



September 2020

TAX ADMINISTRATION

Opportunities Exist to Improve Oversight of Hospitals' Tax-Exempt Status

Accessible Version

GAO Highlights

Highlights of [GAO-20-679](#), a report to congressional requesters

Why GAO Did This Study

Slightly more than half of community hospitals in the United States are private, nonprofit organizations. IRS and the Department of the Treasury have recognized the promotion of health as a charitable purpose and have specified that nonprofit hospitals are eligible for a tax exemption. IRS has further stated that these hospitals can demonstrate their charitable purpose by providing services that benefit their communities as a whole.

In 2010, Congress and the President enacted PPACA, which established additional requirements for tax-exempt hospitals to meet to maintain their tax exemption.

GAO was asked to review IRS's implementation of requirements for tax-exempt hospitals. This report assesses IRS's (1) oversight of how tax-exempt hospitals provide community benefits, and (2) enforcement of PPACA requirements related to tax-exempt hospitals.

What GAO Recommends

GAO is making one matter for congressional consideration to specify in the IRC what services and activities Congress considers sufficient community benefit. GAO is also making four recommendations to IRS, including to establish a well-documented process to ensure hospitals' community benefit activities are being reviewed, and to create codes to track audit activity related to hospitals' community benefit activities. IRS agreed with GAO's recommendations.

View [GAO-20-679](#). For more information, contact Jessica Lucas-Judy at (202) 512-9110 or lucasjudyj@gao.gov.

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TAX ADMINISTRATION

Opportunities Exist to Improve Oversight of Hospitals' Tax-Exempt Status

What GAO Found:

Nonprofit hospitals must satisfy three sets of requirements to obtain and maintain a nonprofit tax exemption (see figure).

Requirements for Nonprofit Hospitals to Obtain and Maintain a Tax-Exemption

ORGANIZATIONAL AND OPERATIONAL REQUIREMENTS

A hospital must be organized and operate to achieve a charitable purpose—the promotion of health for the benefit of the community.

COMMUNITY BENEFITS

Internal Revenue Service has identified six factors that demonstrate community benefit:

- Operate an emergency room open to all, regardless of ability to pay
- Maintain a board of directors drawn from the community
- Maintain an open medical staff policy
- Provide care to all patients able to pay, including those who do so through Medicare and Medicaid
- Use surplus funds to improve facilities, equipment, and patient care
- Use surplus funds to advance medical training, education, and research

PATIENT PROTECTION AND AFFORDABLE CARE ACT (PPACA) REQUIREMENTS

Hospitals must:

- Conduct a community health needs assessment
- Set a limit on charges
- Maintain a written financial assistance policy
- Set billing and collection limits

IRS must review each tax-exempt hospital's community benefit activities at least once every 3 years.

Source: GAO review of relevant laws and regulations. | GAO-20-679

While PPACA established requirements to better ensure hospitals are serving their communities, the law is unclear about what community benefit activities hospitals should be engaged in to justify their tax exemption. The Internal Revenue Service (IRS) identified factors that can demonstrate community benefits, but they are not requirements. IRS does not have authority to specify activities hospitals must undertake and makes determinations based on facts and circumstances. This lack of clarity makes IRS's oversight challenging. Congress could help by adding specificity to the Internal Revenue Code (IRC).

While IRS is required to review hospitals' community benefit activities at least once every 3 years, it does not have a well-documented process to ensure that those activities are being reviewed. IRS referred almost 1,000 hospitals to its audit division for potential PPACA violations from 2015 through 2019. However, IRS could not identify if any of these referrals related to community benefits. GAO's analysis of IRS data identified 30 hospitals that reported no spending on community benefits in 2016, indicating potential noncompliance with providing community benefits. A well-documented process, such as clear instructions for addressing community benefits in the PPACA reviews or risk-based methods for selecting cases, would help IRS ensure it is effectively reviewing hospitals' community benefit activities.

Further, according to IRS officials, hospitals with little to no community benefit expenses would indicate potential noncompliance. However, IRS was unable to provide evidence that it conducts reviews related to hospitals' community benefits because it does not have codes to track such audits.

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Abbreviations

CBAR	Community Benefit Activity Review
IRC	Internal Revenue Code
IRS	Internal Revenue Service
PPACA	Patient Protection and Affordable Care Act
SOI	Statistics of Income
TE/GE	Tax Exempt and Government Entities

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September 17, 2020

The Honorable Charles E. Grassley
Chairman
Committee on Finance
United States Senate

The Honorable Kevin Brady
Republican Leader
Committee on Ways and Means
House of Representatives

Slightly more than half of community hospitals in the United States are private, nonprofit organizations.¹ Nonprofit organizations can obtain and maintain a federal tax exemption if they are organized for one or more purposes specified in the Internal Revenue Code (IRC) section 501(c)(3). These purposes could include providing charity or education, and continuously operating in pursuit of those purposes.² The public policy underlying the exemption for charitable organizations is based on the concept that the federal government's loss of tax revenue is offset by relief from the need to appropriate public funds and from benefits resulting from the promotion of general welfare.³

Hospitals are on the front line of our national response to Coronavirus Disease 2019 (COVID-19), with hospitals across the country working at maximum capacity to treat the sick. The Internal Revenue Service (IRS) and the Department of the Treasury (Treasury) have recognized the promotion of health as a charitable purpose and have specified that nonprofit hospitals are eligible for a tax exemption.⁴ IRS has further stated

¹American Hospital Association, Fast Facts, accessed July 8, 2020, <https://www.aha.org/statistics/fast-facts-us-hospitals>. Community hospitals exclude nonfederal psychiatric hospitals and other hospitals, including long-term care hospitals and those within an institution.

²26 U.S.C. § 501(c)(3).

³H.R. Rep. No. 75-1860, at 19 (1938).

⁴Rev. Rul. 69-545, 1969-2 C.B. 117.

that these hospitals can demonstrate their charitable purpose by providing services that benefit their communities as a whole.

The Joint Committee on Taxation estimated the total revenue loss from the tax exemption of hospitals at \$12.6 billion in 2002.⁵ Hospitals reported that they provided \$76 billion in community benefits in 2016—the most recent data available at the time of our review.⁶

In a 2008 review, we found that IRS guidance allowed hospitals broad latitude in determining what constitutes community benefit activities. That guidance allowed individual hospitals wide discretion in the determination and measurement of those activities as community benefit for federal purposes.⁷ In addition, we reported that prior studies by us and the Congressional Budget Office indicated that tax-exempt hospitals may not have been defining community benefit in a consistent manner that would enable policymakers to hold them accountable for providing benefits commensurate with their tax exemption.

Since then, Congress and the executive branch have taken steps to bolster IRS's oversight of tax-exempt hospitals. In 2008, IRS began to require tax-exempt hospitals to report information about their community benefits on their annual tax returns. Two years later, the Patient Protection and Affordable Care Act (PPACA) was enacted, which

⁵Congressional Budget Office, *Nonprofit Hospitals and the Provision of Community Benefits* (Washington, D.C.: December 2006) reports the Joint Committee on Taxation estimate. Rosenbaum et. al., "The Value of The Nonprofit Hospital Tax Exemption Was \$24.6 Billion In 2011," *Health Affairs*, vol. 35, no. 7 (2015) estimate the total revenue loss at \$24.6 billion for 2011. Most recently, Ernst and Young estimated the federal cost of the tax exemption in a report for the American Hospitals Association at \$9 billion in 2016. EY, *Estimates of the Federal Revenue Forgone Due to the Tax-Exemption of Non-Profit Hospitals Compared to the Community Benefit They Provide*, 2016 (2019). All of these estimates were based on federal tax rates prior to the implementation of the Tax Cuts and Jobs Act, which reduced corporate tax rates and would likely result in lower estimates of the revenue loss.

⁶For the purposes of this report, we use the term "tax-exempt hospitals" to refer to nongovernmental, nonprofit, and tax-exempt hospitals. Government hospitals—including those at the federal, state, local, and tribal levels—are also exempt from federal taxation.

⁷GAO, *Nonprofit Hospitals: Variation in Standards and Guidance Limits Comparison of How Hospitals Meet Community Benefit Requirements*, [GAO-08-880](#) (Washington, D.C.: Sept. 12, 2008).

established additional requirements for tax-exempt hospitals to meet to maintain their tax exemption.⁸

You asked us to review IRS's implementation of requirements for tax-exempt hospitals. This report assesses IRS's (1) oversight of how tax-exempt hospitals provide community benefits, and (2) enforcement of PPACA requirements related to tax-exempt hospitals.

For both objectives, we reviewed relevant provisions of the Internal Revenue Code, Treasury regulations, revenue rulings, and guidance. We also reviewed IRS policies, procedures, audit plans, and determining factors for reviewing tax-exempt hospitals and interviewed IRS officials. We examined the most recent data available (tax year 2016) from forms hospitals are required to file with IRS documenting the community benefits they provide and their compliance with PPACA. To assess data reliability, we analyzed the content of those data for discrepancies and interviewed IRS officials about their procedures for preparing the data. We determined the data were sufficiently reliable for the purposes of our objectives.

