that hospitals that have not received a compliance check conduct the self-assessment compensation and community benefit reviews discussed in the AHA’s November 22, 2005 Regulatory Advisory on IRS Guidelines Affecting Tax-Exempt Hospitals, Health Organizations, found at www.aha.org/aha/members_only/member/content/051122maIRSGuidelines.pdf.

Further Questions:

If you have questions, please contact Melinda Hatton, vice president and chief Washington counsel, at mhatton@aha.org or (202) 626-2336, or Maureen Mudron, Washington counsel, at mmudron@aha.org or (202) 626-2301.

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BACKGROUND

The Internal Revenue Service (IRS) recently began sending to as many as 600 tax-exempt hospitals a nine-page “Compliance Check Questionnaire” (compliance check), which asks a series of detailed questions regarding hospital operations. In the cover letter, the IRS describes the contact as “a compliance check of your organization as part of our ongoing efforts to increase voluntary compliance by tax-exempt organizations.”

The compliance check is part of a more comprehensive effort on the agency’s part to scrutinize the tax-exempt sector, including hospitals. Testimony given by IRS Commissioner Mark W. Everson last year before the House Ways and Means Committee made it clear that the agency’s strategic plan for 2005-2009 is focused on tax-exempt hospitals in particular, and that many of its inquiries and proposed reforms will directly impact that segment of the hospital field.

A copy of the compliance check can be found at www.irs.gov/pub/irs-tege/eo_hospital_questionnaire.pdf.

Compliance Check Questionnaire

The compliance check is the most recent IRS effort to collect information on tax-exempt hospitals. The fact sheet accompanying the compliance check says that it is being conducted to determine:

- whether an organization is adhering to recordkeeping and information reporting requirements; and
- whether an organization’s activities are consistent with its stated tax-exempt purpose.

According to the IRS, the compliance check is not an “examination” in that it does not directly relate to determining “tax liability for any particular period.” **The IRS also notes that failure to provide the information requested in the compliance check will cause a hospital to be forwarded for “examination consideration,” meaning an audit.**

The categories covered in the compliance check are: operations, emergency room, board of directors, medical staff privileges, medical research, professional medical education and training, uncompensated care, billing practices, community programs and compensation practices. Generally, the compliance check tracks areas that the IRS identified in previous revenue rulings as indicative that a hospital is meeting the required community benefit standard.

Some Questions May Be Particularly Challenging

For the most part, the questions are straightforward, requiring a “yes” or “no” answer and an estimate of some sort (e.g., numbers of patients served, amount expended in serving patients). However, some questions may present certain challenges.

For example, in questions under the “board of directors” category, the compliance check asks hospitals to designate the professional background of each board member and provides a reference checklist. It is not entirely clear how a hospital would respond for a board member that has a dual (or greater) professional background in both accounting and law, for example.

Under questions labeled “billing practices,” the IRS asks many questions about hospital charges. Specifically, it asks a series of questions about whether hospitals charge certain categories of patients or payers higher prices. In recent years, there has been a good deal of discussion about charges and whether hospitals are following the dictates of the Medicare program by applying charges uniformly to all patients. The IRS has not been a participant in those discussions. Therefore, it may be advisable for hospitals to provide some framework, such as pertinent regulatory background, for their answers to these questions, and to reference their financial assistance and/or charity care policies to assist uninsured patients of limited means.

Under a different set of questions labeled “community programs,” the IRS provides a catchall question (question number 72) that permits hospitals to list all the programs, not already described, that promote or benefit the health of the community. Because the touchstone of the community benefit standard is providing services and programs to benefit the health of the larger community, hospitals should be certain to describe and quantify the wide and impressive range of programs and services provided.

The *Community Benefit Reporting* document produced by the Catholic Health Association of the United States and VHA Inc., which was recently endorsed by the AHA Board of Directors, is one tool for reporting community benefit. That document can be found at www.chausa.org/Pub/MainNav/ourcommitments/CommunityBenefits/TheGuide/. For the purposes of calculating the amount of benefit provided, the AHA Board also endorsed including the direct and indirect costs of subsidized health care services, charity care, bad debt and the unpaid costs of government-sponsored

health care, including Medicaid, Medicare and public and/or indigent care programs. A copy of the Board-approved statement can be found at www.aha.org/aha/advocacy-grassroots/advocacy/content/5_1_06_sb_billingcoll.pdf.

Finally, in providing responses to the questions under the category labeled “compensation practices,” it may be useful to review materials on AHA’s Web site that the IRS provided during its May 17-18, 2006 telephone forum on Compensation Issues for Exempt Organizations that more fully detailed the agency’s current compensation initiative. Those materials can be found at www.aha.org/aha/key_issues/compliance/issues/issues.html#taxexempt.

IRS Rules on Extending the Time to Reply

The compliance check requests a response within 30 days. IRS procedures provide for an automatic 14-day extension upon request, and the agency will typically grant a 30-day extension if asked to do so. Longer extensions also may be available. Hospitals should contact the IRS representative listed in the cover letter and follow up with a written request.

NEXT STEPS

Hospitals receiving the compliance check should work with counsel familiar with tax-exempt issues in completing the form. We recommend that hospitals that have not received the compliance check conduct the self-assessment compensation and community benefit reviews discussed in the AHA’s November 22, 2005 Regulatory Advisory on IRS Guidelines Affecting Tax-Exempt Hospitals, Health Organizations, found at www.aha.org/aha/members_only/member/content/051122maIRSGuidelines.pdf.

The AHA will continue to work with the IRS to ensure that its various compliance initiatives do not impede a hospital’s ability to fulfill its mission to the community. If you have questions, please contact Melinda Hatton, vice president and chief Washington counsel, at mhatton@aha.org or (202) 626-2336, or Maureen Mudron, Washington counsel, at mmudron@aha.org or (202) 626-2301.