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# SYMPOSIUM: HEALTH CARE AND TAX EXEMPTION: THE PUSH AND PULL OF TAX EXEMPTION LAW ON THE ORGANIZATION AND DELIVERY OF HEALTH CARE SERVICES -- Introduction

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SYMPOSIUM:  
HEALTH CARE AND TAX EXEMPTION:  
THE PUSH AND PULL OF TAX  
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HEALTH CARE SERVICES  
INTRODUCTION

*Laura B. Chisolm*<sup>†</sup>

At about the same time that Congress, yet again, began to take a close look at tax exemption, with hospitals at the center of the inquiry,<sup>1</sup> dozens of class action suits were being filed by the Scruggs Law Firm against hospitals and health care systems alleging, among other things, that these institutions are not meeting an obligation to provide charity care to the poor and affordable care to the uninsured that is part of the “contract” of § 501(c)(3).<sup>2</sup> This is not the first time that the tax exemption of health care institutions has been in the spotlight, and we can be certain it will not be the last. The health care sector accounts for a very large piece of the tax-exempt universe. At hearings last summer, Ways and Means Chair William Thomas noted that hospitals account for “41 percent of the tax expenditures” that result from the § 501(c)(3) tax exemption for charitable organizations.<sup>3</sup> Rising health care costs, increasing numbers of uninsured people, and vast changes over the last half century in the way health care is organized and delivered raise fundamental questions of health care policy. A skeptic might suggest that the focus on tax exemption stan-

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<sup>1</sup> See, e.g., Fred Stokeld, *Thomas Announces Review of Exempt Organizations’ Activities*, 44 EXEMPT ORG. TAX REV. 14 (2004); Christopher Quay, *W & M Subcommittee Hears Testimony on Hospital Pricing*, 45 EXEMPT ORG. TAX REV. 11 (2004); *Charity Oversight and Reform: Keeping Bad Things from Happening to Good Charities: Hearing Before the Senate Comm. on Finance*, 108th Cong. (2004).

<sup>2</sup> See, e.g., Fred Stokeld, *Lawsuits Filed Against Tax-Exempt Hospitals*, 45 EXEMPT ORG. TAX REV. 12 (2004).

<sup>3</sup> Quay, *supra* note 1, at 11.

dards and framing the question as “why sophisticated, well-heeled hospitals and health care systems that get the benefit of exemption are getting away with doing so little to solve the problems” is one way to dodge larger, harder questions about whether and how we will, as a society, provide for quality, affordability, and access in health care - trading those questions for still difficult, but certainly more manageable, questions about what we ought to be demanding in return for the “subsidy” of tax exemption. On the other hand, it can hardly be denied that it makes perfect sense to be vigilant about whether our tax exemption rules are fair, consistent, and constructive, and about whether they are being ill-used.

Hospitals and other health care organizations are subject to an array of laws, regulations, and public financing programs, most of which are deliberately fashioned to promote broad public health care policy goals. Clearly, the tax exemption rules that apply to private, nonprofit hospitals, HMOs, and complex health care systems also shape institutional structural choices and behavior. Some of that influence is deliberate, but much of it is not by design, or at least not by design that accounts for the broader health care policy context within which these entities operate. Tax exemption rules often have effects on health care organizations that are unintended, or at least not driven by deliberate health care policy choices.

The articles in this symposium address various ways in which tax exemption laws support, are in tension with, or could be better tailored to promote broader health care policy goals. The authors - professors and practitioners - are all experts in tax exemption law, health care law, or both. All of them acknowledge the significant influence of exemption law on the way health care is organized and delivered - intended or not, for better or worse. Tax exemption rules exert a strong pull on choice of organizational structure and on practices like the setting of executive compensation, the use of joint ventures, and the fiduciary functions of nonprofit hospital boards. Indeed, the very definition of charity - what makes health care “charitable” for purposes of § 501(c)(3)? - has both responded to and shaped evolution in the organization and delivery of health care services.

Douglas Mancino maintains that the evolution of § 501(c)(3) exemption qualification requirements from charity care to a broader community benefit standard in 1969 appropriately reflected the significant changes in the structure, content, and financing of complex health care services that occurred during the 1960s and 1970s. Subsequent interpretation of the community benefit standard continues to influence the organization and delivery of health care services, but, Mancino asserts, in ways that may counter broader health care policy goals. According to Mancino, the IRS and courts interpreting exemp-

tion rules have, without justification and perhaps unwisely, limited the availability of § 501(c)(3) exemption to most HMOs and integrated delivery systems, have inserted into the criteria for exemption for hospitals de facto requirements for open medical staff membership and board composition, and have applied the community benefit standard for determining charitability that was adopted in 1969 in a way that has reverted to the very charity care standard that the community benefit standard replaced.

John Colombo also explores the community benefit standard that is at the heart of § 501(c)(3) exemption for hospitals and other health care entities. He agrees with Mancino that the IRS and courts have gradually reintroduced charity care as a central – perhaps virtually necessary – feature of community benefit, although neither the IRS nor the courts have clearly articulated the requirements for exemption in precisely those terms. He proposes that the standard as currently articulated – the promotion of health “plus” something more – is neither well-defined nor well-suited for reliably sorting organizations that merit the support of exemption under § 501(c)(3) from those that do not. Considering various proposals for alternative approaches, Colombo ends by proposing an “enhancing access” approach to align exemption standards with broader health care policy goals.

Lorry Spitzer examines the impact of exemption-related provisions, particularly the intermediate sanctions rules of § 4958, on executive compensation practices of hospitals and health care systems. He observes that the safe harbor provisions of § 4958 are very well aligned with exempt organization best practices and proposes that IRS enforcement efforts focus on process rather than measure the success of the efforts in terms of downward pressure exerted on salaries.

Michael Sanders identifies the forces that encourage well-managed health care organizations dealing with today’s health care environment to enter into a variety of joint venture arrangements to accomplish some or all of their activities. He chronicles the IRS’s shift away from an outmoded per se prohibition on participation in joint ventures, and applauds the issuance of recent guidance that goes far to provide a roadmap for organizations that want to use joint venture vehicles without risking their § 501(c)(3) exemption.

Finally, Nina Crimm looks at the role of tax exemption law in defining and implementing the fiduciary obligations of hospital board members. She concludes that the existing mix of legal, moral, and professional fiduciary standards work quite effectively in the context of hospitals to encourage behavior that is consistent with broad health care policy goals. Incorporating an explicit duty of care obligation into § 501(c)(3), as contemplated in proposals currently under consideration, would be, at best, redundant and, at worst, counterproductive.

Together, the articles in this symposium offer a wide-ranging, albeit not exhaustive, survey of features of tax exemption law that may encourage or impede behavior that is consistent with a strong, accessible, high-quality health care sector. Policymakers would do well to bear in mind both the potential and the limitations of tax exemption rules as a mechanism to promote the objects of broader health care policy.