Uncharitable Hospitals: Why the IRS Needs Intermediate Sanctions to Regulate Tax-Exempt Hospitals

Rachel Weisblatt
Boston College Law School, rachel.weisblatt@bc.edu

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UNCHARITABLE HOSPITALS: WHY THE IRS NEEDS INTERMEDIATE SANCTIONS TO REGULATE TAX-EXEMPT HOSPITALS

Abstract: Tax-exempt hospitals receive millions of dollars worth of tax breaks each year for the purpose of providing care to their communities. Despite these tax breaks, however, there is little evidence to suggest that such breaks significantly benefit the hospitals’ communities. When a hospital no longer meets the federal standard for tax exemption, the Internal Revenue Service currently has two enforcement options: (1) do nothing; or (2) move to revoke the hospital’s tax-exempt status. Revocation, however, is a harsh option that is not appropriate for every circumstance where a hospital fails to meet one or more of the requirements for exemption. As a result, many tax-exempt hospitals fail to meet the exemption standard but do not have their tax-exempt status revoked. Commentators have recommended modifying the qualifying standard for hospital tax exemption to address this growing problem. This Note takes a different position and argues that Congress should give the IRS statutory authority to impose excise tax intermediate sanctions on underperforming hospitals as an enforcement tool short of revocation. Intermediate sanctions would provide the IRS with the flexibility to regulate the boundaries of a hospital’s tax-exempt status while ensuring that communities continue to benefit from the services of tax-exempt hospitals.

INTRODUCTION

In the late 1990s, Sondra Henderson was unemployed and struggling to make ends meet after a divorce destroyed her family business. After seeking treatment for her heart condition at Yale-New Haven Hospital, Ms. Henderson—while uninsured—was sued by the hospital in its effort to recover the $4000 costs of her treatment. In addition, the hospital placed a lien on Ms. Henderson’s home without her knowledge and initiated foreclosure proceedings to satisfy the debt. Ms. Henderson appealed to relatives to help her pay a lump sum to settle the debt—the $4000 along with growing interest, foreclosure expenses, and attorney’s fees. The day after Yale-New Haven’s attorneys received Ms. Henderson’s $10,313 payment, they nailed a foreclosure sign to a

2 Id.
3 Id.
4 Id. at 7.
tree in front of her house, claiming that she was still liable for $875 in attorney’s fees. Ultimately, Ms. Henderson paid her own attorney $1000 to get the hospital to drop its additional claim.

It is clear from this episode that Yale-New Haven Hospital acted in violation of its mission as a tax-exempt “charitable” organization. Under Section 501(c)(3) of the Internal Revenue Code, hospitals are exempted from federal taxation as “charitable” organizations if they meet the “community benefits” standard. Under this standard, hospitals must promote health in a manner that benefits the whole community and are prohibited from acting in ways that solely benefit the organization economically. The IRS considers multiple factors—with no one factor being determinative—to determine whether a hospital merits tax-exempt status.

Despite the existence of the community benefits standard, tax-exempt hospitals routinely act in ways that stretch or violate the standard and the IRS has no meaningful way to redress this problem. When a hospital does not meet the standard, the IRS currently has two enforcement options: (1) do nothing; or (2) move to revoke the hospital’s tax-exempt status. Revocation,

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5 Id.
6 Id.
7 Id. at 1; see I.R.C. § 501(c)(3) (2012) (providing the tax exemption for certain charitable organizations). Yale-New Haven Hospital is Connecticut’s largest, most prestigious hospital. CONN. CTR. FOR A NEW ECON., supra note 1, at 1. Its state and federal tax exemptions are estimated to be worth millions of dollars. Id.
11 See I.R.C. § 501; Mary Crossley, Tax-Exempt Hospitals, Community Health Needs and Addressing Disparities, 55 HOW. L.J. 687, 691 (2012); George A. Nation, III, Non-Profit Charitable Tax-Exempt Hospitals—Wolves in Sheep’s Clothing: To Increase Fairness and Enhance Competition in Health Care All Hospitals Should Be For-Profit and Taxable, 42 RUTGERS L.J. 141, 170 (2010); Thai, supra note 10, at 770–71.
12 See Berg, supra note 8, at 382; David M. Studdert et al., Regulatory and Judicial Oversight of Nonprofit Hospitals, 356 NEW ENG. J. MED. 625, 626 (2007); David A. Levitt, Excess Benefit Transactions Under Section 4958 and Revocation of Tax-Exempt Status, PRAC. TAX LAW., Spring 2009, at 13, 14.
however, is a harsh option that is not appropriate for every circumstance. As a result, many tax-exempt hospitals fail to meet the exemption standard but are not subjected to revocation.

To remedy this problem, the IRS needs authority to impose intermediate sanctions on hospitals. Intermediate sanctions would allow the IRS to tailor penalties for a specific violation. Moreover, where the community benefits standard is very flexible, the IRS, too, needs flexible tools to enforce it.

This Note explains why the IRS has been unsuccessful in regulating tax-exempt hospitals’ activities and proposes a solution that would ensure that citizens and communities benefit from their services. Part I begins by examining the legal framework that hospitals must follow to obtain federal tax-exempt status. Part I also examines the IRS’s limited options in enforcing the community benefits standard. Part II then discusses how the IRS’s lack of enforcement options allows hospitals to act uncharitably. Finally, Part III argues that Congress should enact legislation that enables the IRS to use intermediate sanctions to bring the actual behavior of tax-exempt hospitals in line with the expected behavior of a “charitable” organization.

I. REQUIREMENTS FOR HOSPITAL TAX EXEMPTION AND THE IRS’S RELATED ENFORCEMENT POWERS

In 1954, Congress enacted Section 501 of the Internal Revenue Code, creating the modern statutory tax exemption for selected organizations, including nonprofit hospitals. Specifically, Section 501(a) creates a federal income tax

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13 See Berg, supra note 8, at 382 (discussing how the IRS has only sought revocation in egregious circumstances); Studdert et al., supra note 12, at 626 (noting the severity of revocation); Levitt, supra note 12, at 14 (highlighting that revocation may not be appropriate for every circumstance).

14 See Berg, supra note 8, at 382; Studdert et al., supra note 12, at 626; Levitt, supra note 12, at 14.

15 See The Tax-Exempt Hospital Sector: Hearing Before the H. Comm. on Ways and Means, 109th Cong. 9 (2005) [hereinafter Tax-Exempt Hospital Sector] (statement of Mark Everson, Commissioner, Internal Revenue Service) (calling for increased enforcement flexibility to better regulate hospitals through intermediate sanctions); Studdert et al., supra note 12, at 626 (discussing the use of intermediate sanctions for related violations).

16 See Berg, supra note 8, at 382; Studdert et al., supra note 12, at 626; Levitt, supra note 12, at 14.

17 See Berg, supra note 8, at 382; Studdert et al., supra note 12, at 626; Levitt, supra note 12, at 14.

18 See infra notes 23–243 and accompanying text.

19 See infra notes 23–72 and accompanying text.

20 See infra notes 73–92 and accompanying text.

21 See infra notes 93–161 and accompanying text.

22 See infra notes 162–243 and accompanying text.

exemption for certain types of organizations described in Section 501(c)(3). 24 “Charitable” organizations qualify for the exemption. 25 To qualify as charitable, the organization must meet an organizational test and an operational test. 26 An organization satisfies the organizational test if its articles of organization limit its purpose to one or more of the exempt purposes listed in Section 501(c)(3) and restrict the organization from engaging in more than an insubstantial amount of non-exempt activities. 27 An organization satisfies the operational test if it engages primarily in activities that accomplish one or more of the exempt purposes listed in Section 501(c)(3) and its net earnings do not inure to the benefit of private individuals or shareholders. 28 If a tax-exempt organization’s net earnings inure to the benefit of private individuals or shareholders—thereby failing both the organizational and operational tests—the IRS can impose intermediate sanctions before moving to revoke an organization’s status. 29 If these tests are satisfied, however, a hospital is considered a charitable organization and receives an exemption. 30

Congress and the IRS frequently expound upon the precise conditions that hospitals must meet to be considered charitable under Section 501(c)(3). 31 For example, over the years, the IRS has issued guidance about its expectations for tax-exempt hospital behavior. 32 In addition, in 2010, Congress amended the Internal Revenue Code to add several new actions that hospitals must perform

\[24\text{ I.R.C. § 501(a), (c)(3). Although this Note focuses on organizations that have obtained or seek to obtain tax-exempt status by operation of § 501(c)(3), the § 501(a) exemption is not limited to such organizations. See id.}
\[25\text{ Id. § 501(c).}
\[26\text{Treas. Reg. § 1.501(c)(3)-1(a) (as amended in 2008); Floyd, supra note 8, at 24. Eligible organizations also must refrain from lobbying for legislation and participating in political campaigns. I.R.C. § 501(c).}
\[27\text{Treas. Reg. § 1.501(c)(3)-1(b) (as amended in 2008); see Floyd, supra note 8, at 24. In addition to charitable organizations, religious, scientific, literary, and educational organizations are also considered to be organized for exempt purposes. I.R.C. § 501(c)(3).}
\[28\text{Treas. Reg. § 1.501(c)(3)-1(c) (as amended in 2008); see Floyd, supra note 8, at 24.}
\[29\text{See I.R.C. § 501 (2012); id. § 4958 (2012); Berg, supra note 8, at 382. For a detailed discussion on intermediate sanctions, see infra notes 129–161 and accompanying text.}
in order to qualify for tax-exempt status. This ad-hoc collection of requirements is called the community benefits standard, and hospitals are required to satisfy this standard in addition to the other statutory requirements of Section 501(c)(3) in order to obtain tax-exempt status.

The government's tax exemption for nonprofit hospitals is grounded in two primary justifications. First, under government subsidy theory, the tax exemption is justified because it relieves the government from the obligation of performing necessary functions for society that it would otherwise have to perform; this relief counterbalances the government's lost tax revenues. Second, the exemption is often justified as necessary to safeguard against depersonalized medicine, which prioritizes turning a profit over treating patients. This makes sense because, where for-profit hospitals have a primary goal of profit maximization, tax exemption can promote the incidence of non-profit hospitals which, alternatively, are exclusively committed to providing quality health care rather than seeking profits. Conversely, tax-exempt hospitals purport to serve the broad needs of society as opposed to the economic interests of their organizers.

This Part explains the standard and enforcement mechanisms for hospital tax exemption. Section A examines the community benefits standard and the new requirements that emerged from the 2010 amendment to the I.R.C. Then, Section B explores the IRS's limited enforcement mechanisms.

