

**REMARKS ON TAX ISSUES: PITT HEALTH
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*Linda Burke**

Ms. Burke: I kept praying that by the time the program got to me, there would be something left to say. My experience is purely as a tax advisor and not as an advisor to a hospital health care provider. Therefore, I do not have quite the overlap that the other speakers have had. But I can tell you how the IRS operates in this area and I can give you perhaps some predictions and some things to look for. Now, these thoughts are entirely mine. I did call my former colleagues at the IRS to find out if they would tell me anything, and they are not about to let somebody like me give information of that nature to an audience like you. Any such breaking information will definitely come directly from members of the IRS and Treasury.

We have heard a lot here about the community benefit standard. Perhaps not so much what it is but what it is not and what it cannot do, and the fact that it might not be a good standard or it might be a good standard except that it changes all the time. And we have also heard a lot about the tax expenditures that are involved in allowing hospitals to have tax exempt status. And I thought I would talk just a little bit about those tax expenditures.

Now, for my purpose, a tax expenditure is a social engineering of a tax code to produce funds for an organization that is considered to be for the public welfare. And the tax expenditures that are normally considered in the hospital area include, obviously, the federal income tax, state income taxes, state and local ad valorem taxes, sales and use taxes, charitable contributions made to hospital organizations and any tax-exempt bond funds.¹

What is interesting about these tax expenditures, and it may or it may not be a surprise, is that the largest tax expenditure is the ad valorem tax

* Operating Division Counsel of the Large and Mid-Size Business Division of the IRS from 2000-2003; Adjunct Professor, University of Pittsburgh School of Law; J.D. 1973, University of Pittsburgh School of Law; B.A. 1970 College of William and Mary.

1. U.S. Cong., Cong. Budget Office, A CBO Paper: Nonprofit Hospitals and the Provision of Community Benefits 1, 5 (Comm. Print 2006).

expenditure.² If you figure that the tax expenditures in this area are roughly in the range of \$13 billion a year, the expenditure for the exemption from property taxes is approximately a quarter of that total.³ Not far behind is the exemption for sales and use taxes.⁴ So that we are to the third highest level of exemption before we even get to what the federal government is interested in, in terms of tax expenditures, and that, of course, is the federal income tax.⁵

Now my expertise as such is in the federal area, so I am going to talk about that area, but as has been adequately pointed out by the rest of the panel, many of the state standards are frankly much more stringent than the federal standards for tax exemption. And in a way, I sort of look at the federal standards as being the lowest common denominator.

Now let me switch to the tax people. Most people who choose to do tax work are somewhat weird, maybe even masochistic. I make no apologies because most of them are also very smart. However, those who do tax-exempt organization work are way out there, even by tax standards. They are very weird and very, very smart. That is a compliment to several members of the panel but it also describes the people that populate the enforcement areas of the Internal Revenue Service.

In the IRS there are four business divisions: the Large and Mid Size Business Division (“LMSD”) for large business organizations; the Small Business Self Employed Division (“SBSE”), for small to medium size businesses and wealthy individuals; the Wage and Income Division (“WI”), for those whose primary source of income is from W-2 wages; and the Tax Exempt/Government Entities Division (“TEGE”), which covers charitable organizations, government entities and pension and welfare plans. This reorganization took place after Senate Finance hearings just pretty much stabbed the IRS in its heart, and forced a reorganization under Commissioner Charles Rossotti.

The first three divisions enforce and collect taxes and all work in the same way. They are the revenue raisers of government, and they can easily be measured on how many dollars per employee are collected and things of that nature. TEGE has a very different mission because its enforcement has nothing to do with collection of taxes but more in making sure that the money that is given away in taxes, the tax expenditure, is done in accordance with statutes and rules. TEGE has been the stepchild of the IRS for many years,

2. *Id.* See also Joint Commission on Taxation, <http://www.house.gov/jct/tableofcnts.html>.

3. *Id.*

4. *Id.*

5. *Id.*

but that is changing. The sheer magnitude of the health care industry and its most common form of organization, the non-profit tax-exempt health provider, has accelerated that change.

Mark Everson, as the Commissioner of the Internal Revenue, has also had a lot to do with this change. Mark Everson does not like to see tax dollars wasted or lost. He is vigilant, and he is a bit of a vigilante. When he was first appointed Commissioner, he told his senior staff that he thought those who promoted and participated in abusive tax shelters should be criminally prosecuted and serve prison terms. We were horrified, as our mode had been to attempt to get taxpayer cooperation and information to head off marketing and use of such shelters. While we assessed civil penalties, we believed that the threat of criminal prosecution would cut off the routes of information and make our enforcement jobs much harder. Commissioner Everson persevered, and while those going to jail are still few, the criminal enforcement measures have really been an effective tool.

