

NOT WHAT THE DOCTORS ORDERED: NONPROFIT  
HOSPITALS AND THE NEW CORPORATE GOVERNANCE  
REQUIREMENTS OF THE FORM 990

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*This Note analyzes whether there is a need for the Internal Revenue Service (IRS) to monitor corporate governance as it applies to nonprofit hospitals. There has been an increase in scandals involving nonprofit hospitals that are receiving tax-exemption, yet a decrease in charitable care in favor of higher pay for administrators. This led to a string of statutes focusing on corporate governance, as well as the IRS deciding to monitor corporate governance of nonprofit hospitals in its own way by requiring the Form 990. Although no evidence exists to show a link between good corporate governance and tax compliance, the IRS has continued to increase the filing burden on nonprofit hospitals.*

*The author argues that the Form 990, now required by the IRS, places an undue and unnecessary burden on nonprofit hospitals. The Form 990 is duplicative of other statutes focusing on corporate governance, and it also requires a much larger amount of time and resources than those predicted by the IRS, causing a strain on already limited nonprofit resources. The author suggests that monitoring corporate governance is both desirable and necessary but that the state and health care statutes already in place do a sufficient job of such monitoring. The author concludes that until the IRS has better data to support a connection between good governance and tax compliance, the Form 990 should be suspended, and the IRS should allow nonprofit hospitals to submit their annual compliance reports under other current reporting statutes in lieu of requiring the Form 990. Such an arrangement would save resources for both the IRS and nonprofit hospitals.*

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\* J.D. 2010, University of Illinois College of Law, Visiting Assistant Professor, University of Illinois College of Law. Thanks to John Colombo, Beth Burkstrand-Reid, and David Hyman for giving valuable comments and guidance on preliminary drafts. A special thanks to certain hospital sources, who cannot be named due to my promise of anonymity, for giving their time and agreeing to be interviewed for this project. Also, I thank the *University of Illinois Law Review* membership, editors, and professional staff for all their hard work. Last, but not least, thanks to my husband and family for their constant support.

## I. INTRODUCTION

Embezzlement, sexual innuendos, insider dealings—no, this is not a description of a movie, but rather a description of some of the acts surrounding the most high profile corporate health care scandals. One need not look too far to find headlines exposing wrongdoing by hospital corporations.<sup>1</sup> One of the most egregious scandals involved a hospital organization that decreased the amount of charitable care to the indigent population while administrators and employees lined their pockets through embezzlement schemes and rampant self-dealing.<sup>2</sup> Public outcry over such abuse resulted in swift legislative changes both at state and federal levels to better monitor the corporate governance of hospitals. Several statutes aimed specifically at hospitals and health care form a complex regulatory scheme focusing on governance and transparency to protect consumers from health care fraud and abuse.<sup>3</sup> Now, the Internal Revenue Service (IRS) has also jumped on the bandwagon to monitor corporate governance of nonprofit tax-exempt organizations, including nonprofit hospitals.

The IRS has always had an interest in ensuring that only those tax-exempt organizations worthy of tax-exempt status receive the benefit of such tax savings. In fact, the tax-exempt status of nonprofit hospitals has been a continuing focus of the IRS.<sup>4</sup> As health care becomes more complex and the distinction between nonprofit and for-profit hospitals becomes less apparent, some seriously question whether all nonprofit hospitals should enjoy exemptions from paying taxes.<sup>5</sup> Furthermore, in

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1. See, e.g., Harry Hurt III, *A Trust Corrupted, a City Betrayed—Part Two*, TEX. MONTHLY, Mar. 1986, at 139, 139, available at <http://books.google.com> (search for “Harry Hurt III and Trust Corrupted”; then follow “Texas Monthly—Mar 1986—Page 139” hyperlink) (mismanagement of Hermann Hospital by estate and hospital administrators and employees); Rhonda L. Rundle, *Tenet Healthcare Settles U.S. Probe*, WALL ST. J., May 18, 2006, at A13; John Commins, *Covenant Medical Center Pays \$4.5M to Settle Stark Law Violations*, HEALTHLEADERS MEDIA (Aug. 27, 2009), <http://www.healthleadersmedia.com/content/COM-238053/Covenant-Medical-Center-Pays-45M-to-Settle-Stark-Law-Violations> (explaining that Covenant Medical Center paid \$4.5 million in fines to resolve allegations that it paid far above fair market value compensation to physicians who referred their patients to Covenant for treatment).

2. Hurt, *supra* note 1, at 139.

3. See *infra* Part III.B.

4. See generally Laura L. Folkerts, *Do Nonprofit Hospitals Provide Community Benefit? A Critique of the Standards for Proving Deservedness of Federal Tax Exemptions*, 34 J. CORP. L. 611, 619–20 n.71 (2009) (“May 2005 was the beginning of heavy debate in both the Senate Finance Committee and the House Ways and Means Committee regarding the tax-exempt status of nonprofit hospitals.”).

5. See John D. Colombo, *The Failure of Community Benefit*, 15 HEALTH MATRIX: J. L.-MED. 29, 45–46 (2005) (citing literature suggesting that the behavior differences between for-profit and nonprofit hospitals are “at best inconclusive regarding whether nonprofit hospitals provide more socially-beneficial behavior in the form of better care, cheaper-but-equally-as-good care, or more charity care” than for-profit hospitals). Professor Colombo questions why proponents of tax-exempt status for nonprofit hospitals grow “almost fanatic” over the possibility of loss of tax-exemption “when virtually every other component of the health care system operates on a for-profit basis.” *Id.* at 53.

2002, nonprofit hospitals enjoyed \$12.6 billion in tax savings.<sup>6</sup> It is no surprise that this figure—coupled with the backdrop of corporate scandals, a declining economy, and the national debate surrounding the rising cost of health care—has prompted the IRS to focus more attention on nonprofit hospitals.<sup>7</sup>

Consequently, it is against this backdrop that the IRS has weighed in on governance and transparency by launching its own corporate governance initiative.<sup>8</sup> In fact, Part VI of the newly redesigned Form 990—the annual informational tax return for tax-exempt organizations, including hospitals—reflects the IRS’s concern by requiring hospitals to disclose detailed information with respect to corporate governance and transparency.<sup>9</sup> The IRS’s position is that good corporate governance will result in better tax compliance and thus guard against careless use of charitable assets.<sup>10</sup> Another justification cited for this governance initiative is that it serves to fill a regulatory gap with regard to smaller charities and complex nonprofit foundations (that are not as extensively regulated as nonprofit hospitals) by encouraging them to institute more solid governance and transparency policies and structures.<sup>11</sup>

For larger nonprofit organizations, specifically nonprofit hospitals, the IRS corporate governance initiative really adds nothing to the increasingly complex health care regulatory framework monitoring governance issues. In fact, the IRS’s governance initiative is duplicative of existing initiatives under state and federal law.<sup>12</sup> Since nonprofit corporate law is regulated by the states, some question whether the IRS should be

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6. U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-08-880, NONPROFIT HOSPITALS: VARIATION IN STANDARDS AND GUIDANCE LIMITS COMPARISON OF HOW HOSPITALS MEET COMMUNITY BENEFIT REQUIREMENTS 1 (2008), <http://www.gao.gov/new.items/d08880.pdf>.

7. See generally Folkerts, *supra* note 4.

8. See *Governance and Related Topics-501(c)(3) Organizations*, INTERNAL REVENUE SERV. (Feb. 4, 2008), [http://www.irs.gov/pub/irs-tege/governance\\_practices.pdf](http://www.irs.gov/pub/irs-tege/governance_practices.pdf) [hereinafter *Governance and Related Topics*].

9. See INTERNAL REVENUE SERV., FORM 990 RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX pt. VI (2009), <http://www.irs.gov/pub/irs-pdf/f990.pdf> [hereinafter FORM 990].

10. Steven T. Miller, Comm’r, Tax Exempt & Gov’t Entities, Internal Revenue Serv., Remarks Before the Georgetown Law Center Seminar on Representing and Managing Tax-Exempt Organizations 4 (Apr. 24, 2008), [http://www.irs.gov/pub/irs-tege/represent\\_manage\\_speech\\_042408.pdf](http://www.irs.gov/pub/irs-tege/represent_manage_speech_042408.pdf).

11. PANEL ON THE NONPROFIT SECTOR, STRENGTHENING TRANSPARENCY GOVERNANCE ACCOUNTABILITY OF CHARITABLE ORGANIZATIONS 14–15 (2005); see also FRANCIE OSTROWER, NONPROFIT GOVERNANCE IN THE UNITED STATES: FINDINGS ON PERFORMANCE AND ACCOUNTABILITY FROM THE FIRST NATIONAL REPRESENTATIVE STUDY 1–4 (2007) (studying over 5000 nonprofits where forty-seven percent of the nonprofits in the study developed a conflict of interest policy after the passage of the Sarbanes-Oxley Act). If governance practices became mandatory for nonprofits, the impact on governance behavior would vary depending on a number of characteristics of the nonprofit. OSTROWER, *supra*, at 4.

12. See *infra* Part III.B; see also Thomas Silk, *Good Governance Practices for 501(c)(3)s: Should the IRS Become Further Involved?*, 107 J. TAX’N 45, 45–46 (2007) (“The purview of state Attorneys General and the IRS overlaps. The jurisdiction of the former includes the prevention of waste of charitable assets, which may occur due to fines or penalties stemming from violations of federal tax laws (as well as state laws).”).

trading into this area at all.<sup>13</sup> Furthermore, no evidence supports the assertion that good governance actually has any relationship to tax compliance issues.<sup>14</sup> The link between governance and tax compliance is tenuous at best. These issues, coupled with the increased time and cost and the public nature of the Form 990, make the new Form 990 filing requirements particularly burdensome for nonprofit hospitals.<sup>15</sup> Thus, a one-size-fits-all approach for corporate governance reporting required by the new Form 990 makes little sense.

This Note explores whether it is appropriate for the IRS to demand governance reporting requirements for nonprofit hospitals. Part II provides a summary of the history of tax-exemption in the United States and how nonprofit hospitals have traditionally been regulated with respect to corporate governance. Part III analyzes whether the IRS's corporate governance initiative undercuts state laws governing nonprofit corporations, whether its examination of governance is necessary in the context of heavily regulated nonprofit hospitals, and whether there is any nexus to tax compliance. Finally, Part IV recommends how the IRS can tailor its Form 990 governance-related inquiries to the size and need of the tax-exempt organization.

## II. BACKGROUND

To fully appreciate the impact of the Form 990 on nonprofit hospitals, one must first understand the basics of tax-exemption and why nonprofit hospitals may be eligible for tax-exemption. Section A discusses a brief history of tax-exemption in the United States. Section B elaborates on the federal government's grant of tax-exemption for nonprofit hospitals. Section C describes the evolution of the Form 990 to its new redesigned version. Section D then describes the specific corporate governance section of the Form 990. Finally, Section E discusses the potential administrative and cost impact of the new Form 990 reporting requirements.

### A. *A Brief History of Tax-Exemption in the United States*

The Sixteenth Amendment to the U.S. Constitution, which was ratified in 1913, gives Congress the power to tax income.<sup>16</sup> Prior to the

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13. See James J. Fishman, *Stealth Preemption: The IRS's Nonprofit Corporate Governance Initiative*, 29 VA. TAX REV. 545, 548–49 (2010).

14. *Id.* at 548.

15. Letter from Melinda Reid Hatton, Senior Vice President and Gen. Counsel, Am. Hosp. Ass'n, to Internal Revenue Serv. 4 (Aug. 21, 2007) (on file with the Internal Revenue Service), <http://www.aha.org/aha/letter/2007/070821-let-IRSSchH.pdf> (detailing estimates on the burdens of filing the tax return).

