



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

February 5, 2001

Number: **200110030**
Release Date: 3/9/2001
CC:TEGE:EOEG:EO2
FREV-106773-01
UILC: 501.03-11

INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR JUDITH PICKEN
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FROM: Assistant Chief Counsel
(Exempt Organizations/Employment Tax/Government Entities)
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SUBJECT: Exempt Hospitals' Compliance with Treas. Reg. § 1.501(c)(3)-1(c).

This Field Service Advice responds to your request for interim guidance on the legal criteria for hospitals to qualify for exemption under section 501(c)(3). Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be used or cited as precedent.

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administration duties with respect to the case and the issues discussed in the document require inspection or disclosure of the Field Service Advice.

You have requested preliminary advice and guidance on case development concerning the following issue.

ISSUE

Whether a hospital whose stated policies are to provide health care services to individuals regardless of their ability to pay satisfies the charity care requirement of the community benefit standard under the operational test in Treas. Reg. § 1.501(c)(3)-1(c)?

CONCLUSION

A hospital's stated policies to provide health care services to the indigent are not sufficient to satisfy the charity care requirement of the community benefit standard under the operational test in Treas. Reg. § 1.501(c)(3)-1(c), unless the hospital demonstrates that such policies actually result in the delivery of significant health care services to the indigent.

LAW AND ANALYSIS

Section 501(a) generally provides that organizations described in section 501(c)(3) shall be exempt from federal income tax. Section 501(c)(3) describes organizations organized and operated exclusively for charitable or other specified purposes. Treas. Reg. § 1.501(c)(3)-1(a)(1) and Treas. Reg. § 1.501(c)(3)-1(c), respectively, set forth an organizational test and an operational test to determine whether an organization qualifies for exemption under section 501(c)(3). An organization must meet both the organizational test and the operational test to qualify for exemption under section 501(c)(3). Levy Family Tribe v. Commissioner, 69 T.C. 615, 618 (1978); Treas. Reg. § 1.501(c)(3)-1(a)(1).

A. Promotion of Health as a Charitable Purpose

Section 501(c)(3) uses the term "charitable" in its generally accepted legal sense. Nationalist Movement v. Commissioner, 102 T.C. 558, 576, aff'd, 37 F.3d 216 (5th Cir. 1994), cert. denied, 513 U.S. 1192 (1995); Treas. Reg. § 1.501(c)(3)-1(d)(2). Accordingly, the courts have looked to the law of charitable trusts to ascertain what activities are charitable for purposes of section 501(c)(3). See, e.g., Redlands Surgical Services v. Commissioner, 113 T.C. 47, 73 (1999), appeal docketed, No. 99-71253 (9th Cir., Sept. 17, 1999); Sound Health Association v. Commissioner, 71 T.C. 158, 178 (1978). Based on the law of trusts, the courts and the Service have ruled that the promotion of health is a charitable purpose under section 501(c)(3). See, e.g., Redlands Surgical Services, 113 T.C. at 73; Sound Health, 71 T.C. at 178; Rev. Rul. 69-545, 1969-2 C.B. 117. See also

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Restatement (Second) of Trusts §§ 368, 372 (1959); 4A Austin W. Scott & William F. Fratcher, *The Law of Trusts* §§ 368, 372 (4th ed. 1989).

B. Requirements of Community Benefit Standard

A hospital or other health care organization does not automatically qualify for exemption under section 501(c)(3) merely because it promotes health. See Federation Pharmacy Services, Inc. v. Commissioner, 72 T.C. 687, 692 (1979), aff'd, 625 F.2d 804 (8th Cir. 1980) ("We do not believe that the law requires that any organization whose purpose is to benefit health, however remotely, is automatically entitled, without more, to the desired exemption."); Sonora Community Hospital v. Commissioner, 46 T.C. 519, 525-526 (1966), aff'd, 397 F.2d 814 (9th Cir. 1968) ("While the diagnosis and cure of disease are indeed purposes that may furnish the foundation for characterizing the activity as 'charitable,' something more is required."). Specifically, the courts and the Service require that a hospital or other health care organization must primarily benefit the community in order to qualify for exemption under section 501(c)(3). See, e.g., Redlands Surgical Services, 113 T.C. at 73; Geisinger Health Plan, 985 F.2d at 1219; Sound Health, 71 T.C. at 180-181; Rev. Rul. 69-545, 1969-2 C.B. 117. The determination by the courts and the Service about whether a hospital satisfies the community benefit standard is based on all the facts and circumstances. See, e.g., Redlands Surgical Services, 113 T.C. at 92; Rev. Rul. 69-545, 1969-2 C.B. 117.

C. Charity Care Establishes a Community Benefit

The provision of free or subsidized care to the indigent is a significant indicator to the courts and the Service that a hospital promotes health for the benefit of the community. In Rev. Rul. 69-545, 1969-2 C.B. 117, the Service ruled that a hospital which operated a full-time emergency room, did not deny emergency care to those who could not afford to pay and met certain other requirements qualified for exemption. These charitable indicia outweighed the fact that the hospital ordinarily limited admissions to individuals who could afford to pay for their hospitalization and referred indigent patients requiring hospitalization to another hospital in the community that served indigent patients. By contrast, Rev. Rul. 69-545 denied exemption to a hospital that maintained an emergency room on a "relatively inactive basis" primarily for the convenience of its paying patients and instructed ambulance services to take emergency cases to other area hospitals. In Rev. Rul. 83-157, 1983-2 C.B. 94, the Service stated that operating a full time emergency room open to all, regardless of a person's ability to pay, "is strong evidence that a hospital is operating to benefit the community." In Rev. Rul. 98-15, 1998-1 C.B. 718, a material factor for the Service's conclusion that a hospital, which entered into a joint venture with a for-profit entity, furthered charitable purposes was that the hospital would use its partnership distributions "to help provide health care to the indigent."