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33 See Patient Protection and Affordable Care Act § 9007; I.R.C. § 501(r) (codified as amended I.R.C. § 501); id. § 4959 (2012); id. § 6033(b) (2012); Nina J. Crimm, Evolutionary Forces: Changes in For-Profit and Not-for-Profit Health Care Delivery Structures: A Regeneration of Tax Exemption Standards, 37 B.C. L. REV. 1, 54 (1995) (discussing how the IRS determined that a hospital deserved tax-exempt status prior to the 2010 amendments).

34 See Berg, supra note 8, at 381; Crimm, supra note 33, at 54.

35 See I.R.C. § 501(c)(3) (2012); Berg, supra note 8, at 381; Crimm, supra note 33, at 54; supra notes 25–30 (outlining the other statutory requirements for obtaining tax-exempt status).

36 U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-880, VARIATION IN STANDARDS AND GUIDANCE LIMITS COMPARISON OF HOW HOSPITALS MEET COMMUNITY BENEFIT REQUIREMENTS 1 (2008) [hereinafter GAO REPORT]; Gilbert, supra note 9, at 150; Karns, supra note 8, at 404–05; Nation, supra note 11, at 158–59.

37 GAO REPORT, supra note 36, at 1 (“The exemption is based on the principle that the government’s loss of tax revenues is offset by its relief from financial burdens that it would otherwise have to meet with appropriations from public funds, and by the benefits resulting from the promotion of general welfare.”); Gilbert, supra note 9, at 150; Karns, supra note 8, at 519.

38 See Karns, supra note 8, at 404–05.

39 See id.

40 Gilbert, supra note 9, at 150; see Karns, supra note 8, at 404–05.

41 See infra notes 44–92 and accompanying text.

42 See infra notes 44–72 and accompanying text.

43 See infra notes 73–92 and accompanying text.
A. The Community Benefits Standard: A Flexible Approach to Hospital Tax Exemption

In order to obtain tax-exempt status as charitable organizations, hospitals must first satisfy the community benefits standard.44 Although the I.R.C. does not define the term “charitable,” the IRS has explained that the “promotion of health” is a charitable purpose because it generally benefits the community as a whole.45 Regardless of the level of free care offered, a hospital is considered organized and operated exclusively for charitable purposes so long as the class of persons it serves is broad enough that the whole community benefits.46

Under this standard, the IRS recognizes six hospital practices as providing community benefits: (1) operating an emergency room open to all; (2) providing care to all persons who are able to pay; (3) accepting patients enrolled in public programs like Medicare and Medicaid; (4) creating a board of trustees composed of independent civic leaders; (5) providing for an open medical staff with privileges available to all qualified persons; and (6) reinvesting any surplus funds into operations to improve the quality of patient care.47 Accordingly, the IRS conducts a fact-sensitive inquiry when evaluating

46 Rev. Rul. 69-545, 1969-2 C.B. 118 (stating the “[t]he promotion of health . . . 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, such as indigent members”).
47 Id.; see GAO REPORT, supra note 36, at 11; Berg, supra note 8, at 381–82; Noble et al., supra note 8, at 118. The IRS established the community benefits standard in one of its Revenue Rulings in 1969. Rev. Rul. 69-545, 1969-2 C.B. 118. Revenue Rulings are official IRS interpretations that represent the IRS’s conclusions about how the I.R.C. applies to a particular set of facts. Treas. Reg. § 601.601 (2001); Donald L. Korb, The Four R’s Revisited: Regulations, Rulings, Reliance, and Retroactivity in the 21st Century: A View from Within, 46 DUQ. L. REV. 323, 330 (2008). They differ from regulations, which function as general interpretative and policy statements. Korb, supra, at 332. For a detailed account of the history and policy behind IRS Revenue Rulings, see Kristin E. Hickman, IRB Guidance: The No Man’s Land of Tax Code Interpretation, 2009 MICH. ST. L. REV. 239, 243–46; Korb, supra, at 330–35. In particular, Revenue Ruling 69-545 examined the tax-exempt status of two hypothetical hospitals. Rev. Rul. 69-545, 1969-2 C.B. 117–18. Under the Revenue Ruling’s analysis, Hospital A is exempted from tax because it operates an emergency room open to all; provides hospital care to persons in the community who are able to pay for it; maintains an open medical staff; uses its surplus funds on expanding facilities, improving quality of care, and on medical training, education and research; and the hospital is operated by a board of trustees composed of independent civic lead-
whether a hospital meets these criteria—though the presence or absence of any one criterion is not determinative on the IRS’s final determination.\footnote{48}{Rev. Rul. 69-545, 1969-2 C.B. 117–18. There is considerable debate in the hospital industry about whether the community benefits criteria should evaluate whether the hospital has bad debt and Medicaid or Medicare shortfalls. \textsc{Cong. Budget Office, Pub. No. 2707, Nonprofit Hospitals and the Provision of Community Benefits} 3, 17 (2006) [hereinafter 2006 CBO Report] (noting how some industry experts consider Medicaid shortfalls to be a community benefit); \textsc{Courtney, supra} note 8, at 382–83 (discussing the conflicting positions of major U.S. hospital associations regarding inclusion of bad debt and shortfalls in the community benefits standard analysis); Nancy M. Kane, \textit{Tax-Exempt Hospitals: What Is Their Charitable Responsibility and How Should It Be Defined and Reported?}, 51 St. Louis U. L.J. 459, 465–66 (2007) (highlighting differences among U.S. hospital associations’ positions on bad debt and shortfalls). Bad debt represents uncollectible patient bills. \textsc{Courtney, supra} note 8, at 382. It is calculated as the difference between the amounts a hospital expects to receive as payment for services rendered and the actual payment a hospital receives. 2006 \textsc{CBO Report, supra}, at 2; \textsc{Courtney, supra} note 8, at 382. Similarly, Medicaid and Medicare shortfalls are the unreimbursed costs of services to Medicaid and Medicare beneficiaries. 2006 \textsc{CBO Report, supra}, at 17; \textsc{Courtney, supra} note 8, at 382. Shortfall is calculated as the difference between the cost a hospital incurs in treating a Medicare or Medicaid beneficiary and the actual payment it receives from Medicare or Medicaid as reimbursement. 2006 \textsc{CBO Report, supra}, at 17; \textsc{Courtney, supra} note 8, at 382. The IRS and the Centers for Medicare and Medicaid Services—the federal agency that administers these programs—have not taken positions on the issue, but both agencies allow hospitals to include data on bad debt and shortfall expenses when making these calculations. \textsc{Courtney, supra} note 8, at 382–83.}

Despite the enumeration of the above criteria, the IRS defines the community benefits standard as broadly as possible in recognition of the diverse needs of each tax-exempt hospital’s surrounding community.\footnote{49}{\textsc{Thai, supra} note 10, at 768; \textsc{see Rev. Rul. 83-157, 1983-2 C.B. 95; Rev. Rul. 69-545, 1969-2 C.B. 118.}}\footnote{50}{\textsc{See Rev. Rul. 83-157, 1983-2 C.B. 94; \textsc{Karns, supra} note 8, at 404. This was not always the case. \textsc{See E. Ky. Welfare Rights Org. v. Simon}, 506 F.2d 1278, 1289 (D.C. Cir. 1974), \textit{vacated}, 426 U.S. 26 (1976); \textsc{Rev. Rul. 69-545, 1969-2 C.B. 117–18. Prior to 1983, the community benefits standard required a tax-exempt hospital to operate an emergency room open to all, regardless of one’s ability to pay. \textsc{See E. Ky. Welfare Rights Org.}, 506 F.2d at 1289. This change was somewhat controversial because in 1974, in \textit{Eastern Kentucky Welfare Rights Organization v. Simon}, the United States Court of Appeals for the D.C. Circuit upheld the IRS’s broad definition of “charitable” in part because the standard then in place required hospitals to provide a minimal level of free care through the operation of an emergency room open to all, regardless of the ability to pay. \textsc{See id.} The community benefits standard as currently formulated has never been challenged, however. \textsc{See Goodman, supra} note 30, at 719–20.}} For example, a hospital that does not operate an emergency room can still qualify for a tax exemption if a state agency determines that an additional emergency room would duplicate services already being provided elsewhere in the community.\footnote{50}{\textsc{This is particularly important for many specialty hospitals that lack emerg-}...
ergency rooms (e.g., surgical facilities) or other hospitals that typically treat very few Medicare patients (e.g., children’s hospitals).\footnote{See Rev. Rul. 83-157, 1983-2 C.B. 95; Karns, supra note 8, at 404.} Thus, given the broad interpretation of the community benefits standard, a hospital can obtain tax-exempt status as a charitable organization even if it does not provide any charitable care.\footnote{See Rev. Rul. 83-157, 1983-2 C.B. 94–95; Rev. Rul. 69-545, 1969-2 C.B. 118.}

In addition to the community benefits standard, hospitals also must comply with the provisions of the Patient Protection and Affordable Care Act (ACA) to maintain their tax-exempt status.\footnote{See Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 9007, 124 Stat. 119, 128 (2010), amended by Healthcare and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (2010) (adding provisions to the Internal Revenue Code regarding tax-exempt hospitals). Passed in 2010, the ACA introduced comprehensive reforms to the U.S. health insurance system, including the imposition of new requirements on tax-exempt hospitals. See id. Section 9007 of the ACA added § 501(r) and § 4959 to the Internal Revenue Code and amended § 6033(b). Id. Section 501(r) details several new requirements that hospitals must meet to receive or retain tax-exempt status. I.R.C. § 501(r) (2012). The provisions of § 501(r) became effective for tax years beginning after March 23, 2010, except for the community health needs assessment (“CHNA”) requirement, which became effective for tax years beginning after March 23, 2012. Id. Sections 4959 and 6033(b) deal with the monitoring and enforcement associated with § 501(r). Id. § 4959 (2012); id. § 6033(b) (2012). The IRS and the Treasury Department recently proposed rules to guide hospitals in the implementation of § 501(r). Prop. Treas. Reg. § 1.501(r)-1–7, 77 Fed. Reg. 38,148, 38,160–69 (June 26, 2012). The IRS and Treasury Department solicited comments and instructed taxpayers to rely on the proposed regulations unless or until final or temporary regulations are issued. Additional Requirements for Charitable Hospitals, 77 Fed. Reg. at 38,159; see, e.g., Letter from Melinda Reid Hatton, Senior Vice President, Am. Hosp. Ass’n, to IRS (Aug. 23, 2012) [hereinafter American Hospital Association Comment], available at http://www.regulations.gov/#!docketDetail;D=IRS-2012-0036 (responding to request for comments on § 501(r)). The rules clarified that the new legislation did not replace the requirements on tax-exempt hospitals that were already in place. Additional Requirements for Charitable Hospitals, 77 Fed. Reg. at 38,148. Accordingly, hospitals must continue to comply with the community benefits standard as well as the new ACA requirements. See Rev. Rul. 69-545, 1969-2 C.B. 117–18; Additional Requirements for Charitable Hospitals, 77 Fed. Reg. at 38,148; D. Greg Goller & Scott M. Sherman, Thoughts and Comments on New Section 501(r), 22 TAX’N OF EXEMPTS 13, 14 (2010).} The ACA mandates certain behavior and places new constraints on the activities of tax-exempt hospitals.\footnote{See I.R.C. § 501(r). Unlike the Senate Finance Committee’s initial proposal, the new law does not require hospitals to provide a minimum level of free, charitable care in exchange for their charitable tax exemption. See id.; Crossley, supra note 11, at 693; Michael N. Fine & Christopher M. Jedrey, Hospital Exemption Under Section 501(r) Remains a Work in Progress, 24 TAX’N OF EXEMPTS 34, 34 (2012).} First, it requires a tax-exempt hospital to conduct a community health needs assessment (“CHNA”) every three years and to make its findings widely available to the public.\footnote{I.R.C. § 501(r).} Specifically, the CHNA should consider input from various representatives from the community that the hospital serves—including
public health experts.\textsuperscript{56} Thereafter, the hospital must adopt an “implementation strategy” that is designed to meet the community’s health needs as identified in the CHNA,\textsuperscript{57} and the hospital must submit a report to the IRS describing how it is addressing the needs identified in its CHNA.\textsuperscript{58} If a hospital fails to comply with the CHNA requirement, it is subject to a $50,000 excise tax.\textsuperscript{59}

