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TO: WHA Member Executive

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SUBJECT: IRS Compliance Questionnaire -- A Sign of Things to Come?

As reported in the May 26, 2006 Valued Voice, the IRS recently sent a "Compliance Check Questionnaire" (Form 13790) to approximately 600 tax-exempt hospitals across the country requesting that they voluntarily respond. We are aware of three hospitals in Wisconsin that have received Form 13790 and are in the process of preparing their replies to this rather lengthy and involved Questionnaire.

The Questionnaire appears to be a direct result of Congressional investigations by the Senate Finance Committee and the House Ways & Means Committee during 2005 into the accountability, governance and oversight of tax-exempt organizations, specifically including hospitals. The most vocal proponent of these investigations has been Senator Charles Grassley (R-IA), Chairman of the Senate Finance Committee, who sent letters to 10 of the largest healthcare systems in May 2005 asking for much of the same information now requested in Form 13790.

Senator Grassley is not satisfied or done. On June 1, 2006 he sent letters to the IRS Chief Counsel and the Commissioner of its Tax-Exempt and Grant Entities Division encouraging the IRS to use its authority relative to exempt organizations "more frequently and expeditiously." Senator Grassley's efforts are directed at more than just health care organizations, but clearly health care are one of his prime targets: both for general exempt issues such as compensation, political activity and lobbying restrictions; and specifically on charity care and billing practices.

Although most hospitals have not received Form 13790, all tax-exempt hospitals should be aware of its content and be prepared to respond to its questions. The public eye is certainly sharpening its focus on hospital tax-exemptions the IRS is being pressured to undertake more enforcement and there is talk of legislative change, including mandatory reporting of this type. It is incumbent on hospitals to join this debate to help shape its course and hopefully prevent more draconian measures.

Hospitals can take several steps. First, participate in WHA's Community Benefits Reporting process. The final report later this summer will tell our stories on a statewide basis. Second, get the good news out locally and to your political representatives. Third, get the news out to the IRS by paying more attention to the annual Form 990 filing. Part III of Form 990 has long asked for hospitals to describe their tax-exempt activities and programs and the related expenditures. Too many hospitals pay too little attention to reporting their community benefits to the IRS, and through the public availability of the 990, the general public.

Overview of Questionnaire

The Questionnaire is divided into the following main topic areas:

1. Operations (type of hospital and patient base)
2. Emergency Room Policies
3. Board of Directors
4. Medical Staff Privileges
5. Medical Research
6. Professional Medical Education and Training
7. Uncompensated Care
8. Billing Practices
9. Community Programs
10. Compensation Practices

The IRS cover letter included with Form 13790 includes an explanation of the process. The stated purpose is to determine whether the organization is adhering to recordkeeping and information reporting requirements and whether its activities are consistent with stated tax-exempt purposes. A Compliance Check does not consist of a review of underlying books and records, as does an "examination" or audit. The cover letter states that completing the Questionnaire is "voluntary" and that there is no penalty for not responding. However, the IRS then states, "we have the option of opening a formal examination, whether or not the organization agrees to participate in a compliance check." We would advise all hospitals who receive the Questionnaire to respond.

There are a number of questions that will require some data gathering but are relatively straightforward. These include: the types and volumes of patients, emergency room services, board of directors composition, medical staff privileging and medical research and education activities. Likewise there are a series of questions on community programs that will require some additional data gathering and perhaps cost finding (or estimating) to fully reply to questions such as: *"how much did your hospital spend on medical screening programs for the community?"* or, *"how much did your hospital spend on lectures, seminars and other educational programs for the community?"*

Some of the more sensitive questions to answer are those involving uncompensated care and billing practices. Sensitive, not because there are likely to be tax-exemption issues arising out of common practices in the industry, but rather due to "environmental" reasons. Specifically, the implication of the answers given relative to issues raised by the largely failed charity care litigation, and second, the regulatory and policy call for price transparency. Form 13790 will not be a public document, as are the Form 990s filed by exempt hospitals. However, it could be discoverable in the context of specific litigation. Further, even if a hospital is never required to file a Form 13790, these types of questions are being asked in the public policy debate and the industry must be prepared to respond in an appropriate and constructive manner.