16. U.S. CONST. amend. XVI (“The Congress shall have power to lay and collect taxes on incomes, from whatever source derived . . .”). The underlying policy of the taxation system is that the gross income of every “person, corporate or individual, is subject to tax unless there is a statute or some rule of law that exempts that person or element.” *HCSC-Laundry v. United States*, 450 U.S. 1, 5

enactment of the Sixteenth Amendment, however, Congress attempted to pass the first income tax in response to the Depression of 1893; it failed.<sup>17</sup> Under the Tariff Act of 1894, Congress enacted the first tax-exemption for charitable organizations.<sup>18</sup> Section 32 of the Tariff Act of 1894 illustrates the first instance of tax-exemption.<sup>19</sup> The Tariff Act of 1894 exempted the following organizations from tax: “corporations, companies, or associations organized and conducted solely for charitable, religious, or educational purposes.”<sup>20</sup> Thus, this pre-Sixteenth Amendment legislation served as a historical precursor to the modern § 501(c)(3) of the Internal Revenue Code (I.R.C.) which provides for modern tax-exemption for certain entities.<sup>21</sup>

Prior to the enactment of the Sixteenth Amendment, Congress passed the Corporation Excise Tax Act.<sup>22</sup> Therein, tax-exemption became available to those corporations that were “organized and operated exclusively for religious, charitable, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual.”<sup>23</sup> Although, this Act was constitutionally challenged,<sup>24</sup> it reflected Congress’s early commitment to allow certain organizations to be free from taxation. At last, in 1959, Congress codified tax-exemption for organizations performing charitable functions under what is now known as I.R.C. § 501(c)(3).<sup>25</sup>

The initial rationale behind tax-exemption within the Tariff Act is not readily clear from the statutory history.<sup>26</sup> It is suggested, however, that tax-exemption is rooted in history, morality, and successful lobbying.<sup>27</sup> For example, Congress believed that taxing the savings of the poor

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(1981). After the enactment of the Sixteenth Amendment, Congress was free to tax the income of everyone, including corporations.

17. Tariff Act of 1894, ch. 349, § 32, 28 Stat. 509, 556 (codified as amended at I.R.C. § 501(c)(3) (2006)); see *Pollock v. Farmers’ Loan & Trust Co.*, 157 U.S. 429, 607–08 (1895), *overruled on other grounds by South Carolina v. Baker*, 485 U.S. 505, 524 (1988). For a discussion tracing the roots of direct taxation in the United States, see *Pollock*, 157 U.S. at 457–69.

18. Tariff Act of 1894 § 32. Ultimately, this legislation was constitutionally challenged leading to the enactment of the Sixteenth Amendment. See *Pollock*, 157 U.S. at 442–43, 607–08.

19. Tariff Act of 1894 § 32.

20. *Id.*

21. I.R.C. § 501(c)(3).

22. Corporation Excise Tax Act of 1909, ch. 6, § 38, 36 Stat. 11, 112.

23. *Id.* For a commentary on the evolution of § 501(c)(3), see James J. McGovern, *The Exemption Provisions of Subchapter F*, 29 TAX LAW. 523, 529 (1976).

24. See, e.g., *Pollock v. Farmers’ Loan & Trust Co.*, 157 U.S. 429, 607–08 (1895) (holding that Congress could not directly tax individual income because it would violate the then constitutional requirement that direct taxes be apportioned among the states on the basis of their populations.). After the passage of the Sixteenth Amendment, this was no longer an issue because the federal government was empowered to directly tax income.

25. See I.R.C. § 501(c)(3); Andréa I. Castro, Comment, *Overview of the Tax Treatment of Non-profit Hospitals and Their For-Profit Subsidiaries: A Short-Sighted View Could Be Very Bad Medicine*, 15 PACE L. REV. 501, 504–05 (1995).

26. THOMAS K. HYATT & BRUCE R. HOPKINS, *THE LAW OF TAX-EXEMPT HEALTHCARE ORGANIZATIONS* 8 (3d ed. 2008).

27. McGovern, *supra* note 23, at 525–27.

would be a “crowning infamy.”<sup>28</sup> Historically, charitable organizations also enjoyed tax-exemption because they had the burden of providing public needs, thereby saving the government from such burden.<sup>29</sup> Authors have offered other competing rationales for the existence of tax-exemption.<sup>30</sup> From the historical perspective, however, the overarching rationale behind granting nonprofit entities exemption from taxation is based on the public policy decision that by not taxing these entities, the government does not inhibit activities beneficial to the community and public interests.<sup>31</sup>

### B. *A Brief History of Tax-Exemption for Nonprofit Hospitals*

Churches and educational institutions are the quintessential example of tax-exempt organizations.<sup>32</sup> Generally, they enjoy prima facie exemption from taxation.<sup>33</sup> Historically, religious charities funded health care for those unable to afford private physicians.<sup>34</sup> Tax-exemption for hospitals, however, grew out of their historical charitable role in society.<sup>35</sup> In the nineteenth century, hospitals were institutions that served the needs of the destitute and were funded by charitable donations and municipalities.<sup>36</sup> Consequently, these hospitals were also primarily tax-exempt entities because they “provid[ed] custodial care for those who were both sick and poor [and their] income was derived largely or entirely from voluntary charitable donations, not government subsidies, taxes, or patient fees.”<sup>37</sup> Thus, tax-exemption for health care entities, like to-

28. 26 CONG. REC. 6622 (1894) (“This Government can not afford to permit the savings of the poor to be taxed through a Federal income tax. It would be the crowning infamy of this bill.”).

29. HYATT & HOPKINS, *supra* note 26, at 9–10.

30. JAMES J. FISHMAN & STEPHEN SCHWARZ, *TAXATION OF NONPROFIT ORGANIZATIONS* 75–97 (2d ed. 2006) (outlining purported rationales for the existence of tax-exemption including: (1) Quid Pro Quo/Relief of Government Burden (Chauncey Belknap); (2) Community Benefit Theory; (3) Bittker’s Tax-Base Theory; (4) Hansmann’s Capital Subsidy Theory; and (5) Colombo-Hall Donative Theory); *see also* HYATT & HOPKINS, *supra* note 26, at 11.

31. HYATT & HOPKINS, *supra* note 26, at 11.

32. *See* FISHMAN & SCHWARZ, *supra* note 30, at 192–208.

33. HYATT & HOPKINS, *supra* note 26, at 9. *But see* *Bob Jones Univ. v. United States*, 461 U.S. 574, 595–96 (1983) (holding that tax-exemption for tax-exempt organizations may be stripped from institutions that violate established public policy).

34. Cecilia M. Jardon McGregor, *The Community Benefit Standard for Non-profit Hospitals: Which Community, and for Whose Benefit?*, 23 J. CONTEMP. HEALTH L. & POL’Y 302, 305 (2007).

35. *Id.*

36. *Id.*

During this time, hospitals were “often . . . the only professional medical care available” to the poor. However, hospital care was a last resort for many rather than the initial point of care, as there was a high risk of infection and death. Because the hospitals of this era attracted primarily indigent patients, few hospitals “charg[ed] a significant amount above the relatively low cost . . . .” *Id.* (alterations in original) (footnotes omitted); *see also* PAUL STARR, *THE SOCIAL TRANSFORMATION OF AMERICAN MEDICINE* 150–51 (1982). “Voluntary” hospitals, like public hospitals (which evolved from almshouses for the dependent poor), performed a “welfare” function rather than a medical or curing function: the poor were housed in large wards, largely cared for themselves, and often were not expected to recover. *See* STARR, *supra*.

37. McGregor, *supra* note 34, at 305 (alteration in original).

day's nonprofit hospitals, is rooted in the historical charitable purposes that they traditionally served.

Today, § 501(c)(3) specifically enumerates the types of organizations exempt from taxation.<sup>38</sup> According to § 501(c)(3), if an organization is operated exclusively for charitable, religious, educational, scientific, or literary purposes, or for the purpose of testing for public safety, it is eligible for tax-exemption.<sup>39</sup> It is important to note that hospitals are not specifically enumerated in § 501(c)(3) even though, today, tax-exemption may extend to hospitals and health care organizations, typically to nonprofit hospitals.<sup>40</sup> Therefore, hospitals do not automatically enjoy tax-exempt status like churches do, for example. Rather, hospitals and other health care organizations must qualify as “charitable” under the I.R.C. to qualify as tax-exempt.<sup>41</sup> In 1956, the IRS provided the first guidance on tax-exemption for hospitals.<sup>42</sup> Specifically, hospitals may qualify as tax-exempt if they are organized and operated exclusively for nonprofit charitable purposes.<sup>43</sup> Then, in 1969, the IRS redefined the tax-exemption requirements for nonprofit hospitals.<sup>44</sup> The IRS suggested that hospitals could qualify for tax-exemption by fulfilling a “community benefit standard.”<sup>45</sup> Today, the “community benefit standard” has been expanded such that most acute care nonprofit hospitals will qualify for tax-exemption.<sup>46</sup>

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38. I.R.C. § 501 (2006). In particular, § 501(c)(3) provides:

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

*Id.* § 501(c)(3).

39. *Id.*

40. FISHMAN & SCHWARZ, *supra* note 30, at 105; *see also* I.R.C. § 501(c)(3).

41. McGregor, *supra* note 34, at 312.

42. Rev. Rul. 56-185, 1956-1 C.B. 202 (distinguishing between charity care and bad debt and encouraging hospitals to clearly identify when providing charity care).

43. *Id.*; *see also* Rev. Rul. 69-545, 1969-2 C.B. 117.

44. Rev. Rul. 69-545, 1969-2 C.B. 117.

45. *Id.* To satisfy the “community benefit” standard, hospitals were required to (1) be governed by a community board; (2) have an open emergency room and medical staff; (3) provide care to all paying patients (this includes patients with government insurance); and (4) operate an emergency room open to the public. *Id.* The IRS also recognized that a “community benefit” includes making “available” those services to those unable to pay. Lawrence E. Singer, *Leveraging Tax-Exempt Status of Hospitals*, 29 J. LEGAL MED. 41, 45–46 (2008). In 1983, however, the IRS withdrew the qualification of an open emergency room because the existence of the emergency room should be based upon community needs. Mark A. Hall & John D. Colombo, *The Charitable Status of Nonprofit Hospitals: Toward a Donative Theory of Tax Exemption*, 66 WASH. L. REV. 307, 320–22 (1991).

46. The United States Court of Appeals for the Tenth Circuit further elaborated on “community benefit” by indicating that the test for tax-exemption for nonprofit hospitals should include a health care “plus” analysis. *IHC Health Plans, Inc. v. Comm’r*, 325 F.3d 1188, 1198 (10th Cir. 2003); *see also* FISHMAN & SCHWARZ, *supra* note 30, at 112.

The tax-exemption requirements for nonprofit hospitals have gained renewed attention in light of concerns regarding the uninsured.<sup>47</sup> The diverse health care landscape of the present-day has left Congress and special interest groups questioning the efficacy of the community benefits standard.<sup>48</sup> Specifically, they have focused on the charitable nature of health care and issues of whether the operation of nonprofit hospitals and their compliance with state and federal laws truly reflect charitable attributes.<sup>49</sup> Furthermore, recent litigation challenging the tax-exempt status of nonprofit hospitals has also fueled the renewed debate on the requirements for tax-exempt status of health care organizations.<sup>50</sup> Given that in 2002 tax-exempt hospitals were estimated to save \$12.6 billion in federal, state, and local taxes,<sup>51</sup> it is not surprising that so much federal tax compliance focus has been placed on nonprofit hospitals.

