

Explaining the New Rules for Measuring Community Benefit

Ronald Schultz of the IRS Relates the Story Behind the Redesigned Form 990 and the New Schedule H

As a senior member of the Internal Revenue Service's Tax Exempt and Government Entities staff, Ronald Schultz has worked extensively on its major redesign of the Form 990 for not-for-profit organizations — the first major redesign since 1979 — and on the Schedule H, a new section of the 990 that applies specifically to hospitals.

HP: What motivated the IRS to review tax exemptions for nonprofit hospitals as part of its Exempt Organizations Work Plan (public document indicating priorities and projects) in recent years?

Schultz: Those of us who work on tax exemptions for the IRS wanted to put hospitals on the work plan in order to get a better understanding of the nonprofit hospital community. We frankly realized we did not have good understanding of the sector, which has changed so much over the last few decades, so we felt it was time for us to take a close look and see what we could learn about nonprofit hospitals. Second, hospitals are the only sector that has a schedule dedicated to them — Schedule H — on the new 990. That's why there's been so much interest.

HP: Some members of Congress have stated that the IRS should change its 1969 ruling on community benefits, which allows not-for-profit hospitals to fulfill their charitable obligation through an appropriate mix of functions, including charity care, financial assistance to low-income patients, education, research, and so forth. Is there any relationship between Congressional interest in the 1969 ruling and the IRS's decision to add the Schedule H?

Schultz: Congressional interest was certainly not the cause of our looking at nonprofit hospitals or doing the Schedule H, but it's fair to say that we were aware of the interest of some members of Congress, just as we were aware of growing media attention paid to non-profit hospitals over recent years and to benefits being delivered by not-for-profit hospitals —

and even in the question of whether there should continue to be tax exemptions for them.

HP: How did the IRS use and balance the input it solicited and received as it was developing the form — from Congress, the Government Accountability Office, consumers, academics,

associations, hospitals and the like?

Schultz: We circulated the first draft of the new 990 form in June of last year, including the hospital schedule. We announced in a press release and in a press conference that we would give the public 90 days to make comments, and that we would make changes based on those. My recollection is that we received about 700 public comments — about 3,000 pages. About a third were on hospitals. All of the comments are now available on our website. We have been very open and public about the whole development process. We went out and made speeches, we participated in panel presentations, we had telephone conferences with associations.

In particular, with respect to the Schedule H, we worked very closely with the American Hospital Association, as well as Catholic Health Association and other associations in reaching out to

their members. We wanted to know whether our questions were well-written, whether — as far as they were concerned — they were on the right topics, and what kind of burden would be associated with completing the form. So everything was fair game. Then we had a team back here at the IRS of individuals who have expertise in tax-exempt organizations — we had one group familiar with hospitals — and we sat down and tried to process the comments we received and made decisions about what to include, what not to include. And to the extent we felt we needed more information, we went back and reached out to the sector.

HP: Did you make significant changes based on that input?

Schultz: Oh, yes we did. You can track this publicly from our



Photo by Rick Reinhard

Ronald Schultz

website. We made significant changes, in particular on the Schedule H, from the June draft last year to the December version we released in final form. There were whole sections that we took out. For example, on the June draft, we had a section on financial information, where we were asking for revenues by type of patient — Medicare, Medicaid, uninsured, third-party insured, and so forth. We felt that that was good information for us to get so we'd have a good sense of which of those patient pools was contributing to income. But when we rolled that out, we received significant push-back from the sector, most of it related to burden. They said "we don't really have this information, so don't cast it that way." But some of it was also a position on their part that what we were asking them for was highly confidential information. We understood that this was something they should be concerned about and, as a result, we dropped it. We also made a number of changes in the way we ask questions about charity care or other community benefits.

Among the most controversial issues we sought input on was how to report Medicare shortfalls and debt expense, which some hospitals treat as community benefit and some don't. One of the changes we made in the final form was to enhance the separate reporting on the form of bad debt expense and Medicare on Part III from reporting of community benefits on Part I.