Second, under the ACA, tax-exempt hospitals are required to adopt a written financial assistance policy and an emergency care policy.\textsuperscript{60} A hospital’s financial assistance policy complies with the ACA if it specifies the type of financial assistance that is available and the eligibility criteria that an individual must meet to receive such assistance.\textsuperscript{61} The statute and the proposed rules do not establish any specific eligibility criteria that a hospital’s financial assistance policy must meet, nor do they mandate a fixed amount or type of financial assistance a hospital must provide.\textsuperscript{62} In a hospital’s emergency care policy, the hospital must obligate itself to provide emergency medical services to all persons, regardless of ability to pay or eligibility for financial assistance.\textsuperscript{63} The emergency care policy also must prohibit debt collection activities from occur-

\textsuperscript{56} Id.
\textsuperscript{57} Id.
\textsuperscript{58} Id. \textsection 6033(b). In addition, the report must include a statement of any needs that are not being addressed and the reasons why such needs are being overlooked. Id.
\textsuperscript{59} Id. \textsection 4959 (2012). The proposed regulations do not address the application of the excise tax. See Additional Requirements for Charitable Hospitals, 77 Fed. Reg. 38,148, 38,150–51 (June 26, 2012). In a Notice and Request for Comments, the IRS advised that it planned to impose the $50,000 excise tax on hospitals that fail to conduct CHNAs in any three-year period. I.R.S. Notice 2011-52, 2011-30 I.R.B. 60, 65. For example, if a hospital does not conduct CHNAs in 2011, 2012, 2013, and 2014, it will be subject to an excise tax for both the 2013 or 2014 taxable years. See id. Section 4959’s $50,000 excise tax is the only new remedy for the IRS to enforce the ACA’s additional requirements. See I.R.C. \textsection 501(r) (2012); id. \textsection 4959; id. \textsection 6033(b) (2012); I.R.S. Notice 2011-52, supra, at 65.
\textsuperscript{60} I.R.C. \textsection 501(r).
\textsuperscript{61} Id.; Prop. Treas. Reg. \textsection 1.501(r)-4, 77 Fed. Reg. 38,148, 38,161 (June 26, 2012). The financial assistance policy must discuss: (1) the hospital’s eligibility criteria for financial assistance; (2) the basis for calculating fees to patients; (3) the method patients must follow to apply for financial assistance; (4) for hospitals that lack a separate billing and collections policy, actions that the hospital may take if a patient fails to pay; and (5) the measures that the hospital will take to widely publicize the policy within the community it serves. Prop. Treas. Reg. \textsection 1.501(r)-4, 77 Fed. Reg. at 38,161.
\textsuperscript{63} I.R.C. \textsection 501(r); Prop. Treas. Reg. \textsection 1.501(r)-4, 77 Fed. Reg. at 38,164. This requirement essentially mirrors existing federal law under the Emergency Medical Treatment and Labor Act (“EMTALA”). Fine & Jedrey, supra note 54, at 38; see 42 U.S.C. \textsection 1395dd (2012). EMTALA requires all hospitals—tax-exempt and for-profit—to provide stabilizing treatment to any individual who comes to the hospital with an emergency medical condition, regardless of the person’s ability to pay. 42 U.S.C. \textsection 1395dd. Section 501(r) states that a hospital’s financial assistance policy must require it to provide care for emergency medical conditions within the meaning of EMTALA. I.R.C. \textsection 501(r); see 42 U.S.C. \textsection 1395dd (defining “emergency medical condition” to include any severe condition that, if left without immediate treatment, could reasonably lead to “placing the health of the individual . . . in serious jeopardy”).
ring in places where they could interfere with the treatment of emergency medical conditions.  

Third, the ACA prohibits tax-exempt hospitals from applying gross charges to any health care services used by individuals who are eligible for financial assistance. In addition, the charges to such patients for emergency or medically necessary care are capped at the amounts generally billed to persons who have insurance coverage. Hospitals may choose between two methods of calculating the amount that is generally billed for a particular service. The “look-back” method uses actual past claims paid to the hospital—by both Medicare and private health insurers—to determine the applicable amount. Alternatively, the “prospective” method enables hospitals to estimate the amount that Medicare would reimburse the hospital for the care in question if the eligible patient were actually a Medicare fee-for-service beneficiary.  

Finally, tax-exempt hospitals are now prohibited from engaging in extraordinary collection actions before making a reasonable effort to determine a patient’s eligibility for financial assistance. Extraordinary collection actions occur when a hospital engages a legal or judicial process to procure payment of a hospital bill for care that is covered under the hospital’s financial assistance policy. It is also considered an extraordinary collection action to sell an

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66 I.R.C. § 501(r).
68 Id. Medicare is a federal insurance program that pays the costs of hospital care, related post-hospital care, home health services, and hospice care for individuals aged sixty-five or older. 42 U.S.C. § 1395c (2012). Medicare beneficiaries are individuals who enjoy Medicare insurance. See id. Providers that treat Medicare patients are reimbursed under a fee-for-service model at rates set by the Secretary of Health and Human Services. 42 U.S.C. § 1395g (2012).
70 I.R.C. § 501(r).
71 Prop. Treas. Reg. § 1.501(r)-6, 77 Fed. Reg. 38,148, 38,166 (June 26, 2012). Actions that require a legal or judicial process include: (1) obtaining a lien on an individual’s property; (2) foreclosing on an individual’s real property; (3) attaching or seizing an individual’s personal property; (4) commencing a civil suit against an individual; (5) causing an individual’s arrest; (6) subjecting an individual to a writ of body attachment; and (7) garnishing an individual’s wages. Id.
individual’s debt to a third party or to report adverse information about an individual to consumer credit reporting agencies.  

B. Revoke or Do Nothing: A Dearth of Options for Community Benefits Standard Enforcement

Although the IRS receives significant information regarding the activities of tax-exempt hospitals, it is limited in its enforcement options against a hospital that ceases to meet the community benefits standard. In response to such information, the IRS can either overlook the bad conduct or revoke the hospital’s tax-exempt status—there is no middle ground. Furthermore, the IRS does not have the ability to tailor penalties for a specific violation.

The IRS—recognizing that revocation is a drastic action with far-reaching effects—has determined that revocation of tax-exempt status is generally inappropriate when a hospital meets some but not all of the community benefits requirements. This hesitance to revoke tax-exempt statutes, however, has far-reaching effects: estimates as to the exact value of federal income tax exemptions for all charitable hospitals range from $6.1 billion to $50 billion.
over, these hospitals also are exempt from the federal unemployment payroll tax and the communications services excise tax. Additionally, many state and local governments exempt Section 501(c)(3) organizations from state and local sales, income, and property taxes. Correspondingly, when the IRS revokes a hospital’s tax-exempt status, many states and municipalities often follow suit. Thus, when a hospital’s tax-exempt status is revoked, it incurs large federal and state tax bills. As a result, these large tax bills may cause hospitals to reduce the quality of care provided to patients or even close.

The harm from revocation of tax-exempt status, however, is broader than simply the effects of new tax liabilities. Revocation of this status is also likely to affect the viability of the hospital’s ongoing grants that fund medical research and quality health care. This is the case because it is the hospital’s...
Section 501(c)(3) status that makes it eligible for both federal research grants and private grants from foundations. Revocation also removes the intangible benefits that correspond with being labeled as a tax-exempt charitable organization, such as the public’s increased trust and favorable perception of the hospital.

Moreover, revocation affects a hospital’s ability to raise capital. Donors prefer to give charitable contributions to Section 501(c)(3) organizations because they receive personal tax benefits when they calculate their own income tax, gift tax, and estate tax liability. As a result, revocation affects previous donors who anticipated significant tax benefits from their donations to a tax-exempt organization. These benefits disappear with revocation. Finally, revocation also removes a hospital’s ability to issue tax-exempt “qualified bonds,” which provide Section 501(c)(3) qualified organizations with an attractive way to raise capital. Given the wide-ranging effects of revocation, the IRS rarely takes action against hospitals that fail to fully meet the community benefits criteria because the results often exceed the severity of the infraction.

http://perma.cc/6NZW-L44U. An IRS revocation proceeding against a hospital signals to the NIH that the hospital is not a proper candidate for such grants. See Berg, supra note 8, at 382.}

85 Berg, supra note 8, at 380; Bloche, supra note 84, at 1048.

86 Berg, supra note 8, at 380.

87 See I.R.C. § 170 (2012); id. § 2055 (2012); id. § 2522 (2012); Crimm, supra note 33, at 7–8 n.19.

88 I.R.C. § 170 (establishing a deduction from income tax for charitable contributions); id. § 2055 (reducing estate tax liability by the amount of all charitable transfers); id. § 2522 (establishing a deduction from gift tax for charitable gifts); Crimm, supra note 33, at 7–8 n.19 (cataloging the special tax benefits available to § 501(c)(3) organizations). Specifically, individual and corporate donors are eligible to receive income tax deductions for charitable donations at the federal and state levels. See I.R.C. § 170; Gilbert, supra note 9, at 156. Additionally, individuals are not liable for any federal gift taxes on inter vivos transfers to tax-exempt organizations. Id. § 2522; Gilbert, supra note 9, at 156. Individuals may also receive credit on estate taxes at the federal and state levels for such donations. See I.R.C. § 2055; Gilbert, supra note 9, at 156.