In addition, we interviewed selected stakeholder groups—interest groups representing both tax-exempt and for-profit hospitals, patient advocacy groups, and research organizations—to obtain their views on the clarity and enforcement of the community benefit standard and requirements included in PPACA. We identified these groups using our prior reports on tax-exempt hospitals and the recommendations of representatives of the organizations we interviewed. For more information on our methodology, see appendix I.

We conducted this performance audit from March 2019 to September 2020 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

⁸26 U.S.C. § 501(r).

Background

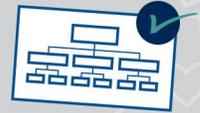
Requirements for Hospitals to Obtain and Maintain a Federal Tax Exemption

Nonprofit hospitals must satisfy three sets of requirements to obtain and maintain a federal tax exemption (see figure 1).

Figure 1: Requirements for Nonprofit Hospitals to Obtain Federal Tax-Exempt Status

ORGANIZATIONAL AND OPERATIONAL REQUIREMENTS

A hospital must be organized and operate to achieve a charitable purpose—the promotion of health for the benefit of the community.



COMMUNITY BENEFITS

Internal Revenue Service has identified six factors that demonstrate community benefit:

- Operate an emergency room open to all, regardless of ability to pay
- Maintain a board of directors drawn from the community
- Maintain an open medical staff policy (i.e., not restrict medical staff privileges to a limited group of physicians)
- Provide care to all patients able to pay, including those who do so through Medicare and Medicaid
- Use surplus funds to improve facilities, equipment, and patient care
- Use surplus funds to advance medical training, education, and research



PATIENT PROTECTION AND AFFORDABLE CARE ACT REQUIREMENTS

Hospitals must:

- Conduct a community health needs assessment
- Maintain a written financial assistance policy
- Set a limit on charges
- Set billing and collection limits

IRS must review each tax-exempt hospital's community benefit activities at least once every 3 years.



Source: GAO review of relevant laws and regulations. | GAO-20-679

Organizational and Operational Requirements

The IRC requires that all organizations seeking a tax exemption under section 501(c)(3) be organized and operated for one or more purposes, which can be charitable, religious, or educational, among others.⁹ The IRC does not specifically identify hospitals as being eligible for a tax exemption. However, IRS and federal courts have recognized that the promotion of health for a community's benefit is a charitable purpose.¹⁰

In addition, Treasury regulation provides that an organization will be considered as operating exclusively for one or more exempt purposes if it engages primarily in activities that accomplish those purposes.¹¹ The IRC does not clarify what activities can demonstrate a charitable purpose, but IRS has issued revenue rulings with this type of information.¹² For example, in a 1956 revenue ruling, IRS required tax-exempt hospitals to provide charity care to the extent of their financial abilities.¹³

IRS determined in the ruling that only hospitals that operated for the benefit of those not able to pay, and not exclusively for the benefit of those who were able and expected to pay, could qualify for a tax exemption. Then, in 1959, Treasury updated its regulations to establish that organizations can receive tax-exempt status by demonstrating a charitable purpose such as the promotion of health.¹⁴

⁹Section 501 of the IRC covers the majority of these organizations, which include public charities, social welfare organizations, business leagues, and private foundations. Other types of organizations, such as education-oriented programs, farmers' cooperatives, and political organizations, are also wholly or partially tax exempt. 26 U.S.C. §§ 501(c)(3), 521, 527, 529-530.

¹⁰See *Geisinger Health Plan v. Comm'r*, 985 F.2d 1210, 1216 (3d Cir. 1993) (discussing IRS policy and cases construing exemption provisions for hospitals).

¹¹26 C.F.R. § 1.501(c)(3)-1(c)(1).

¹²A revenue ruling is an official interpretation of the IRC, related statutes, tax treaties or regulations as applied to a specific set of facts.

¹³Rev. Rul. 56-185, 1956-1 C.B. 202. Charity care is generally defined as care provided to patients whom the hospital deems unable to pay all or a portion of their bills.

¹⁴26 C.F.R. § 1.501(c)(3)-1(d)(2).

Community Benefits

In 1969, 4 years after Congress and the President created Medicare and Medicaid, IRS removed the requirement for tax-exempt hospitals to provide charity care—patient care without charge or at rates below cost—when it issued Revenue Ruling 69-545.¹⁵ The ruling compares the extent to which two hypothetical hospitals satisfy the IRC’s requirements for a tax exemption. In making that comparison, the ruling identifies six factors that distinguish how one hospital satisfies the requirements and how the second does not. There is no specific definition of community benefit. These six factors currently serve as the primary examples of community benefits that hospitals can provide to obtain and maintain a tax exemption. The factors are commonly referred to as the community benefit standard. IRS describes the six factors on its website:

- **Operate an emergency room open to all, regardless of ability to pay.** A hospital that does not operate a full-time emergency room may not be fulfilling the community’s need for emergency health care. If that emergency room is not open to everyone regardless of ability to pay, the hospital may not be serving a significant segment of the community.¹⁶
- **Maintain a board of directors drawn from the community.** A hospital board of directors comprised of independent civic leaders helps to ensure that the hospital serves public, rather than private, interests, and therefore operates for the benefit of the community.
- **Maintain an open medical staff policy (i.e., not restrict medical staff privileges to a limited group of physicians).** A hospital that restricts its medical staff privileges to a limited group of physicians is likely to be operating for the private benefit of the staff physicians rather than for the public interest.
- **Provide care to all patients able to pay, including those who do so through Medicare and Medicaid.** A hospital that restricts admissions to patients of staff members, or otherwise

¹⁵Rev. Rul. 69-545, 1969-2 C.B. 117.

¹⁶IRS Revenue Ruling 83-157 established that if a state health planning agency determined that additional emergency facilities would be unnecessary and duplicative, or if the hospital offers medical care limited to special conditions unlikely to necessitate emergency care, such as eye or cancer hospitals, then the fact that a hospital organization does not operate an emergency room will not, by itself, disqualify it from a tax exemption. Rev. Rul. 83-157, 1983-2 C.B. 94.

discriminates against patients with the ability to pay for nonemergency services, is not operating for the benefit of the community.

- **Use surplus funds to (1) improve facilities, equipment, and patient care; and (2) advance medical training, education, and research.** The use of surplus funds for these purposes demonstrates that a hospital is promoting the health of the community.¹⁷

The standard makes clear that the factors are examples of ways in which hospitals can demonstrate community benefits. The standard states that a hospital need not meet all of the factors to qualify for a tax exemption. The absence of any one factor, or the presence of others, may not necessarily be conclusive of the hospital's community benefits. IRS says that though a hospital is no longer required to provide charity care it considers doing so to be a significant factor indicating community benefit. Furthermore, IRS considers all of a hospital's facts and circumstances relevant when determining whether a hospital's community benefits are sufficient to warrant a tax exemption.

Patient Protection and Affordable Care Act Requirements

The Patient Protection and Affordable Care Act (PPACA) established four additional requirements that tax-exempt hospitals must meet to maintain a tax exemption.¹⁸

- **Conduct a community health needs assessment.** Every 3 years, each tax-exempt hospital must identify the community's health needs and develop an implementation plan for how it will address those needs.¹⁹
- **Maintain a written financial assistance policy.** Each tax-exempt hospital must publish a written policy that identifies who can qualify for financial assistance for medical services, how the

¹⁷IRS, *Charitable Hospitals -- General Requirements for Tax-Exemption Under Section 501(c)(3)*, accessed April 30, 2020. <https://www.irs.gov/charities-non-profits/charitable-hospitals-general-requirements-for-tax-exemption-under-section-501c3>.

¹⁸26 U.S.C. § 501(r).

¹⁹PPACA establishes that a tax-exempt hospital that does not meet the community health needs assessment requirement must pay an excise tax. 26 U.S.C. § 4959.

hospital calculates costs for those services, and the actions the hospital will take in the event of nonpayment.

- **Set a limit on charges.** A tax-exempt hospital cannot charge individuals eligible for financial assistance more for medical services than they do patients with insurance.
- **Set billing and collection limits.** A tax-exempt hospital may not take extraordinary collection actions against an individual, such as filing a lawsuit, before the hospital determines whether that individual is eligible for financial assistance.

In addition, the law established a new requirement for IRS to review the community benefit activities of each tax-exempt hospital at least once every 3 years.²⁰

IRS Oversight of Tax-Exempt Hospitals

The Tax Exempt and Government Entities (TE/GE) division within IRS oversees tax-exempt hospitals. TE/GE officials said they use two primary methods to collect information about tax-exempt hospitals and enforce their compliance with applicable law and guidance: (1) annual tax forms and (2) regular reviews of hospitals' community benefit activities.

