

**INTERSECTION OF TAX-EXEMPTION AND  
FRAUD AND ABUSE ISSUES: PITT HEALTH  
LAW CERTIFICATE PROGRAM 10TH  
ANNIVERSARY SYMPOSIUM  
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Mr. Boyle: Thank you, Alan. First, I want to thank Jan Wenzel from our firm who is a 1999 Health Law Certificate graduate for pulling together some research material.

With regard to Tom Hyatt's comments, let me raise a couple of questions or comments to respond to those comments before I move into some of the other areas. First off, when you look at the test that was designed by the IRS in 1969 we really did not have many hospitals in large parts of the country that were participating in Medicare and Medicaid. In other words, you had a lot of hospitals that were not Medicare/Medicaid providers. You also at that time did not have a very high population that was covered by Medicare and Medicaid. UPMC today, my guess is, 50 to 60 percent of their revenue or patient flow is from Medicare or Medicaid. So of course you have today very few hospitals that do not participate in Medicare or Medicaid because the percentage of the population that has gone into those programs has grown far beyond what was projected in the mid-60s and certainly by 1969.<sup>1</sup>

There are many reasons for non-profit and for-profit hospitals to start to look more and more alike. One reason is that, in large portions of the country, we never used to have for-profit hospitals. They were really creatures of the Southeast and the Far West. We had none in Pennsylvania until a few years ago. Now we have quite a few and the number is growing.<sup>2</sup> And that is true around many parts of the country. So, again, for-profit and non-profit

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1. Steven Hayward & Erik Peterson, *The Medicare Monster: A Cautionary Tale*, REASON, Jan. 1993, available at <http://www.reason.com/news/show/29339.html>; Doug Bandow, *Principals on Life Support: Medicare expansion and the mirage of fiscal responsibility*, National Review Online, available at <http://www.nationalreview.com>.

2. Thomas Reinke, *For-profit hospitals expand in region*, PHYSICIAN'S NEWS DIGEST, available at <http://www.physiciansnews.com/cover/302dv.html>.

hospitals are starting to look more alike for that reason. They are also looking more alike because I think the non-profit hospital or tax-exempt hospital has been told for 20 to 25 years at least that they need to be more businesslike; that they are not a cottage industry; that they need to be efficient, that the percentage of the gross domestic product that is going into health care is growing faster than many people think is appropriate; and that we need to bring businesslike methods to the non-profit service sector, certainly including the hospital sector. So there are a number of reasons for them to start morphing more and more alike, which just frankly makes the job of the IRS and Congress and the courts and tax lawyers harder and harder.

One point I would make for a difference, however—and this is from somebody who sits in boardrooms of both non-profit and for-profit health care providers—one thing you hear in hospital boardrooms of tax-exempt non-profits is, “What about the community wellness program?” For example, UPMC is doing a prenatal program. I have a client that is doing a diabetes program and pediatric obesity program. And these are programs that are typically not funded. Nobody pays for them. The provider pays for them, and they have the effect of diminishing the demand for services of the provider and the payment for those services. So it is opposite what you would do in a pure business model. It is what you do in a social setting where you are trying to benefit the community as a whole. These are not complete answers obviously to the very good questions that Tom [Hyatt] has raised but I think they help explain at least in part some of the reasons we see healthcare providers becoming more and more alike, and also point out some of the differences that are hard to detect—the community wellness program being one of them.

I would like to turn briefly to some state issues. Pennsylvania is actually ahead of the curve. We have since 1997 had a very detailed statute to try and deal with what is an exempt organization in Pennsylvania.<sup>3</sup> And the exemption is important for sales tax exemption and for ad valorem real estate exemption. Ad valorem real estate tax exemption is typically somewhere in the range of two percent of the value of your real estate so it is a very sizable number, frankly, oftentimes much bigger than the federal exemption might be worth. And after probably ten years of litigation, Ed Weisgerber, Henry Casale’s partner Dan Mulholland from the Horthy firm and Seymour Shafer and I got together to draft some potential legislation. The Hospital Association of Pennsylvania and some other trade groups then carried it. The

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3. Institutions of Purely Public Charity Act, 10 PA. STAT. ANN. § 371 (West 2007).

draft legislation, of course, morphed in the process but what we ended up with is a series of pretty objective tests in Pennsylvania for determining whether you are doing enough to be an institution of purely public charity.<sup>4</sup> And those tests were largely derived by looking at federal case law, some federal rulings and lots of other states, including Utah with Intermountain Healthcare.<sup>5</sup> So we tried to borrow from that. And I do not point it out as a perfect bill by any means—it is not a panacea—I would not recommend it to Congress to consider—but it is an illustration of one way to deal with this problem. And one of the most amazing things in hindsight and at the time is that the statute passed without any opposition within the State House and the State Senate even though it had the potential to take substantial revenue away from school districts, municipalities, cities and the like. So I guess it had something going for it.

It led to, or continued, in Pennsylvania, the frequent use of payments in lieu of taxes, which is a fancy way of saying a settlement agreement, to avoid this whole issue. And we do not often get those at the federal level but occasionally we do. So in Pennsylvania we try to deal with it in part that way.

We have also dealt with it pre-Sarbanes Oxley. We had our own problem. AHERF, as many of you will recall, was a very large health care system based in Pittsburgh but had a number of hospitals and a medical school at the eastern end of the state.<sup>6</sup> They had a rather abrupt financial collapse. It was the largest I believe, at the time, health care bankruptcy in history. It led the Pennsylvania Attorney General to establish a series of requirements, if you will, protocols, that were not authorized by statute—there were no regulations—he just published them.<sup>7</sup> But basically, it now drags any significant deal, hospital to hospital deal, non-profit to for-profit, or non-profit to non-profit, through a fairly stringent review process. Among other things, they look at the board process, the board composition, the process that was

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4. § 375.