89 Berg, supra note 8, at 382.

90 See I.R.C. § 170; id. § 2055; id. § 2522; Crimm, supra note 33, at 7–8 n.19.

91 See I.R.C. § 145 (2012); Crimm, supra note 33, at 7–8 n.19. A § 501(c)(3) organization may issue qualified bonds with lower-than-market interest rates that are still attractive in the market because the bonds’ after-tax rate of return will equal the market rate. See I.R.C. § 145.

92 See G. Edgar Adkins, Jr., Executive Compensation and the Intermediate Sanctions, 24 TAX’N OF EXEMPTS 26, 26 (2012) (describing revocation of status as the “death penalty” for tax-exempt organizations); Berg, supra note 8, at 382 (noting that the reluctance of the IRS to enforce the criteria is due to the draconian results of revocation); Studdert et al., supra note 12, at 626 (“The severity [of revocation proceedings] has tended to discourage its use.”); Levitt, supra note 12, at 14 (discussing the lack of IRS enforcement flexibility due to revocation proceedings’ excessive penalties); supra notes 77–91 and accompanying text (describing the wide-ranging effects of revocation). Individual states, however, have been far more active in challenging hospitals to provide concrete community benefits in exchange for their state tax exemptions, and revoking their status when they do not. Colombo, supra note 44, at 38–39; Nation, supra note 11, at 176.
II. THE FAILURE OF THE COMMUNITY BENEFITS STANDARD: HOW TAX-EXEMPT HOSPITALS ACT UNCHARITABLY

The IRS’s lack of enforcement flexibility has allowed tax-exempt hospitals to reap huge economic benefits without giving comparable benefits back to their communities.93 Remedies are being sought to address this problem.94 The IRS has been given enhanced enforcement authority in other areas.95 Section A first examines the ramifications of the IRS’s failure to adequately enforce the community benefits standard.96 Then, Section B discusses the use of intermediate sanctions to regulate the behavior of tax-exempt organizations.97 Section B further explains how intermediate sanctions could work to redress the IRS’s enforcement problem.98

A. Hospitals Behaving Badly: The Consequence of the IRS’s Failure to Properly Enforce the Community Benefits Standard

The IRS’s enforcement of the community benefits standard has allowed hospitals to act quite uncharitably.99 Most notably, the community benefits

93 See Colombo, supra note 44, at 51 (arguing that “the community benefit test does not perform the function of consistently identifying nonprofits that produce socially worthy outputs meriting reward via exemption”); Nation, supra note 11, at 174–75 (characterizing the tax exemption as “a bad deal for taxpayers” because the community benefits standard was the result of poor judgment and historical error); Thai, supra note 10, at 768–69 (blaming uncharitable tax-exempt hospital behavior on the “vague” wording and indecisive enforcement of the community benefits standard). Supporters of the community benefits standard, however, posit that the proliferation of for-profit hospitals into the health care market—not the community benefits standard—caused tax-exempt hospitals to employ “aggressive business decisions.” See Karns, supra note 8, at 494–95 (disagreeing with exemption critics who rebuke tax-exempt hospitals simply for utilizing sound business practices).

94 See Beverly Cohen, The Controversy over Hospital Charges to the Uninsured—No Villains, No Heroes, 51 VILL. L. REV. 95, 95–97 (2006); Crossley, supra note 11, at 691; Lisa Kinney Helvin, Caring for the Uninsured: Are Not-for-Profit Hospitals Doing Their Share?, 8 YALE J. HEALTH POL’Y L. & ETHICS 421, 424–27 (2008); Nation, supra note 11, at 175–76; Thai, supra note 10, at 772.

95 See Cohen, supra note 94, at 96–97; Helvin, supra note 94, at 424–27; Nation, supra note 11, at 175–76; Thai, supra note 10, at 772. Most states have adopted the federal tax exemption rules and community benefits standard. Nation, supra note 11, at 175. Moreover, the new I.R.C. § 501(r) enables the IRS to impose a $50,000 penalty on hospitals that fail to complete a community health needs assessment. I.R.C. § 501(r) (2012); Thai, supra note 10, at 772.

96 See infra notes 99–128 and accompanying text.

97 See infra notes 129–161 and accompanying text.

98 See infra notes 129–161 and accompanying text.

99 See M. Gregg Bloche, Health Policy Below the Waterline: Medical Care and the Charitable Exemption, 80 MINN. L. REV. 299, 359 (1995) (arguing that because hospitals have virtually unrestricted access to tax exemptions, the benefits function like a general government subsidy for hospital services); Colombo, supra note 44, at 41–42 (discussing how the community benefits standard fails to isolate differences between tax-exempt and for-profit hospital behavior); Karns, supra note 8, at 520 (concluding that the tax exemption has not achieved the goal of providing additional health care); Goodman, supra note 30, at 719 (criticizing the community benefits standard because it does not dif-
standard does not explicitly require hospitals to provide free care to qualify for tax exemption. Through the use of a flexible standard with no explicit charitable care requirements, the IRS has sought to recognize that each hospital is unique and has diverse needs that stem from its surrounding community. As a result, the flexibility of the community benefits standard allows specialty hospitals that benefit their communities in many ways but lack emergency rooms or have few or no indigent patients—such as surgical facilities and children’s hospitals—to obtain exemptions. Accordingly, the IRS anticipates that these tax-exempt hospitals will make up for the foregone taxes by serving their communities in other ways by, for example, conducting research or offering health education to the public. These other activities are expected to bestow tangible economic and social benefits to the community—as is necessary—in order to justify the government’s forfeiture of millions of dollars in tax revenue. In practice, however, there is rarely such a reciprocal exchange of benefits.

Although the IRS expects that a tax-exempt hospital with no charitable care would be the exception, this scenario is quite common. Many tax-exempt hospitals provide little free care, with some provide no free care whatsoever. In practice, most of the exceptional tax-exempt hospitals that provide significant charitable care are those that are government-run or serve as teaching hospitals—not private nonprofit hospitals. Thus, the responsibility of picking up the tab for care to indigent patients—as is it primarily performed by government and teaching hospitals, both of which are publically support-


104 See Courtney, supra note 8, at 366.

105 See Colombo, supra note 44, at 46–47; Karns, supra note 8, at 521; Nation, supra note 11, at 174. For example, in 2007, ten Massachusetts hospital companies received $638 million in tax benefits, which exceeded the value of community benefits they provided—including indigent care and other charity work—by more than $264 million. Courtney, supra note 8, at 366.

106 Cohen, supra note 94, at 103–04; Colombo, supra note 44, at 49.

107 See Cohen, supra note 94, at 103–04 (detailing investigational reports about tax-exempt hospitals that did not provide any charity care or failed to publicize their limited charity care programs); Colombo, supra note 44, at 47–49 (studying empirical data that shows the lack of differences between tax-exempt and for-profit hospitals); Nation, supra note 11, at 170–72 (arguing that the billions of dollars that tax-exempt hospitals save in taxes is ultimately paid by taxpayers).

108 Colombo, supra note 44, at 49.
ed—primarily falls on the government and taxpayers.\textsuperscript{109} The IRS, however, has no way to remedy this problem because of its “all or nothing” enforcement tools.\textsuperscript{110}

As a result, the IRS has been unsuccessful in challenging a medical organization’s Section 501(c)(3) status when the organization minimally meets the community benefits standard.\textsuperscript{111} In 1978, in Sound Health Ass’n v. Commissioner, the Tax Court determined that a medical organization must only minimally satisfy the community benefits standard in order to maintain its tax-exempt status.\textsuperscript{112} In South Health Ass’n, the organization was able to maintain its tax-exempt status even though it required prepayment for services that lacked a donative element and provided preferential medical treatment to its paying subscribers.\textsuperscript{113} The court reasoned that the organization minimally met the community benefits standard because it operated an emergency room open to all, established a research program that studied ways to improve health care delivery, maintained a medical staff open to all qualified physicians, and had a board of directors composed of prominent members of the community.\textsuperscript{114} After South Health Ass’n, it became clear that when a hospital minimally meets the community benefits standard, the IRS is powerless to change the hospital’s behavior.\textsuperscript{115}

The IRS is equally powerless when tax-exempt hospitals—engaging in particularly egregious behavior—flagrantly disregard the community benefits standard.\textsuperscript{116} One common—yet flagrant—course of action involves charging uninsured indigent persons much higher rates than the insured for the same

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\textsuperscript{109} Id.; Cohen, supra note 94, at 103–04.
\textsuperscript{110} See I.R.C. § 501 (2012); Sound Health Ass’n v. Comm’r, 71 T.C. 158, 159 (1978); Rev. Rul. 69-545, 1969-2 C.B. 118; supra notes 73–75 and accompanying text (describing the “all or nothing” enforcement tools of the IRS).
\textsuperscript{111} See, e.g., Sound Health Ass’n, 71 T.C. at 188.
\textsuperscript{112} See id. at 187–88. Sound Health Association operated as a Health Maintenance Organization (HMO), not a hospital. Id. at 174. The court determined, however, that the tests for granting HMOs tax-exempt status should be substantially similar to those applied to determine the status of hospitals. Id. at 178–79. As is the case with hospitals, the basis of an HMO’s tax-exempt status rests on its provision of charitable health care services. Id. at 179.
\textsuperscript{113} Id. at 167–68.
\textsuperscript{114} Id. at 184–85; see Rev. Rul. 69-545, 1969-2 C.B. 117.
\textsuperscript{115} See 71 T.C. at 187–88 (overruling the IRS and reinstating tax-exempt status to a hospital that minimally met the community benefits standard).
\textsuperscript{116} See Crossley, supra note 11, at 691 (noting accounts of hospitals treating indigent patients in a “distinctly uncharitable fashion”); Nation, supra note 11, at 170 (discussing charitable hospitals’ harsh treatment of the poor); Thai, supra note 10, at 770–71 (reviewing the high prices hospitals charge to uninsured patients and their predatory collection practices). See generally Cohen, supra note 94 (providing extensive discussion of the many investigational reports and newspaper articles that highlighted aggressive hospital practices); Helvin, supra note 94 (examining the highly publicized cases of egregious hospital behavior).
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services. Indigent patients routinely are denied non-emergency care if they are unable to pay upfront. Moreover, when treatment is provided before payment, tax-exempt hospitals often engage in aggressive collection techniques if the full bill is not paid on time. Such aggressive collection techniques can involve sending excessive letters, making repeated phone calls, suing patients, garnishing wages and bank accounts, and taking liens on patients’ homes. This problem is exacerbated by the reality that patients often do not realize how large their hospital bills will be. When they fill out financial aid paperwork prior to treatment, they assume—often incorrectly—that the procedures will be covered. Despite this dynamic, the IRS remains reluctant to take enforcement action against tax-exempt hospitals that engage in such practices because revocation is such a drastic step and the hospitals may otherwise be meeting community benefits standards. Federal courts have also been unwilling to get involved to prevent these uncharitable practices.