Form 990, Schedule H

Certain tax-exempt nonprofit organizations, including hospitals, are required to file Form 990 annually.²¹ The form requires organizations to report information including

- employees, governance, and compensation;
- revenue and expenses;
- assets and liabilities;
- employment tax compliance; and
- specific organizational issues, such as lobbying by charities and private foundations.

²⁰PPACA, Pub. L. No. 111-148, title IX, subtitle A, § 9007(c), 129 Stat. 119, 857 (2010).

²¹26 U.S.C. § 6033.

In addition, a tax-exempt hospital is required to file Schedule H, titled "Hospitals," with its Form 990 annually.²² TE/GE uses Schedule H to collect information on the activities and policies of tax-exempt hospital organizations and the hospital facilities and other nonhospital health care facilities they operated during the tax year.²³ Specifically, the schedule requires tax-exempt hospitals to report information on their

- community benefits provided;
- community building activities;
- bad debt, Medicare costs, and collection practices;
- management structure;
- facilities, including how they met PPACA requirements for each; and
- supplemental information, including how they promote health.²⁴

Community Benefit Activity Reviews

TE/GE conducts Community Benefit Activity Reviews (CBAR) to meet the PPACA requirement that it review each tax-exempt hospital's community benefit activities at least once every 3 years. TE/GE states that these reviews determine if tax-exempt hospitals are in compliance with both the community benefit standard and PPACA requirements. TE/GE revenue agents, who conduct the CBARs, may refer a hospital for audit if they determine there is potential noncompliance with either the community benefit standard or PPACA requirements.²⁵

²²In certain circumstances, tax-exempt hospitals may be required to file other schedules with their Form 990, in addition to Schedule H.

²³IRS defines a hospital organization as an entity that operated at least one hospital facility during a tax year. A hospital facility is an entity that is required to be licensed, registered, or similarly recognized by a state as a hospital. Nonhospital health care facilities may include, but are not limited to, rehabilitation and other outpatient clinics, mobile clinics, and skilled nursing facilities.

²⁴IRS defines community building activities as activities that improve or protect a community's health and safety.

²⁵An IRS audit is an examination of an organization's or individual's accounts and financial information to ensure information is reported correctly according to the tax laws and to verify the reported amount of tax is correct.

Opportunities Exist to Improve Oversight of Tax-Exempt Hospitals

Congress Could Clarify the IRC to Improve Oversight of Tax-Exempt Hospitals

Congress has taken actions that convey an expectation that hospitals, in exchange for a tax exemption, should provide services and activities that benefit the immediate communities in which they operate. Specifically, in PPACA Congress required tax-exempt hospitals to identify each hospital's community's health needs indicating an expectation that hospitals provide benefits to the immediate community.²⁶ Hospitals that fail to do so must pay an excise tax. However, a broad range of activities fall within the IRC's requirement for a tax exemption for charitable organizations, making it challenging to effectively ensure that the community benefits hospitals provide justify their tax exemption.

Ensuring hospitals are able to meet community health needs is especially important at this time, as the COVID-19 response strains many of the nation's public resources. Congress has provided billions in direct funding to hospitals to help prevent, prepare for, and respond to the coronavirus. In doing so, however, Congress set explicit expectations for the use of that funding.²⁷

By contrast, IRS does not have authority to define specific types of services and activities that a hospital must undertake to qualify for a tax exemption. Instead, it provides guidance on the types of activities that can demonstrate community benefits. Some health care industry stakeholders we spoke to told us that IRS's community benefit standard does not ensure that the community benefits that tax-exempt hospitals provide justify their tax exemptions. They explained that the standard only provides examples and does not establish requirements or expectations

²⁶26 U.S.C. § 501(r).

²⁷Specifically, the funds were to be used for certain types of activities, such as building temporary structures and emergency operation centers, buying medical supplies and equipment including personal protective equipment and testing supplies, and retrofitting facilities. See, for example, Coronavirus Aid Relief, and Economic Security Act, Pub. L. No. 116-136, division B, title VIII, 134 Stat. 281 (2020).

of services and activities that can demonstrate a hospital's community benefits. They also identified the following specific issues:

- **Hospitals could address some of the standard's factors in ways that do not benefit surrounding communities.** Patient advocate organizations and researchers we spoke to told us, for example, that a hospital could use its surplus funds to conduct research that does not specifically benefit the individual community in which the hospital is located—though it may benefit the healthcare industry as a whole. Similarly, a hospital could use surplus funds to build a new facility, such as a state-of-the-art cancer treatment center, that primarily benefits affluent, insured patients. Such an activity would not necessarily benefit individuals across the community in which the hospital is located.
- **Some of the standard's factors may have lost relevance.** Some factors in the community benefit standard may no longer be relevant for distinguishing between nonprofit and for-profit hospitals. In 2005, the Commissioner of Internal Revenue told Congress that some community benefit factors, such as maintaining an open medical staff policy and accepting patients on Medicare and Medicaid, are now common features of all hospitals.²⁸ Additionally, the Emergency Medical Treatment and Active Labor Act, signed into law in 1986, requires that all hospitals that operate emergency rooms provide emergency treatment to all, regardless of ability to pay.²⁹ As a result, these standards may be a less useful gauge for measuring community benefit than they once were.
- **The standard does not identify some factors that can demonstrate substantial community benefit.** Stakeholders told us, for example, that the standard does not clearly identify that a hospital's spending on social determinants of health is an example of community benefits. Social determinants of health are economic or social conditions, such as the quality of one's housing, that influence health outcomes within groups or individuals. IRS's instructions to hospitals for completing their annual tax returns state that some spending in this area can be

²⁸*The Tax-exempt Hospitals Sector before the Committee on Ways and Means U.S. House of Representatives*, 109th Cong. 8-18, (2005) (statement of Mark W. Everson, Commissioner of Internal Revenue).

²⁹Emergency Medical Treatment and Active Labor Act, Pub. L. No. 99-272, title IX, § 9121(b), 100 Stat 164 (1986).

claimed as community benefit. However, stakeholders told us these instructions are not clear. As a result, tax-exempt hospitals might underinvest in such activities, which reduces the benefit to communities.

Given this ambiguity, a hospital could, in theory, maintain a tax exemption by operating an emergency room open to all and accepting patients on Medicare or Medicaid, which are common among hospitals, while spending little to no money on charity care or other community benefit activities.

However, other stakeholders, such as representatives of tax-exempt hospitals, told us that current law and the community benefit standard offer hospitals needed flexibility in demonstrating community benefits. They said community health needs vary substantially across the country. Therefore, community benefits can vary substantially from place to place. For example, a hospital located in a remote rural community may be the only hospital within hundreds of miles. Its primary benefit may be the fact that it exists to serve the community. Such a reason could be sufficient to justify its tax exemption.

IRS states that it reviews hospitals' services and activities to ensure that they are providing community benefits that justify their tax exemptions. For example, one of the purposes of IRS's Community Benefit Activity Reviews is to enforce tax-exempt hospitals' compliance with the requirement that they provide community benefits. However, IRS officials told us that they could not identify whether any tax-exempt hospitals were referred to its audit division during the period from fiscal years 2015 through 2019 for potentially providing insufficient community benefits because, as discussed later, the agency does not track this information. Furthermore, IRS officials told us that the agency has not revoked a hospital's tax-exempt status for failing to provide sufficient community benefits in the last 10 years.

We have previously reported that criteria for a good tax system include transparency and administrability.³⁰ A transparent tax system is one that taxpayers are able to understand. Administrable tax systems allow the government to collect taxes as cost effectively as possible. The way the tax system is structured by Congress can affect how it is administered, and this can affect compliance. A nontransparent tax system is

³⁰GAO, *Understanding the Tax Reform Debate: Background, Criteria, and Questions*, GAO-05-1009SP (Washington, D.C.: September 2005).

challenging to administer because tax administrators will have difficulty consistently applying the law to taxpayers in similar situations.

As we have previously reported, the IRC, and IRS's implementation of it, provides tax-exempt hospitals with broad latitude to determine the nature and amount of community benefits they provide.³¹ However, these broad requirements create challenges for IRS in administering tax law. IRS, in its 2009 report on hospital compliance, stated that the community benefit standard is difficult to administer.³² The lack of clarity makes it difficult for IRS to ensure that hospitals receiving a tax exemption undertake services and activities that provide benefits to the communities in which they operate.

Additional clarity in the IRC about specific services and activities Congress believes would provide sufficient community benefits could improve IRS's ability to oversee tax-exempt hospitals.

IRS Could Improve the Transparency of Community Benefit Data

IRS Does Not Collect Consistent Data on Community Benefits

IRS requires a tax-exempt hospital to file a Schedule H with its Form 990 annually to provide the public with information on their policies, activities, and the community benefits that their facilities provide. IRS has stated that a tax-exempt organization's Form 990, along with its schedules, can be the primary or sole source of information the public uses to understand a tax-exempt organization's operations, such as the community benefits a hospital provides. The publicly available data are also intended to enable researchers and the broader public to better understand the level of community benefits that these hospitals provide.