Responding to the specific questions on billing practices in Form 13790 is further complicated by the disconnect between the nature of the questions and the way the industry and payment practices work. Question 52 asks, "Did your hospital charge all patients the same price for the same services? -- Yes or No." If this question is answered Yes, then the subsequent questions on billing practices can be skipped. If it is answered No, then four questions must be answered which focus on whether the hospital charged patients with or without private insurance more or less than they charged Medicare and Medicaid patients.

The answer to the initial question 52 depends on the definition of "charge," which is not provided - gross or net? The questions seem completely oblivious to the reality of the industry. If charges are the hospital's gross charge used to meet the Medicare uniform charge rules, then the answer to this question must be yes. Yet those familiar with the industry realizes that hardly anyone pays this amount. Private insurance patients usually obtain some discount. The amount the hospital "charges" to Medicare or Medicaid is generally irrelevant to what the hospital gets paid. Typically it gets paid far less than the total stated charges and sometimes less than cost. Although a bill may be issued to an uninsured patient listing total charges, hospitals are rarely paid this amount and frequently discount significantly from these "charges," if they are paid at all. Is the net price the charge, such that all patients are not charged the same price?

The prudent reply to these questions will not be a simple yes or no without any, or with the bare minimum of explanation. Rather, the answer should be provided with an explanation of these circumstances and the hospital policies and practices for dealing with these difficult issues.

The Form also includes a series of questions about the timing of the hospital's billing and collection practices, including: how many notices are sent out when accounts are sent to collection agencies and whether installment payment arrangements are used. The answers to these questions, of course, all also implicate the Medicare guidelines for allowing bad debt expense. These answers should be reviewed to ensure they (and the hospital's practices) are consistent with Medicare's requirements.

Finally, the last section of Form 13790 addresses compensation practices. The questions must be answered as they pertain to employees in the hospital who are disqualified persons under the intermediate sanctions law. The schedule requested is similar to the Part V compensation schedule in the annual Form 990. So hospitals should be sure to coordinate consistent answers when the Form 990 is filed for the same period reported on Form 13790. Unlike Form 990, the compensation practices section does not request information about compensation paid by related organizations. However, it may be prudent to include this information in the same way it would be reported on the hospital's Form 990.

The Form goes on to request information about who determines compensation for these individuals within the organization and what sorts of resources and information are used to set that compensation and confirm that it is within market value ranges. Interestingly,

the Form does not inquire whether the hospital uses any form of incentive or net earnings based compensation.

The Form also includes an "insider dealing" section by asking whether the hospital has a "business relationship" with any of its officers, directors, trustees or key employees, other than their position as such. The term business relationship is not defined here; however, the nature of the question is similar to Part III of Schedule A on the annual Form 990. Part III, however, includes within its scope financial relationships with other entities with which its board and officers may have ownership or executive positions. Form 13790 is apparently limited only to business relationships directly with the individuals. Although this distinction could be used in responding to this question, it may be prudent to take the broader view and provide the same disclosures that are included on Part III of Schedule A.

Conclusion

Public disclosure has always been a part of the tax-exempt hospital's world. It is part of the price for tax-exemption. The Form 990 has always been available to the public through the IRS and for 20 years now from the hospital's main business office. The hospital's tax-exemption application is also subject to public inspection. The Medicare cost report is also available through Freedom of Information Act requests. Public policy winds are blowing in the direction of expanded transparency and disclosure. Hospitals must be prepared to deal with this and will be best served by proactively addressing the challenge. Our community hospitals do many good things that justify their exemption. However, if the industry does not help shape public perception and take the message of its many good deeds to the public, it may be forced into more onerous disclosure requirements, or possibly erosion of exemption benefits.