117 Nation, supra note 11, at 170. Hospitals are required to formulate a “chargemaster,” which is a list of prices for their health care services. STAFF OF S. COMM. ON FIN., supra note 77, at 13. Private insurance companies negotiate their reimbursement rates with hospitals and receive large discounts off the “chargemaster” price. Id.; Cohen, supra note 94, at 100; Helvin, supra note 94, at 424. Medicare and Medicaid also set their own reimbursement rates, which are typically lower than the “chargemaster” rates. STAFF OF S. COMM. ON FIN., supra note 77, at 13; Cohen, supra note 94, at 100; Helvin, supra note 94, at 424. Alternatively, uninsured patients are charged the full “chargemaster” rates. STAFF OF S. COMM. ON FIN., supra note 77, at 13 (noting that self-paying patients are sometimes charged two or three times more than private and public payers for the same services); Cohen, supra note 94, at 101 (“Through ‘the insanity of the system,’ uninsured patients, those who are least able to pay, are charged at the highest point of the rate scale.”); see Helvin, supra note 94, at 424 (explaining how 1980s reforms that cut hospital reimbursement rates from third-party payers caused hospitals to aggressively seek full payment from self-paying patients).

118 Nation, supra note 11, at 170.

119 Id.; Thai, supra note 10, at 770–71.

120 Thai, supra note 10, at 771. For example, in one year, Carilion Clinic, a Virginia-based 501(c)(3) hospital, sued 9888 patients, garnished the wages of 5478 former patients, and placed liens on the homes of 3920 former patients. Id.

121 Id.

122 Id.

123 See Tax-Exempt Hospital Sector, supra note 15, at 16 (statement of Mark Everson, Commissioner, Internal Revenue Service) (stating that the IRS has not been able to do enough enforcement regarding tax-exempt hospitals because revocation causes “disproportionate hardship”); Berg, supra note 8, at 382 (discussing the IRS’s hesitancy to enforce the community benefits standard through revocation because of the “drastic” effects); Thai, supra note 10, at 771 (highlighting inappropriate activities of some tax-exempt hospitals); see also Cecilia M. Jardon McGregor, The Community Benefit Standard for Non-Profit Hospitals: Which Community, and for Whose Benefit?, 23 J. CONTEMP. HEALTH L. & POL’Y 302, 338–39 (2007) (considering the negative effects of eliminating a hospital tax exemption); Kane, supra note 48, at 471 (discussing the consequences of revoking tax-exempt status for hospitals).

In sum, the IRS has been unsuccessful in regulating tax-exempt hospital behavior.\(^{125}\) The community benefits standard—which evaluates a number of factors—leaves the IRS only has one real enforcement option: revocation of Section 501(c)(3) status.\(^{126}\) As a result, it is currently very difficult for the IRS to shape hospital behavior regarding any one factor in particular.\(^{127}\) As the IRS looks on, tax-exempt hospitals continue to engage in egregiously uncharitable behavior.\(^{128}\)

B. Intermediate Sanctions: A Limited Attempt to Control the Behavior of Tax-Exempt Organizations

To address the IRS’s “all or nothing” enforcement problem, Congress passed the 1996 Taxpayer Bill of Rights, which created intermediate sanctions as a limited enforcement tool.\(^{129}\) Prior to the enactment of this legislation, if a charitable organization did not comply with the Section 501 requirement that

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Zamoff & Zaetta, supra. They claimed that the hospitals charged uninsured patients higher rates than insured patients and engaged in abusive collections practices in violation of their obligations as tax-exempt organizations. \(\text{Id.}\) The plaintiffs contended that Section 501(c)(3) created a private cause of action and sought to recover as damages the taxes that the hospitals had not paid due to their tax-exempt status. \(\text{Id.}\) Alternatively, they sought to hold the hospitals liable under state law theories that included breach of contract, breach of the duty of good faith and fair dealing, and unjust enrichment. Cohen, supra note 94, at 112–13; Zamoff & Zaetta, supra. Federal courts resoundingly rejected both theories of liability. Zamoff & Zaetta, supra; see, e.g., Maldonado v. Ochsner Clinic Found., 493 F.3d 521, 523–24 (5th Cir. 2007) (affirming the denial of class certification for a group of uninsured patients, who received medical care from their tax-exempt provider and were then billed at undiscounted rates, because “individualized issues . . . overwhelm class cohesiveness”); Urquhart v. Manatee Mem’l Hosp., No. 8:06-CV-1418-T-17-EAJ, 2007 WL 781738, at *2, *6 (M.D. Fla. Mar. 13, 2007) (granting a motion to dismiss claim against tax-exempt hospital because plaintiffs failed to allege any damages that were related to hospital’s charging of allegedly unreasonable rates for medical treatment); Ferguson v. Centura Health Corp., 358 F. Supp. 2d 1014, 1019 (D. Colo. 2004) (“The plaintiffs’ claims under § 501(c)(3) fail because formulating federal health care policy is not a proper function of an Article III court.”).

\(^{125}\) Tax-Exempt Hospital Sector, supra note 15, at 10 (statement of Mark Everson, Commissioner, Internal Revenue Service) (testifying that the IRS does not have sufficient enforcement tools and cannot properly differentiate between for-profit and tax-exempt hospitals); Colombo, supra note 44, at 41–42 (describing how the community benefits standard fails to distinguish for-profit and tax-exempt profit behavior).


\(^{128}\) See Tax-Exempt Hospital Sector, supra note 15, at 8–9 (statement of Mark Everson, Commissioner, Internal Revenue Service); Colombo, supra note 44, at 46-47; Karns, supra note 8, at 521; Goodman, supra note 30, at 719.

no net earnings inure to the benefit of any individual or private shareholder, the IRS’s sole recourse was to revoke the organization’s exemption. Section 4958 of the legislation—now incorporated as Section 4958 of the I.R.C.—solved this problem, as it permits the IRS to impose excise taxes on persons who gain from “excess benefit” transactions with tax-exempt organizations, including hospitals. An excess benefit transaction—as defined by Section 4958—is “any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration.” For example, an excess benefit transaction occurs when a tax-exempt hospital acquires a product for higher than market value from a board member or another “disqualified” person.

Disqualified persons are persons who are in a position, or who have been in a position in the last five years prior to the transaction, to exercise substantial influence over the organization’s affairs. Accordingly, persons who make substantial charitable contributions to the organization and persons who have control over all or part of the budget of an organization also are disqualified persons. Under this standard, the IRS has the burden of proof to show that

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130 See Caracci, 118 T.C. at 414. This same problem—as this Note has explained—continues to exist with regard to enforcement of the community benefits standard. See supra notes 111–124 and accompanying text (discussing the difficulties with enforcement of the community benefits standard).

131 See I.R.C. § 4958; Caracci, 118 T.C. at 414; Adkins, supra note 92, at 26; Noble et al., supra note 8, at 119; Studdert et al., supra note 12, at 626; Levitt, supra note 12, at 14.

132 I.R.C. § 4958.

133 See id. Other common excess benefit transactions involve the compensation of disqualified persons, the sale of property between a tax-exempt organization and a disqualified person, a loan between an organization and a disqualified person, and the use by a disqualified person of an organization’s assets. Levitt, supra note 12, at 14.

134 I.R.C. § 4958; see Treas. Reg. § 53.4958-3 (as amended in 2009) (expounding on the definition of a disqualified person). Disqualified persons include the directors, certain officers, and key employees of the organization, as well as their family members. Levitt, supra note 12, at 14; see I.R.C. § 4958; see also I.R.S. Priv. Ltr. Rul. 201225016 (June 22, 2012) (determining that an organization’s corporate officers and office manager Councilman were disqualified persons under § 4958); I.R.S. Priv. Ltr. Rul. 201131024 (Aug. 5, 2011) (determining that an organization’s founder and his daughter were disqualified persons under § 4958); I.R.S. Priv. Ltr. Rul. 200829049 (July 18, 2008) (determining that a board member of an organization was a disqualified person under § 4958). An entity is considered a disqualified person when disqualified individuals control thirty-five percent of the entity. I.R.C. § 4958. In the case of a corporation, this occurs when persons, who are in positions to exercise substantial influence over the organization’s affairs, or their family members, own more than thirty-five percent of the total combined voting power. Id. For a partnership, this occurs when such persons own more than thirty-five percent of the profits interest. Id. A trust or estate is considered a disqualified person when such persons own more than thirty-five percent of the beneficial interest. Id.

135 Levitt, supra note 12, at 14; see I.R.C. § 4958 (2012).
an excess benefit transaction has occurred between a disqualified person and an applicable tax-exempt organization.\footnote{Treas. Reg. § 53.4958-6 (2006) (giving disqualified persons a rebuttable presumption of reasonableness in transactions with the organization under a compensation arrangement).}

If the IRS satisfies its burden, it may impose tax liability—on top of ordinary income tax liability—as a sanction on the benefitting disqualified person, or on both the person and the participating organization’s managers.\footnote{I.R.C. § 4958.} A disqualified person who benefits from an excess benefit transaction may be taxed on twenty-five percent of the excess benefit received.\footnote{Id.} The value of the excess benefit is calculated by subtracting the economic benefit that the disqualified person provided to the applicable organization from the economic benefit the disqualified person received from the organization.\footnote{Id.} The disqualified person also must correct the excess benefit by returning it to the organization within the taxable period.\footnote{Id.} If the excess benefit is not corrected during this time, the IRS additionally may tax the disqualified person’s excess benefit at two hundred percent.\footnote{I.R.C. § 4958 (2012).} Moreover, the managers of an organization who knowingly, willfully, and without reasonable cause take part in an excess benefit transaction can be held liable individually for a tax of ten percent of the excess benefit.\footnote{Id.} A manager’s tax liability, however, cannot exceed $20,000 for any individual excess benefit transaction.\footnote{Id.}

The focus of these intermediate sanctions is exclusively on the Section 501(c)(3) requirement that no net earnings inure to the benefit of any individual or private shareholder.\footnote{See I.R.C. § 501(c)(3) (2012); id. § 4958.} Section 4958 is designed to prevent persons with influence over a tax-exempt organization from using their power to extract a personal, private benefit from the operation of the organization.\footnote{See Berg, supra note 8, at 382; Studdert et al., supra note 12, at 626.} Accordingly, these intermediate sanctions are not available remedies in the instances when organizations fail to meet or maintain the community benefits standard.\footnote{Berg, supra note 8, at 382; see I.R.C. § 4958.} 