However, Form 990, Schedule H solicits information inconsistently, resulting in a lack of clarity about the community benefits hospitals provide. The schedule includes questions intended to capture information

³¹GAO, *Nonprofit Hospitals: Variation in Standards and Guidance Limits Comparison of How Hospitals Meet Community Benefit Requirements*, GAO-08-880 (Washington, D.C.: Sept. 12, 2008).

³²IRS, "Tax Exempt and Government Entities," *IRS Exempt Organizations Hospital Study Executive Summary of Final Report* (February 2009) https://www.irs.gov/pub/irs-tege/execsum_hospprojrept.pdf.

Letter

on each of the six factors of the community benefit standard. These questions are located on different parts of the schedule and hospitals are instructed to address them in different ways (see figure 2).

Figure 2: Location of Community Benefit Factors on Internal Revenue Service Form 990, Schedule H

LOCATION ON FORM 990, SCHEDULE H

COMMUNITY BENEFIT FACTORS

Part I (aggregated)

7 Financial Assistance and Certain Other Community Benefits at Cost						
Financial Assistance and Means-Tested Government Programs	(a) Number of activities or programs (optional)	(b) Persons served (optional)	(c) Total community benefit expense	(d) Direct offsetting revenue	(e) Net community benefit expense	(f) Percent of total expense
a Financial Assistance at cost (from Worksheet 1)						
b Medicaid (from Worksheet 3, column a)						
c Costs of other means-tested government programs (from Worksheet 3, column b)						
d Total. Financial Assistance and Means-Tested Government Programs						
Other Benefits						
e Community health improvement services and community benefit operations (from Worksheet 4)						
f Health professions education (from Worksheet 5)						
g Subsidized health services (from Worksheet 6)						
h Research (from Worksheet 7)						
i Cash and in-kind contributions for community benefit (from Worksheet 8)						
j Total. Other Benefits						
k Total. Add lines 7d and 7j						

Provide care to all patients able to pay, including those who do so through Medicare and Medicaid.

Use surplus funds to advance medical training, education, and research.

Part V (by facility)

Policy Relating to Emergency Medical Care				
21	Did the hospital facility have in place during the tax year a written policy relating to emergency medical care that required the hospital facility to provide, without discrimination, care for emergency medical conditions to individuals regardless of their eligibility under the hospital facility's financial assistance policy?	21		
If "No," indicate why:				
a	<input type="checkbox"/> The hospital facility did not provide care for any emergency medical conditions			
b	<input type="checkbox"/> The hospital facility's policy was not in writing			
c	<input type="checkbox"/> The hospital facility limited who was eligible to receive care for emergency medical conditions (describe in Section C)			
d	<input type="checkbox"/> Other (describe in Section C)			

Operate an emergency room open to all, regardless of ability to pay.

Part VI (aggregated, open question)

5 Promotion of community health. Provide any other information important to describing how the organization's hospital facilities or other health care facilities further its exempt purpose by promoting the health of the community (e.g., open medical staff, community board, use of surplus funds, etc.).

Not restrict medical staff privileges to a limited group of physicians (i.e., maintain an open medical staff policy). | Maintain a board of directors drawn from the community. | Use surplus funds to improve facilities, equipment, and patient care.

Source: GAO. | GAO-20-679

For three of the factors in the community benefit standard—provide care to all patients able to pay; use surplus funds to advance medical training, education, and research; and operate an emergency room open to all—

IRS explicitly directs tax-exempt hospitals to report on Form 990, Schedule H the extent to which they have addressed them. For example, regarding the factors on surplus funds, IRS directs hospitals to identify the specific costs they incur by providing health education and medical research.

However, IRS does not explicitly direct tax-exempt hospitals to report on the other three community benefit factors on Form 990, Schedule H—maintain an open medical staff policy; have a board of directors drawn from the community; and use surplus funds to improve facilities, equipment, and patient care. Rather, IRS asks hospitals to describe narratively additional information important to understanding the full scope of the community benefits they provide. In doing so, those three factors are suggested only as examples they could use in their description.

This reporting structure can affect the comprehensiveness and consistency with which a tax-exempt hospital presents its community benefits:

- It creates uncertainty about where information on certain types of activities should be reported. For example, hospital representatives we spoke to said some of their members are confused about whether they should report information under community benefits or community building activities.
- It generally precludes tax-exempt hospitals from specifically identifying the amount of surplus funds used to improve facilities, equipment, and patient care. According to IRS officials, those costs are located on the main Form 990. However, the information to which IRS referred—functional expenses and the hospital's overall balance sheet—do not break out costs attributable to the improvement of facilities, equipment, or patient care.
- It could result in potentially incomplete information on how hospitals are providing community benefits. For example, our analysis of hospitals' Form 990, Schedule H filings for tax years 2015 through 2018 identified hospitals that described their open medical staff policy and how their board of directors was made up of members from the community. These hospitals also provided numerous examples of how they used surplus funds to improve their facilities and patient care. Conversely, we identified other hospitals that did not address whether they had an open medical staff policy, a board of directors drawn from the community, or the

use of surplus funds to improve patient care, facilities, or equipment.

- It limits the comprehensiveness of publicly available data. IRS releases quantitative, machine-readable files on the community benefits reported by each tax-exempt hospital on Form 990, Schedule H.³³ However, the files do not contain any community benefit information that hospitals describe narratively.

We have previously reported on the importance of transparently reporting open government data.³⁴ Specifically, we reported that data designed to be open to the public should be provided in useful formats, such as ensuring users have detailed and disaggregated data. In addition, agencies should facilitate data discovery for all users, such as utilizing central data repositories and catalogues to help users easily find the data they seek.

IRS officials told us that the current Form 990, Schedule H is sufficient, as it allows tax-exempt hospitals to fully identify and describe their community benefit activities throughout the form. IRS officials also stated that Form 990, Schedule H does not specifically ask about surplus costs for facilities, equipment, and patient care because that information is already reported by hospitals in another part of Form 990. IRS officials said they believe that revising the form to include more specific information would put undue burden on hospitals. According to IRS officials, hospitals often use prior forms to update their information, and changes to a form could make it challenging to do so. Additionally, officials said that new forms take time to design and vet.

However, the Form 990, Schedule H, as it is currently structured, does not enable tax-exempt hospitals to demonstrate clearly for the public the extent to which they provide community benefits. Furthermore, the reliance on an optional narrative answer for some factors results in data that potentially provide an incomplete picture of a hospital's community benefits. A revised Form 990, Schedule H that enables tax-exempt hospitals to present community benefit information clearly, consistently, and comprehensively could help IRS, Congress, and the broader public

³³Forms 990 are disclosable to the public and can be requested by submitting Form 4506-A.

³⁴GAO, *Treasury Could Better Align USAspending.gov with Key Practices and Search Requirements*, [GAO-19-72](#) (Washington, D.C.: Dec. 13, 2018).

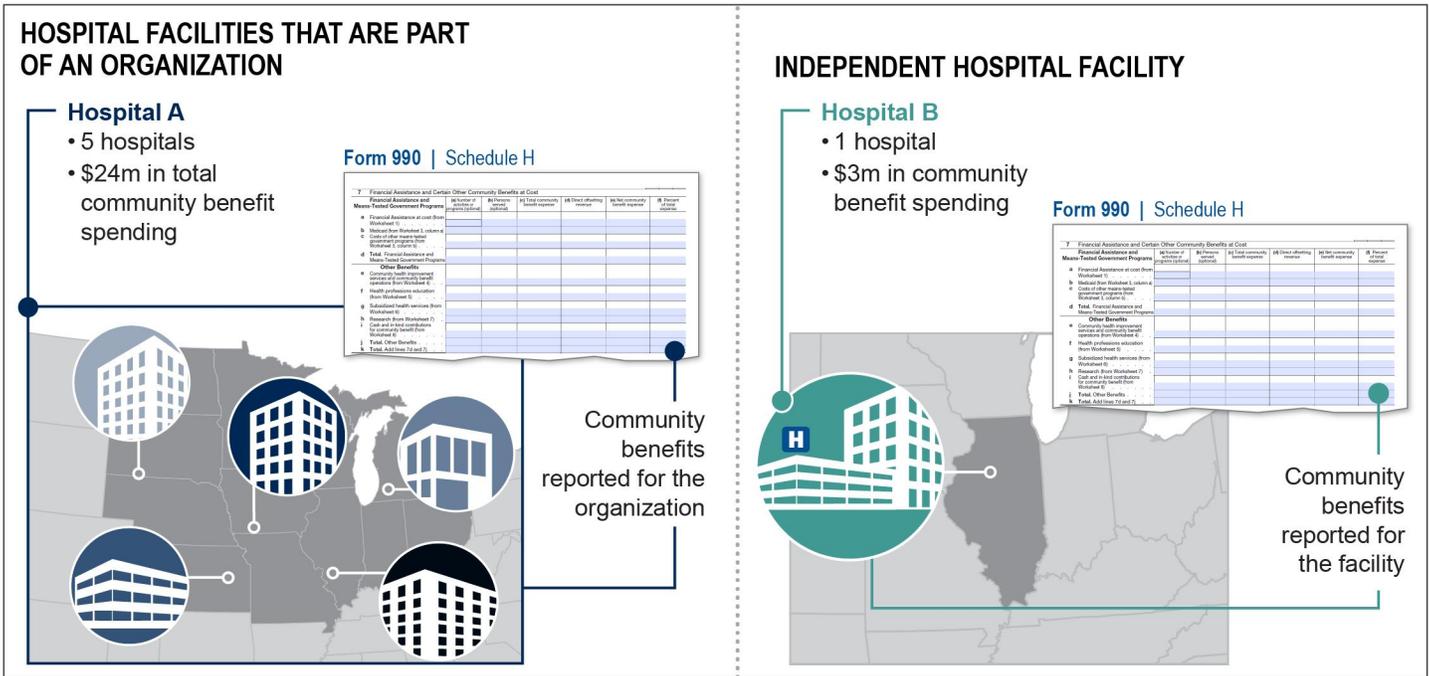
better understand the full scope of the community benefits a hospital provides and whether the benefits sufficiently justify a tax exemption.