### C. *The Federal Government's Focus on Nonprofit Hospital Governance*

As hospital systems have evolved, their corporate structures have become increasingly complex.<sup>52</sup> Today, hospitals and hospital systems are embracing complex corporate reorganizations reflecting a “[p]olycorporate enterprise model[]”—a complex system consisting of for-profit and nonprofit entities controlled by administrators.<sup>53</sup> This multi-faceted structure allows nonprofit hospital systems to compete with for-profit organizations for improved medical technology and improved treatments, and it allows these hospitals to achieve financial goals by offsetting the revenues generated by the for-profit subsidiaries with the op-

47. Singer, *supra* note 45, at 48–49; see Press Release, U.S. Senate Comm. on Fin., Senator Chuck Grassley, Grassley Seeks GAO Study of Nonprofit Hospital's Community Benefits (Apr. 5, 2007), <http://finance.senate.gov/newsroom/ranking/release/?id=b5438b6c-baaa-45b7-a639-196716523ea6> (“We need to get a better handle on how nonprofit hospitals are fulfilling their requirement to serve the community in exchange for the generous tax breaks they receive.”); see also John M. Quirk, *Turning Back the Clock on the Health Care Organization Standard for Federal Tax Exemption*, 43 WILLAMETTE L. REV. 69, 84 (2007).

48. Singer, *supra* note 45, at 48–49; see Press Release, U.S. Senate Comm. on Fin., *supra* note 47.

49. Singer, *supra* note 45, at 48–49; see also Delia D. Johnson, Comment, *The Economic Benefit of Nonprofit Hospitals: Broadening the Evaluation of Tax-Exempt Status at the State Level*, 53 WAYNE L. REV. 1583, 1587–88 (2007).

50. KEITH ANDERSON & GEORGE GEVAS, NAT'L CITY, THE TAX STATUS OF NOT-FOR-PROFIT HOSPITALS UNDER SIEGE & THE FINANCIAL IMPLICATIONS OF RECENT ATTACKS 1–5 (2006), <http://www.drinkerbiddle.com/files/Publication/3798d6f1-868f-4950-9b2e-0a98767c99cc/Presentation/PublicationAttachment/188499da-64f6-45dd-a800-1335d664ca97/HCNationalCityWhitePaper.pdf>.

Efforts to consolidate the more than 75 federal class action lawsuits that were filed during the first wave of litigation were quickly rejected. Twenty-nine federal cases have been dismissed in whole or in part for a variety of reasons, including the conclusion by some federal courts that a private citizen did not have a right to bring a case to enforce the 501(c)(3) section against another private citizen or public not-for-profit hospital.

*Id.* at 5. For a discussion on the judicial system's evaluation of the “community benefit standard” at both federal and state levels see Folkerts, *supra* note 4, at 617–19.

51. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 6, at 1.

52. Castro, *supra* note 25, at 513–15 (describing the trend of nonprofit hospitals developing for-profit subsidiaries in order to diversify sources of revenue).

53. *Id.* at 515 (describing the trend of nonprofit hospitals developing for-profit subsidiaries in order to diversify sources of revenue).



erating costs of the nonprofit organizations.<sup>54</sup> The more these large tax-exempt nonprofit health systems begin to resemble for-profit enterprises, however, the more the IRS becomes focused on raising the level of scrutiny of these complex health care organizations to ensure compliance with the tax-exemption requirements.<sup>55</sup>

Specifically, the focus on corporate governance practices of nonprofit hospitals by other arms of the government parallels the tax-exempt status scrutiny of nonprofit hospitals.<sup>56</sup> In particular, nonprofit hospitals have been the focus of articles citing various concerns regarding governance such as disproportionate compensation of executives, inadequate provision of charity care, and deceptive pricing of health care services.<sup>57</sup> Compensation scandals against the backdrop of the Sarbanes-Oxley Act<sup>58</sup> (SOX) have contributed to increased scrutiny of the corporate governance of nonprofit health care organizations.<sup>59</sup> Enacted in response to the huge financial fraud scandals in the early 2000s, SOX requires extensive safeguards in order to ensure that upper management has independence, control, and direct oversight of the corporation.<sup>60</sup> The SOX legislation does not apply to nonprofit organizations,<sup>61</sup> but several states have already enacted similar legislation for nonprofit organizations, and others are considering enacting such legislation.<sup>62</sup> Furthermore, momentum from this legislation has created thrust within the health care statutory framework to oversee the corporate governance within hospital organizations.<sup>63</sup>

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54. *Id.* Often these nonprofit hospital systems include a diverse range of ventures including (1) for-profit ventures promoting the exempt mission of the organizations; (2) for-profit program related ancillary services such as parking, cafeteria, and other services used by those visiting patients; (3) staff and client resources; and (4) real property. *Id.* at 515–16.

55. I.R.S. Gen. Couns. Mem. 39,862 (Nov. 22, 1991).

56. *See infra* Part III.B.

57. Jeffrey A. Alexander et al., *Governance and Community Benefit: Are Nonprofit Hospitals Good Candidates for Sarbanes-Oxley Type Reforms?*, 33 J. HEALTH POL. POL'Y & L. 199, 200 (2008); *see also* Lisa W. Clark et al., *What May Arrive in Tomorrow's Mail?: An Analysis of Class Action Lawsuits Concerning Hospital Billing of Uninsured Patients*, 13 HEALTH L. REP. 1134, 1134 (July 29, 2004), available at <http://healthcenter.bna.com/pic2/hc.nsf/id/BNAP-65HP74?OpenDocument>.

58. 15 U.S.C. §§ 7201, 7202, 7211–7219, 7231–7234, 7241–7246, 7261–7266 (2006).

59. A.L. Spitzer, *Executive Compensation in Nonprofit Health Care Organizations: Who's in Charge?*, 15 HEALTH MATRIX: J. L.-MED. 67, 69 (2005).

60. Peter D. Hardy, *Health Care Organizations and Compliance: Best Practices for Preventing White Collar Infractions in the Health Care Industry*, in CORPORATE GOVERNANCE SAFEGUARDS AGAINST WHITE COLLAR INFRACTIONS: LEADING LAWYERS ON COUNSELING CLIENTS, DEVELOPING A COMPLIANCE PROGRAM, AND UNDERSTANDING EMERGING ISSUES AND TRENDS IN HIGH-RISK AREAS 27, 34 (Jo Alice Darden ed., 2009) (“It creates a host of requirements, including rules pertaining to internal controls and audit committees, the use of outside auditors, bans on most personal loans, and, significantly, the need for chief executive officers and chief financial officers to certify personally the accuracy of financial reports and the effectiveness of internal controls.”).

61. The Sarbanes Oxley Act of 2002 applies only to publicly traded companies. *See, e.g.*, 15 U.S.C. § 7211.

62. *See infra* Part III.B.6; *see also* Spitzer, *supra* note 59, at 75 (“Several states, including New York and Massachusetts, are considering the enactment of legislation that will apply to nonprofit organizations rules similar to those contained in the Sarbanes-Oxley legislation, and California has recently enacted such legislation.”).

63. *See infra* Part III.B.

In fact, scrutiny over the corporate governance of nonprofit health systems has been driven by several factors apart from the SOX backdrop: the emergence of the board's duty to ensure that an effective reporting system exists,<sup>64</sup> the emergence of hospital liability directly to the patient,<sup>65</sup> the focus of states attorneys on the mismanagement of nonprofit boards,<sup>66</sup> board standards set by public health agencies,<sup>67</sup> oversight of quality by the Centers for Medicare and Medicaid Services (CMS) and the U.S. Office of Inspector General (OIG),<sup>68</sup> and enforcement actions under the False Claims Act (FCA).<sup>69</sup> Traditionally, the courts have been reluctant to hold nonprofit board members to bright-line fiduciary standards,<sup>70</sup> resulting in the need for accountability and oversight. The lack of transparency, absence of shareholders, and limited resources for state oversight compound the issues surrounding nonprofit corporate governance.<sup>71</sup> Thus, a complex framework of statutory enactments meant to address these issues has emerged over the past decade.<sup>72</sup>

From the general corporate law perspective, a number of courts have established that boards of directors of nonprofit organizations must meet the fiduciary duties of care and loyalty.<sup>73</sup> In addition, nonprofit directors owe a duty of obedience to the mission of the corporation.<sup>74</sup> Specifically, the I.R.C.'s operational test for tax-exemption, a fundamental requirement for granting exemption, also imposes this fiduciary duty.<sup>75</sup> The operational test requires that an organization "serve[] a public rather than a private interest"; in other words, it must operate for *prima facie* charitable purposes.<sup>76</sup> Thus, the common law and statutory law

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64. See *In re Abbott Labs. Derivative S'holders Litig.*, 325 F.3d 795, 807–11 (7th Cir. 2003) (explaining that the board of directors has a duty of oversight with respect to corporate compliance matters); *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 961 (Del. Ch. 1996).

65. Tracy E. Miller & Valerie L. Gutmann, *Changing Expectations for Board Oversight of Healthcare Quality: The Emerging Paradigm*, 2 J. HEALTH & LIFE SCI. L. 31, 50 n.81 (2009).

66. *Id.* at 51.

67. *Id.*

68. *Id.* at 55.

69. 31 U.S.C. §§ 3729(a), 3731(b)(1)–(2) (2006).

70. James J. Fishman, *Improving Charitable Accountability*, 62 MD. L. REV. 218, 234 (2003).

There have been differing degrees of care expected from nonprofit directors. Since most directors are unpaid and serve out of a sense of civic duty, there is a reluctance to impose financial liabilities upon them. One cannot make the position of director so legally burdensome that people will not join boards or will refuse to allow the organization to undertake risks. A tension exists between a desire to encourage competent and energetic people to serve on boards and society's need to assure that directors are accountable for the activities of public benefit nonprofits, whose rationale is to serve the community.

*Id.* (footnotes omitted).

71. Miller & Gutmann, *supra* note 65, at 46.

72. See *infra* Part III.B.

73. See Miller & Gutmann, *supra* note 65, at 43 (providing a good discussion on the fiduciary duties of care and loyalty).

74. See MODEL NONPROFIT CORP. ACT § 8.30(a)–(b) (2008); see also Rob Atkinson, *Obedience as the Foundation of Fiduciary Duty*, 34 J. CORP. L. 43, 79–80 (2008).

75. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) (as amended in 2009).

76. *Id.*; see also HYATT & HOPKINS, *supra* note 26, at 793.

provide a basic foundation of fiduciary duties required of nonprofit boards of directors.

In light of the above stated concerns, the federal and state governments have become more active in enacting legislation aimed at regulating corporate governance of nonprofit hospitals and health care organizations.<sup>77</sup> These statutes impose both civil and criminal penalties on health care organizations that fail to meet the requirements.<sup>78</sup> Federal statutes governing corporate governance include: the FCA, the Anti-Kickback Statute (AKS), the Stark Law, and the Health Insurance Portability and Accountability Act (HIPAA).<sup>79</sup> Although this Note does not attempt to thoroughly analyze these statutes, a brief examination of the provisions affecting the corporate governance of nonprofit hospital boards is necessary to illustrate that the IRS's attempts at regulating corporate governance through the Form 990 overlap regulation by other health care statutes.<sup>80</sup>

#### D. *The Evolution of the Form 990*

Today, tax-exempt organizations file an annual informational return with the IRS called the Form 990.<sup>81</sup> This annual reporting requirement began in 1942.<sup>82</sup> In fact, the Treasury Department's decision to require an annual information return for tax-exempt organizations was a direct result of concerns regarding their widespread commercial activities.<sup>83</sup> The early version of this annual return was two pages and required only an income statement, a balance sheet, answers to three questions, and signatures by two officers.<sup>84</sup> These returns were treated as public records, but the public could only access them by order of the president.<sup>85</sup> By 1950, inspection of the annual returns was open to the public upon written request to the IRS.<sup>86</sup> President Truman expressed his concerns that tax-exempt organizations were abusing their status.<sup>87</sup> In fact, President Truman stressed that tax-exemption, by certain charities, "ha[d]

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77. See *infra* Part III.B.