The Commissioner's interest is focused, as you have heard from others, by legislative and staff hearings, meetings and written questionnaires. And by the way, the outsiders are not the only people who get written questionnaires from Senator Grassley. We also would get written questionnaires from Senator Grassley and we would have to respond within 30 days. And that was often very, very difficult, so he was not partial about how he distributed his requests for information. And he is not the only Senator or legislator that does that. There are inquiries all the time.

Now, Commissioner Everson is charged by the Secretary of the Treasury, to whom he reports, to work on certain issues. His emphasis on the non-profit hospital area therefore is clearly not by accident or whim. The resources that the IRS is devoting to the tax-exempt organization area are up 14 percent while the IRS budget as a whole is only up a half percent.⁶ Many more audits are being conducted.⁷ They take great pride in saying that their audit level is back up now to the rate it was in 2000, but I think that was still pretty miserable.⁸ And where the audits involve complicated organizations such as the joint ventures that Tom referred to, they are using what they call team audits, which means that they use appropriate resources from other divisions,

6. *A Review of the Tax-Exempt Hospital Sector: Hearing before the Comm. on Ways and Means, 109th Cong. 2 (2005)* (statement of Mark W. Everson, Commissioner of Internal Revenue).

7. Examination—Tax Exempt Organization Return Closures, <http://www.irs.gov/newsroom/article/0,,id=164435,00.html>.

8. *Id.*

such as partnership or corporate specialists from LMSB. This is not good news for the health care charities by the way.

What is a problem of course with the IRS, as Tom pointed out, is joint ventures are complicated. They are complicated for those of us who practice with very sophisticated tax business organizations. And they take an awful lot of resources; so, the IRS is trying very hard to find ways not to have to audit the joint ventures—they are trying to have questionnaires for agents that do not leave much room for judgment. You can find some of these guidelines on the IRS website and I would encourage you to look at them.

The enforcement of tax-exempt organization standards, unlike revenue enforcement, is somewhat hamstrung by the absence of viable penalties which can be asserted. Except in the private inurement area, the only remedy to apply to nonconforming organizations is revocation of the tax exemption. This is a draconian penalty which is rarely invoked because it harms so many people who had nothing to do with the infraction. But I believe that this Commissioner would use such revocations to get the attention of the sector. It is also possible that Congress will give him other tools to use. For instance, tax-exempt parties to an abusive tax shelter can now be penalized under recently enacted rules.⁹

There are some areas to watch. The published guidance plan put out by Treasury and the IRS business sector strategic plans are important documents.¹⁰ The published guidance plan put out by the Deputy Assistant Secretary of the Treasury for Tax Policy gives a good clue as to what is in process in the rule making.¹¹ The plan should be published by the first of March. You can expect to see some response to the recent information-gathering activities on Community Benefit. I think most of you know the IRS sent questionnaires to about 600 of the largest hospital organizations requesting a vast amount of information that was supposedly voluntary, but I think it would have been a very bad move for an organization not to have responded. Requested information included compensation information, information about charity care and other types of information affecting community benefits.

The strategic plan is actually pretty vague about what the IRS is actually going to do with the information, except that it promises it will analyze this material in 2007.¹² It is clear that more viable standards for community

9. IRC § 4965 (2006).

10. IRS Guidance Priority List, <http://www.irs.gov/pub/irs-utl/2006-2007pgp.pdf>.

11. *Id.*

12. *Id.*

benefit will be addressed. Other areas sure to be examined include loans to non-profit hospital executives, revenue-based pay or bonuses, conflict of interest policies in joint ventures with for-profit organizations or acquisitions of formerly for-profit organizations such as physician practices. The IRS will be aided enormously in its effort by the electronic filing of Forms 990 by all organizations with \$10 million or more in assets that file 250 or more tax returns in this taxable year. Electronic filing makes review of returns significantly easier and more accurate than those that occurred in manual reviews, assuming that the forms were reviewed at all. Very little can be hidden because electronic markers are used.

The Commissioner as much as admitted in recent testimony that prior to the publication of the 990 electronic filing initiative, the Forms 990 were actually not reviewed.¹³ This, by the way, does not surprise me. Having been in the organization, I know many information returns were not reviewed. The Service looked very hard, obviously, at the tax exemption requests, but as the 990s came in, the tax exemption forms were that which formulated its audits, not the 990s. Well, they are looking at them now. The statistical data resulting from such review will also be very useful to help the law making bodies as they consider the appropriate tax regime. If an organization meets the requirements for electronic filing but files a paper return, it will be treated as not having filed the return and have all the penalties associated with non-filers.

One other caveat is in order. If the IRS publishes sample documents such as its sample conflict of interest policy, it is highly advisable to use them. The use of sample documents forestalls careful examination of an area and in fact may forestall examination of that issue altogether. Modifications invite request scrutiny.

Last, this Commission will be backed in his efforts by very smart, capable and committed personnel. Even with very limited resources, they will find a way to get the job done.

13. Everson, *supra* note 6, at 2.