IRS Does Not Require Hospitals to Report Community Benefit Expenses by Facility

Form 990, Schedule H directs tax-exempt hospitals to report their community benefit expenses at the hospital organization level rather than at the facility level. Therefore, hospital organizations report community benefits in the aggregate for all of their facilities. For example, a hospital organization reports the amount of charity care it provides and its costs for medical training, education, and research for all of its facilities as a whole, not for each facility.

In tax year 2016, 46 percent of hospital facilities were part of a hospital organization, and therefore those facilities' community benefit expenses were reported as part of the organization as a whole. For example, a hospital organization with five facilities could report \$24 million in community benefit expenses on its Form 990, Schedule H. In that case, it would not be transparent how much each facility contributed to the total. Two of the facilities could contribute \$12 million each in community benefit expenses, while the other three contribute none. Alternatively, the community benefit expenses reported by independent hospital facilities would be transparent (see figure 3).

Figure 3. Illustration of Community Benefit Data Reported by Hospital Organizations and Independent Hospitals



Source: GAO. | GAO-20-679

Congress and the executive branch have previously signaled the importance of tax-exempt hospitals reporting information on hospital facilities by including in the Patient Protection and Affordable Care Act (PPACA) requirements for those hospitals to create community health needs assessments and associated implementation plans for each of their facilities. Furthermore, *Standards for Internal Control in the Federal Government* states that an organization should use quality information to achieve its objectives and communicate that information externally. These standards also call for management to design and implement internal controls within programs based on the related benefits and costs.³⁵

IRS officials told us that the agency requires a tax-exempt hospital to report its community benefit expenses on their Form 990, Schedule H at the organization level because the IRC provides a tax exemption at the organizational level, not the facility level. IRS directs hospital organizations to report information about PPACA requirements at the

³⁵GAO, *Standards for Internal Control in the Federal Government*, GAO-14-704G (Washington, D.C.: September 2014).

facility level on the form because it is legally required.³⁶ Because hospitals are now required by PPACA to provide information at the facility level, reporting all information at the facility level could potentially reduce the burden of aggregating data to the organization level. However, IRS has not assessed the benefits and costs of requiring hospitals to report their community benefit expenses at the facility level. Without doing so, IRS may be missing an opportunity to collect information that would more clearly and transparently demonstrate the benefits tax-exempt hospitals provide to the communities in which they operate. This information, in turn, would allow Congress, IRS, and the public to weigh the costs and benefits of the hospital's tax exemption.

IRS Could Improve Oversight of PPACA Community Benefit Requirements

IRS Verifies Hospitals' Self-Reported Compliance with the Four PPACA Requirements

IRS requires hospitals to self-report compliance with all four PPACA requirements on Form 990, Schedule H, Part V.³⁷ Hospitals must answer a series of yes or no questions for each of the four PPACA requirements. For example, they must answer the question, "During the tax year or either of the two immediately preceding tax years did the hospital facility conduct a community health needs assessment?"

The Tax Exempt and Government Entities (TE/GE) division of IRS verifies many aspects of the hospitals' reports during its triennial Community Benefit Activity Reviews (CBAR). Using guidance called the ACA Desk Guide, TE/GE revenue agents answer a list of questions to review how hospitals comply with the PPACA requirements. These questions are primarily tied to the questions on the Form 990, Schedule H, Part V, but also include follow-up questions that depend on hospitals' responses. For

³⁶26 U.S.C. § 501(r).

³⁷Those requirements are to (1) conduct a community health needs assessment every 3 years and develop an implementation plan for how it will address those needs; (2) publish a written financial assistance policy; (3) not charge individuals eligible for financial assistance more for medical services than they do patients with insurance; and (4) not take extraordinary collection actions against an individual before the hospital determines whether that individual is eligible for financial assistance.

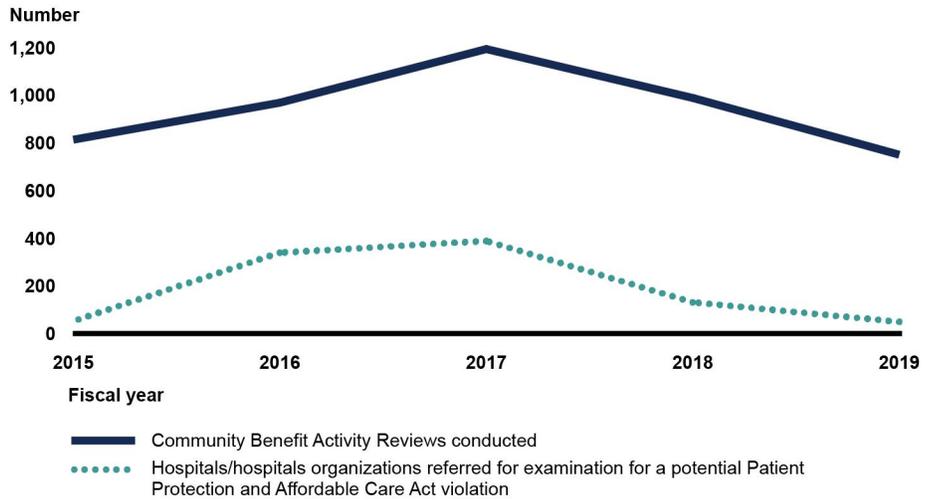
example, the guide asks revenue agents to verify that the hospital conducted a community health needs assessment, but also includes detailed questions on how it was conducted.

TE/GE revenue agents determine a hospital organization's compliance by collecting information from a range of public sources, but they do not contact the organization itself when conducting the CBAR.³⁸ If the revenue agent cannot verify a hospital's compliance with all the PPACA requirements, the hospital is to be referred for audit.³⁹ Over the period from fiscal years 2015 through 2019, TE/GE conducted more than 4,700 CBARs and referred almost 1,000 tax-exempt hospitals for audit because they identified a potential PPACA violation (see figure 4). Figure 4 shows that there was an initial rise in the number of CBARs conducted. According to TE/GE officials, changes in the number of CBARs conducted are due to several factors, including openings, closings, and mergers, as well as refinements in selection criteria.

³⁸Public sources revenue agents are instructed to use include Google, Medicare, and state and hospital websites.

³⁹Revenue agents may also refer a hospital for a compliance check. A compliance check, while less detailed than an audit, consists of a more thorough review than the CBAR and is used to determine if the hospital is adhering to recordkeeping and reporting requirements and if its activities are consistent with its state d tax-exempt purpose. It does not relate to determining tax liability or verifying the hospital's responses coincide with its records.

Figure 4: Results of Community Benefit Activity Reviews (CBAR), Fiscal Years 2015-2019



Source: GAO analysis of Internal Revenue Service data. | GAO-20-679

Note: Hospitals can demonstrate their charitable purpose by providing services that benefit their communities.

Both TE/GE enforcement of the PPACA requirements and an increase in self-reported compliance may have contributed to the recent decline in referrals. As part of that enforcement, TE/GE has issued more than 300 written advisories and levied excise taxes on 40 noncompliant hospitals from CBARs and resulting audits from fiscal years 2015 through 2018. In addition, representatives from tax-exempt hospitals told us that TE/GE’s reviews have been thorough. For example, they cited instances in which IRS required their hospitals to provide additional documentation to support information they reported on the Form 990, Schedule H. Our analysis of Form 990, Schedule H data shows that hospitals’ self-reported compliance increased each year from fiscal years 2014 to 2016 (see table 1).