78. Hardy, *supra* note 60, at 28.

79. 31 U.S.C. §§ 3729–3733 (2006); 42 U.S.C. § 1320a-7b; 42 U.S.C. § 1395nn; Pub. L. No. 104-191, 110 Stat. 1936 (1996).

80. For a discussion on the corporate governance aspects of the listed statutes see *infra* Part III.B.

81. James J. Fishman, *The IRS' Corporate Governance Initiative: Recommendations for Medium and Smaller Nonprofits*, in *ADVISING NONPROFIT ORGANIZATIONS 2009*, at 299, 323–24 (2009).

82. Revenue Act of 1943, Pub. L. No. 78-235, § 117, 58 Stat. 21, 36–37 (1944).

83. *Id.*; see MARION R. FREMONT-SMITH, *GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION 65* (2004); see also *ADVISORY COMM. ON TAX EXEMPT & GOV'T ENTITIES, INTERNAL REVENUE SERV., THE APPROPRIATE ROLE OF THE INTERNAL REVENUE SERVICE WITH RESPECT TO TAX-EXEMPT ORGANIZATION GOOD GOVERNANCE ISSUES 29* (2008), [http://www.irs.gov/pub/irs-tege/tege\\_act\\_rpt7.pdf](http://www.irs.gov/pub/irs-tege/tege_act_rpt7.pdf).

84. FREMONT-SMITH, *supra* note 83, at 65.

85. I.R.C. § 55(a)(1) (1939).

86. FREMONT-SMITH, *supra* note 83, at 66.

87. *ADVISORY COMM. ON TAX EXEMPT & GOV'T ENTITIES, supra* note 83, at 91.

been used as a cloak for speculative business ventures, and the funds intended for charitable purposes buttressed by tax-exemption, ha[d] been used to acquire or retain control over a wide variety of industrial enterprises.”<sup>88</sup> Thus, over the next several decades, Congress expanded the reporting requirements of tax-exempt organizations in order to address the perceived abuses of such organizations.<sup>89</sup> The Form 990 emerged, requiring broader reporting requirements.<sup>90</sup> Specifically, all tax-exempt organizations were required to include: “the names and addresses of all substantial contributors, directors, and trustees, and other management officials” and the “[c]ompensation and other payments to managers and highly compensated employees . . . .”<sup>91</sup> Moreover, the Form 990 also required greater public availability.<sup>92</sup>

Until 2007, the Form 990 had evolved into “six pages with *forty-five pages of instructions*, and two schedules.”<sup>93</sup> This complex form served as the primary disclosure tool for the IRS to oversee tax-exempt organizations.<sup>94</sup> Between 1979 and 2007, there were few revisions to the Form 990.<sup>95</sup> Then, in June 2007, the IRS submitted for public comment a newly revised version of the form.<sup>96</sup> As a result of the public comment, the IRS incorporated many additional changes and released the updated revised Form 990 in December 2007.<sup>97</sup> The revised form requires far more extensive reporting than its predecessors.<sup>98</sup> The redesigned 2008 Form 990 is eleven pages in length with an additional sixteen schedules.<sup>99</sup> Thus, the general trend towards broadening the reporting requirements of tax-

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88. 96 CONG. REC. 771 (1950) (message from President Harry S. Truman).

89. See ADVISORY COMM. ON TAX EXEMPT & GOV'T ENTITIES, *supra* note 83, at 92.

90. H.R. REP. NO. 91-413, pt. 1, at 36-37 (1969).

91. ADVISORY COMM. ON TAX EXEMPT & GOV'T ENTITIES, *supra* note 83, at 93.

92. *Id.* “The new publicity provisions required that the Forms 990 be made available to State officials and that private foundation filers allow public inspection of their information returns at the foundation offices for at least 180 days. In addition, private foundations had to publicize these forms’ availability.” *Id.* (footnote omitted).

93. FREMONT-SMITH, *supra* note 83, at 65 (emphasis added).

94. Fishman, *supra* note 81, at 325.

95. *Id.*

96. Eric M. McNeil, *The Redesigning Form 990-Key Issues for Tax-Exempt Healthcare Organizations to Consider Today*, HEALTH LAW., Apr. 2008, at 14, 14. Consequently, “[t]he IRS received approximately 700 e-mails and letters totaling approximately 3,000 pages of comments.” *Id.* (internal quotation marks omitted).

97. *Id.*; see INTERNAL REVENUE SERV., FORM 990 RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX, SCHED. H (2008), <http://www.irs.gov/pub/irs-prior/f990sh--2008.pdf> [hereinafter FORM 990 SCHED. H 2008]. This Schedule is optional for tax year 2008, but tax year 2009 and forward will be required to complete the schedule. INTERNAL REVENUE SERV., FORM 990 INSTRUCTIONS FOR SCHED. H 1 (2008), <http://www.irs.gov/pub/irs-prior/f990sh--2008.pdf> [hereinafter FORM 990 SCHED. H INSTRUCTIONS 2008].

98. Compare INTERNAL REVENUE SERV., FORM 990 RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX (2007), <http://www.irs.gov/pub/irs-prior/f990--2007.pdf> (consisting of nine pages), with INTERNAL REVENUE SERV., FORM 990 RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX (2008), <http://www.irs.gov/pub/irs-prior/f990--2008.pdf> [hereinafter FORM 990 2008] (consisting of eleven pages).

99. FORM 990 2008, *supra* note 98. The 2009 form has increased to twelve pages. FORM 990, *supra* note 9.

exempt organizations parallels the expansion of the number of tax-exempt organizations over time.<sup>100</sup>

The IRS good governance initiative serves as a specific impetus for the changes in the new Form 990. Due to mounting media attention regarding oversight of internal governance issues within both the for-profit and nonprofit sector, the IRS launched its good governance initiative in 2002.<sup>101</sup> Media attention relating to fraud, breach of fiduciary duties, and improper use of charitable funds was the basis of the IRS's interest in promoting good governance practices of nonprofit organizations.<sup>102</sup> The Senate Finance Committee began to look closer into the practices of charitable nonprofit organizations and conducted a hearing and roundtable discussion.<sup>103</sup> Several issues came to surface: (1) misuse of the charitable entity, (2) overstated charitable deductions, (3) widely varying methods of determining the compensation of executives, and (4) inconsistent and limited disclosure on governance practices.<sup>104</sup> Not surprisingly, the IRS then responded with its good governance initiative.<sup>105</sup> The IRS has committed itself to a significant role in promoting good governance, asserting that "a well-governed charity is more likely to obey the tax laws, safeguard charitable assets, and serve charitable interests than one with poor or lax governance."<sup>106</sup>

Although the IRS provides no solid empirical evidence in support of this assertion, it intends to prove it through the outcome analysis of the informational returns.<sup>107</sup> Furthermore, the IRS admits that it has no statutory authority to monitor corporate governance or the efficiency of tax-exempt organizations.<sup>108</sup> The IRS's concerns over perceived abusive transactions at the corporate governance level of nonprofit hospitals, and whether favorable tax treatment for these hospitals is justified, prompted the redesign of the Form 990.<sup>109</sup> The theory is that by encouraging internal and external transparency, a hospital board will better fulfill its fiduciary duties of oversight and obedience to the nonprofit mission of the

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100. See PANEL ON THE NONPROFIT SECTOR, *supra* note 11, at 10. Today, there are over 455,693 501(c)(3) exempt organizations. *Number of Non-501(c)(3) Exempt Organizations in the United States, 2010*, Nat'l Ctr. for Charitable Statistics, <http://nccsdataweb.urban.org/PubApps/profileDrillDown.php?state=US&rpt=CO> (last visited Nov. 13, 2010).

101. See PANEL ON THE NONPROFIT SECTOR, *supra* note 11, at 13; U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-07-1084T, NONPROFIT SECTOR: INCREASING NUMBERS AND KEY ROLE IN DELIVERING FEDERAL SERVICES 10 (2007), <http://www.gao.gov/new.items/d071084t.pdf>; see also Tim V. Eaton & Michael D. Akers, *Whistleblowing and Good Governance: Policies for Universities, Government Entities, and Nonprofit Organizations*, CPA J., June 2007, at 66, 66–68.

102. PANEL ON THE NONPROFIT SECTOR, *supra* note 11, at 13.

103. *Id.*

104. *Id.*

105. *Governance and Related Topics*, *supra* note 8.

106. *Id.*; see also Miller, *supra* note 10, at 4.

107. Miller, *supra* note 10, at 4–5.

108. *Id.*

109. James R. King et al., *Form 990 Disclosure Requirements Challenge Hospitals, Provide Opportunities*, HEALTH LAW., Feb. 2009, at 1, 1.

organization.<sup>110</sup> The new Form 990 requirements are supposed to reflect the principles of compliance, transparency, and minimizing taxpayer burden.<sup>111</sup> Among other updates, the most startling change is the extensive corporate governance reporting requirements and the level of detail.<sup>112</sup> The detail required may be explained by the scant disclosure offered by organizations who filed under prior versions of the form.<sup>113</sup>

In light of the significant tax savings enjoyed by the 501(c)(3) sector,<sup>114</sup> concerns over abuse of the use of the tax-exempt status are still the prime concern and continuing impetus behind the expansion of the Form 990 requirements.<sup>115</sup> For example, between 1998 and 2004, the number of 501(c)(3) organizations grew from 650,000 with gross receipts of \$990 billion to 1.2 million organizations yielding gross receipts nearing \$2 trillion.<sup>116</sup> In addition, from 2000 to 2005, the number of nongovernment nonprofit health care systems increased by nineteen percent.<sup>117</sup> The American Hospital Association (AHA) reports a fifty-six percent increase in the number of nonprofit hospitals associated with these health systems.<sup>118</sup> The Government Accountability Office (GAO) estimates that tax-exempt hospitals alone save \$12.6 billion in federal, state, and local taxes.<sup>119</sup> Therefore, it is not surprising that the IRS's good governance experiment may aid in hand-picking organizations for audit; those likely to lose their tax-exempt status.

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110. Kathleen M. Boozang, *Board Independence and Transparency: Searching for the Key to Good Governance*, 1 J. HEALTH & LIFE SCI. L. 127, 136 (2008).

111. *IRS Releases Discussion Draft of Redesigned Form 990 for Tax-Exempt Organizations*, IRS.GOV (June 14, 2007), <http://www.irs.gov/newsroom/article/0,,id=171329,00.html>.

112. See FORM 990, *supra* note 9, at pt. VI.

113. For example, the Office of Legal and Regulatory Affairs of the American Hospital Association (AHA) published a report with respect to nonprofit hospitals indicating:

(1) that the returns rarely included any information about the hospitals' community benefit programs; (2) a lack of consistency in allocating expenses between program, management and general, and fundraising; (3) minimal disclosure of program service accomplishments; (4) lack of mention of donated services and materials; (5) no consistency in the preparation of the analysis of income-producing activities; (6) minimal and/or incorrect disclosures of the relationship of activities to the accomplishment of exempt purposes; (7) that some of the returns were technically incomplete; and (8) a large number of the returns indicated that the hospitals did not receive any gross unrelated business income.

