

**Foundation-Related Issues
Form 990, Schedule H
June 7, 2010**

Of all the Schedule H questions CHA receives, a large number involve how to correctly count funds received by a hospital from a related foundation. This confusion is understandable as the IRS instructions on this are not entirely clear, and in some cases, appear to be counter-intuitive. Set forth below is some information that attempts to shed some light on when and when not to count funds transferred from a related foundation as community benefit.

It should be noted that there are two usual ways that hospital foundations are structured. The first is where the foundation is not a separate legal entity, but is instead operated as part of the same Employer Identification Number (EIN) as the hospital. In this case, when funds raised by the foundation are “given” to the hospital, there is not a legal transfer occurring. Thus, the Schedule H rules discussed below would not apply because for legal purposes, the foundation and the hospital are the same corporate entity.

The second structure is where the foundation and the hospital are two legal entities, each with their own EIN. In many cases, the foundation and hospital are related to one another because they share a common parent organization (a “brother-sister relationship”). In other cases the foundation is related to the hospital as a subsidiary (where the hospital is the parent of the foundation) or through overlapping board members (a “common control” relationship.). The Schedule H rules discussed below will apply because for legal purposes, the foundation and hospital are separate legal entities. Thus, as a starting place, it is very important to determine the structure of the relationship between your foundation and your hospital.

Grants from a Related Foundation Used Directly by a Hospital for Community Benefit Activities

In some instances, a foundation may make a grant to its related hospital without specifying what the hospital may use the funds for. This is an unrestricted grant. In the event the hospital then directly uses some of these grant funds to support a community benefit activity, then it can report the amount spent on the activity in the appropriate category of the Part I Community Benefit Table of the Schedule H (the “CB Table”). For example, if the foundation gives the hospital a \$10,000 unrestricted grant, and the hospital uses \$5,000 of that to operate a mobile mammography unit aimed at underserved populations, the hospital can report that \$5,000 on Line 7e of the CB Table

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(less any revenue generated by the activity) without having to count the grant amount as direct offsetting revenue. This would be the case even if the grant had been restricted and even if it came from an unrelated party.

Grants from a Related Foundation Used by a Hospital to Fund Community Benefit Activities Provided by Others

The area where most of the questions arise is what can be included on Schedule H, Part I, Line 7i, entitled “Cash and in-kind contributions to community groups.” Worksheet 8 contains the rules which govern when a hospital can and cannot count donations to other community groups as its own community benefit.

The general rule is that you **can** report cash contributions or grants given to other organizations to support charity care, health professional education and the other types of community benefit activities that are reflected on the CB Table. In order to count, the funds **must be restricted** for use only for a community benefit purpose. For example, if a hospital provides funds generated from its operations to a school in an inner city specifically to pay for a school nurse, then it can count the amount of the grant on Line 7i.

However, there is a **significant** exception to the above rule where the funds that the hospital is giving to another organization originally came as a restricted grant from a related foundation. Take the example above, except that in this scenario, the funds that the hospital grants for the school nurse are not from operations, but instead were given to the hospital by its related foundation (which is a separate legal entity) as part of a restricted grant for community benefit purposes. Under the Worksheet 8 rules, the hospital **cannot** count the grant to the school on Line 7i because the funds: (1) originated from a related foundation; and (2) were restricted. This would be the case regardless of whether the school was related or unrelated to the hospital. The hospital would not, however, have to count the amount of the grant as direct offsetting revenue anywhere on the CB Table.

While the previous example is relatively straightforward, another example from Worksheet 8 introduces some confusion regarding application of this rule. In this scenario, a hospital system is comprised of 4 hospitals (A, B, C and D) which are brother-sisters (and thus, “related”), each of which has its own EIN. The first hospital (A) makes a restricted grant of funds from its operations to the second hospital (B) specifically for community benefit purposes. The first hospital (A), as the originator of the funds, **can** count its restricted grant to the second hospital on Line 7i of its CB Table.