Table 1: Percent of Tax-Exempt Hospitals Reporting Compliance with Patient Protection and Affordable Care Act Requirements, by Tax Year

Category	2014	2015	2016
Conduct Community Health Needs Assessments Every 3 Years	85	89	90
Maintain a Financial Assistance Policy	16	33	62
Set a Limit on Charges	91	92	94
Set Billing and Collections Limits	56	70	77

Source: GAO analysis of Internal Revenue Service data. | GAO-20-679

TE/GE Could Improve Its Review of Hospitals' Community Benefit Activities

IRS referred almost 1,000 hospitals to its audit division for potential PPACA violations from fiscal years 2015 through 2019. However, IRS could not identify whether any of these referrals related to community benefits. Our analysis of schedule H data indicates there were hospitals that could have been at risk for noncompliance with the community benefit standard during a similar period (see table 2).

Table 2: Number of Hospital Organizations with Little to No Community Benefit Spending, Tax Years 2014-2016

Category	2014	2015	2016
No financial assistance	64	68	48
No community benefit spending	48	45	30
Less than 1 percent community benefit spending	142	137	108

Source: GAO analysis of Internal Revenue Service data. | GAO-20-679

Note: Financial assistance includes financial aid (i.e., charity care), Medicaid, and other means-tested government programs. The calculation of community benefit corrects for hospitals that reported negative spending values due to excess off-setting revenues, such as grants or Medicaid reimbursements.

Specifically, we identified 30 hospitals in 2016 that reported no spending on community benefits, as shown in table 2.⁴⁰ TE/GE states that it sends back forms that are materially incomplete and requests that hospitals complete the missing information; however, we found that some of the hospitals left the required community benefit section of Form 990, Schedule H blank. These hospitals may have actually spent funds on community benefit activities, but did not complete the form. Other hospitals reported spending amounts that were approximately 0 percent of expenses.⁴¹

In addition to requiring IRS to review hospitals' compliance with the PPACA requirements, PPACA required IRS to review information about hospitals' community benefit activities at least every 3 years. However,

⁴⁰The calculation of community benefit spending included direct offsetting revenue, such as grants or Medicaid reimbursements that could result in zero net spending.

⁴¹IRS agents in the Statistics of Income group in the Research Applied Analytics and Statistics Division correct some of the Form 990, Schedule H data for obvious errors before posting the public files onto IRS's website. However, those changes do not extend to the forms themselves that TE/GE officials would review in a CBAR.

TE/GE does not have a well-documented process, such as clear instructions on referring hospitals for audit during its triennial reviews or automated queries to identify hospitals at risk for noncompliance with the community benefit standard. TE/GE also does not have a way to track audits related to tax-exempt hospitals' community benefit activities.

Referring Hospitals for Audit

TE/GE revenue agents are to follow the ACA Desk Guide to conduct their triennial reviews of hospitals' community benefit activities. The ACA Desk Guide states that the purpose of the CBAR is to determine if hospitals are compliant with the community benefit standard as well as the additional requirements for tax-exempt hospitals in PPACA. It also states that the CBAR survey addresses "501(r)" questions, which relate specifically to PPACA requirements. However, the instructions for conducting CBARs do not identify how or when a revenue agent should refer a hospital at risk of providing insufficient community benefits for audit.

The instructions for conducting CBARs provide general guidance for the types of issues that a revenue agent may identify. However, this guidance does not specifically include potential noncompliance with the community benefit standard. While there are specific questions that address the community benefit factors, there is no direction on when a hospital should be referred for audit if the revenue agent is unable to verify the factor. According to TE/GE officials, during the CBAR, revenue agents may refer a hospital for audit because it provides insufficient community benefits, but the agents do not have guidance that would enable them to make this determination consistently.

The ACA Desk Guide has specific questions related to community benefits. These include questions concerning whether the hospital:

- maintains a financial assistance policy;
- budgets amounts for free or discounted care;
- operates an emergency room, open to all without regard for ability to pay;
- maintains medical staff at each facility that is open or if it is restricted to a certain group of physicians;
- maintains a governing body that is composed of a majority of members of the community; or

- uses surplus funds to improve patient care, expand facilities, or advance medical education and research.

TE/GE officials stated that these questions ask the revenue agent to verify that the organization demonstrates these community benefit factors.

However, those questions simply ask revenue agents if they can verify that the hospitals reported in the affirmative; during the CBAR review, the revenue agent is not able to request any more detailed information on the amount of care provided or activities conducted. During an audit, an examiner can request additional information. Further, the guide does not indicate which or how many of those questions that the revenue agent is unable to verify justifies referring the hospital for audit.

According to IRS officials, the decision to refer the hospital for an audit is based on the facts and circumstances of each review conducted. Updating the instructions for conducting the CBARs to more clearly direct revenue agents on how to identify and recommend for audit tax-exempt hospitals at risk of providing insufficient community benefits could help ensure that revenue agents are identifying hospitals that are potentially noncompliant with the community benefit standard.

According to TE/GE officials, the CBAR reviews are IRS's primary method used for overseeing hospitals' tax-exempt status. TE/GE will accept referrals for audit independent of the CBAR, such as those resulting from audit selections based on the Form 990 that did not relate specifically to hospitals. However, it does not have a system outside the CBAR for identifying hospitals at risk for providing insufficient community benefits. According to TE/GE officials, TE/GE only reviews Form 990 data during the CBAR.

TE/GE uses models to analyze data from the Form 990 that most tax-exempt organizations file. Those models include questions to identify responses on returns that may indicate noncompliance because they do not meet certain criteria or expected values. Although a hospital may be selected for an audit as a result of these automated queries, none of the queries address the community benefit standard or apply to the schedule H that a hospital includes with its Form 990. According to TE/GE officials, hospitals with little to no community benefit expenses would be indicative of potential noncompliance and may warrant an audit. However, as discussed below, TE/GE was unable to provide us evidence that it conducts reviews specifically related to hospitals' community benefits.

TE/GE officials stated that of 37 hospitals that reported zero or negative community benefit spending in tax year 2016, 21 were referred for examination or compliance check as a result of their CBAR reviews.⁴² Six of the hospitals were referred for audit based on CBAR review of the 2016 Form 990. The other 15 referrals were made based on other tax years. In all these cases, the referrals were made as a result of possible issues with the financial assistance policy or community health needs assessment. TE/GE officials said that the other 16 hospitals that reported no spending on community benefits were not referred for audit because they met the PPACA requirements. According to TE/GE officials, these requirements address community benefit issues as they relate to financial assistance policies and community health needs assessments, but they do not necessarily address the facts and circumstances determination of meeting the community benefit standard.

TE/GE officials also said automated queries for selecting hospitals to audit related to the community benefit standard are not needed because the entire population of hospitals is reviewed at least every 3 years during the CBAR. TE/GE officials stated that, through these reviews, IRS collects information necessary for its role in administering the tax law. Risk-based audit selection methods, such as automated queries to flag values below certain percentages, could help better identify a hospital at risk for noncompliance rather than relying solely on the CBAR reviews.

PPACA requires IRS to review, at least once every 3 years, the community benefit activities of each hospital organization subject to the PPACA provisions.⁴³ A well-documented and consistently implemented process for identifying hospitals at risk for noncompliance with the community benefit standard would help IRS ensure it is effectively reviewing hospitals' community benefit activities.

Tracking Review of Hospitals' Community Benefit Activities

TE/GE also does not have a way to track audits related to tax-exempt hospitals' community benefit activities. Specifically, it does not have a way to determine if hospitals are being selected for audit for potential noncompliance related to community benefits during a CBAR. Hospitals

⁴²We provided IRS with a list of 37 hospitals that, based on our review of Form 990, Schedule H data, reported zero or negative net community benefit spending for tax year 2016. This number is larger than the amount reported in table 2, because the values in table 2 correct for the cases for which hospitals reported negative spending in Medicaid.

⁴³PPACA, Pub. L. No. 111-148, title IX, subtitle A, § 9007(c), 129 Stat. 119, 857 (2010).

can also be referred for audit through channels outside of the CBAR and not all cases referred for audit are accepted for audit. IRS also does not have a method to track how many hospitals have actually been audited based on potential noncompliance with community benefits.

According to TE/GE, it uses audit issue codes that differentiate between PPACA-related noncompliance and other noncompliance. Revenue agents and examiners use the same set of codes for PPACA-related issues—revenue agents use them to indicate a deficiency with PPACA found during a CBAR review and examiners use them to identify issues found while conducting an audit. TE/GE designates these codes “ACA,” and they include seven specific categories related to the individual PPACA requirements. According to TE/GE, issues unrelated to the PPACA requirements, such as having unrelated business income, are labeled “non-ACA.” However, there are no codes related to potential noncompliance with the community benefit standard.

