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2019 Cumulative Supplement

4th Edition

Thomas K. Hyatt and Bruce R. Hopkins

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the law of tax-exempt healthcare organizations

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Thomas K. Hyatt and Bruce R. Hopkins

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Preface

This is the fourth cumulative supplement of *The Law of Tax-Exempt Healthcare Organizations*, fourth edition. It reviews developments in the tax law affecting the tax-exempt healthcare sector through 2018. Much like the year before, the year was marked by the choices of a reduced and overburdened Internal Revenue Service to carry on enforcement activities with regard to the obligations under the Affordable Care Act for charitable hospitals, and dogged application of the commerciality doctrine to withhold recognition of tax-exempt status. It also saw important efforts by the IRS to provide guidance on key portions of the Tax Cuts and Jobs Act affecting exempt organizations.

With regard to the Affordable Care Act, the IRS, in accordance with its statutory mandate, has continued to conduct reviews to ensure compliance with the Act's obligations to undertake regular community health needs assessments, to have an effective and beneficial financial assistance policy, and to utilize appropriate billing and collection practices. It revoked exemption in three similar cases, involving "dual status" public hospitals that had mostly forgotten that they were also recognized as section 501(c)(3) organizations. These types of revocations are the low-hanging fruit of enforcement in this area and it remains to be seen how aggressively the IRS will act when a hospital challenges attempts at revocation. Continued activity here is mandated by the ACA and remains in the Exempt Organizations Work Plan.

Meanwhile, the IRS continues to wield its commerciality doctrine to challenge charitable organizations for using modern business practices and reliance upon fee-for-service activity in their efforts to achieve their missions with push-back on any activity that it contends has a substantial private benefit component to it. Efforts by organizations to clothe activities as charitable in nature under the broad rubric of the promotion of health are increasingly being met with a denial or revocation of recognition of exemption by the IRS when that "I know it when I see it" threshold of commerciality has been crossed. The IRS has further signaled its continuing interest in this area by announcing in its Fiscal Year 2019 Work Plan that it will focus on organizations formerly operated as for-profit entities prior to their conversion to charitable organizations.

This was also the year in which the IRS began to explain the mysteries of the Tax Cuts and Jobs Act, including the addressing of two key provisions for exempt organizations: those impacting the calculation and treatment of unrelated business taxable income and applying penalties for the payment of "excess" compensation to executives. In the latter case, the IRS issued as one of its opening forays into guidance for 2019 a notice, 92 pages in length and

PREFACE

comprising 28,000 words, providing interim guidance and the plan to issue proposed regulations on an 874-word provision of the Act, just getting it out in time to be summarized (in only 1030 words) in this cumulative supplement.

And to cap it all off, in the first year that the IRS will have to process tax returns under the new tax reform regime, substantial portions of the government—including the IRS, of course—were shut down for 35 days, the longest such event in U.S. history. Whether proverb or curse, we “live in interesting times.”

We appreciate the assistance we have received from John Wiley & Sons in the preparation of this cumulative supplement. Our thanks are extended, in particular, to our development editor, Brian T. Neill, and Koushika Ramesh, production editor, for their assistance and support in connection with this cumulative supplement.

Thomas K. Hyatt
Bruce R. Hopkins
January, 2019

About the Authors

Thomas K. Hyatt is a partner in the law firm Dentons US LLP, resident in the Washington, DC office. His practice is focused on corporate and tax-exempt organization issues for nonprofit organizations. He has particular expertise in legal issues affecting tax-exempt healthcare providers and in governance and public policy issues affecting tax-exempt higher education institutions. Mr. Hyatt has represented organizations including public and private hospitals, multihospital systems, integrated delivery systems, academic medical centers, home health agencies, health maintenance organizations, continuing care retirement communities, provider associations, physician clinics, faculty practice plans, physician-hospital organizations, and shared services organizations in such matters. He also frequently works with nonprofit governing boards and board committees to address such issues as regulatory compliance, fiduciary duty, conflicts of interest, bylaws development and revision, senior management compensation and benefits, chief executive contracts and transition, fundraising, lobbying and political campaign activity, board development, policy development, adoption of best governance practices, membership matters, corporate restructuring, mergers, and joint ventures. He is admitted to practice in the District of Columbia and Pennsylvania.