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Now, the second hospital (B) decides to pass along the funds it got from the first hospital (A) to the third hospital (C). The funds remain restricted for community benefit purposes. Because the second hospital (B) is “re-gifting” restricted funds from the first hospital (A) to the third hospital (C), the second hospital (B) **cannot** count the funds on its CB Table.

The third hospital (C) then decides to “re-gift” the funds (originally from the first hospital (A) to the fourth hospital (D). Like the second hospital (B), the third hospital (C) **cannot** count the funds on its CB Table because they are restricted funds from a related party.

The IRS’s stated purpose of this rule is to prevent related parties from passing around the same funds, with each recipient counting the grant to the next as community benefit.

While this “anti-churning” rule is somewhat understandable, the example itself is not. For unknown reasons, the IRS states that the third hospital’s (C) grant of the funds to the fourth hospital (D) is **unrestricted**. Based on this fact, the IRS concludes that the fourth hospital (D) can make a further grant of the same funds for community benefit purposes and count the grant on Line 7i of the CB Table. The reason that this is so confusing is that under well-settled legal principles, a recipient of restricted funds is not permitted to unilaterally remove the restrictions, whether it keeps the funds itself or grants them to another. Thus, it is unlikely that this situation could occur in “real life” and a better conclusion is that once restricted funds flow from a related party to another, the same funds will not be able to be counted as community benefit by an entity which then passes them along.

It is important to reiterate that if a grant from a foundation to its related hospital is **unrestricted** (*i.e.*, for general purposes), then the hospital can grant the funds to a related or unrelated organization, and if such funds are restricted for community benefit purposes, can be counted on Line 7i of the hospital’s CB Table.

“Real Life” Questions and Analysis

Having set forth the basic rules from Worksheet 8 above, we thought that it might be helpful to work through some of the scenarios that CHA members have requested our feedback on.

Scenario A

St. X’s Foundation, which is related to St. X Hospital, provides grants to St. X Hospital to support a number of St. X’s outreach activities along with in-patient support. Which of the following activities and what amounts can St. X report on its CB Table, assuming that all the activities meet an unmet community need?

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Question #1

St. X has a Mobile Health Outreach Ministry which provides free care for the poor and uninsured via three RV-type vehicles that are fully equipped doctors' offices. The annual cost for the service is about \$1.4 million of which the Foundation provides \$1.2million. The other \$ 200,000 comes from patient revenues. Can these costs be counted?

Response #1

Based on the description, it appears that the related Foundation provides St. X with a restricted grant of \$1.2 million to support St. X's provision of free care. St. X **can** count the entire \$1.2 million as net community benefit on Line 7g of its CB Table (the \$200,000 would be reported as direct offsetting revenue.). The answer would be the same if the grant from the Foundation were unrestricted.

Question #2

St. X's Mission Integration Department provides funding for two school nurses to provide care in the low-income parochial schools as well as a public school serving profoundly disabled children. The Foundation reimburses those costs. Can these costs be counted?

Response #2

The answer likely depends on how the reimbursement between the Foundation and St. X. is structured. If St. X directly funds the school nursing program without knowing in advance if the costs will be reimbursed by the Foundation, then it **can** count the entire costs on Line 7i of its CB Table. The fact that it later gets funds from the Foundation that can be used to replenish St. X's funds available for community benefit activities should not change the result.

However, if the Foundation has promised St. X in advance that it will reimburse the costs of the school nurse program, then it is likely that the IRS would treat this in the same manner as it would if the Foundation had given St. X a restricted grant for community benefit purposes and then St. X re-granted the funds to the school to pay the nurses. In that case, St. X could **not** count the funds on its CB Table because they came from a related entity.

Finally, it should be noted that if the program were structured such that the Foundation gave a grant for school nurses to St. X and St. X provided nurses to work at the school, then the nurses' salaries could be counted on its CB Table.

Question #3

St. X's employees are donating to the St. X's Foundation for Haiti relief. Can the donated funds be counted as the hospital's community benefit if St. X's Mission Integration Department requests them for distribution to a US 501(c)(3) with ties to Haiti?