HYATT & HOPKINS, *supra* note 26, at 858 n.39.

114. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 6, at 1.

115. See Miller, *supra* note 10, at 3.

116. *Id.* at 2.

117. LAWRENCE PRYBIL ET AL., GOVERNANCE IN NONPROFIT COMMUNITY HEALTH SYSTEMS: AN INITIAL REPORT ON CEO PERSPECTIVES 1 (2008), [http://www.990forhospitals.org/docs/Prybil\\_report.pdf](http://www.990forhospitals.org/docs/Prybil_report.pdf).

118. *Id.* at 35 n.11 (citing personal correspondence from Mr. Peter Kralovec, Director, Hospital Data Center, American Hospital Association (AHA) (October 19, 2007) ("In 2000, 1,602 of the nation's 3,003 non-governmental, nonprofit hospitals were affiliated with nonprofit multi-unit systems (53.3%); in 2005, the corresponding figures were 1,662 of 2,958 (56.2%).").

119. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 6, at 1.

### *E. The Corporate Governance Requirements of the Form 990*

This Note focuses on the revised corporate governance requirements of Part VI of the Form 990. Part VI of the form, entitled “Governance, Management and Disclosure,” requires reporting all supplemental information in Schedule O.<sup>120</sup> Many of the questions within Part VI of the revised form reflect the IRS’s suggestions for good governance practices for 501(c)(3) organizations.<sup>121</sup> These suggested practices, though not mandatory, indicate that organizations not following the good governance practices may be subject to an audit.<sup>122</sup>

Specifically, there are questions related to the general corporate governance of the organization.<sup>123</sup> The questions within Part VI seek to elicit information as to whether the organization is managed appropriately.<sup>124</sup> For example, the organization must describe its board composition; its governance structure; its policies for promoting accountability and transparency to its members; its conflicts of interest policies for directors, officers, and key employees; any potential conflicts of interests;<sup>125</sup> and the organization’s policies and procedures used for establishing compensation of key employees and officers.<sup>126</sup>

Nonprofit hospitals, in addition to the requirements of the form, must also fill out Schedule H, which requires nonprofit hospitals to quantify the community benefit with a breakdown of activities and programs.<sup>127</sup> The addition of Part VI supports the IRS’s goal to increase transparency.<sup>128</sup>

### *F. The Potential Impact of the New Form 990 Reporting Requirements*

Because the newly revised form came into force recently for taxation year 2008, it is unclear what the true impact of the form will be on

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120. See FORM 990, *supra* note 9.

121. See, e.g., *Governance and Related Topics*, *supra* note 8.

122. King, *supra* note 109, at 3–4.

123. Fishman, *supra* note 81, at 327.

124. See FORM 990, *supra* note 9, at pt. VI.

125. This is a potentially onerous question for large organizations specifically because of the broad scope of the types of conflicts that must be reported. King, *supra* note 109, at 3–4.

126. *Id.* at 4.

127. See FORM 990 SCHED. H 2008, *supra* note 97, at 1–2. For the tax reporting year 2008, hospitals need only fill out certain portions of Schedule H. FORM 990 SCHED. H INSTRUCTIONS 2008, *supra* note 97, at 1. However, for tax year 2009, full Schedule H reporting will be required. INTERNAL REVENUE SERV., FORM 990 INSTRUCTIONS FOR SCHED. H 1 (2009), <http://www.irs.gov/pub/irs-pdf/i990sh.pdf>. In order to ensure hospitals are meeting the community benefit standard, Schedule H is essential. Steven T. Miller, Comm’r, Tax-Exempt and Gov’t Entities, Internal Revenue Serv., Community Benefit and Nonprofit Hospitals, Remarks Before the Office of the Attorney General of Texas Charitable Hospitals: Modern Trends, Obligations and Challenges 9 (Jan. 12, 2009), [http://www.irs.gov/pub/irs-tege/miller\\_speech\\_011209.pdf](http://www.irs.gov/pub/irs-tege/miller_speech_011209.pdf).

128. McNeil, *supra* note 96, at 15; see FORM 990 SCHED. H 2008, *supra* note 97. This Schedule is optional for tax year 2008, but for tax year 2009 and forward, hospitals will be required to complete the schedule. FORM 990 SCHED. H INSTRUCTIONS 2008, *supra* note 97, at 1.

hospital organizations.<sup>129</sup> The instructions of the Form 990 provide estimates on the amount of time the IRS believes it will take an organization to complete the return.<sup>130</sup> The total time estimated for completion of the Form 990 and requisite record keeping by hospitals is approximately 192 hours and 57 minutes—well over one month’s work time for the average finance department.<sup>131</sup> In fact, during the public comment period, the AHA, though applauding the IRS’s commitment to transparency, predicted that in order to gather the substantial amount of information required by the Form 990, specifically Schedule H, significant changes by hospital organizations would be required.<sup>132</sup> Specifically, the AHA stated:

We conservatively estimate that only half of the nation’s tax-exempt hospitals have had practical experience gathering and reporting data using the Guide. Those that have not will therefore require additional time to, among other tasks, redesign or purchase and install the necessary new software systems. And if other areas of questioning remain on Schedule H, they would require substantial additional work and cost.<sup>133</sup>

In fact, after the first year of the new filings, one hospital spent far more resources and time than estimated by the IRS.<sup>134</sup> At present, there is no empirical evidence indicating whether there is a relationship between good governance and tax compliance.<sup>135</sup> Because the filings for tax year 2008 marked the first year the new Form 990 has been implemented, it is unclear whether the data provided by various tax-exempt hospitals and hospital systems will yield the information required for such a conclusion. Some practitioners suggest that the data retrieved from these

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129. However, during the course of research, I interviewed an accountant from a hospital that recently filed the Form 990 for tax year 2008. The interviewee was promised anonymity, and so quotations cannot be attributed. When asked about the impact of the new Form 990, the interviewee responded as follows: “To estimate how many man hours it took to prepare, complete, and clean the form, it would be near impossible since it required at least 10–15 people as resources and preparers. The preparers spent the better part of 5 months to compile the information and enter it into the tax organizer . . . .”

130. See INTERNAL REVENUE SERV., INSTRUCTIONS FOR FORM 990 RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX 42 (2009), <http://www.irs.gov/pub/irs-pdf/i990.pdf> [hereinafter FORM 990 INSTRUCTIONS].

131. See Fred, *There is a Cost for Everything*, TATE & TRYON’S FORM 990 FORUM (Feb. 27, 2008, 11:06 AM), [http://990tipsandtricks.typepad.com/tate\\_tryons\\_form\\_990\\_foru/2008/02/index.html](http://990tipsandtricks.typepad.com/tate_tryons_form_990_foru/2008/02/index.html). But see *supra* note 129. The anonymous interviewee also mentioned the time estimated by the IRS was “completely laughable.” *Id.*

132. Letter from Melinda Reid Hatton, *supra* note 15, at 4.

133. *Id.*

134. See *supra* note 129. Specifically, the anonymous interviewee mentioned that specific detail was required in Part VI which proved challenging. “There were many descriptions needed for further explanation in Schedule O that required time for narratives. For us, one of the portions of Part VI that we found challenging was the Conflict of Interest since it was so expanded from the previous version [of the form].” *Id.*

135. See OSTROWER, *supra* note 11, at 21 (“[I]t will be of great interest to follow whether the mere inclusion of questions about certain practices (such as the conflict of interest policy) on the annual IRS Form 990 that nonprofits are required to file will promote adoption of those practices—even though these are not mandatory.”).



informational returns will instead be the platform for tax-exempt status reform.<sup>136</sup> For example, some claim that the information from these returns will be used by the IRS in an attempt to change the basis for tax-exemption.<sup>137</sup> Because the IRS has indicated that the tax-exemption requirements are outdated,<sup>138</sup> it is not inconceivable that in the future the criteria for tax-exemption will change.<sup>139</sup> In the meantime, organizations will be burdened by the new extensive filing requirements.<sup>140</sup> For many organizations, the fear is that the extensive information contained in the publicly available filing “lacks proper context . . . and carries huge public consequences.”<sup>141</sup> Such an extensive filing can increase the probability of public misunderstanding.<sup>142</sup> Furthermore, without the hospital being given the ability to explain the filing, members of the public may adversely affect the necessary complex business relationships that, in today’s economy, hospitals cannot afford to risk losing.<sup>143</sup> Nevertheless, greater transparency can achieve proactive communication to allow the community to easily understand the information provided in the Form 990.<sup>144</sup> The hope is that “[t]hose hospitals that effectively demonstrate the great story of how they fulfill their mission and provide community benefit will continue to enjoy a solid relationship with their community, strengthening their nonprofit status.”<sup>145</sup> But greater transparency is already encouraged and compelled under state and federal health care statutes. The question that remains is whether it is within the province of the IRS to require substantive corporate governance reporting within the Form 990 to elicit that transparency or whether the current statutory fabric of both state and federal health law already fulfills that purpose.

### III. ANALYSIS

Nonprofit hospitals, along with all tax-exempt organizations, were required to file the new Form 990 returns for tax year 2008. This is the first time nonprofit hospitals have been required to include answers to specific governance-related questions in the public filing.<sup>146</sup> These questions highlight and are based upon certain themes: organizations are

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136. Scott J. Mariani, *The Redesigned Form 990: What Hospitals Need to Know*, NEWSCAST, Jan.–Feb. 2008, at 16, 17, <http://www.withum.com/fileSave/Redesigned%20Form%20990%20Hospitals%20S.%20Mariani.pdf>.

137. *Id.*

138. See FREMONT-SMITH, *supra* note 83, at 65.

139. Mariani, *supra* note 136, at 17.

140. Kevin O’Brien, *Nonprofit Hospitals Must Explain What Their IRS Filings Really Mean*, CLEVELAND.COM (May 1, 2009), [http://www.cleveland.com/opinion/index.ssf/2009/05/nonprofit\\_hospitals\\_must\\_expla.html](http://www.cleveland.com/opinion/index.ssf/2009/05/nonprofit_hospitals_must_expla.html).

141. *Id.*

142. *Id.*

143. *Id.*

144. *Id.*

145. *Id.*

146. FORM 990, *supra* note 9, at pt. VI (requiring tax-exempt organizations to answer specific governance related questions).

more likely to be tax-compliant if they are well-governed, organizations adopting certain policies are likely to be well-governed, and transparency of governing documents reflects corporate responsibility.<sup>147</sup> Furthermore, the questions are structured such that detailed explanations must be provided in a separate schedule for those answers that might not meet IRS approval.<sup>148</sup> By its own admission, the IRS concedes that it has no statutory authority to regulate corporate governance.<sup>149</sup> Nevertheless, the IRS has the ultimate power to grant tax-exempt status.<sup>150</sup> Thus, despite the IRS's lack of authority, many organizations will feel compelled to conform to the ideals set forth in the corporate governance initiative, even if those ideals are not suitable for the size or type of organization.<sup>151</sup> Furthermore, since the Form 990 is available for public inspection, reputational concerns will also encourage substantial compliance.<sup>152</sup> Thus, although compliance with these governance ideals is not mandatory, non-compliance is certain to cause problems for organizations filing the form.<sup>153</sup> Given the potential administrative burdens associated with the breadth and depth of information required, it is important to examine the appropriateness of the IRS's role in corporate governance issues. This Note analyzes the following questions: (a) whether the IRS has the statutory authority to regulate nonprofit hospital governance?; (b) even if the IRS has this authority, does Part VI of the Form 990 duplicate governance regulation under current health care regulations and statutes?; and, (c) is there a link between good governance and tax compliance?