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In Geisinger Health Plan, the court stated that “to qualify as a tax exempt charitable organization, a hospital must still provide services to indigents.” 985 F.2d at 1217. In Redlands Surgical Services, the court stated that one of the indicia of community benefit is “whether the organization provides free care to indigents.” 113 T.C. at 73. In Sound Health, the court ruled that a health care organization operated for charitable purposes, in part because it offered free emergency room care to the indigent and directed the ambulance company that it would treat any emergency patient. 71 T.C. at 172, 184. See Harding Hospital, Inc. v. United States, 505 F.2d 1068, 1077 (6th Cir. 1974) (Hospital’s lack of “a specific plan or policy for the treatment of charity patients” was a factor for denying exemption under section 501(c)(3)).

D. Hospital’s Activities Must Actually Produce a Community Benefit

A hospital will not qualify for exemption under the community benefit standard merely by stating that its policies are designed to provide health care services for the indigent. The operational test under section 501(c)(3) obligates an organization to engage “primarily in activities which accomplish one or more” exempt purposes. Treas. Reg. § 1.501(c)(3)-1(c)(1) (emphasis added). The hospital, therefore, must demonstrate that its charity care policies actually yield significant health care services to the indigent to qualify for exemption. See Redlands Surgical Services, 113 T.C. at 86-88; Geisinger Health Plan, 985 F.2d at 1219.

In Sound Health, the court stated that the policy behind the community benefit standard is “insuring that adequate health care services are actually delivered to those in the community who need them.” 71 T.C. at 180-181 (emphasis added). In Geisinger Health Plan, the third circuit overruled a determination by the Tax Court that a health maintenance organization qualified for exemption under the community benefit standard. 985 F.2d at 1221, rev’g and remanding, 62 T.C.M. (CCH) 1656 (1991). The third circuit concluded that “the mere presence of the subsidized dues program” for the poor did not establish that the organization benefitted the community, because the amount of benefit the program actually conferred was minuscule. 985 F.2d at 1219-1220. In Redlands, a surgery center argued that, by changing its policy for performing surgery “from an economic to exclusively a medical decision,” it “achieved its goal of providing complete access to . . . care for all members of the Redlands community irrespective of their ability to pay.” 113 T.C. at 86 (emphasis added). The court rejected this assertion, finding that the administrative record did not support the surgery center’s claim that it actually provided any charity care. 113 T.C. at 86, 87. As further evidence of its charitable purposes, the surgery center stated that it had “no requirement that patients demonstrate an ability to pay before receiving treatment.” 113 T.C. at 87. The court also rejected this claim, finding that the record contained no evidence that the organization had communicated this policy to its patients. 113 T.C. at 87. See Federation Pharmacy Services, Inc. v. Commissioner, 72 T.C. at 692 (Organization denied exemption because it did not provide drugs for free or below cost to

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the indigent); Sonora Community Hospital, 46 T.C. at 524, 526 (Hospital denied exemption because it provided only minimal charity care).

Based on the foregoing, a hospital's mere assertions that it has a policy to provide health care services to the indigent is not sufficient to establish that the hospital meets the charity care requirement of the community benefit standard. Instead, the hospital also must show that it actually provided significant health care services to the indigent.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

Set forth below are a series of questions to address when developing the factual record on the charitable care policies and activities of a hospital.

1. Does the hospital have a specific, written plan or policy to provide free or low-cost health care services to the poor or indigent?
2. Under what circumstances may, or has, the hospital deviated for its stated policies on providing free or low-cost health care services to the poor or indigent?
3. Does the hospital broadcast the terms and conditions of its charity care policy to the public?
4. Does the hospital maintain and operate a full-time emergency room open to all persons regardless of their ability to pay?
5. What directives or instructions does the hospital provide to ambulance services about bringing poor or indigent patients to its emergency room?
6. What inpatient, outpatient, and diagnostic services does the hospital actually provide to the poor or indigent for free or for reduced charges?
7. Under what circumstances does the hospital deny health care services to the poor or indigent?
8. Does the hospital operate with the expectation of receiving full payment from all persons to whom it renders services?
9. How and when does the hospital ascertain whether a patient will be able to pay for the hospital's services?

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10. What documents or agreements does the hospital require poor or indigent patients to sign before receiving care?
11. What is the hospital's policy on admitting poor or indigent patients as inpatients and outpatients?
12. Under what circumstances does the hospital refer poor or indigent individuals who require services to other hospitals in the area that do admit poor or indigent patients?
13. Does the hospital maintain separate and detailed records about the number of times, and circumstances under which, it actually provided free or reduced-cost care to the poor or indigent?
14. Does the hospital maintain a separate account on its books that segregates the costs of providing free or reduced-cost care to the poor or indigent? Does this account include any other items, such as write-offs for care to patients who were not poor or indigent?

6010. If you have any further questions, please call Don Spellmann at (202) 622-

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