5. *Airlie Foundation, Inc. v. United States*, 826 F. Supp. 537 (D.D.C. 1993); *Lowry Hosp. Ass'n v. Comm'r of Internal Revenue*, 66 T.C. 850 (Tax Court 1976); *B.H.W. Anesthesia Foundation Inc. v. Comm'r of Internal Revenue*, 1979 WL 3743 (Tax Court 1980); *Utah County, By and Through County Bd. of Equalization of Utah County v. Intermountain Health Care, Inc.*, 709 P.2d 265 (Utah 1985); *Utah County, By and Through County Bd. of Equalization of Utah County v. Intermountain Health Care, Inc.*, 725 P.2d 1357 (Utah 1986); *Hospital Utilization Project v. Commonwealth*, 487 A.2d 1306 (Pa. 1985); *G.D.L. Plaza Corp. v. Council Rock School Dist.*, 526 A.2d 1173 (Pa. 1987).

6. Further information pertaining to AHERF is available at <http://www.post-gazette.com/aherf/>.

7. Office of Attorney General Review Protocol for Fundamental Change Transactions Affecting Health Care Nonprofits, available at <http://www.attorneygeneral.gov/uploadedFiles/Consumers/nonprofitbooklet.pdf>.

followed to approve the deal, valuations if there are any, the business plans to make the deal successful; and they also oftentimes ask about private interests, or side deals if you will. For example, is the executive who is promoting this deal for the selling hospital going to get a \$500,000 bonus for closing the deal? If so, you probably ought not even bother taking that deal forward because it would never be approved. So in Pennsylvania for those reasons we are actually somewhat ahead of the curve. Again, the Attorney General protocol, much like Act 55 sales tax exemption, is not a perfect work of art and it does not really lay out much of what the tests are. It really lays out the process the Attorney General wants you to follow and the documents that they typically request and the Attorney General reserves the right to ask for additional information.

Back to the federal level for a minute. I practice not so much in the tax area but I spend a lot of time counseling non-profit providers on health care regulatory issues, including the fraud and abuse area. For those unfamiliar with health care, we are saddled with a series of laws that essentially make a federal felony of many business practices that are perfectly common in virtually every other business. That is, giving something of value to get business, to generate a referral, is very common in other businesses. It is a felony in Medicare/Medicaid or any other federally-funded program.<sup>8</sup> Most states have corollary acts that are similar,<sup>9</sup> and the federal law has, besides the felony penalties, the exclusion of the individual or the organization that is convicted for a period of not less than five years.<sup>10</sup> So the federal law has fairly severe teeth. It is similar in many ways to the private inurement and private benefit rules that apply to tax-exempt organizations but it is much more fully developed because there is a lot more case law.<sup>11</sup> They do issue advisory opinions still in the fraud and abuse area even though they do not do private letter rulings in this area for the exempt organizations any more. And it is one of those situations where usually when you are counseling an exempt client that has a potential inurement problem with a referral source, a physician or a referring hospital, you do mention tax exemption, and consider the effect on the tax-exempt status argument, but we typically do not spend a lot of time on it because the penalties in the other areas are so great that

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8. 42 U.S.C.A. § 1320a-7b (2007).

9. 62 PA. STAT. ANN. § 1407 (West 2007).

10. 42 C.F.R. § 1001.102 (2007).

11. See *United States v. Bay State Ambulance & Hosp. Rental Serv., Inc.*, 874 F.2d 20 (1st Cir. 1989); *United States v. Hancock*, 604 F.2d 999 (7th Cir. 1979); *United States v. Tapert*, 625 F.2d 111 (6th Cir. 1980); *United States v. Greber*, 760 F.2d 68 (3d Cir. 1985).

typically clients back way off of that kind of behavior pretty quickly. And if they do not back off from it, you really do not want them as a client because it is not good for your career.

Concerns over the effect of fraud and abuse on exemption also led me to learn about an English common law doctrine.<sup>12</sup> What I know about English common law would fit into a thimble with plenty of room left over, but there is a doctrine called the illegality doctrine.<sup>13</sup> The IRS out of old English common law basically says if you are a health care provider or any other exempt organization and you are engaged in substantial illegal activity, you cannot be tax-exempt.<sup>14</sup> That is contrary to exemption. Much like some of the other things Tom [Hyatt] talked about, you will not find that in the statute, you will not really find it in the regulations; you will find a series of rulings, some old guidance in a very wonderful 1994 CPE document that goes through that.<sup>15</sup> So if you are practicing in this area and fraud and abuse rules do not do enough for you, you could trot out the good old illegality doctrine. Those were the comments I wanted to provide.

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12. See Jean Wright & Jay H. Rotz, *Illegality and Public Policy Considerations*, 1994 EO CPE Text, available at [www.irs.gov/pub/irs-tege/eotopic194.pdf](http://www.irs.gov/pub/irs-tege/eotopic194.pdf).

13. The common law doctrine was perhaps best expressed by the District Court for the District of Columbia when it stated that all charitable trusts are “subject to the requirement that the purpose of the trust may not be illegal or contrary to public policy . . . ; [o]therwise, for example, Fagin’s school for pickpockets would qualify for a charitable trust.” *Green v. Connally*, 330 F. Supp. 1150, 1159-60 (D.C. 1971); see also *Bob Jones University v. United States Goldsboro Christian Schools, Inc.*, 461 U.S. 574, 578-79 (1983) (citing to *Green v. Connally* regarding the common law concept).

14. See Rev. Rul. 75-384, 1975-2 C.B. 204.

15. See Wright & Rotz, *supra* note 12.