\footnote{136 Treas. Reg. § 53.4958-6 (2006) (giving disqualified persons a rebuttable presumption of reasonableness in transactions with the organization under a compensation arrangement).}
\footnote{137 I.R.C. § 4958.}
\footnote{138 Id.}
\footnote{139 Id.}
\footnote{140 Id. An excess benefit transaction is corrected when the disqualified person acts to undo the excess benefit to the extent possible and takes any additional necessary measures to place the organization back in a financial position that is not worse than the position that it would have been in had the disqualified person acted under the highest fiduciary standard. Id. In order to avoid additional tax liability, the disqualified person must correct the transaction within the taxable period. Id. The taxable period begins on the date that the transaction occurs and ends on the earlier of the date of mailing the excess benefit tax deficiency notice and the date of the excess benefit tax assessment. Id.}
\footnote{141 I.R.C. § 4958 (2012).}
\footnote{142 Id.}
\footnote{143 Id.}
\footnote{144 See I.R.C. § 501(c)(3) (2012); id. § 4958.}
\footnote{145 See Berg, supra note 8, at 382; Studdert et al., supra note 12, at 626.}
\footnote{146 Berg, supra note 8, at 382; see I.R.C. § 4958.}
Although intermediate sanctions have rarely been imposed in the hospital setting, they have been used successfully in other contexts. The IRS engaged in two major projects designed to discover and cease excess benefit transactions from 2004 to 2007, looking specifically at the compensation and benefits that tax-exempt organizations paid to their executives and directors. Approximately 2000 tax-exempt organizations—including hospitals and other health care organizations—were sent compliance check letters. Ultimately, the IRS either proposed to assess or actually assessed excise taxes under Section 4958 on twenty-five organizations. None of the selected organizations, however, were hospitals. Although the IRS recognized that some hospitals’ executive compensation levels would “appear high to some,” it concluded that they were not so high as to constitute any excess benefit transactions.

Intermediate sanctions—like the sanction available under Section 4958—may implicate complex issues of valuation. For example, in 2006, in Caracci v. Commissioner, the U.S. Court of Appeals for the Fifth Circuit considered the imposition of excise taxes on three privately held home-health agencies that had converted from nonprofit tax-exempt entities to for-profit entities. The Tax Court applied Section 4958 and found that the taxpayers owed $69,702,390 in excise taxes because they had received a net excess benefit. The Fifth Circuit reversed. The court held that the IRS and the Tax Court had made a “cascade of errors” in their valuation methods and in other areas. First, the IRS levied the initial tax based on calculations that the Fifth

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149 IRS Sharpens Focus on Tax-Exempt Organization Compensation, supra note 148.
150 Id. Excise taxes were also proposed or assessed against forty disqualified persons and organizational managers. Id. The taxes were worth over $21 million in the aggregate, not including the cost that organizations would have to pay to correct the excess benefits. Id.
151 HOSPITAL STUDY EXECUTIVE SUMMARY, supra note 147, at 4.
152 Id.
154 See 456 F.3d at 450.
155 Caracci, 118 T.C. at 417.
156 Caracci, 456 F.3d at 450.
157 Id. at 456.
Circuit described as “brief, intermediate internal analysis.” And, second, the excise tax amount ordered was not offset by a calculation of the liabilities that the entities had assumed when converting from tax-exempt to nonexempt entities. The Fifth Circuit also held that the Tax Court acted improperly because it failed to place the burden of proof on the IRS to show that the taxpayers owed the correct amount of taxes. For these reasons, Caracci underscores the valuation difficulties that can affect a Section 4958 excess benefit analysis.

III. RIGHTING A WRONG: HOW TO ENFORCE THE COMMUNITY BENEFITS STANDARD USING INTERMEDIATE SANCTIONS

Scholars have suggested a variety of solutions to change the way in which the IRS evaluates whether a hospital qualifies as charitable. The solutions proposed thus far all have something in common: they all examine the test that nonprofit hospitals must meet in order to qualify for tax exemption. Because the community benefits standard has proven difficult to administer, it is un-

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158 Id. (noting that the analysis itself stated that it was intermediate and would require further study).
159 Id. at 450, 457 (describing how the failure to offset led to a vast overstatement of tax liability).
160 Id. at 457–58 (noting that the failure to place the burden of proof on the IRS was an “error”).
161 See id. at 447; Allen D. Hahn, Caracci and the Valuation of Exempt Organizations, 40 J. HEALTH L. 267, 279–88 (2007) (discussing Caracci’s lessons for properly conducting the § 4958 valuation analysis); Broccolo et al., supra note 153, at 4 (identifying Caracci’s implications for the valuation of excess benefits in the health care industry).
162 See Colombo, supra note 44, at 29, 52–53; Crimm, supra note 33, at 103; Nation, supra note 11, at 206; Noble et al., supra note 8, at 131. Some have called for a repeal of the community benefits standard entirely. See Bloche, supra note 99, at 404–05 (arguing for the repeal of the community benefits standard and, ultimately, for the phase-out of all tax exemptions for nonprofit hospitals); Crimm, supra note 33, at 103 (proposing a completely different tax regime as an alternative to the community benefits standard); Nation, supra note 11, at 206 (proposing that the community benefits standard be replaced by limiting the definition of “charitable” to the provision of free care to the public). Others propose tying tax-exempt status to set levels of charity care. See Noble et al., supra note 8, at 131. For example, Texas has statutorily mandated charity care as a requirement for a state tax exemption. Id. At least one scholar has discussed reformulating the community benefits standard based on enhancing access to desirable health care services. See Colombo, supra note 44, at 62–63. Another has proposed reformulating the system for tax exemptions entirely, and making available a tax deduction or credit to reward both for-profit and nonprofit health care providers that engage in certain desirable charitable activities. Crimm, supra note 33, at 103–04.
163 See Colombo, supra note 44, at 62–63 (proposing to reformulate the community benefits test based on enhancing access to desirable health care services); Crimm, supra note 33, at 103–04 (advocating for repeal of the tax exemption to be replaced by a system of tax deductions and government subsidies to reward nonprofit and for-profit hospitals that engage in broadly defined charitable activities); Nation, supra note 11, at 206 (endorsing a narrow definition of charitable so that hospitals are allowed only a tax deduction for the marginal cost of any free care provided); Noble et al., supra note 8, at 131 (recommending national consistency with regard to state and federal attempts to define “charity” and “community benefits”).
164 See Cohen, supra note 94, at 95–97; Crossley, supra note 11, at 691; Helvin, supra note 94, at 424–27; Nation, supra note 11, at 175–76; Thai, supra note 10, at 772.
deniably beneficial for academics and lawmakers to thoroughly evaluate the standard to see how it can be better implemented.165 As the health care environment in the United States continues to evolve, it has become even more worthwhile to challenge the standard and tweak it accordingly.166

The currently proposed solutions, however, do not address the most serious problem facing the administration of tax-exempt status for hospitals: the lack of flexibility with the IRS’s enforcement powers.167 The IRS has not vigorously enforced the community benefits standard because its only option is revocation of status, which often sounds the death knell for the hospital.168 This Part argues that Congress should give the IRS statutory authority to employ intermediate sanctions against hospitals that fail to uphold their obligations under the community benefits standard and the ACA.169 Giving the IRS this power would enable the service to target discrete unsatisfactory hospital practices and take action against them.170 Moreover, intermediate sanctions would allow the IRS to better regulate tax-exempt hospital behavior while ensuring that communities benefit from their services.171

Accordingly, Section 4958 intermediate sanctions should be adapted to work with the community benefits regime to determine whether a hospital should incur tax liability.172 The current intermediate sanctions available to the IRS are only penalty excise taxes that may be imposed on a disqualified person who benefits from an excess benefit transaction with a tax-exempt organization.173 Under these existing sanctions, the IRS may levy a tax upon the disqualified person and the participating organization’s managers, but not the organiza-

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165 See Colombo, supra note 44, at 62–63; Crimm, supra note 33, at 103–04; Nation, supra note 11, at 206; Noble et al., supra note 8, at 131.

166 See Colombo, supra note 44, at 52–63 (addressing scholarly arguments for and against the community benefits standard and proposing an access-based solution).

167 See, e.g., id. at 62–63 (proposing an “enhancing access” standard for exemption); Crimm, supra note 33, at 103–05 (arguing for favorable tax treatment for broadly defined charitable behaviors); Nation, supra note 11, at 206 (advocating for a narrower standard for exemption); Noble et al., supra note 8, at 131 (recommending a nationally consistent standard for exemption); supra notes 111–124 and accompanying text (discussing the difficulties that the IRS and courts have faced in enforcing the community benefits standard).

168 See supra notes 73–92 and accompanying text (discussing the lack of appropriate enforcement options and the negative consequences of revocation).

169 See infra notes 172–243 and accompanying text.

170 See I.R.C. § 4958 (2012); Tax-Exempt Hospital Sector, supra note 15, at 8–9 (statement of Mark Everson, Commissioner, Internal Revenue Service); Studdert et al., supra note 12, at 626.

171 See Berg, supra note 8, at 382 (discussing the IRS’s reluctance to enforce the standard due to the draconian results of revocation); Studdert et al., supra note 12, at 626 (“The severity [of revocation proceedings] has tended to discourage its use.”); Levitt, supra note 12, at 14 (noting the absence of IRS enforcement flexibility with regards to the community benefits standard).


