

**Statement for the Record
of the
Alliance for Advancing Nonprofit Health Care
for the
U.S. House of Representatives
Committee on Ways and Means**

Hearing on the Tax-Exempt Hospital Sector

May 26, 2005

Mr. Chairman, Ranking Member Rangel, and distinguished Members of the Committee, the Alliance for Advancing Nonprofit Healthcare is dedicated to preserving and enhancing the abilities of nonprofit healthcare organizations to serve society and their individual communities. Through research, public education, and advocacy, the Alliance seeks to provide a strong, cohesive and persistent "voice" for a wide range of nonprofit healthcare organizations sharing many common goals and challenges--hospitals, health insurers, nursing homes, malpractice liability insurers, home care providers, and others. In addition, through education and other types of programs, the Alliance seeks to enhance the performance of nonprofit healthcare organizations in carrying out their unique roles and responsibilities in their communities.

Background on the Alliance for Advancing Nonprofit Healthcare

Started in mid-2003, the Alliance is a unique blend of nonprofit healthcare enterprises, all dedicated to a two-fold mission of advancing and improving the performance of nonprofit healthcare in the United States. The Alliance also serves as a forum for colleagues on both the nonprofit financing and delivery sides of healthcare to explore how at the regional and local levels they can establish more effective value-based relationships focused on community benefit, including quality, access, and affordability of health care.

To assist nonprofit health care organizations in carrying out their special missions, the Alliance for Advancing Nonprofit Healthcare has developed guidance documents on community benefits and governance. The community benefit guidance incorporates the excellent work previously done by the Catholic Health Association (CHA) and VHA, Inc.

The Alliance commends the Committee for examining the issue of tax-exempt status in the health care community, and hopes that this examination will reaffirm the widespread commitment of nonprofit hospitals and other nonprofit health care organizations to serving their communities. In the face of some well publicized reports in the media that have highlighted some alleged inappropriate behaviors by a very small percentage of nonprofit health care providers, we hope that these hearings will help publicize the much more prevalent story of the great benefits that the vast majority of nonprofit health care organizations provide to the communities they serve, as well as to broader society. The Alliance is very willing to explore with you whether some additional reporting or oversight mechanisms may be necessary to further ensure that the public trust is maintained, and that all are serving as good stewards of their community's resources. However, we urge the Committee to carefully consider any alterations to the existing law or regulations to avoid unintended consequences. Each community is different, and each nonprofit hospital tries to address the needs of its community in targeted ways designed to attend to those needs in the most effective manner. It is the flexibility inherent in the current system that is its greatest strength, allowing the government to monitor and work with nonprofit hospitals as they seek the best ways to serve their communities.

Background on Tax-Exemption of Hospitals

Nonprofit hospitals have played a vital role throughout our nation's history in delivering health care services to their communities. According to the latest available data from the American Hospital Association (AHA), there are 2,984 private nonprofit hospitals in the U.S., representing 61% of all of the short-term acute care hospitals (4,895) in the U.S. Another 1,121 hospitals are owned by state or local government (23%), and 790 (16%) are for-profit/investor-owned. 787 (26%) of the private nonprofit hospitals are religiously sponsored.

In order to qualify for tax exemption as a charitable organization under the Internal Revenue Code, an organization must be organized and operated exclusively in furtherance of a charitable purpose, and must not be operated, directly or indirectly, for the benefit of private interests. However, the activities of organizations carrying on many vital charitable functions, notably education and the promotion of health, are at least superficially similar to the activities of commercial organizations, *i.e.*, for-profit schools and hospitals. In addition, educational organizations and hospitals both impose charges (with exceptions) for their services and may operate with an annual surplus of receipts over disbursements. While nonprofit health care organizations must operate under the adage, "No money, no mission", they do not face the demands of the equity markets to maximize earnings for investors. Nonprofit earnings need not be as high, or as constant, and all that they are able to earn is "plowed" back into facilities, programs and services benefiting the community in a variety of ways.

The IRS has appropriately recognized that a nonprofit hospital may qualify for exemption as a charitable organization even though it operates at an annual surplus of receipts over disbursements. Thus, in Revenue Ruling 69-545, the IRS concluded that the promotion of health, like the relief of poverty and the advancement of education and religion, was one of the purposes in the general law of charity that is deemed beneficial to the community as a whole even though the class of beneficiaries eligible to receive a direct benefit from its activities does not include all members of the community, so long as the class that is benefited is not so small that its relief is not of benefit to the community.

In Revenue Ruling 69-545, the IRS approved the exemption of the hospital considered in that Ruling in large part because, by operating an emergency room open to all persons and by providing hospital care for all those persons in the community able to pay the cost thereof either directly or through third party reimbursement, that hospital was promoting the health of a broad class of persons and thus providing a benefit to the community. The favorable conclusion in Revenue Ruling 69-545 also reflected the fact that control of the hospital rested with a board of trustees, which was composed of independent civic leaders; that the hospital maintained an open medical staff, with privileges available to all qualified physicians; and that all members of its active medical staff had the privilege of leasing available space in its medical building.