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147. See MICHAEL W. PEREGRINE, AM. HEALTH LAWYERS ASS'N, CORPORATE GOVERNANCE TASK FORCE, EMPHASIS ON CORPORATE GOVERNANCE IN FINAL FORM 990 (2007), [http://www.mwe.com/info/pubs/peregrine\\_ahla1207.pdf](http://www.mwe.com/info/pubs/peregrine_ahla1207.pdf).

148. Fishman, *supra* note 13, at 566–68; see also FORM 990, *supra* note 9, at pt. VI; INTERNAL REVENUE SERV., FORM 990 RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX, SCHED. O (2009), <http://www.irs.gov/pub/irs-pdf/f990so.pdf>.

149. Sarah Hall Ingram, Comm'r, Tax Exempt and Gov't Entities, Internal Revenue Serv., Remarks Before the Georgetown University Law Center Continuing Legal Education 3 (June 23, 2009), [http://www.irs.gov/pub/irs-tege/ingram\\_gtown\\_governance\\_062309.pdf](http://www.irs.gov/pub/irs-tege/ingram_gtown_governance_062309.pdf) (“Nor do I mean the IRS should intrude on areas under the jurisdiction and supervision of the attorneys general or charity officials of the states.”); see also Miller, *supra* note 10, at 4.

150. The IRS reviews an organization's Form 1023 to determine whether the organization is eligible for tax-exemption under 501(c)(3). See INTERNAL REVENUE SERV., FORM 1023 APPLICATION FOR RECOGNITION OF EXEMPTION UNDER SECTION 501(C)(3) OF THE INTERNAL REVENUE CODE 3 (2006), <http://www.irs.gov/pub/irs-pdf/f1023.pdf>.

151. This Note does not suggest that encouraging good corporate governance is a bad thing. However, “it is important that each charity be thoughtful about the governance practices that are most appropriate for that charity in assuring sound operations and compliance with the tax law.” Fishman, *supra* note 13, at 548 n.8. Thus, for example, governance practices that work for larger charities may not be best suited for smaller charities. *Id.*

152. *Id.* at 548. One can view the Form 990 informational return of any tax-exempt organization on the internet at [www.guidestar.org](http://www.guidestar.org). Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1750 (2001) (explaining that loss of reputation may be a motivating force encouraging firms to engage in trustworthy behavior).

153. Fishman, *supra* note 13, at 567–68.

*A. Regulation of Corporate Governance—Who Has Authority?*

Most charitable, tax-exempt, nonprofit corporations are organized at the state level.<sup>154</sup> State statutes typically govern structure and organization of nonprofit corporations.<sup>155</sup> Generally, the laws relating to governance of nonprofit corporations tend to be ill-defined; consequently, the case law relating to for-profit entities serves as a reference in deciphering the obligations of nonprofits.<sup>156</sup> In fact, most state corporate statutes do little to regulate specific approaches to nonprofit governance.<sup>157</sup> The decision and scope of nonprofit governance procedure is largely determined internally within each organization.<sup>158</sup>

Generally, the supervision and oversight of charitable nonprofit corporations have been vested in the states' attorneys general for most jurisdictions.<sup>159</sup> In fact, many jurisdictions confer statutory authority to states' attorneys general for the oversight and enforcement of charities.<sup>160</sup> The variations relating to governance procedures with respect to nonprofit corporations coupled with the scarcity of resources has led to sporadic enforcement and regulatory gaps.<sup>161</sup> As a result, the IRS's corporate governance initiative is meant to fill the gaps in enforcement in a rapidly expanding nonprofit sector.<sup>162</sup> Ironically, the IRS itself is short-staffed in proportion to the nonprofit sector it monitors.<sup>163</sup> Nevertheless, the IRS began its promotion of good governance practices with its five points of contact with tax-exempt organizations: (1) determination of tax-exempt status, (2) examination of compliance initiatives, (3) Form 990 reporting, (4) education, and (5) outreach.<sup>164</sup>

The IRS has an interest in governance to the extent that governance relates to tax compliance. The trickier question is whether the IRS can

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154. FISHMAN & SCHWARZ, *supra* note 30, at 52.

155. MARILYN E. PHELAN & ROBERT J. DESIDERIO, *NONPROFIT ORGANIZATIONS LAW AND POLICY* 31 (2003). Many states have adopted the Model Nonprofit Corporation Act. *Id.* at 30. "Most states prohibit nonprofit corporations from issuing stock . . . [and] all state statutes prohibit nonprofits from paying dividends." *Id.* at 31.

156. *Id.* at 93; *see, e.g.*, *La. World Exposition v. Fed. Ins. Co.*, 864 F.2d 1147, 1149 (5th Cir. 1989) (standards applicable to officers and directors); *Stern v. Lucy Webb Hayes Nat'l Training Sch. for Deaconesses or Missionaries*, 381 F. Supp. 1003, 1031 (D.D.C. 1974) (examination of Hospital's fiscal management); *Litwin v. Allen*, 25 N.Y.S.2d 667 (N.Y. Sup. Ct. 1940) (examining fiduciary obligations of a nonprofit corporate director).

157. Fishman, *supra* note 13, at 553.

158. *Id.*

159. Generally, the states' attorneys general are responsible for the supervision and oversight of charitable trusts. *Id.* at 554.

160. Fishman, *supra* note 81, at 313.

161. Fishman, *supra* note 70, at 268. ("[G]overnment regulators . . . tend to allocate their scarce regulatory resources to other more politically potent portions of their domains.") (citing Professor Harvey P. Dale).

162. *Id.* *But see* PANEL ON THE NONPROFIT SECTOR, *supra* note 11, at 13 (citing a serious shortage of resources, including the fact that since 1974 the number of charitable organizations has doubled and yet the size of the IRS staff has increased by only three percent).

163. PANEL ON THE NONPROFIT SECTOR, *supra* note 11, at 13.

164. ADVISORY COMM. ON TAX EXEMPT & GOV'T ENTITIES, *supra* note 83, at 11.

regulate governance outside of its jurisdiction, where there is no proven link to tax compliance. As stated previously, the IRS recognizes that it has no real statutory authority to regulate governance.<sup>165</sup> Congress has never adopted provisions predicating tax-exempt status on specific governance practices.<sup>166</sup> In the past, state corporate law has been preempted by federal regulation.<sup>167</sup> Under the Supremacy Clause of the Constitution, Congress may preempt state legislation by enacting federal legislation relating to the same matters.<sup>168</sup> Typically, Congress does not expressly include specific intent to preempt a field of state regulation.<sup>169</sup> The more difficult problem is when a federal regulatory agency, like the IRS, is acting through its interpretation of federal statute or rule-making.<sup>170</sup>

According to Professor James Fishman,<sup>171</sup> who has written prolifically on the nonprofit sector and governance, the IRS corporate governance initiative most likely improperly preempts state approaches to corporate governance.<sup>172</sup> He suggests that if the IRS's initiative was legally challenged, it might not pass judicial muster.<sup>173</sup> After all, the IRS recognizes that it has not been given the appropriate congressional authority to evaluate the corporate governance structure of organizations.<sup>174</sup> Nevertheless, until there is a legal challenge, tax-exempt organizations are under a great deal of pressure to comply with the governance recommendations.<sup>175</sup> At present, state attorneys general seem to be silent on the IRS's initiative, indicating some acquiescence to this overlapping jurisdiction.<sup>176</sup> It may be that the second set of eyes is welcome when resources are limited for within-state enforcement. After all, the IRS may serve the useful function of identifying potential violations of governance practice for state authorities.<sup>177</sup> Given that the acceptable governance practices vary from state to state, however, states' attorneys general face the danger of silently permitting the usurpation of state-specific rules that may be more favorable than or different from those in-

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165. See Ingram, *supra* note 149, at 3.

166. Fishman, *supra* note 81, at 319–20. *But see* I.R.C. § 4958 (2006) (relating to corporate governance requirements with respect to excess benefit transactions).

167. Fishman, *supra* note 13, at 578 n.115.

168. *Id.* at 579.

169. For a good discussion regarding federal preemption, see *id.* at 580–83.

170. See *id.* at 583–84.

171. James J. Fishman, Professor of Law, Pace University School of Law, is the author of many articles in the area of corporate governance and tax policy.

172. Fishman, *supra* note 13, at 583 (“[I]t seems clear that the Service’s corporate governance initiative violates the norms of federalism, and inadequately respects our constitutional structure.”).

173. *Id.* at 584–86 (discussing *Chevron v. Natural Res. Def. Council*, 467 U.S. 837 (1984) (giving deference to the authority of agencies to make policy through statutory interpretation)).

174. *Id.* at 584. Therefore, *Chevron* deference would not apply because “*Chevron* applies only to Service rules issued pursuant to a general or express delegation of lawmaking authority.” *Id.* at 585.

175. *Id.* at 588 (“One cannot expect attorneys general to bite the hand that feeds them evidence.”).

176. *Id.* at 587.

177. *Id.* at 587–88.

cluded in the IRS's governance vision.<sup>178</sup> Thus, ultimately, the overall effect of the IRS's governance initiative will be to undercut the state regulation of nonprofit corporate governance.<sup>179</sup> It will serve to stifle the decision-making power and freedom of nonprofit organizations regarding policies and practices suitable to the purpose, size, and relative expertise of the organization.<sup>180</sup> Therefore, given that the IRS has no express statutory authority and is likely preempting state regulation of corporate governance, Part VI of the Form 990 is outside the jurisdictional purview of the IRS.

*B. Duplicating Governance Provisions Within Other State and Health Care Statutes*

Apart from the preemption issues, there is the practical problem of duplicating resources already expended on similar governance initiatives. This issue is more pertinent to nonprofit hospitals and other large nonprofit organizations that are subject to extensive regulatory enforcement.<sup>181</sup> Given the limited resources of the IRS,<sup>182</sup> it makes little sense to perform a duplicate review of the corporate governance of large nonprofit organizations, like hospitals, that are routinely monitored pursuant to other statutes. Furthermore, if the rationale behind the IRS's oversight of governance is based on the notion that it is filling in the gaps of state enforcement of nonprofit governance issues, then it makes little sense for the IRS to engage in extensive governance oversight for nonprofit hospitals in light of the extensive regulatory oversight of health care organizations. As discussed below, nonprofit hospitals are regulated by very specific and complex statutes and regulations.<sup>183</sup> Most of these statutes regulate aspects of institutional governance either directly or indirectly.<sup>184</sup> Furthermore, in light of the complexity of these statutes and the associated penalties for noncompliance, most nonprofit hospitals have an internal compliance department or an officer designated to advise and investigate many of the governance issues reflected in the Form 990.<sup>185</sup> Some of these statutes and regulations affect governance and require a great deal of oversight and reporting. Therefore, many of the governance standards set out by the IRS are already being addressed by the strict health care regulatory environment. The key statutes include: FCA, AKS, the Stark Law, HIPAA, Office of Inspector General-U.S.

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178. *Id.* at 588.

179. For example, the regulation of corporate governance post-SOX has been the focus of several states. *See infra* Part III.B.6 (discussing the nonprofit integrity acts recently enacted by five states).

180. OSTROWER, *supra* note 11, at 4 (stating that compliance with governance initiatives will vary "depending on the practice and the characteristics of the nonprofit"); *see also* PANEL ON THE NONPROFIT SECTOR, *supra* note 11, at 13–14.