Mr. Hyatt is a member of the American Health Lawyers Association (AHLA), the American Bar Association, and the District of Columbia Bar. He served as a member of AHLA's Board of Directors from 1992 to 1998. Mr. Hyatt is one of the inaugural Fellows of AHLA. He is the Chair Emeritus and on the faculty of the annual Tax Issues in Healthcare Organizations seminar sponsored by AHLA, and is also the past chair of AHLA's Tax and Finance Practice Group. In 2004, Mr. Hyatt received AHLA's David J. Greenburg Service Award. He also serves as Senior Fellow for Public Policy with the Association of Governing Boards of Universities and Colleges. He has been listed in *Best Lawyers in America* since 2005 and as a DC Super Lawyer. He has also been listed in Chambers USA Healthcare, District of Columbia, since 2012. Mr. Hyatt is a licensed consultant for the Standards for Excellence Institute. He frequently lectures on business and tax planning issues for nonprofit organizations and has written numerous articles for publication on tax-exempt organization topics. Mr. Hyatt received the 2017 Outstanding Nonprofit Lawyer award from the American Bar Association.

Mr. Hyatt is a 1979 cum laude graduate of Boston College, and received his law degree in 1982 from the University of Pittsburgh, where he served as editor-in-chief of the *Journal of Law and Commerce*.

ABOUT THE AUTHORS

Bruce R. Hopkins is the principal in the law firm Bruce R. Hopkins Law Firm, LLC, in Kansas City, Missouri. He concentrates on the representation of tax-exempt organizations, including healthcare organizations. His practice ranges over the entirety of law matters involving exempt organizations, with emphasis on the formation of nonprofit organizations, acquisition of recognition of tax-exempt status for them, governance and the law, the private inurement and private benefit doctrines, the intermediate sanctions rules, legislative and political campaign activities issues, public charity and private foundation rules, unrelated business planning, use of exempt and for-profit subsidiaries, joint venture planning, tax shelter involvement, review of annual information returns, Internet communications developments, the law of charitable giving (including planned giving), and fundraising law issues.

Mr. Hopkins is the Professor from Practice at the University of Kansas School of Law, where he teaches courses on the law of nonprofit and tax-exempt organizations.

Mr. Hopkins served as Chair of the Committee on Exempt Organizations, Tax Section, American Bar Association; Chair, Section of Taxation, National Association of College and University Attorneys; and President, Planned Giving Study Group of Greater Washington, DC.

Mr. Hopkins is the series editor of Wiley's Nonprofit Law, Finance, and Management Series. In addition to coauthoring *The Law of Tax-Exempt Healthcare Organizations, Fourth Edition*, he is the author of *The Law of Tax-Exempt Organizations, Twelfth Edition*; *Planning Guide for the Law of Tax-Exempt Organizations: Strategies and Commentaries*; *Tax-Exempt Organizations and Constitutional Law: Nonprofit Law as Shaped by the U.S. Supreme Court*; *Bruce R. Hopkins' Nonprofit Law Dictionary*; *Bruce R. Hopkins' Nonprofit Law Library (e-book)*; *IRS Audits of Tax-Exempt Organizations: Policies, Practices, and Procedures*; *The Tax Law of Charitable Giving, Fifth Edition*; *The Law of Fundraising, Fifth Edition*; *The Tax Law of Associations*; *The Tax Law of Unrelated Business for Nonprofit Organizations*; *The Nonprofits' Guide to Internet Communications Law*; *The Law of Intermediate Sanctions: A Guide for Nonprofits*; *Starting and Managing a Nonprofit Organization: A Legal Guide, Sixth Edition*; *Nonprofit Law Made Easy*; *Charitable Giving Law Made Easy*; *Private Foundation Law Made Easy*; *Fundraising Law Made Easy*; *650 Essential Nonprofit Law Questions Answered*; *The First Legal Answer Book for Fund-Raisers*; *The Second Legal Answer Book for Fund-Raisers*; *The Legal Answer Book for Nonprofit Organizations*; and *The Second Legal Answer Book for Nonprofit Organizations*. He is the coauthor, with Jody Blazek, of *Private Foundations: Tax Law and Compliance, Third Edition*; also with Ms. Blazek, of *The Legal Answer Book for Private Foundations*; with David O. Middlebrook, of *Nonprofit Law for Religious Organizations: Essential Questions and Answers*; with Douglas K. Anning, Virginia C. Gross, and Thomas J. Schenkelberg, of *The New Form 990: Law, Policy, and Preparation*; with Ms. Gross, of *Nonprofit Governance: Law, Practices & Trends*; and with Ms. Gross and Mr. Schenkelberg, of *Nonprofit Law for Colleges and*

ABOUT THE AUTHORS

Universities: Essential Questions and Answers for Officers, Directors, and Advisors. He also writes *Bruce R. Hopkins' Nonprofit Counsel*, a monthly newsletter published by John Wiley & Sons.

