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Why are Charitable Healthcare Providers Under Attack and What Can They do to Protect Themselves?

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The media has reported recently on the numerous class-action lawsuits brought against hospitals and healthcare systems by the same lawyers who successfully sued the tobacco industry during the 1990s. With a highly effective public relations system in place, these lawyers claim that healthcare providers are failing to live up to their charitable mission, are gouging the poor and uninsured and forcing many of them into bankruptcy, are sitting on millions of dollars and are run primarily for the benefit of private interests.

In addition, the press has spotlighted the Provena Covenant healthcare system in Champaign-Urbana, Illinois, which had its state real estate tax exemption revoked by the Illinois Department of Revenue, and the Yale-New Haven Hospital in New Haven, Connecticut, which has been sued by former patients claiming the hospital and its affiliates failed to live up to their obligations to provide free care under state law.

While there undoubtedly are some problems — and perhaps even abuses — within the charitable healthcare sector, the fact is that many providers struggle to provide high quality services under an increasingly complex set of federal and state laws and regulations. The question whether tax-exempt status should be eliminated for such providers — and for other traditional charities — has received attention from Congress and has resulted in increased scrutiny from the Internal Revenue Service (IRS). Clearly the recent spate of litigation will lead to judicial review as well.

This attack presents both problems and opportunities. On the problematic side, to the extent that those providers which are true charities are swept along with those providers that take advantage of their tax-exempt status, the ultimate losers are likely to be all of us who are dependent on having access to local, community-based healthcare entities. With respect to opportunities, there is no better time than the present to engage in an internal audit of certain critical issues and, to the extent necessary, with the assistance of appropriate outside experts.

The first critical issue relates to the provision of charity care and care to the uninsured. Despite the lumping together of the medically indigent with all uninsured persons in the class-action suits, the fact is that there are significant differences, and a person with a substantial income and significant assets who chooses either to forgo insurance or obtain only catastrophic insurance should not be treated in the same manner as a family with an income below the federal poverty level. Sorting out who should receive charity care, how to make delivery of such care available operationally and what the uninsured should be charged are three difficult

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questions to which there are no simple or pat answers. Nevertheless, a starting point is recognizing and evaluating both what a provider's policies are and how and to what extent those policies are being carried out.

The second critical issue relates to maintenance of the state tax exemption afforded by state constitutional and statutory provisions. In the Provena Covenant matter, the local county board of review relied on the fact that many of Provena Covenant's core functions were carried out by private parties. Having failed to receive supporting documentation from Provena Covenant which might have explained why the system chose to contract with for-profit entities rather than increase its employees, the county board concluded that Provena Covenant was allowing its facilities to be used for private, for-profit purposes rather than charitable purposes. Given the shortage of tax revenues at the state and local level, proving an entity's charitable status under state law — which varies from its status as a 501(c)(3) organization under the Internal Revenue Code (Code) — requires a combination of internal review and external communication and education.

A third critical issue relates to transactions between officers and directors — and, in some cases, medical staff members — and the charitable entity. The IRS has announced that, as part of an increased review and enforcement effort, it will be sending out some 1000 letters this summer to charities — including healthcare providers — whose executives have received significant compensation. These types of transactions, along with other relationships between charities and those who govern and influence them, are subject to scrutiny under state law as well.

It seems naïve to think that northern New England will be exempt from the challenges which healthcare providers are facing in other, more populated parts of the nation. Accordingly, charitable healthcare providers should begin a process of review and analysis in these targeted areas and take the proactive measures necessary to ensure compliance with all federal, state and local obligations. The effect of such action is, in our judgment, twofold: first, and most important, it assures an appropriate template for operations going forward; and second, to the extent there are potential problems, they can be addressed in a non-hostile and non-adversarial context.

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