181. PANEL ON THE NONPROFIT SECTOR, *supra* note 11, at 14.

182. *Id.* at 13.

183. *See infra* Part III.B.1–5.

184. *See infra* Part III.B.

185. *See* Compliance Program Guidance for Hospitals, 63 Fed. Reg. 8987, 8989 (Feb. 23, 1998).

Department of Health and Human Services (OIG-HHS) Guidelines, and State Nonprofit Integrity Acts.<sup>186</sup> This Section discusses how these statutes cover similar disclosure obligations as those in the Form 990.

### 1. *False Claims Act*

The FCA<sup>187</sup> was enacted to prevent fraud and abuse by imposing liability on any person who makes a “false or fraudulent claim” or “false record or statement” or “conspires to defraud the [g]overnment” for payment or approval by the federal government.<sup>188</sup> Civil money penalties for offending organizations range from \$5,000 to \$10,000, “plus 3 times the amount of damages which the Government sustains because of” those false claims.<sup>189</sup> In addition, the FCA permits a private party who has knowledge of fraud and abuse of an entity against the federal government to bring a suit “for the United States Government.”<sup>190</sup> Such a private party or “*qui tam relator*” would enjoy a percentage of the proceeds of the FCA action or settlement.<sup>191</sup> The FCA applies to all organizations that make claims to the federal government or participate in federal programs.<sup>192</sup> All tax-exempt nonprofit hospitals are subject to the FCA, because they participate in the Medicare and Medicaid programs—both federal programs.<sup>193</sup>

For hospitals, potential *qui tam* actions by whistleblowers may result in significant civil money penalties and may lead to mandatory or permissive exclusion from participation in federal health care programs like Medicare or Medicaid.<sup>194</sup> Exclusion from a federal health care program like Medicare or Medicaid serves as the ultimate penalty and can put an

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186. See *infra* Part III.B.

187. False Claims Act, 31 U.S.C. §§ 3729–3733 (2006).

188. *Id.* § 3729(a)(1)–(3).

189. *Id.* § 3729(a).

190. *Id.* § 3730(b)(1).

191. *Id.* § 3730(d)(1). The *qui tam relator* may receive at least fifteen percent but no more than twenty-five percent of the proceeds to the “extent to which the [relator] substantially contributed to the prosecution of the action.” *Id.* When the government does not intervene, § 3730(d)(2) provides that the *qui tam relator* shall receive an amount that “the court decides is reasonable for collecting the civil penalty and damages” and shall be not less than twenty-five percent and not more than thirty percent. *Id.* § 3730(d)(2).

192. See *id.* § 3729(a).

193. Recall, to be considered “charitable” for tax-exemption purposes, nonprofit health care hospitals must provide health care to government insured patients—meaning Medicare and Medicaid patients. See *supra* Part II.B. These hospitals, thus, submit claims to the federal government for Medicare or Medicaid reimbursement. See also 42 U.S.C. § 1320a-7 (discussing the anti-fraud provisions specifically relating to the Medicare and Medicaid programs).

194. 42 U.S.C. § 1320a-7. For example, Tenet Healthcare Corporation entered into a \$900 million settlement for alleged unlawful billing, including claiming excessive sums from Medicare and other federal health care programs. Press Release, Dep’t of Justice, Tenet Healthcare Corporation to Pay U.S. More than \$900 Million to Resolve False Claims Act Allegations (June 29, 2006), available at [http://www.justice.gov/opa/pr/2006/June/06\\_civ\\_406.html](http://www.justice.gov/opa/pr/2006/June/06_civ_406.html). The settlement is in large part pursuant to lawsuits filed by whistleblowers. *Id.*

entity out of business completely.<sup>195</sup> Thus, the FCA provides great incentive for nonprofit hospitals and their employees or private parties to disclose fraud and abuse.<sup>196</sup> Consequently, hospitals have a significant interest in ensuring that they have the appropriate whistleblower policies in place and promoting good corporate governance to prevent fraud and abuse. Through good governance, the practice of internal reporting, and solid whistleblower policies, nonprofit hospitals can protect themselves from substantial liability.<sup>197</sup> Thus, the FCA's regulation and enforcement against fraud and abuse promotes transparency by requiring a whistleblower policy for nonprofit hospitals.<sup>198</sup>

Similarly, Part VI of the Form 990 asks whether the organization has a written whistleblower policy.<sup>199</sup> Virtually all nonprofit hospitals are necessarily going to answer this question in the affirmative, because they face risks of huge penalties without such a policy.<sup>200</sup> Thus, the question will do little to encourage already existing whistleblower policies in the nonprofit hospital context. Therefore, does this information reveal anything regarding the propensity for nonprofit hospital tax compliance to the IRS? If so, how? Perhaps, a better inquiry is how the IRS plans to evaluate these informational points. For example, if a nonprofit hospital were to answer that it did not have a whistleblower policy, would that jeopardize its tax-exemption? If yes, then why? To be certain, a hospital's chief motivation to institute a whistleblower policy will not come from the IRS disclosure requirement; rather, the threat of exclusion and civil money penalties is enough to ensure compliance.<sup>201</sup> Thus, with respect to nonprofit hospitals, the whistleblower policy question is unnecessary and duplicative.

## 2. *Anti-Kickback Statute*

The AKS criminalizes "knowing and willful" payment, offer, solicitation, or any remuneration in exchange for patient referrals or referral of some other business by health care entities that provide services reimbursable by Medicare or Medicaid or other health care programs.<sup>202</sup> In

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195. Greg Piche, *Tenet Medicare Exclusion-Being Pecked to Death by Federal Ducks*, HOLLAND & HART HEALTHCARE LAW BLOG (May 11, 2006), [http://www.hollandharthealthcare.com/healthcare/2006/05/tenet\\_medicare.html](http://www.hollandharthealthcare.com/healthcare/2006/05/tenet_medicare.html).

196. In 1987, whistleblowers accounted for fifteen percent of FCA claims filed. In 2005, eighty percent of FCA claims filed were by whistleblowers. THE FALSE CLAIMS ACT LEGAL CTR., THE 1986 FALSE CLAIMS ACT AMENDMENTS: A RETROSPECTIVE LOOK AT TWENTY YEARS OF EFFECTIVE FRAUD FIGHTING IN AMERICA 6 (2006), <http://www.taf.org/retrospective.pdf>.

197. See Compliance Program Guidance for Hospitals, 63 Fed. Reg. 8987, 8998 (Feb. 23, 1998). A whistleblower is typically "[a]n employee who refuses to engage in and/or reports illegal or wrongful activities of his employer or fellow employees." BLACK'S LAW DICTIONARY 1596 (6th ed. 1990).

198. Recall that most nonprofit hospitals participate in Medicare/Medicaid programs to qualify for tax-exempt status and therefore are subject to the FCA. See Rev. Rul. 69-545, 1969-2 C.B. 117.

199. FORM 990, *supra* note 9, at pt. VI, question 13.

200. See, e.g., False Claims Act, 31 U.S.C. § 3729(a)(3) (2006).

201. *Id.*

202. 42 U.S.C. § 1320a-7b(b)(1)-(2).

general, remuneration may include gifts, deductibles, co-pays, or anything else with monetary value, but special safe harbors may apply.<sup>203</sup> Violation of the AKS can lead to imprisonment, civil or criminal fines, and exclusion from participation in federal health care programs.<sup>204</sup> The consequences of violation are severe. Thus, even though the AKS does not directly police corporate governance, hospitals must govern themselves accordingly so that they are in compliance with the AKS. Hospital corporate compliance programs generally audit and track financial relationships and any remuneration that may be captured by the statute.<sup>205</sup> Compliance policies and internal procedures for enforcement serve to guard against the very fraud and abuse the AKS was designed to regulate.<sup>206</sup> The consequences of violation are severe enough that nonprofit hospitals are compelled to self-monitor compliance.<sup>207</sup> In turn, this will do more to promote good governance.

The IRS covers similar territory in the Form 990 with questions relating to conflicts of interest.<sup>208</sup> The revised Form 990 asks whether the organization has a written conflict of interest policy and requires disclosure of transactions with “interested” persons.<sup>209</sup> The question seems to imply that generally conflicts of interest are inherently wrong.<sup>210</sup> What the Form 990 or the corporate governance initiative fails to recognize, however, is that the law governing nonprofit hospitals, like the AKS, is detailed and lists transactions within safe harbors that may be perfectly fair and acceptable.<sup>211</sup> Therefore, even if a transaction falls within an acceptable safe harbor of the AKS, the “yes/no” answer format of Part VI of the form may not tell the whole story. Thus, detailed explanations will be required in the attached Schedule O.<sup>212</sup> In addition, sometimes interested transactions may be a necessity. For example, interested transactions may be unavoidable in a small rural community where many of the service providers are either related to or have some connection to a key

203. See *id.* § 1320a-7b(b)(1)-(3); 42 C.F.R. §§ 1001.951-952 (2009).

204. See 42 U.S.C. § 1320a-7b(b)(1)-(2); 42 C.F.R. §§ 1001.951-952; see also Stanley A. Twardy & Michael P. Shea, *Anti-Kickback Anxiety: How a Criminal Statute Is Shaping the Health-Care Business*, BUS. LAW TODAY, May-June 2000, at 18, 18, <http://www.abanet.org/buslaw/blt/blt00may-kickback.html> (last visited Nov. 13, 2010). The regulations provide for detailed and narrow safe harbors regarding physician recruitment, rental arrangements, and other common transactions related to health care. 42 C.F.R. § 1001.952(b), (c), (n).

205. See Compliance Program Guidance for Hospitals, 63 Fed. Reg. 8987, 8996 (Feb. 23, 1998) (suggesting auditing and monitoring as part of a compliance program).

206. *Id.*

207. See *id.* at 8997.

208. FORM 990, *supra* note 9, at pt. VI, questions 12(a)-(b) (“(a) Does the organization have a written conflict of interest policy? . . . (b) Are officers, directors or trustees, and key employees required to disclose annually interests that could give rise to conflicts?”).

209. Fishman, *supra* note 13, at 569.

210. *Id.* at 570.

211. See Anti-Kickback Safe Harbors, 42 C.F.R. § 1001.952 (2009).

212. See *supra* note 129. “There were many descriptions needed for further explanation in Schedule O that required time for narratives. For us, one of the portions of Part VI that we found challenging was the Conflict of Interest since it was so expanded from the previous version [of the form].” Due to the anonymity promised to the interviewee, quotes cannot be attributed. See *id.*



employee or someone connected with the local nonprofit hospital in that community.<sup>213</sup> Thus, a number of the Form 990 questions leave nonprofit hospitals in a precarious situation, in which they may feel compelled not to engage in perfectly legal, interested transactions because the public nature of the filing may harm their institutional reputation and tax-exemption, or may invite an audit.<sup>214</sup> On the other end of the spectrum, hospitals disclosing interested transactions may harm their reputations by publicly disclosing interested transactions of which the public may not be aware are otherwise legally permissible. In short, IRS questions regarding conflicts of interest are in danger of being misinterpreted by nonprofit hospitals, because there is no way to differentiate between transactions meeting the legal standards and safe harbors like those set by more detailed statutes, such as the AKS.