Mr. Hopkins maintains a website providing information about the law of tax-exempt organizations, including healthcare organizations, at www.brucehopkinslaw.com. Material posted on this site includes a periodically updated current developments outline and indexes for his newsletter. For the outline, click on "Nonprofit Law Center." Mr. Hopkins received the 2007 Outstanding Nonprofit Lawyer Award (Vanguard Lifetime Achievement Award) from the American Bar Association, Section of Business Law, Committee on Nonprofit Corporations. He is listed in the Best Lawyers in America, Nonprofit Organizations/Charities Law, 2007–2018.

Mr. Hopkins earned his JD and LLM degrees at the George Washington University National Law Center, his SJD at the University of Kansas School of Law, and his BA at the University of Michigan. He is a member of the bars of the District of Columbia and the state of Missouri.

Book Citations

Throughout this book, 10 books by Bruce R. Hopkins (in some cases as co-author), all published by John Wiley & Sons, Inc., are referenced in this way:

Book	Cited As
1. <i>IRS Audits of Tax-Exempt Organizations: Policies, Practices, and Procedures</i> (2008)	IRS Audits
2. <i>The Law of Fundraising, Fifth Edition</i> (2013)	Fundraising
3. <i>The Law of Tax-Exempt Organizations, Twelfth Edition</i> (2019)	Tax-Exempt Organizations
4. <i>The Law of Intermediate Sanctions: A Guide for Nonprofits</i> (2003)	Intermediate Sanctions
5. <i>Planning Guide for The Law of Tax-Exempt Organizations: Strategies and Commentaries</i> (2004)	Planning Guide
6. <i>The Tax Law of Private Foundations, Fifth Edition</i> (2018)	Private Foundations
7. <i>Starting and Managing a Nonprofit Organization: A Legal Guide, Seventh Edition</i> (2017)	Starting and Managing
8. <i>The Tax Law of Charitable Giving, Fifth Edition</i> (2014)	Charitable Giving
9. <i>The Tax Law of Unrelated Business for Nonprofit Organizations</i> (2005)	Unrelated Business
10. <i>Tax-Exempt Organizations and Constitutional Law: Nonprofit Law as Shaped by the Supreme Court</i> (2012)	Constitutional Law

The second, third, sixth, and eighth of these books are annually supplemented. Also, updates on all of the foregoing subjects (plus *The Law of Tax-Exempt Healthcare Organizations*) are available in *Bruce R. Hopkins' Nonprofit Counsel*, a monthly newsletter, also published by Wiley.

CHAPTER ONE

Tax-Exempt Healthcare Organizations: An Overview

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§ 1.2 DEFINING TAX-EXEMPT ORGANIZATIONS

p. 9. *Insert as second paragraph:*

The U.S. Supreme Court, reflecting these principles, wrote that a “nonprofit entity is ordinarily understood to differ from a for-profit corporation principally because it ‘is barred from distributing its net earnings, if any, to individuals who exercise control over it, such as members, officers, directors or trustees.’”^{23.1} The Court has discussed the concept of nonprofit organizations on other occasions.^{23.2} (Of course, before there can be a nonprofit organization or a tax-exempt organization, there must first be an organization.^{23.3})

§ 1.5 CHARITABLE HEALTHCARE ORGANIZATIONS

p. 15. *Insert following existing text at note 79:*

Meanwhile, state courts continue to challenge the qualification of hospitals as charitable organizations for real property tax exemption purposes. In a 91-page decision that describes the current structure and operations of the majority of hospitals in the United States, the New Jersey Tax Court revoked the property tax exemption for Morristown Memorial Hospital. The court concluded that “[i]f it is true that all non-profit hospitals operate like the

^{23.1}*Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 585 (1987).

^{23.2}*Burwell v. Hobby Lobby Stores, Inc.*, 134 S. Ct. 2751, 2768-2772 (2014); *Corporation of the Presiding Bishop of the Church of Jesus Christ of Latter-Day Saints v. Amos*, 483 U.S. 327, 344-346 (1987) (concurring opinion).

^{23.3}E.g., *George v. Commissioner*, 110 T.C.M. 190 (2015) (where the court concluded that, for tax exemption purposes, an organization was not formed).

Hospital in this case ... then for purposes of the property tax exemption, modern non-profit hospitals are essentially legal fictions. Clearly, the operation and function of modern non-profit hospitals do not meet the current criteria for property tax exemption under [New Jersey law.]” *AHS Hospital Corp., d/b/a Morristown Memorial Hospital v. Town of Morristown*, 2015 BL 206190 (N.J. Tax Ct. 2015). See generally, Paff, “Is Your Nonprofit Hospital’s Property Tax Exemption Safe?,” Bloomberg Daily Report for Executives, August 25, 2015.