While the conclusion of Revenue Ruling 69-545 rested in part on the fact that the hospital considered in that Ruling operated an emergency room open to all persons, the IRS has characterized the presence of an “open” emergency room only as “strong evidence” of a charitable purpose, and has never made the operation of an “open” emergency room either a sufficient or a necessary condition to tax exemption. For example in Revenue Ruling 69-544 which was published concurrently with Revenue Ruling 69-545, the IRS denied tax exemption to the hospital considered in that Ruling even though that hospital also operated an emergency room open to all persons.

The basis for the denial of exemption in Revenue Ruling 69-544 was the conclusion of the IRS that the hospital considered in that Ruling, which had initially been established as a proprietary institution operated for the benefit of its owners and later transferred to a nonprofit organization, had continued to operate for the private benefit of its original owners who exercised control over the hospital through the board of trustees and the medical committee. Revenue Ruling 69-544 concluded that this group had used their control to restrict the number of doctors admitted to the medical staff, to enter into favorable rental agreements with the hospital, and to limit emergency room care and hospital admission substantially to their own patients.

More recently, the IRS has also concluded that, in appropriate cases, a nonprofit hospital could qualify for tax exemption even though it did not maintain an “open” emergency room. For example in Revenue Ruling 83-157, the IRS concluded that a nonprofit hospital that was not required to operate an emergency

room where a state or local health planning agency had found that this would unnecessarily duplicate emergency services and facilities that were adequately provided by another medical institution in the community could still qualify for exemption as a charitable organization based on other significant factors, including a board of directors drawn from the community, an open medical staff policy, treatment of persons paying their bills with the aid of public programs like Medicare and Medicaid, and the application of any surplus to improving facilities, equipment, patient care, and medical training, education, and research, indicate that the hospital is operating exclusively to benefit the community.

More generally, Revenue Ruling 83-157 also noted that certain specialized hospitals, such as eye hospitals and cancer hospitals, offer medical care limited to special conditions unlikely to necessitate emergency care and do not, as a practical matter, maintain emergency rooms. Revenue Ruling 83-157 stated that these organizations may also qualify for exemption as a charitable organizations based on other significant factors that demonstrate that the hospitals operate exclusively to benefit the community.

Tax-Exemption and Community Benefit

The fact that nonprofit hospitals typically find themselves in competitive markets does not mean that they are principally commercial enterprises like for-profit hospitals. To be sure they are often competing for patients who are beneficiaries of large government financing programs like Medicare and Medicaid or who are members of private health plans. They also often face intense competition for private philanthropic support from a variety of other types of national, state and local nonprofit organizations. Despite competition, nonprofit hospitals continue to play a unique and critical role in our society.

The difference between nonprofit and for-profit hospitals has recently been called into question, but the difference is really quite simple: nonprofit hospitals exist to serve their communities, while for-profit ventures exist primarily to serve their investors. While it may seem elementary, this distinction is not a simple one that can be easily quantified through the cursory examination of charity care or other numbers. The community benefits provided by nonprofit hospitals extend far beyond the number of Medicaid patients they treat, their annual amount of charity and discounted care, and even the offering of typically unprofitable services like emergency care or burn care. The true community benefit of a nonprofit hospital is all of these things and more that come together to form a total composite of value for the community.

Nonprofit hospitals also engage in community outreach activities and programs in a variety of ways to promote wellness and improve the health status and well-being of their communities. Community benefit outreach efforts are not sought out for marketing purposes, or increasing potential patient visits for profitable services. Nonprofit hospitals seek ways to address these needs as part of their essential mission to serve the community. These outreach efforts are not typically uniform to all parts of the nonprofit hospital's geographic service area,, but instead are often specific to the mix of people in the communities

they serve. Some hospitals provide culturally sensitive services targeted to underserved immigrant populations in their region, others provide preventive care services in their community such as childhood fitness and screening in conjunction with school districts, others provide free car seats and training on their use, day care services, and outreach and counseling to the elderly. While the costs of such activities in actual dollars may vary widely, the effects and benefits they have in their communities can be immense, albeit very difficult to measure.

An additional challenge to determining the true community benefit of a nonprofit hospital centers around defining exactly what is the community in question. While most people define a community solely by the geographic region or catchment of the hospital, that is an oversimplification of the larger roles that nonprofit hospitals play. Nonprofit hospitals are heavily engaged in medical and health professions education, which serve the entire health care sector, as well as their specific geographic regions. Nonprofit hospitals are often at the forefront of research, not just in the clinical applications of new techniques and technology, but also research into improving patient outcomes, creating new efficiencies, preventive medicine and wellness activities, innovative access demonstration projects, and reducing medical errors. Through the extensive and intensive research being performed everyday by nonprofit hospitals, the entire healthcare industry benefits from the sharing of this knowledge, and achieves even greater degrees of efficacy and efficiency.