According to IRS, from 2016 through 2019, fewer than 10 cases each year were referred to its audit division during the CBAR for an issue not related to PPACA. As stated above, IRS officials told us that they could not identify whether any tax-exempt hospitals were referred to its audit division from 2016 through 2019 for potentially providing insufficient community benefits.

According to TE/GE officials, if a hospital was referred for audit due to concerns about the community benefits it was providing, a revenue agent would probably use one of the non-ACA codes, such as “operational requirements” or possibly “disqualifying operations.” Officials further stated TE/GE does not have an issue code specifically related to “community benefit” because the community benefit standard relates to qualification for exemption, which has existed since 1969. According to TE/GE officials, the codes they currently use in the CBAR were implemented specifically for tracking issues related to the PPACA provisions identified during CBARs and not for issues with qualification for exemption. They also said it would be inefficient to have codes that identify every type of exemption or operational issue that could be encountered in a case.

Standards for Internal Control in the Federal Government states that agencies should design information systems to obtain and process

information to meet the agency's objectives.⁴⁴ This design allows the agency to effectively monitor its operations and ensure it is meeting its goals.

Similar to how IRS established seven issue codes for the PPACA provisions, establishing codes for the six community benefit factors would allow IRS to track audit activity related to community benefits. These codes for community benefit issues would enable revenue agents to indicate in their respective review summaries that a hospital is being referred for audit based on potential noncompliance with the community benefit standard. In addition, these codes would enable TE/GE to systematically track whether examiners found deficiencies in how hospitals provide community benefits during their audits. This information would enable IRS to demonstrate to Congress and the public that hospitals' community benefit activities are being reviewed and whether hospitals are complying with the community benefit standard.

Conclusions

Hospitals have been able to receive a tax exemption since their inception. The reasons for that exemption have changed over time from a focus on charity to a focus on providing community benefits. Congress and the executive branch have taken steps to bolster IRS's oversight of tax-exempt hospitals, including establishing additional requirements to better ensure that hospitals are adequately serving their communities. However, the lack of clarity in the law regarding what types of activities hospitals should be engaged in to justify that tax exemption make it challenging for IRS to ensure effective oversight.

IRS has identified factors that demonstrate community benefits, but the agency does not require any one factor to be satisfied and it audits hospitals on a facts and circumstances basis. These factors vary significantly from activities that demonstrate direct benefits, such as using surplus funds for patient care, to broader concepts of community benefit, such as general medical research. The data IRS collects to provide the public with information on the policies, activities, and community benefits that hospital facilities provide are not clear or detailed, reducing both the transparency of hospitals' activities and IRS's ability to effectively verify the benefits hospitals provide to their communities. IRS actively reviews

⁴⁴GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014).

hospitals' compliance with PPACA requirements. However, IRS does not have a well-documented process to ensure or demonstrate it is consistently reviewing the community benefits hospitals provide. By taking steps to improve its oversight of hospitals' tax-exempt status, IRS could provide Congress and the public with confidence that these hospitals are adequately serving their communities.

Matter for Congressional Consideration

Congress should consider specifying in the IRC what services and activities it considers sufficient community benefit. (Matter for Consideration 1)

Recommendations for Executive Action

We are making the following four recommendations to IRS:

The Commissioner of Internal Revenue should update Form 990, including Schedule H and instructions where appropriate to ensure that the information demonstrating the community benefits a hospital is providing is clear and can be easily identified by Congress and the public, including the community benefit factors. (Recommendation 1)

The Commissioner of Internal Revenue should assess the benefits and costs, including the tax law implications, of requiring tax-exempt hospital organizations to report community benefit expenses on Schedule H by individual facility rather than by collective organization and take action, as appropriate. (Recommendation 2)

The Commissioner of Internal Revenue should establish a well-documented process to identify hospitals at risk for noncompliance with the community benefit standard that would ensure hospitals' community benefit activities are being consistently reviewed. (Recommendation 3)

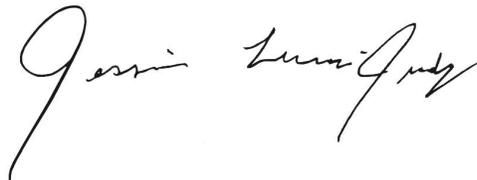
The Commissioner of Internal Revenue should establish specific audit codes for identifying potential noncompliance with the community benefit standard. (Recommendation 4)

Agency Comments

We provided a draft of this report to the Commissioner of Internal Revenue for review and comment. IRS provided written comments, reproduced in appendix II, stating that it agreed with GAO's recommendations. In addition, after a discussion with the IRS Commissioner for Tax Exempt and Government Entities and other senior program officials on August 20, 2020, we clarified two recommendations. First, we clarified Recommendation 1 to include updating instructions where appropriate and to ensure the information addresses the community benefit factors. Second, we clarified Recommendation 2 to include tax law implications as part of assessing the benefits and costs.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies of this report to the appropriate congressional committees, Commissioner of Internal Revenue, and other interested parties. In addition, the report will be available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-9110 or lucasjudyj@gao.gov. Contact points for our offices of Congressional Relations and Public Affairs are on the last page of this report. GAO staff who made key contributions to this report are listed in appendix III.



Jessica Lucas-Judy
Director, Strategic Issues

Appendix I: Objectives, Scope, and Methodology

This report assesses the Internal Revenue Service's (IRS) (1) oversight of how tax-exempt hospitals provide community benefits, and (2) enforcement of requirements related to tax-exempt hospitals included in the Patient Protection and Affordable Care Act (PPACA).¹

To assess IRS's oversight of how tax-exempt hospitals provide community benefits we reviewed relevant provisions of the Internal Revenue Code, Department of the Treasury regulations, revenue rulings, and guidance. We assessed IRS's oversight efforts against relevant federal internal control standards and our criteria for a good tax system. The relevant internal control principles focus on using and communicating quality information and designing information systems to achieve objectives and respond to risks. The criteria for a good tax system describe principles of transparency and administrability.² We also reviewed IRS policies, procedures, audit plans, and determining factors for reviewing tax-exempt hospitals.

We examined data on community benefit information hospitals report from Forms 990, Schedule H, which hospitals are required to file with IRS documenting the community benefits they provide. Those data were obtained from IRS Statistics of Income (SOI) public microdata files that cover the entire population of tax-exempt hospitals for tax year up to 2016, the most recent year available at the time of our review. While we found instances in which some sections of the form H were incomplete, we determined that the data were sufficiently reliable for addressing our objectives. We made this determination by performing detailed tests for errors or discrepancies and interviewing SOI officials on their procedures for preparing the data.

¹26 U.S.C. § 501(r).

²GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014), and *Understanding the Tax Reform Debate: Background, Criteria, and Questions*, [GAO-05-1009SP](#) (Washington, D.C.: September 2005).

To assess IRS's enforcement of requirements related to tax-exempt hospitals included in PPACA, we reviewed its primary guidance for Tax Exempt and Government Entities (TE/GE) reviewers—the ACA Desk Guide—to determine what topics their triennial reviews of hospitals cover. We also analyzed TE/GE's audit referral system to determine the steps IRS has in place to enforce hospitals' compliance with the PPACA provisions and the community benefit standard. We compared data on Forms 990, Schedule H on hospitals' self-reported compliance with PPACA and their reported community benefits with the triennial review guidance.

In addition, we interviewed selected interest groups representing both tax-exempt and for-profit hospitals to obtain their views on the clarity and enforcement of the community benefit standard and requirements included in PPACA. To identify these groups, we reviewed our past reports on tax-exempt hospitals that yielded an initial list of seven groups. Two of those groups declined to participate. The remaining groups that we spoke to were: American Hospital Association, Association of American Medical Colleges, Catholic Health Association of the United States, Federation of American Hospitals, and Healthcare Financial Management Association. In each of those interviews, we solicited suggestions for other groups to interview that yielded one group not already included. That group also declined to be interviewed.

We also spoke to national patient advocacy groups that represent broad patient interests. We initially identified five groups by soliciting suggestions from our own health specialists and methodologists. Two declined to be interviewed and we solicited suggestions for other groups to contact during our interviews with the three remaining groups identified. Those groups were Families USA, American Public Health Association, and Community Catalyst. They suggested additional groups to interview that were either part of our hospital group interviews, policy group interviews, or outside our scope.

Lastly we conducted a detailed literature review to identify groups that have written on the policy implications related to tax-exempt hospitals. In addition to numerous academic, government, and trade publications, it also yielded nine articles from think tanks. Based on the results of the think tank articles we interviewed the following organizations: Hilltop Institute, Commonwealth Fund, Baker Institute for Public Policy, Brookings Institute, and Urban Institute. The results of our interviews with interest groups, advocacy groups, and think tanks may not represent the views of all groups involved in or with an interest in tax-exempt and for-

**Appendix I: Objectives, Scope, and
Methodology**

profit hospitals. However, they illustrate a range of perspectives on these topics.

