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ROBINSON & COLE LLP

# Health Law Pulse

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### IRS Issues Governance Guidelines For Tax Exempt Organizations

The Internal Revenue Service (IRS) released draft voluntary governance guidelines for tax exempt organizations on February 2, 2007. According to the IRS, the draft guidelines reflect ideas from sources within and outside the exempt sector and are intended to assist tax exempt governing boards in understanding their roles and responsibilities.

The guidelines stress that governing boards of exempt organizations should be composed of a diversified group of people, actively engaged in the charity's operations and finances. Successful boards, the IRS suggests, include individuals who are knowledgeable and passionate about the organization's programs and have expertise in accounting, finance, compensation and ethics. Without specifying an exact number, the IRS cautioned that governing boards should not be too large or too small. Some of the more specific practices outlined by the IRS include establishing a clear mission statement adopted by the board of directors to "explain and popularize the charity's purpose and serve as a guide to the organization's work;" developing a code of ethics and a whistleblower policy to communicate to employees that the institution has ethical integrity and will not tolerate financial impropriety; determining what constitutes a conflict of interest among directors and staff and developing a policy that such conflicts must be disclosed; ensuring that fundraising materials are accurate and truthful; and evaluating director compensation to ensure it is reasonable.

The guidelines also include recommendations regarding ensuring the accuracy of Form 990 information returns and other documents and making them publicly available. To help ensure that a charity's financial resources are used to advance charitable purposes, the IRS suggests that the board receive and review updated financial statements, "including Form 990, auditor's letters and finance and audit committee reports." A charity with large assets or revenues should undergo annual audits by an independent auditor, who should be monitored by an independent audit committee established by the board, the guidelines say, adding that smaller charities should have annual audits conducted by an independent certified public accountant.

While satisfaction of the guidelines is not a requirement for tax exemption, the issuance of the voluntary guidelines confirms that the IRS expects tax exempt boards to be fully accountable for their organization's good governance practices.

A copy of the guidelines, in their entirety, is available at http://www.irs.gov/charities/charitable/article/0,,id=167626,00.html.

*If you have any questions regarding the IRS guidelines or would like assistance with reviewing your current governance policies in light of the governance guidelines, please contact a member of Robinson & Cole's Health Law Group or Tax Exempt Organizations Group.* (back)

**Connecticut Non-Profit Health Care Organization Denied Property Tax Exemption**

The Connecticut Tax Court recently denied a request for property tax exemption sought by St. Joseph's Living Center, Inc. (the "Living Center"), a non-profit corporation exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code ("IRC"). The court's February 23, 2007 decision in *St. Joseph Living Center, Inc. v. Town of Windham* follows two similar and highly publicized cases in Illinois and suggests a trend that may be developing nationwide.

The Living Center, which is affiliated with the Roman Catholic Diocese of Norwich, was organized in 1987 to develop, operate and maintain a skilled nursing facility, which provides long-term care and short-term rehabilitative services. The Living Center generates its revenue from health care services provided to Medicare, Medicaid and private pay patients. In order to cover its unreimbursed costs attributable to care of Medicaid patients, the Living Center charges private pay patients the actual cost of care plus an additional amount. The Living Center generally does not provide free care. In 1994, the Living Center applied to the Town of Windham for an exemption from property taxes. The town denied the request and the Living Center did not appeal. The Living Center subsequently requested and was once again denied a property tax exemption from municipal taxes in 2003. The Living Center appealed this denial.

Agreeing with the town's denial of the Living Center's 2003 property tax exemption application, the Connecticut Tax Court concluded that the Living Center's property is used as a nursing facility, as opposed to a church, and is not exempt as a house of worship. The court further stated that Connecticut General Statutes Section 12-81 does not specifically exempt 501(c)(3) corporations from the payment of property taxes. Rather, in order to receive exemption from property tax under Connecticut law, the property must (i) belong to or be held in a trust for an organization organized exclusively for charitable purposes and used exclusively for carrying out such purposes; (ii) be held for one of the purposes stated in the statutory list of exemptions (e.g., scientific, educational, literary, historical or charitable purposes); and (iii) produce no rent, profits or income. Additionally, the extent to which an organization uses its property for purposes not directly related to its charitable purpose is relevant to the determination of whether the organization's property is entitled to tax exempt status.