Another important type of community benefit is where a nonprofit hospital can demonstrate superior operating performance compared to other hospitals operating in its community with respect to one or more measures of cost, quality and/or patient satisfaction. Some nonprofit hospitals may also have, and be sharing with others, innovations in medical management or in other areas of operations. Excellent performance in various performance dimensions represents a benefit to current and potential future patients and can “raise the bar” for others, resulting in benefits for the broader community. The Alliance has conducted its own review of the research literature and has posted on its Web site, www.nonprofithealthcare.org, a summary of findings which strongly suggests overall superior performance by nonprofit hospitals on various cost, quality and service indicators that were studied.

In addition to this tapestry of community services, nonprofit hospitals also provide more intangible benefits. One essential assurance that for-profit enterprises can never guarantee with the same degree of certainty – nonprofit hospitals are typically permanent fixtures and health care providers in the community, and will not sell, close or move due to short-term fiscal pressures. One cannot put a price tag on community trust that the organization will stay to serve the community through thick or thin, that the organization’s business practices will be ethical, and that energies will be expended on a sustained basis by the organization to advocate public policies to improve

One final point requires emphasis. Tax exemptions and other special tax treatments are essential for ensuring that nonprofit hospitals have reasonable access to capital so that they can compete on a fairly level playing field with for-profit hospitals having access to the equity markets.

Observation on Proposed Alternatives

While some observers have chosen to focus their attention solely on the cost benefit analysis of charity care dollars provided in relation to the estimated dollar value of the tax-exempt benefit, the forgoing discussion is intended to underscore that this is not an accurate or appropriate measure of a nonprofit hospital's community benefit performance. If charity care dollars were to become the sole or primary measure of a hospital's community benefit, the system would then be encouraging a "lowest common denominator" approach that would force the hospital to shun unprofitable medical education and research, and shun innovative outreach efforts that could indeed help to reduce the very need for charity care, often provided in emergency rooms and other expensive care settings as a result of a lack of preventive, early detection and early treatment services. Moreover, the demographics of some communities are such that charity care would be far down the list of community health care priorities.

This model would also not encourage hospitals to apply funds back into their facilities, new technologies, research, and the provision of high level specialized care. The ultimate result could be that a charity care-only model of determining community benefit would encourage hospitals to provide emergency triage services, and scale back their efforts to innovate and invest in better facilities and technology.

Accordingly, it is essential that any modifications to the current system of determining community benefit allow nonprofit hospitals the flexibility necessary to address fluctuating health needs in their communities in relation to their operational needs and their financial capabilities at any point in time.

Very few observers have advocated the total elimination of tax-exemptions for hospitals, or for only allowing the exemption in the case of academic medical centers and research intensive hospitals. Can one really imagine what our health care system would be like without a strong hospital sector that puts communities ahead of profits? Can one imagine the consequences of the loss of the predominately nonprofit hospital sector which, together with physicians and other health care practitioners, have made our system the best in the world, despite its shortcomings?

The Alliance for Advancing Nonprofit Health Care strongly urges the Committee to ask the appropriate Federal agencies and bodies to undertake a far more detailed study if any changes to the current model are to be seriously contemplated.

Conclusion

The Alliance for Advancing Nonprofit Health Care would be pleased to work with the Committee to determine which areas, if any, of the current system of reporting and oversight may need to be strengthened

The Alliance strongly believes that the current system is not broken, and that the flexibility inherent in the community benefit model is its greatest strength. The IRS has done a commendable job of working with the nonprofit health care sector to preserve the focus on their community benefit mission, and the flexibility needed by hospitals to address their individual community health needs. While the IRS might benefit from a wider array of options in providing corrective guidance and measures to hospitals, we would encourage the Committee to work with them to avoid implementing bright-lines that could have unintended adverse consequences.

We commend the Committee for taking the time to examine this important sector of health care, and would be happy to work with the Committee throughout its deliberations, and to try and answer any questions it might have. The Alliance would also be pleased to discuss with you the voluntary guidance that we have already developed for our members on community benefits and governance and any ways in which such guidance might be embellished.

Thank you.

MEMBERS OF THE ALLIANCE FOR ADVANCING NONPROFIT HEALTHCARE

The Voice for Nonprofit Hospitals, Health Plans and Others in Healthcare
Serving Their Communities, Not Stockholders

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Alliance of Catholic Health Care
Cleveland Clinic
Colorado Physicians' Insurance Company
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Fallon Community Health Plan
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Group Health Cooperative
Henry Ford Health System
Illinois Blue Cross Blue Shield
Jewish Guild for the Blind
Kaiser Permanente
Latrobe Area Hospital
The Lifetime Healthcare Companies

Massachusetts Blue Cross Blue Shield
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Rehabilitation Institute of Chicago
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