Appendix II: Comments from the Internal Revenue Service

Appendix II: Comments from the Internal Revenue Service



DEPUTY COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

September 2, 2020

Jessica K. Lucas-Judy
Director, Strategic Issues
United States Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Ms. Lucas-Judy:

Thank you for the opportunity to review the draft report of the Government Accountability Office, GAO-20-679, entitled ***Tax Administration: Opportunities Exist to Improve Oversight of Hospitals' Tax-Exempt Status*** (job code 103426). We appreciate the analysis in the report, which observes that administration of the tax law in this area presents challenges.

Over the past years, the Internal Revenue Service (IRS) has worked toward continuous improvement of tax administration for tax-exempt hospitals. In 2008, the IRS concluded a study of tax-exempt hospitals and used this information to develop the Form 990, Schedule H. This Schedule was designed, with stakeholder input and consultation, to collect uniform information from tax-exempt hospitals with respect to the community benefit standard described in Revenue Ruling 69-545. In 2010, we implemented key provisions of the Affordable Care Act (ACA) addressing additional, statutorily mandated requirements that must be met by hospitals that are tax-exempt under Section 501(c)(3) of the Internal Revenue Code. As noted in the report, the ACA also requires the IRS to conduct a review of the community benefit activities of every tax-exempt hospital at least every three years. We quickly instituted a program to conduct those reviews, and we continue to review these organizations. We have also engaged in education with respect to the various requirements, and we have seen the positive results of this outreach in the form of increased compliance in the sector.

It is true that there are challenges with respect to administration of the community benefit standard, which requires consideration of "all of the relevant facts and circumstances in each case" and under which "the absence of particular factors [set out in Revenue Ruling 69-545] or the presence of other factors will not necessarily be determinative." See Rev. Rul. 69-545, 1969-2 C.B. 117. Those challenges are a product of the inherent flexibility required under the existing legal guidance to ensure that hospitals' activities are considered in the context of their own communities. This is something the IRS continues to address, and to that end, we have fully considered each of your recommendations. There are inherent advantages and disadvantages of

**Appendix II: Comments from the Internal
Revenue Service**

2

imposing either a standard or a rule, a question of policy on which the IRS must defer to the Department of the Treasury and the Congress.

We appreciated the opportunity to review and comment on the draft report. Responses to your specific recommendations to the IRS are enclosed. If you have questions, please contact me, or a member of your staff may contact Maria D. Hooke, Director, Compliance Planning and Classification, at 214-413-5500.

Sincerely,

Sunita B. Lough

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Lough
Date: 2020.09.02 20:56:49 -04'00'

Sunita Lough
Deputy Commissioner for
Services and Enforcement

Enclosure

Appendix II: Comments from the Internal Revenue Service

Enclosure

Matter for Congressional Consideration:

Congress should consider specifying in the IRC what services and activities it considers sufficient community benefit.

Comment:

No comment from the IRS.

Recommendation 1: The Commissioner of Internal Revenue should update Form 990, including Schedule H and Instructions where appropriate to ensure that the information demonstrating the community benefits a hospital is providing is clear and can be easily identified by Congress and the public, including the community benefit factors.

Comment:

The IRS agrees with this recommendation. The current Form 990, including Schedule H allows for, but is not limited to, reporting on the six factors identified in Revenue Ruling 69-545. Those six factors were relevant in the application of the law to the particular set of facts in that revenue ruling, but as indicated in the revenue ruling itself, no factor is determinative in every instance, and other factors may be relevant. The current Form 990, including Schedule H thus appropriately provides flexibility to report information on “all of the relevant facts and circumstances” regarding the demonstration of community benefit. Nevertheless, the IRS will review and revise forms and/or instructions to further clarify and allow for clear identification of information that demonstrates community benefit as appropriate.

Recommendation 2:

The Commissioner of Internal Revenue should assess the benefits and costs, including the tax law implications, of requiring tax-exempt hospital organizations to report community benefit expenses on Schedule H by individual facility rather than by collective organization and take action, as appropriate.

Comment:

The IRS agrees with this recommendation. The IRS will assess the benefits and costs of requiring community benefit reporting on a facility-by-facility basis and will take action as appropriate. As part of the assessment, IRS will take into account that under pre-existing law, tax exemption is granted and the community benefit standard is therefore applicable at the organizational level. On the other hand, as enacted by Congress in 2010, the ACA imposes additional requirements codified in Section 501(r) that must be met, specifically, on a facility-by-facility basis.

Recommendation 3:

The Commissioner of Internal Revenue should establish a well-documented process to identify hospitals at risk for non-compliance with the community benefit standard that would ensure hospitals' community benefit activities are being constantly reviewed.

Appendix II: Comments from the Internal Revenue Service

2

Comment:

The IRS agrees with this recommendation. Where compliance with the existing community benefit standard is based on “all of the relevant facts and circumstances,” it would not be feasible to identify uniformly applicable indicators of noncompliance with the standard. However, IRS will update instructions and procedures to improve documentation of the relevant community benefit facts and circumstances considered during a review.

Recommendation 4:

The Commissioner of Internal Revenue should establish specific audit codes for identifying potential non-compliance with the community benefit standard.

Comment:

While potential noncompliance with the community benefit standard is an “operational issue” for which there are existing codes, the IRS continually seeks to improve its processes. Accordingly, the IRS agrees with this recommendation and will establish an Exam Issue Code to more specifically identify potential non-compliance with the community benefit standard.

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Jessica Lucas-Judy, (202) 512-9110 or LucasJudyJ@gao.gov

Staff Acknowledgments

In addition to the contact named above, Sonya Phillips (Assistant Director), Jennifer G. Stratton (Analyst-in-Charge), William R. Chatlos, Steven Flint, Robert Gebhart, James A. Howard, Matthew Levie, Ed Nannenhorn, Cynthia Saunders, Sonya Vartivarian, Daniel Webb, and Alicia White made key contributions to this report.

Appendix IV: Accessible Data

Data Table

Accessible Data for Figure 4: Results of Community Benefit Activity Reviews (CBAR), Fiscal Years 2015-2019

Fiscal Year	Community Benefit Activity Reviews conducted	Hospitals/hospitals organizations referred for examination for a potential Patient Protection and Affordable Care Act violation
2015	813	52
2016	968	339
2017	1193	388
2018	988	131
2019	750	49

Agency Comment Letter

Accessible Text for Appendix II Comments from the Internal Revenue Service

Page 1

September 2, 2020

Jessica K. Lucas-Judy

Director, Strategic Issues

United States Government Accountability Office

441 G Street, NW

Washington, DC 20548

Dear Ms. Lucas-Judy:

Thank you for the opportunity to review the draft report of the Government Accountability Office, GAO-20-679, entitled Tax Administration: Opportunities Exist to Improve Oversight of Hospitals' Tax-Exempt Status (job code 103426). We appreciate the analysis in the report, which observes that administration of the tax law in this area presents challenges.

Over the past years, the Internal Revenue Service (IRS) has worked toward continuous improvement of tax administration for tax-exempt hospitals. In 2008, the IRS concluded a study of tax-exempt hospitals and used this information to develop the Form 990, Schedule H. This Schedule was designed, with stakeholder input and consultation, to collect uniform information from tax-exempt hospitals with respect to the community benefit standard described in Revenue Ruling 69-545. In 2010, we implemented key provisions of the Affordable Care Act (ACA) addressing additional, statutorily mandated requirements that must be met by hospitals that are tax-exempt under Section 501(c)(3) of the Internal Revenue Code. As noted in the report, the ACA also requires the IRS to conduct a review of the community benefit activities of every tax-exempt hospital at least every three years. We quickly instituted a

program to conduct those reviews, and we continue to review these organizations. We have also engaged in education with respect to the various requirements, and we have seen the positive results of this outreach in the form of increased compliance in the sector.

It is true that there are challenges with respect to administration of the community benefit standard, which requires consideration of “all of the relevant facts and circumstances in each case” and under which “the absence of particular factors [set out in Revenue Ruling 69-545] or the presence of other factors will not necessarily be determinative.” See Rev. Rul. 69-545, 1969-2 C.B. 117. Those challenges are a product of the inherent flexibility required under the existing legal guidance to ensure that hospitals’ activities are considered in the context of their own communities. This is something the IRS continues to address, and to that end, we have fully considered each of your recommendations. There are inherent advantages and disadvantages of

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imposing either a standard or a rule, a question of policy on which the IRS must defer to the Department of the Treasury and the Congress.

We appreciated the opportunity to review and comment on the draft report. Responses to your specific recommendations to the IRS are enclosed. If you have questions, please contact me, or a member of your staff may contact Maria D. Hooke, Director, Compliance Planning and Classification, at 214-413-5500.

Sincerely,

Sunita Lough

Deputy Commissioner for Services and Enforcement

Enclosure

Page 3

Enclosure

Matter for Congressional Consideration:

Congress should consider specifying in the IRC what services and activities it considers sufficient community benefit.

Comment:

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Page 4

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