173 I.R.C. § 4958; see supra notes 129–161 and accompanying text (providing background on I.R.C. § 4958 and its application).
tion itself. In a similar way, in the community benefits context, the IRS should have the authority to impose tax liability directly on a violating hospital.175

To enforce the community benefits standard, however, the valuation methodology for Section 4958 intermediate sanctions would need to be modified.176 Under Section 4958, a disqualified person is taxed on twenty-five percent of the excess benefit received.177 Additionally, if the benefit is not returned to the organization within a certain timeframe, the person is taxed on two hundred percent of the benefit retained.178 The IRS calculates the value of the excess benefit by subtracting the economic benefit that the disqualified person provided to the tax-exempt organization from the economic benefit the disqualified person received from the organization.179

The intermediate sanctions imposed to enforce the community benefits standard should mirror the ACA’s community health needs assessment penalties.180 Such intermediate sanctions could expand the new $50,000 penalty applied to hospitals that fail to comply with the community health needs assessment requirement.181 Specifically, legislation could give the IRS authority to

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174 I.R.C. § 4958.
175 See id. (imposing tax liability on a disqualified person or on an organization’s managers, but not the organization itself). Section 4958 created intermediate sanctions to deter or punish a disqualified person engaging in an inappropriate transaction. See id.; Caracci v. Comm’r, 118 T.C. 379, 417 (2002) (“[I]ntermediate sanctions are the sole sanction imposed in those cases in which the excess benefit does not rise to a level where it calls into question whether . . . the organization functions as a charitable . . . organization.” (quoting H.R. REP. NO. 104-506, at 106 n.15 (1996), reprinted in 1996 U.S.C.C.A.N. 1143, 1191) (internal quotation marks omitted)), rev’d on other grounds, 456 F.3d 444 (5th Cir. 2006); Adkins, supra note 92, at 26. Conversely, the proposed model encourages hospitals to follow the community benefits standard to avoid organizational exposure to intermediate sanctions because revocation has not served a proper deterrent function. See Tax-Exempt Hospital Sector, supra note 15, at 9 (statement of Mark Everson, Commissioner, Internal Revenue Service); Colombo, supra note 44, at 41–42; Crossley, supra note 11, at 701.
177 I.R.C. § 4958. In addition, an organization’s managers who knowingly, willfully, and without reasonable cause take part in an excess benefit transaction can be held liable for a tax of ten percent of the excess benefit, not to exceed $20,000. Id.
178 Id.
179 Id. For a more complete description of the methodology for valuing § 4958 intermediate sanctions, see supra notes 132–143 and accompanying text.
180 See I.R.C. § 4958; Tax-Exempt Hospital Sector, supra note 15, at 9 (statement of Mark Everson, Commissioner, Internal Revenue Service) (explaining that the IRS does not currently have the tools to properly enforce the community benefits standard); Hahn, supra note 161, at 279–88 (describing the function of intermediate sanctions in the excess benefit context); Colombo, supra note 44, at 41–42 (critiquing the lack of a “specific, quantifiable” community benefits standard); Crossley, supra note 11, at 701 (arguing that hospitals are unlikely to change behavior without “meaningful prodding” in the form of economic sanctions).
181 I.R.C. § 4959 (2012) (establishing a $50,000 penalty excise tax for any hospital that fails to conduct a community health needs assessment). For a comprehensive explanation of the community
impose a $50,000 excise tax on any tax-exempt hospital that engages in a discrete behavior that is contrary to the purpose and intent of the community benefits standard. For example, the IRS could use this tool if hospitals offer too little charity care or fail to provide health education to the public.\footnote{182}{See I.R.C. § 4959. The amount of $50,000 is simply a suggested measure that mirrors the § 4959 tax. See id. As an alternative, the IRS could create a sliding scale of excise tax rates based on either the hospital’s size and ability to pay or the degree of improper activity. See id. Regardless, the IRS would have to use its discretion as to which behaviors would merit imposition of such a tax. See id.; I.R.S. Notice 2011-52, supra note 59, at 65 (explaining the IRS’s enforcement plan for when it will seek to impose the $50,000 penalty).}

Furthermore, legislation could allow the IRS to impose a twenty-five percent tax on hospitals that continued to engage in undesirable behavior.\footnote{183}{See Rev. Rul. 69-545, 1969-2 C.B. 118; Colombo, supra note 23, at 626; Nation, supra note 11, at 168; Goodman, supra note 30, at 719–20.} This scheme could resemble Section 4958’s twenty-five percent tax on individuals who benefit from excess benefit transactions.\footnote{184}{See I.R.C. § 4958 (2012).} Under this scheme, the IRS first would calculate a hospital’s income tax as if that hospital were not tax-exempt.\footnote{185}{See id. Again, the twenty-five percent tax is merely a suggested rate of taxation mirroring the tax rate under § 4958. See id. Clearly, additional study would be necessary before definitively valuing such taxes. See id.} It would then calculate the estimated costs of all the hospital’s community benefits activities.\footnote{186}{See id.} Next, the IRS would subtract the sum of the value of the hospital’s community benefits activities from the hospital’s hypothetical income tax liability.\footnote{187}{See id.} This number represents the approximate benefit that the hospital receives for being tax-exempt, over and above the amount it returns to the community in the form of community benefits activities.\footnote{188}{See id.} Under this Note’s proposed plan, the IRS could be given authority to tax the hospital twenty-five percent of that value as a more extreme measure—short of revocation—to pressure hospitals into full compliance with the community benefits standard.\footnote{189}{See I.R.C. § 4958 (2012).}

The $50,000 excise tax on isolated, unsatisfactory practices helps to pair the flexible community benefits standard with a correspondingly flexible enforcement mechanism.\footnote{190}{See Colombo, supra note 44, at 46–47; Karns, supra note 8, at 520; Nation, supra note 11, at 174.} This is necessary in this instance because, although a flexible standard for tax exemption is desirable, it is only workable when
paired with a flexible enforcement mechanism.\textsuperscript{192} Flexibility is desirable because every community has distinct needs in terms of what it wants or requires from a tax-exempt hospital.\textsuperscript{193} For example, some communities may have a large population of indigent patients who require significant amounts of subsidized or free care.\textsuperscript{194} Other communities, however, may be less in need of free care, but have a large percentage of Medicare or Medicaid enrollees and need their local hospitals to address Medicare and Medicaid shortfalls.\textsuperscript{195} Yet other communities may benefit from substantial health education and outreach programs.\textsuperscript{196}

Because of each community’s varying needs, the current system allows the IRS to look at the totality of the circumstances to determine whether tax-exempt status for a hospital is warranted.\textsuperscript{197} If a hospital engages in a discrete undesirable practice, such as providing extremely little charitable care, an exemption may still be granted if this practice is balanced by desirable hospital characteristics.\textsuperscript{198} The current model, however, allows hospitals to flagrantly disregard the community benefits standard without consequences.\textsuperscript{199} With the flat excise tax, however, the IRS could correct any harmful hospital practices, while still allowing an otherwise deserving hospital to keep its exemption.\textsuperscript{200}

The proposed intermediate sanctions model also would rationally link the enforcement of the hospital tax exemption to the policy underlying it.\textsuperscript{201} A central policy justification for the exemption is that the government’s lost tax rev-

\textsuperscript{192} See Colombo, supra note 44, at 60; Thai, supra note 10, at 768.
\textsuperscript{193} See Crossley, supra note 11, at 688 (discussing the prevalence of health disparities based on gender, race, and socio-economic status); Thai, supra note 10, at 768 (noting how the community benefits standard is flexible so that hospitals may respond to the specific needs of their communities).
\textsuperscript{194} See 2006 CBO REPORT, supra note 48, at 4 (highlighting the benefits of providing uncompensated care to indigent patients); Thai, supra note 10, at 768 (discussing the purpose of a flexible community benefits standard).
\textsuperscript{195} See 2006 CBO REPORT, supra note 48, at 17–19; Courtney, supra note 8, at 382; Kane, supra note 48, at 465–66; Thai, supra note 10, at 768.
\textsuperscript{196} See Bloche, supra note 99, at 389 (postulating that nonprofit hospitals are more likely than for-profit hospitals to offer outreach services for low-income community members); Colombo, supra note 44, at 40 (noting the significance of outreach programs like wellness education and medical research); Thai, supra note 10, at 768.
\textsuperscript{197} See Geisinger Health Plan v. Comm’r, 985 F.2d 1210, 1219 (3d Cir. 1993); Rev. Rul. 69-545, 1969-2 C.B. 118.
\textsuperscript{198} See Rev. Rul. 69-545, 1969-2 C.B. 118. Desirable characteristics include maintaining an open medical staff membership, a board of trustees made up of prominent community members, and providing health education and outreach programs to the public. Id.
\textsuperscript{199} See supra notes 99–128 and accompanying text.
\textsuperscript{200} See I.R.C. § 4958 (2012); Caracci, 118 T.C. at 414; Adkins, supra note 92, at 26; Noble et al., supra note 8, at 119; Studdert et al., supra note 12, at 626; Levitt, supra note 12, at 14. The IRS would still have the authority to revoke a hospital’s status in extreme situations. See I.R.C. § 501 (2012); Caracci, 118 T.C. at 417; Adkins, supra note 92, at 26.
\textsuperscript{201} See I.R.C. § 4958; GAO REPORT, supra note 36, at 1.
enues are offset by its relief from obligations that it would otherwise have to meet in promoting the general welfare. Here, challenged hospitals that fail to clean up their acts are effectively taxed on the value of their exemption to the extent that such value exceeds the benefits that they are giving back to the community. Giving the IRS the ability to impose—or perhaps more importantly, to threaten to impose—such penalty taxes on tax-exempt hospitals should motivate the hospitals to change their behavior in a way that simply revising the test for exemption or threatening revocation has not.

This model will likely prompt two key challenges. First, critics may argue that such a revision to the IRS’s enforcement powers would be premature at best, and superfluous at worst, in light of the new ACA requirements. They may claim that the proposed intermediate sanctions model and the ACA requirements are designed to achieve the same purpose. Because the ACA requirements are still being implemented, a case could be made that Congress should hold off on passing new legislation directed at tax-exempt hospitals until they are fully evaluated.

Upon further reflection, however, the ACA’s relevant provisions readily address this challenge. The ACA merely adds new conditions that tax-exempt hospitals must satisfy besides the community benefits standard. Although the new requirements are a step in the right direction, they do not go far enough to solve the problems associated with enforcement of the hospital tax

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202 GAO REPORT, supra note 36, at 1; see supra notes 36–40 and accompanying text (discussing this justification).


204 See I.R.C. § 4958; Brody, supra note 75, at 543. Indeed, this was the primary purpose of enacting § 4958 intermediate sanctions. Caracci, 118 T.C. at 417 (“[T]he intermediate sanction regime was enacted in order to provide a less drastic deterrent to the misuse of a charity than revocation of that charity’s exempt status.”).

205 See I.R.C. § 501(r); id. § 4959 (2012); id. § 6033(b) (2012); Caracci v. Comm’r, 456 F.3d 444, 456–57 (5th Cir. 2006); infra notes 206–238 and accompanying text.

206 See I.R.C. § 501(r) (2012); id. § 4959; id. § 6033(b); see also Nation, supra note 11, at 148 (arguing against hospital tax exemption in general); American Hospital Association Comment, supra note 53, at 2 (lamenting that proposed rules implementing § 501(r) are inflexible and compliance will “divert resources from patient care”).

207 See, e.g., Thai, supra note 10, at 776–77 (arguing that the ACA amendments will “redraw the fading distinction between charitable, nonprofit hospitals worthy of federal tax exemption and for-profit hospitals”); American Hospital Association Comment, supra note 53, at 2–3 (requesting flexibility with implementation of § 501(r) because additional requirements on hospitals diverts resources from patient care and initiatives to improve quality and efficiency).