Response #3

The IRS was concerned that hospitals would try to “take credit” for funds donated by its employees for community benefit purposes. Accordingly, Worksheet 8 provides that an organization **cannot** report on its CB Table cash or in-kind contributions contributed by employees. These are the gift of the employees and not of the organization. (Note: This can be distinguished from the situation where employees give funds to a hospital foundation, and the foundation grants the funds to the hospital, which then uses them for community benefit activities. In that case, the hospital still cannot count the employees’ donations at the time they are given, but could count the funds from the foundation when spent on the community benefit activities.)

Question #4

St. X supports an unrelated 501(c)(3) Emergency Pregnancy Services (75 percent of clients qualify for Medicaid) by providing them with space in the hospital and with operating funds which are reimbursed by the Foundation. Can the hospital report the value of the space and the operating funds on its CB Table?

Response #4

Worksheet 8 defines “in-kind contributions” to include the indirect cost of space donated to tax-exempt community groups. Thus, the cost of the space provided to the Emergency Pregnancy Services can be reported on line 7i of its CB Table. As for the operating funds which are subsequently reimbursed by the related Foundation, they could be counted on St. X’s CB Table if there were no advance agreement with the Foundation that it would in fact cover these specific costs. (See the response to Question #2 above.)

Scenario B

XYZ Hospital has a very active Foundation. It is a separate legal entity with its own EIN, but is related to the XYZ Hospital. The Foundation provides funds to the hospitals as well as directly to the community to support activities that would qualify as community benefit under the Schedule H definition.

Question #1

Can XYZ Hospital count the time and dollars as well as the value of the overhead (space, supplies, etc.) incurred by its Marketing Department to raise community benefit restricted funds for the related Foundation? If so, what category would this fall under?

Response #1

Worksheet 8 states that “in-kind contributions include the cost of staff hours donated by the organization to the community while on the organization’s payroll” and “the financial value (generally measured at cost) of donated food, equipment and supplies.” As long as the funds being raised are specifically designated for community benefit purposes (and as such will be restricted to such uses), then the Hospital could count as community benefit the costs that the Marketing Department incurs to raise such

restricted funds. This should be reported on Line 7i as an in-kind contribution to the Foundation.

Alternatively, if the funds raised are restricted solely for use by the Hospital (and not for other community organizations) for community benefit activities, it might be acceptable to report the costs as fundraising costs on Line 7e of the Hospital's CB Table.

In either event, it is **very** important that the Hospital have good documentation showing (1) that the donors specifically gave the funds for community benefit purposes, and (2) the apportionment of the Marketing Department's hours and expenses specifically incurred in raising the funds for community benefit.

Question #2

XYZ Hospital gives a restricted grant of \$5,000 to another hospital in the XYZ System for community benefit purposes. The second hospital then uses the \$5,000 to run a free clinic in an impoverished neighborhood. Which hospital should report the \$5,000 on its Schedule H? Could both do so?

Response #2

The examples in Worksheet 8 (refer to the Schedule H Instructions – Worksheet 8 at <http://www.irs.gov/pub/irs-pdf/i990sh.pdf> to see the examples) do not directly address this situation. In Example 1, the grantor foundation makes a restricted grant to a related hospital. The IRS concludes that the hospital recipient can report the granted funds on its Schedule H when it uses them for a community benefit purpose. However, because the grantor in the example is a foundation that does not file a Schedule H, the example does not address what would happen if the grantor also files a Schedule H.

In Example 3, a hospital gives a restricted grant to a related hospital for community benefit purposes. The IRS concludes that the grantor hospital can count the granted funds on its CB Table.

Based on the principles included in each of these examples, it would appear that in the XYZ situation described above, both hospitals can count the \$5,000 on its CB Table. The grantor hospital would report the \$5,000 grant as a cash contribution on line 7i of its CB Table and the recipient hospital would count the \$5,000 spent on the free clinic on line 7g of its CB Table.