And finally, in another major change, on Part VI we ask open-ended questions so hospitals could give us narrative responses rather than just a "yes" or "no" or checking a box. Providing a place for supplemental information allows them

that, we don't have a preference on completing other parts of the form. The most likely candidates for completing the whole form are those who have already done significant work in trying to capture community benefit information along the same lines it should be reported here, because their accounting systems and their community benefit systems, while not identical to what we ask for, is reasonably close. They may want to do that because that's their culture and they are prepared to do it. But I think that frankly there are a lot of organizations who want to be transparent and would be very willing to put numbers out to the public, but who will not do it the first year because they'll be concerned they still need to work out glitches in their information-gathering processes. Those organizations are likely to use the one-year transition relief in the way it was intended: to give them a chance to practice, basically, by completing the form without sending it in to the IRS. I have no doubt that many hospitals out there will not send in a fully completed Schedule H for 2008 but probably almost all of them will do it internally.

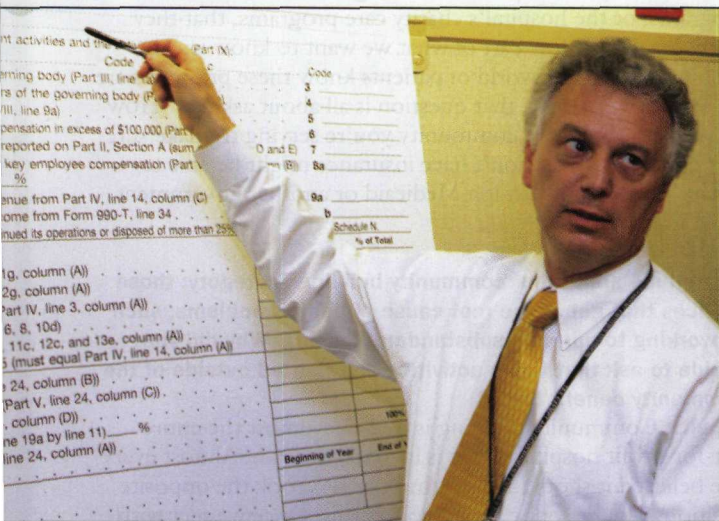
HP: After the Schedule H is filed, who will review it, and what will be done with the data collected?

Schultz: We haven't worked out all the details yet for processing information for the 990 in general and the Schedule H in particular, but we have been doing some work on that. Our expectation is that the Schedule H will provide, first and foremost, a wealth of data and enable us to get picture of the nonprofit hospital sector broadly. We'll be able to look at the thousands of nonprofit hospitals that are out there and start making comparisons from one organization to another on how community benefits are being reported and the like. It'll give us a chance to assess whether there continues to be a lack of uniformity in the reporting of certain pieces of it.

At present, there is no uniformity in reporting on bad debt or Medicare, and we want them to tell us how they're treating it and why they believe it should be treated as community benefit. We believe this overall Schedule H information will help us assess whether particular organizations are complying with the 1969 revenue ruling, which is the current community benefit standard.

HP: If hospitals say "no" to certain questions, such as "Does the organization prepare an annual community benefit report," should they expect an audit by the IRS?

Schultz: They should not expect an audit by the IRS just because of the way they respond to a particular question on the Schedule H, or [to a particular question] on the whole 990 form for that matter. We've been telling people publicly, and this is our intention: We are not going to go out and open up examinations just because of the way they respond to one question on the form. However, when we build compliance programs and examination programs, it's fair to say, and the sector should expect, that various questions will be put into a profile. It may be that a particular question is one of 10 or 15 that we build into an examination or compliance profile, depending upon what we're looking for. For example, if what we're interested in is looking at executive compensation in the hospital area, it's unlikely that a question about community need assessment [which appears under



Schultz points to an enlarged version of the redesigned Form 990.

to tell us their stories, to talk about things they think are important, but which maybe we don't ask about, or to supplement responses where we do ask questions.

HP: Most of the Schedule H is optional for the 2008 tax year. Do you suggest hospitals complete the entire schedule before it becomes mandatory?