In reaching its conclusion that the Living Center is not a corporation organized exclusively for charitable purposes, the court explained that (i) the Living Center receives a substantial amount of revenue from private pay patients and provides services to patients for rehabilitative services regardless of the patient's age, and (ii) there was no financial burden from the operation of the facility on either the Living Center or on the Roman Catholic Diocese of Norwich. Moreover, the court noted that the Living Center does not admit indigent patients at the expense of the Living Center. The operation of the Living Center does not lessen the burden on society or taxpayers since it receives compensation for services rendered. Finally, the Living Center reported an excess of revenue over expenses for several years.

The court's decision to deny the Living Center's request for property tax exemption follows recent rulings in Illinois which have provoked a great deal of concern on the part of non-profit organizations across the nation.

In a decision denying the request of Provena Covenant Medical Center ("PCMC"), a not-for-profit hospital, for exemption from property tax for the 2002 tax year, the Illinois Department of Revenue Services ("DRS") concluded that PCMC's commitment to charitable care was insufficient under state laws that require that property eligible for an exemption be used "exclusively for charitable purposes." The primary basis for the DRS' conclusion was that PCMC admitted that its 2002 revenues exceeded $113 million and that its charitable activities totaled only seven percent of total revenue. Similarly, the Illinois DRS, in Champaign County Board of Review, Carle Hospital Decision 11 (2005), denied a request for property tax exemption for the Carle Foundation (the "Foundation"), a group of properties used by Carle Foundation Hospital and other entities as part of the Foundation's health care delivery system. Playing a significant role in the DRS' decision was the fact that the Foundation leased the facility to Carle Clinic, a for-profit physician practice association.

The publicity generated by the Provena and Carle decisions has led several states, including Minnesota, Ohio, New Hampshire, North Carolina, and Kansas to aggressively review the activities of non-profit hospitals and to consider corresponding legislation related to property tax exemption. While it seems premature to categorize such activities as a trend, non-profit health care organizations may wish to comprehensively identify and record all of the charity care they provide in anticipation that the charity care they provide may be subject to heightened scrutiny.

*If you have any questions about your organization's exemption from property tax or general questions about property tax exemption, please contact a member of Robinson & Cole's Health Law Group.* (back)

**IRS Releases Form 990 Discussion Draft**

On June 14, 2007, the Internal Revenue Service ("IRS") released a Discussion Draft of a redesigned Form 990 (the "Discussion Draft"), the annual information return filed by tax-exempt organizations, including tax-exempt hospitals and other healthcare providers.

The Discussion Draft consists of a Core Form and a series of fifteen (15) associated schedules, some of which require reporting only from organizations performing certain activities. There are now disclosure schedules for fundraising, executive compensation, hospitals and tax exempt bonds. In addition, new questions have been added regarding governance, expenses, and achievement of mission.

In releasing the Discussion Draft, the IRS stated that the redesign was based on three guiding principles: enhancing transparency to provide the IRS and the public with a realistic picture of the filing organization, promoting tax compliance by accurately reflecting the filing organization's operations so the IRS may efficiently assess the risk of noncompliance, and minimizing the burden on the filing organization. Given that one of the primary purposes of the redesigned Form 990 is to provide more transparency regarding a tax exempt organization's operations, tax exempt healthcare organizations can expect increased reporting and compliance efforts once the final Form 990 is issued.

The IRS anticipates using the redesigned Form 990 for the 2008 tax year (for returns filed in 2009) and is accepting comments regarding the Discussion Draft until September 14, 2007. For information on how to submit comments, a copy of the Discussion Draft, the Core Form, the schedules, instructions and other materials related to the Discussion Draft, visit http://www.irs.gov/charities/article/0,,id=171216,00.html.

*If you have any questions regarding the proposed Form 990, or would like assistance preparing comments on the proposed Form 990 to be submitted to the IRS, please contact a member of Robinson & Cole's Health Law Group.* (back)

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