***§ 1.8 PROMOTION OF HEALTH**

p. 20. *Insert at end of first paragraph:*

In some instances, activities that would seem to promote health are insufficient to support qualification as a charitable organization. An organization was formed to promote sports, recreation, health, and fitness through church leagues and tournaments, exercise programs, and recreational activities. The organization’s goal was to organize adult and youth athletic competitions. Its proposed sources of financial support were ticket sales, advertising income, auctions, annual fundraisers, and donations.

The IRS determined that the organization did not qualify as a charitable organization because it did not meet the organizational or operational tests for charitable status. The IRS focused on the fact that the bulk of the organization’s activities were geared toward encouraging sports, recreational, and social interaction between adults. These are not exempt purposes in the IRS’s view. Sports and social and recreational activities are not considered exempt activities. The IRS distinguished other guidance in which sports were provided to children under the age of 18. Recreational sports for adults are not considered charitable or educational purposes, according to the IRS.^{118.1}

p. 22. *Insert following existing material:*

§ 1.10 ABLE PROGRAMS

The newest category of tax-exempt organization, modeled somewhat on the state-sponsored qualified tuition program,¹³⁷ is the ABLE program.¹³⁸ This is a program established and maintained by a state, or agency or instrumentality of a state, under which a person may make contributions for a tax year, for

^{118.1}Priv. Ltr. Rul. 201835012.

¹³⁷IRC § 529. See *Tax-Exempt Organizations* § 19.19(a).

¹³⁸IRC § 529A (effective January 1, 2015). This acronym is in reference to the Achieving a Better Life Experience Act of 2014, Pub. L. 113-295, div. B, 128 Stat. 4056.

1.10 ABLE PROGRAMS

the benefit of an eligible individual, to an ABLE account that is established for the purpose of meeting the qualified disability expenses of the designated beneficiary of the account.¹³⁹ A designated beneficiary may have only one ABLE account.¹⁴⁰ A beneficiary must be a resident of the state that established the program or a resident of a contracting state.¹⁴¹ An interest in an ABLE program may not be used as security for a loan.¹⁴²

An *eligible individual* is an individual entitled to benefits based on blindness or disability under the Social Security Act, where the blindness or disability occurred before the date on which the individual attained age 26, or a disability certification¹⁴³ with respect to the individual is filed with the IRS.¹⁴⁴ A *designated beneficiary* in connection with an ABLE account established under a qualified ABLE program is the eligible individual who established an ABLE account and is the owner of the account.¹⁴⁵ The term *disability expenses* means expenses related to the eligible individual's blindness or disability that are made for the benefit of an eligible individual who is the designated beneficiary, including expenses for education, housing, transportation, health, financial management services, and legal fees.¹⁴⁶

Contributions to an ABLE account must be in the form of money.¹⁴⁷ There is an annual per-account funding limit equal to the annual gift tax exclusion.¹⁴⁸ A qualified ABLE program must provide a separate accounting for each designated beneficiary.¹⁴⁹ A beneficiary may, directly or indirectly, direct the investment of contributions to the program, and earnings thereon, no more than two times in any calendar year.¹⁵⁰ Distributions from a qualified program are not includable in the beneficiary's gross income to the extent they do not exceed the amount of qualified disability expenses.¹⁵¹

Each officer or employee having control of the qualified ABLE program or their designee must make reports regarding the program to the IRS and to designated beneficiaries with respect to matters such as contributions,

¹³⁹IRC § 529A(b)(1)(A).

¹⁴⁰IRC § 529A(b)(1)(B). This type of account is defined in IRC § 529A(e)(6).

¹⁴¹IRC § 529A(b)(1)(C).

¹⁴²IRC § 529A(b)(5).

¹⁴³IRC § 529A(e)(2).

¹⁴⁴IRC § 529A(e)(1).

¹⁴⁵IRC § 529A(e)(3).

¹⁴⁶IRC § 529A(e)(5).

¹⁴⁷IRC § 529A(b)(2)(A).

¹⁴⁸IRC § 529A(b)(2)(B). That exclusion amount currently is \$14,000 (IRC § 2503(b)(2)). See *Charitable Giving* § 8.2(h).

¹⁴⁹IRC § 529A(b)(3).

¹⁵⁰IRC § 529A(b)(4).

¹⁵¹IRC § 529A(c)(1)(B)(1).

distributions, and the return of excess contributions.¹⁵² For research purposes, the IRS must make available to the public reports containing aggregate information, by diagnosis and other relevant characteristics, on contributions and distributions from qualified ABLE programs.¹⁵³

¹⁵²IRC § 529A(d)(1).

¹⁵³IRC § 529A(d)(2). The Department of the Treasury promulgated proposed regulations to accompany IRC § 529A (REG-102837-15). An IRS hearing on this proposal was held on October 14, 2015.