Schultz: Part V, facility information, is required for 2008, so we will be expecting organizations to complete that. Beyond

Ronald J. Schultz

Ronald Schultz moved from Washington, D.C., two years ago from Minneapolis to join the staff of the Internal Revenue Service as senior technical advisor

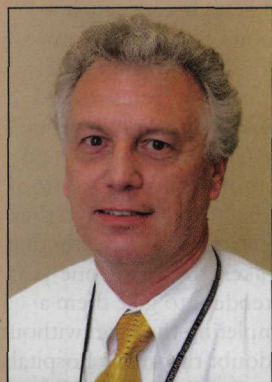


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to the commissioner of the Tax Exempt and Government Entities division. In that role, he provides legal advice to the commissioner and other top executives on programs that serve the division's customers, and technical advice on a wide variety of issues, including legislation, regulations, trends and needs

related to tax-exempt and government entities. He has worked extensively on the IRS Form 990 redesign project.

Schultz grew up in St. Paul, Minn., and earned his bachelor's degree at the University of Minnesota, Minneapolis. He earned his law degree at William Mitchell College of Law in St. Paul and did one year of graduate tax work at Georgetown University, Washington, D.C.

In Minneapolis, he worked in tax law as a member of the law firm of Leonard, Street and Deinard, where his areas of specialization included health, nonprofit and tax-exempt organizations. In a three-year interlude, from May 2002 to January 2005, he worked in Washington, D.C., as legislation counsel on the staff of the Joint Committee on Taxation of the U.S. Congress. There, he advised Congress, including the Senate Committee on Finance and the House Committee on Ways and Means, on hearings, investigations, legislation and tax policy pertaining to various areas of federal income tax law, concentrating on charitable and other exempt organizations, as well as charitable contribution deductions.

"I loved that work," he said. "I went back to Minnesota, but found I couldn't stay away from D.C. "What I like about the job I have now," Schultz said, "is that it's a blend of the abstract, academic stuff that a lot of good professors get to think about: interesting problems from a policy/administration perspective. But there's also a strong practical, realistic side to it. We're putting forms out there, like the 990. So how does the real world deal with that? You need to know a fair amount about the practice of organizations.

"Another thing I really like about it — and I this was not expected when I came — is actually working the sector. I love going out and talking to people about this stuff, whether it's doing a speech, or being on a panel, or just the back and forth we did on this project. It's great work. It's fabulous to deal with smart people who care."

Supplemental Information on the form] would be pertinent. On the other hand, if we're doing an initiative to look at how they go about establishing community needs, how they go about reporting to the public on their programs and the like, questions about community benefits are likely to make the list. Participation in joint ventures might be another area of interest. How organizations are reporting nonquantifiable aspects of community benefit might be another. There'd be conceivably an infinite number of ways to slice it, and we wouldn't know what questions we would pick until we know what we are asking for and why.

HP: What do you hope to learn from the Schedule H about hospital billing and collection practices? How does this information relate to the community benefit standard?

Schultz: In terms of what we hope to learn from it, we ask questions about whether hospitals have written policies on debt collection, and then if they do, whether the policies contain provisions with respect to collection practices related to patients who qualify for charity care or financial assistance. We believe it's fair game to ask about collection practices with respect to charity care — and folks eligible for charity care — because it's a consideration whether it's really charity care or whether it's bad debt. For example, if they report numbers on charity care but have policies that say, look, if patients are eligible for charity care, we're going to try to collect it as bad debt first, that calls into question whether it's charity care.

The other billing and collection question we have is in the supplemental information. It asks how the organization informs and educates patients about government assistance programs, or the hospital's charity care programs, that they might be eligible for. Part of what we want to know is: Are hospitals letting the world of patients know these programs are available? In our view, that question is all about asking, "How do you work with the community you're serving to make sure that those folks who don't have insurance might be able to receive health care through Medicaid or another government program?"

HP: Tell me about the "community building" category: those services that get at the root cause of health problems, such as working to upgrade substandard housing. Why did you decide to ask that these activities be reported outside of the community benefit table?

Schultz: Community building is one area almost the entire not-for-profit hospital sector is in agreement on. Almost everyone believed it should count. And the IRS took the opposite position. The reason we said "no," is this: Once we met with folks, including folks from CHA and AHA, and felt we had a reasonably good understanding of what community building meant, we concluded that there were some activities within community building that sure seemed like they should count as community benefit, and there certainly were some that didn't look to us like they should count, and then there was a large group of activities in between that would depend upon facts and circumstances. So, despite the fact that everyone encouraged us to include it, we determined that it would be inappropriate for us to treat it as community benefit at this time. So what we decided to do — and some recommended it to us,

actually — we decided to get the information on community building separately. We're hoping they will provide information about their various community-building activities, so that we'll have this wealth of data and will be able to look at the types of activities, how frequently they are being provided, what portion they are of the overall expense, and whether they are growing in importance. Then we'll have much more information on which to make decisions about whether some pieces of community building actually should count as community benefit.