208 See Crossley, supra note 11, at 702; Thai, supra note 10, at 773; American Hospital Association Comment, supra note 53, at 2–3.

209 See I.R.C. § 501(r); id. § 4959; id. § 6033(b); supra notes 53–72 and accompanying text (presenting an overview of the ACA amendments).

210 I.R.C. § 501(r); id. § 6033(b).
exemption.\textsuperscript{211} With the exception of a $50,000 excise tax imposed on hospitals that fail to complete a community health needs assessment, the IRS is still left with only two enforcement choices: do nothing or revoke a hospital’s exemption.\textsuperscript{212} Imposing more specific prohibitions on certain practices without simultaneously enhancing the enforcement powers of the IRS is unlikely to affect hospital behavior.\textsuperscript{213}

Although the ACA places additional obligations on tax-exempt hospitals, this Note’s proposed intermediate sanctions model will serve to increase hospitals’ accountability to keep up their end of the exemption bargain.\textsuperscript{214} For example, the ACA limits the rates that tax-exempt hospitals may bill to persons who are eligible for financial assistance and places restrictions on hospitals’ collection practices.\textsuperscript{215} These provisions are designed to address reports of egregious tax-exempt hospital behavior, including the practice of charging indigent patients higher rates than insured patients and using aggressive collection techniques without evaluating a patient’s financial constraints.\textsuperscript{216}

Nevertheless, hospitals are unlikely to take the new legislation seriously.\textsuperscript{217} Many hospitals have already turned over control of Section 501(r) compliance to their marketing departments.\textsuperscript{218} Others view the new reporting requirements “simply as a new hoop to jump through with the least possible effort expended.”\textsuperscript{219} Presently, the IRS is reluctant to take enforcement action against tax-exempt hospitals that engage in such conspicuous practices because revocation is a drastic step, and the hospitals may otherwise be meeting the

\textsuperscript{211} See I.R.C. § 501(r); id. § 6033(b) (2012); Tax-Exempt Hospital Sector, supra note 15, at 9 (statement of Mark Everson, Commissioner, Internal Revenue Service) (testifying that the IRS needs better enforcement tools to effectively regulate tax-exempt hospitals); Crossley, supra note 11, at 701 (warning that hospitals will not change their behavior significantly—despite § 501(r)—without “meaningful prodding by the IRS”).
\textsuperscript{212} See I.R.C. § 4959 (2012).
\textsuperscript{213} See Berg, supra note 8, at 382 (blaming the IRS’s failure to take action against hospitals that do not meet the community benefits standard on the “draconian result” of revocation). But see Thai, supra note 10, at 773 (arguing that the new ACA amendments will have a profound impact on hospital behavior).
\textsuperscript{214} See I.R.C. § 501(r) (2012); id. § 4959; id. § 6033(b); supra notes 180–190 and accompanying text.
\textsuperscript{215} See I.R.C. § 501(r).
\textsuperscript{216} See id.; supra notes 116–124 and accompanying text (reviewing the inappropriate practices of some tax-exempt hospitals).
\textsuperscript{217} See Crossley, supra note 11, at 701–02.
\textsuperscript{218} See id. at 702 n.69.
\textsuperscript{219} See id. at 702.
community benefits standard. Accordingly, expanding the requirements for tax-exempt hospitals does not confront this problematic dynamic.

Furthermore, the new requirements are unlikely to delineate a line between the expected behavior of tax-exempt hospitals and their for-profit equivalents. The ACA requires tax-exempt hospitals to conduct a community health needs assessment and develop written financial assistance and emergency care policies. Yet, the legislation does not establish any specific eligibility criteria for financial assistance or mandate a minimum level of coverage. Thus, tax-exempt hospitals do not necessarily have to change their financial assistance or emergency care policies to comply with this provision; rather, all they must do is write it down and distribute it to patients. Although the ACA’s provisions are a step in the right direction, layering on new requirements alone will not be sufficient to influence tax-exempt hospitals to change their behavior.

An additional anticipated challenge to the intermediate sanctions model is that its use could trigger complex valuation issues. This, however, will not be an issue here. This is because the $50,000 excise tax on discrete behavior can be straightforwardly applied. The twenty-five percent tax on hospitals that fail to change their behavior, however, requires two estimates: the hospital’s hypothetical income tax obligation and the value of its community benefits activities. These amounts arguably could be difficult to assess. There are many possible valuation methods and the IRS would require extensive in-

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220 See Berg, supra note 8, at 382.
221 See id. (noting the IRS’s historical reluctance to enforce the community benefits standard through revocation); Crossley, supra note 11, at 701–02 (questioning whether hospitals will fully comply with the new requirements without “prodding” from the IRS).
222 See I.R.C. § 501(r) (2012); Berg, supra note 8, at 390; Colombo, supra note 44, at 46–47; Crossley, supra note 11, at 701–02; Karns, supra note 8, at 521; Goodman, supra note 30, at 725. But see Thai, supra note 10, at 776–77 (predicting that the new ACA amendments will create distinctions between the behavior of tax-exempt hospitals and that of their for-profit counterparts).
223 I.R.C. § 501(r).
225 See I.R.C. § 501(r). Section 501(r) at least requires hospitals to widely distribute their financial assistance policies. See id. This will prevent the current practice of some hospitals that actively conceal their financial assistance programs in order to limit their use. See id.; see, e.g., Utah Cnty. v. Intermountain Health Care, Inc., 709 P.2d 265, 274 (Utah 1985).
226 See Crossley, supra note 11, at 701–02; Noble et al., supra note 8, at 130.
227 See I.R.C. § 4958 (2012); Caracci, 456 F.3d at 456–57.
228 See infra notes 233–238 and accompanying text.
229 See I.R.C. § 4959 (2012) (straightforwardly stating when the $50,000 tax should be applied).
230 See supra 184–190 and accompanying text (discussing this tax scheme).
231 See GAO REPORT, supra note 36, at 7 (“[S]tandards and guidance vary on . . . the method hospitals may use to measure costs of charity care, government health care programs, and other activities that benefit the community.”).
formation about hospitals’ operating expenses and community benefits practic-

es to complete the valuation process.232

The intermediate sanctions model that this Note proposes addresses the
valuation problem in two ways.233 First, the additional tax is designed for the
uncommon circumstance of a hospital failing to change its behavior after a
$50,000 tax is levied upon it.234 Thus, valuation concerns would only be an
issue on the rare occasions when the IRS might seek to impose the additional
twenty-five percent tax.235 Second, hospitals are already required to annually
report the estimated costs of their community benefits activities to the IRS.236
Thus, the IRS is already in possession of all the information it would need to
calculate the twenty-five percent tax.237 Moreover, Section 4958 intermediate
sanctions for excess benefit transactions have been very valuable to the IRS
when utilized properly.238

The community benefits standard is often blamed for creating a system
where tax-exempt hospitals reap extensive economic benefits without sharing
such benefits with their communities.239 In fact, the absence of a flexible IRS
enforcement mechanism is the culprit.240 To address this systemic issue, Con-
gress should adopt this Note’s proposed intermediate sanctions model, which
would allow the IRS to better regulate tax-exempt hospitals’ activities.241 The
model proposed herein goes beyond the ACA’s requirements because it targets
specific undesirable practices and gives the IRS the proper tools to eradicate

232 See Caracci, 456 F.3d at 456–57; Hahn, supra note 161, at 279–88; Broccolo et al., supra note 153, at 4.
233 See infra notes 234–238 and accompanying text.
234 See supra notes 191–200 and accompanying text (proposing a $50,000 excise tax and discuss-
ing the need for a flexible community benefits standard).
235 See I.R.C. § 4959 (2012) (establishing a $50,000 excise tax for hospitals that fail to conduct a
community health needs assessment).
236 See generally SCHEDULE H, supra note 73 (collecting community benefits and financial in-
formation from hospitals).
237 See generally id. (collecting community benefits and financial information from hospitals).
238 See IRS Sharpens Focus on Tax-Exempt Organization Compensation, supra note 148. For
example, following an aggressive compliance initiative in 2006, the IRS proposed or assessed at least
$21 million in excise taxes under § 4958 against forty disqualified persons or organization managers.
Id. The large-scale exposure of the affected organizations to sizeable tax liability put all tax-exempt
organizations on notice that the IRS would not stand idly by in cases of excess benefit transactions. Id.
239 See Colombo, supra note 44, at 53.
240 See Tax-Exempt Hospital Sector, supra note 15, at 8–9 (statement of Mark Everson, Commissi-
one, Internal Revenue Service) (pushing Congress to give the IRS increased enforcement flexibil-
ity); Colombo, supra note 44, at 53 (“[M]odern empirical evidence shows little difference in the quan-
tifiable behavior of for-profit and nonprofit hospitals with respect to cost, quality of care and charity
care.”); supra notes 99–128 and accompanying text (drawing attention to the egregious behaviors that
resulted from poor enforcement of the community benefits standard).
241 See supra notes 169–200 and accompanying text.
such behavior.\textsuperscript{242} Although the IRS may encounter some valuation difficulties when assessing intermediate sanctions, it can overcome them by utilizing the reported hospital data that it already possesses.\textsuperscript{243}

CONCLUSION

Tax-exempt hospitals receive millions of dollars worth of tax breaks each year, yet many of them act less than charitably. The IRS regulates the standard that hospitals must meet in order to qualify for a tax exemption. When a tax-exempt hospital fails to live up to its charitable requirements, the IRS has two options: (1) do nothing; or (2) move to revoke the hospital’s tax-exempt status. Revocation is a drastic option that cannot be particularized to a hospital’s specific shortcomings, and as a result, the IRS rarely takes enforcement action against hospitals that fail to meet the community benefits standard. Commentators have suggested modifying the qualifying standard for tax-exempt hospitals to address this problem. Alternatively, Congress should give the IRS statutory authority to impose excise tax intermediate sanctions on underperforming hospitals as an enforcement tool short of revocation. Intermediate sanctions would provide the IRS with flexibility to regulate the boundaries of tax-exempt status and ensure that communities continue to benefit from the services of tax-exempt hospitals. Although more time is needed to realize the impact of the Affordable Care Act—which imposes additional requirements—on tax-exempt hospital behavior, one thing is certain: uncharitable hospitals are not and can never be “charitable” organizations.

RACHEL WEISBLATT

\textsuperscript{242} See I.R.C. § 501(r) (2012); id. § 4959 (2012); id. § 6033(b) (2012); supra notes 191–200 and accompanying text (highlighting that communities may have different needs in terms of what it requires from tax-exempt hospitals).

\textsuperscript{243} See supra notes 236–237 and accompanying text.