Now, it's probably worth drilling down a little bit on this; for instance, housing and getting at the root causes of health problems. When we looked at the list of things folks said make up community building, it's making improvements to housing, it's economic development, it's reaching out to the community, it's providing community support, making environmental improvements, and supporting affordable housing projects. These are all good things. They're great things. From our perspective, they're even consistent with tax exemption. What is not clear to us is whether they're consistent with the standard that applies to these hospitals, which is promotion of health — whether, for instance, providing affordable housing fits squarely within the [IRS's] community benefit standard of promotion of health.

We understand that providing better housing for low-income people can lead to long-term health improvement for those individuals, but there's a much less direct connection between that expenditure and promoting health. We just need to work with the sector and get a better understanding and better information about what these programs are and have the arguments develop pro and con on those types of activities before we conclude that they count as community benefit.

HP: A question almost at the end of the Schedule H asks organizations to describe other ways in which they promote the health of their communities. What information does the IRS expect to receive?

Schultz: We think we'll get quite a bit of narrative that will probably provide information related to questions we did not ask. Despite all our work with the sector to try to figure out what kind of questions to ask, some of the nonprofit hospitals are going to say, "You know what? We're doing this, and there's nowhere on the schedule where they ask me about that." We want to get that information because we think the IRS needs to know and the public needs to know. These will be mostly programs that are clearly of benefit to the community but don't fit into any of the buckets we put on the form. It's intended to get information we just didn't anticipate. It's also intended to get information about things we just didn't take into account regarding the changes hospitals will make over time.

HP: Hospitals are focusing on the Schedule H, but what other changes in the Form 990 overall should they be paying attention to?

Schultz: They, like non-hospitals, should pay attention to the changes we've made to reporting of executive compensation. There are some pretty dramatic changes in that area. They should also look at the new governance section. My personal

view is that a lot of the nonprofit hospitals already have in place sophisticated governance structures and policies because of federal and state regulations, and that it will be relatively easy for many hospitals to complete this part of the form. But there is new information we have not asked before, so they should become knowledgeable about that. And then we have a number of questions on related organizations and joint ventures they're involved in — questions we've never really asked them about point blank before. One new area which will affect some hospitals but not others is a schedule on foreign activities, Schedule F, where we ask organizations, not just hospitals, whether they are conducting activities out of the United States.

Another big one for hospitals is tax-exempt bonds. Many of them use tax-exempt bonds to finance buildings. We have a schedule, Schedule K, which asks for quite a bit of information on those bond issues.

HP: What have been the greatest challenges in developing the Schedule H?

Schultz: I think the biggest challenge has been trying to come up with the questions that best reflect and capture the information we need and which we feel promote the guiding principles of the redesign: promote transparency, improve or enhance tax compliance and, consistent with doing both of those things, trying to keep the burden down as much as possible. To me, it was trying to build a form that is really comprehensive and achieves those three things.

HP: Do you anticipate that it will be burdensome for hospitals to complete these forms?

Schultz: The amount of burden and the type of burden will differ depending on the size of the organization and how sophisticated they are and how spread out they are, and whether they qualify for our transition relief. There will be a learning curve, not only for the organizations, but also for the practitioners — the accountants, the software companies, everybody that is associated with it. It is a massive redesign, and we know that. That's why it became so important for us to give them transition relief on the Schedule H, to make most of the 2008 form optional so that they had extra year to get ready for it. That benefits us too because the information we get by waiting a year will be much better than what we would get early on.

HP: Is there anything you would like to add?

Schultz: We do this all the time, but we can't do it too much: to thank the sector and the practitioners and the leaders for all the work they've done with us. They've been great in providing input. They didn't always agree with us; we didn't always do what they wanted us to do. But their help has been invaluable. We know that once we roll out the final instructions, our work isn't done. We'll continue to work with the sector as things emerge during the filing season. ■



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