### 3. *The Stark Law*

The Stark Law, named for Congressman Pete Stark who initiated the bill, has three separate provisions.<sup>215</sup> First, it prohibits referral of Medicare patients to entities in which a physician or a family member of the physician has a financial relationship with the health care entity.<sup>216</sup> Second, it prohibits physician self-referrals.<sup>217</sup> Finally, it imposes strict liability with significant civil money penalties.<sup>218</sup> Though it may seem that the Stark Law covers similar territory to the AKS, the two statutes have significant differences in scope and nature.<sup>219</sup>

Furthermore, the statute has significant reporting requirements. The statute requires the entity to provide to the Secretary of the Department of Health and Human Services (DHHS) “information concerning the entity’s ownership, investment, and compensation arrangements.”<sup>220</sup> Reporting is required upon request and is not currently

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213. See, e.g., Fishman, *supra* note 13, at 569–72.

214. *Id.* at 570.

215. See 42 U.S.C. § 1395nn (2006); see also STARKLAW.ORG, [http://starklaw.org/stark\\_law.htm](http://starklaw.org/stark_law.htm) (last visited Nov. 13, 2010).

216. 42 U.S.C. § 1395nn(a)(1)(A).

217. *Id.*; see also STARKLAW.ORG, *supra* note 215 (“Physician self-referral is the practice of a physician referring a patient to a medical facility in which he has a financial interest, be it ownership, investment, or a structured compensation arrangement.”).

218. 42 U.S.C. § 1395nn(g). Specifically, an entity may be denied payment, required to refund certain claims, or be given civil money penalties for improper claims and circumvention schemes. *Id.*

219. Alice G. Gosfield, *The Stark Truth About the Stark Law: Part 1*, FAMILY PRACTICE MGMT., Nov.–Dec. 2003, at 27, 29, <http://www.aafp.org/fpm/2003/1100/p27.pdf>. The Stark Law is narrower in scope than the AKS since it deals only with physician referrals under the Medicare/Medicaid program whereas the AKS is broader and relates to any federal health care program. *Id.* AKS requires specific bad intent whereas the Stark Law imposes strict liability regardless of intent. *Id.* The Stark Law provides for explicit exceptions. *Id.* The AKS has safe harbors and failure to meet the safe harbors does not necessarily mean that the AKS has been violated. *Id.*

220. 42 U.S.C. § 1395nn(f). The report must include

(1) the covered items and services provided by the entity, and (2) the names and unique physician identification numbers of all physicians with an ownership or investment interest . . . , or with a

mandatory;<sup>221</sup> however, pursuant to a survey by the Centers for Medicare and Medicaid Services (CMS) of 350 hospitals relating to their physician relationships, the CMS indicated that it “would require all hospitals to provide this [type of] information on a periodic basis.”<sup>222</sup> Thereafter, the CMS created the “Disclosure of Financial Relationships Report” (DFRR), which it intended to send to four hundred hospitals.<sup>223</sup> The CMS sought comment on this initiative before going forward.<sup>224</sup> The DFRR would have included extensive reporting worksheets requiring hospitals to list all direct and indirect physician ownership or investment relationships; compensation arrangements including all rental, personal services, and recruitment arrangements; and certain information relating to other types of compensation arrangements.<sup>225</sup> The CMS estimated that completion of the DFRR would take an average of thirty-one hours for each hospital.<sup>226</sup> Ultimately, the CMS delayed its mandatory reporting proposal due to concerns regarding duplication of reporting obligations.<sup>227</sup>

The Form 990 also surveys the types of financial relationships prohibited by the Stark Law. For example, under Part VI of the form, question two asks: “Did any officer, director, trustee, or key employee have a family relationship or a business relationship with any other officer, director, trustee, or key employee?”<sup>228</sup> Nonprofit hospitals are already compelled by the Stark Law to monitor these transactions because of the severe strict liability consequences.<sup>229</sup> Thus, any questions regarding re-

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compensation arrangement . . . in the entity, or whose immediate relatives have such an ownership or investment interest or who have such a compensation relationship with the entity.

*Id.*

221. *Id.*

222. Karl A. Thallner et al., *Proposed Stark Law Changes in CMS's 2009 IPPS Proposed Rule*, LIFE SCIENCES LEGAL UPDATE (May 30, 2008), <http://www.lifescienceslegalupdate.com/2008/05/articles/health-care/proposed-stark-law-changes-in-cmss-2009-ippss-proposed-rule/>.

223. *CMS Postpones Hospital Reporting of Disclosure of Financial Relationships Report (DFRR)*, CTRS. FOR MEDICARE & MEDICAID SERVS., [http://www.cms.gov/PhysicianSelfReferral/70\\_Disclosure.asp](http://www.cms.gov/PhysicianSelfReferral/70_Disclosure.asp) (last visited Nov. 13, 2010) [hereinafter *CMS Postpones*]; see also Comment Request, 73 Fed. Reg. 77,701, 77,702 (Dec. 19, 2008).

224. Comment Request, 73 Fed. Reg. at 77,702; see *CMS Postpones*, *supra* note 223 (“CMS has determined that mandating hospitals to complete the DFRR may duplicate some of the reporting obligations . . . in section 6001 of the ACA.”).

225. CTRS. FOR MEDICARE & MEDICAID SERVS., DISCLOSURE OF FINANCIAL RELATIONSHIPS REPORT 3, <http://www.bricker.com/documents/resources/stark/dfrr.pdf>.

226. *Financial Relationships Between Hospitals and Physicians*, 73 Fed. Reg. 23,528, 23,697 (Apr. 30, 2008).

We reviewed the responses from the 33 hospitals and determined that the average number of hours to complete the DFRR was 31 hours. This figure represents a significant increase from our most recent time and burden estimate. Therefore, we believe it would be beneficial to seek further comments on the accuracy of the time and burden estimates associated with this information collection instrument.

*Id.*; see Bob Wade, *DFRR Appears in IPPS Rule; CMS Seeks Hospital Feedback on Gathering MD Data*, REP. ON MEDICARE COMPLIANCE, Apr. 21, 2008, at 1, [http://www.foley.com/files/tbl\\_s38News/FileUpload257/3460/MedicareComplianceApril2008.pdf](http://www.foley.com/files/tbl_s38News/FileUpload257/3460/MedicareComplianceApril2008.pdf).

227. *CMS Postpones*, *supra* note 223.

228. FORM 990, *supra* note 9, at pt. VI, question 2.

229. 42 U.S.C. § 1395nn(g)(3) (2006).

lated-party transactions are not only duplicative from a regulatory standpoint, but they also have a questionable relationship to tax compliance.<sup>230</sup> Finally, Form 990 questions requiring disclosure of “any officer, director, trustee, or key employee hav[ing] a family relationship or a business relationship with any other officer, director, trustee, or key employee” may be nearly impossible to answer in large complex nonprofit hospital organizations.<sup>231</sup> For example, for an organization with a multitude of directors and management relationships, the task of tracking the family relationships of these individuals and examining whether or not any related party transactions took place may be almost impossible. Furthermore, depending on the geographic location, a hospital may have to answer “yes” given that there is a limited population and the fact that inevitably someone will be in a “family relationship” with a key employee. Would answering yes then invite a negative perception of governance by the IRS? Through what lens would the IRS analyze this information? There is no current guidance on how the IRS plans to evaluate the answers to these questions.<sup>232</sup> Furthermore, should the organization answer this question in accordance with the information it normally collects as part of its corporate compliance program or does the IRS require something more? Again, it makes little sense for the IRS to police an area that is already within the enforcement authority of the CMS.<sup>233</sup> Question two of Part VI is another example of how the governance initiative is duplicative of other federal government regulation of nonprofit hospitals.

#### 4. *The Health Insurance Portability and Accountability Act of 1996*

The Health Insurance Portability and Accountability Act of 1996 and its accompanying regulations is a complex regulatory scheme that makes provisions for: (1) the protection of health insurance coverage for workers and their families; (2) the requirements for national standards for electronic transactions and national identifiers for providers, insurance plans, and employers; and (3) the protection of the privacy and security of health information and data.<sup>234</sup> HIPAA applies to covered entities that include health plans; health care clearinghouses, such as billing

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230. Fishman, *supra* note 13, at 568 (“Other questions, attenuated to tax law compliance, place new and undefined burdens on organizations. They concern the independence of directors, conflicts of interest, disclosure policies, related party transactions and general issues of corporate governance that have little relationship to tax law compliance.”).

231. FORM 990, *supra* note 9, at pt. VI, question 2.

232. The Instructions to the form indicate no guidance. See FORM 990 INSTRUCTIONS, *supra* note 130. To date, the IRS has provided no further guidance to the answers to these questions.

233. See 42 C.F.R. § 411.361(a) (2009).

Except as provided in paragraph (b) of this section, all entities furnishing services for which payment may be made under Medicare must submit information to CMS or to the Office of Inspector General (OIG) concerning their reportable financial relationships (as defined in paragraph (d) of this section), in the form, manner, and at the times that CMS or OIG specifies.

*Id.*

234. Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, 110 Stat. 1936.

services and community health information systems; and health care providers.<sup>235</sup> Thus, nonprofit hospitals are necessarily subject to HIPAA. Under the privacy regulations, covered entities are required to protect individually identifiable health information (including electronic information) that might identify a patient.<sup>236</sup> Given the breadth of the regulations, HIPAA affects the governance of a covered organization. The regulations are specific, and the requirements relating to patient health information (PHI), which must be de-identified, and further regulations relating to electronic patient health information are extensive.<sup>237</sup> Covered organizations must have a HIPAA Privacy and Security Officer who is charged with ensuring compliance of the HIPAA policies of the organization.<sup>238</sup> Among the privacy provisions is the requirement that the covered entity have some sort of document retention policy.<sup>239</sup>

Most hospitals have at least one document retention policy pertaining to all institutional documents, including medical records.<sup>240</sup> Furthermore, apart from HIPAA there are several federal statutes that make provisions for the maintenance of specific records.<sup>241</sup> Thus, it is certain that most hospitals filing a Form 990 have some sort of document retention policy covering a wide variety of institutional documents.

The new Form 990 also asks the filing organization whether it has a document retention and destruction policy.<sup>242</sup> This question comes from SOX legislation encouraging document retention, because state law typically does not require retention or destruction.<sup>243</sup> To be sure, most hospitals have policies regarding the destruction of key governance documents—records and minutes—to comply with HIPAA.<sup>244</sup> Therefore, the Part VI question regarding document retention is superfluous for non-

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235. 45 C.F.R. § 160.103.

236. *Id.* §§ 164.102–.106.

237. *Id.* §§ 164.102–.106, 164.30–.318, 164.524.

238. *Id.* § 164.308(a)(2).

239. Standards for Privacy of Individually Identifiable Health Information, 64 Fed. Reg. 59,918, 59,994 (Proposed Nov. 3, 1999).

240. Sue Dill Calloway, *Record Retention Periods*, HIPAA ADVISORY (June 29, 2006, 3:54 PM), <http://www.glrn-online.com/pdfs/HIPAA%20Record%20Retention%20Periods%202006.pdf>.

241. *Id.* In addition to HIPAA, the following federal statutes requiring record keeping measures apply to nonprofit hospitals: (1) Fair Labor Standards Act (requiring employers to keep specific employment records for two years), 29 C.F.R. §§ 516.2–.6, 516.11–.29 (2010); (2) Occupations Safety and Health Administration Act (OSHA) (requiring employers to keep records for thirty years of employees who have been exposed to harmful agents and toxic substances); (3) Hospitals must maintain inpatient and outpatient medical records, radiology and nuclear medicine records for five years, 42 C.F.R. §§ 482.24, 482.26, 482.53 (2009); (4) Certain facilities like comprehensive outpatient rehabilitation facilities, nursing facilities, and public health service providers under the Medicare program also have specific record keeping requirements; (5) Employers Retirement Security Act (ERISA) requires hospitals having pension or employee benefit plans to maintain plain summaries for at least six years. *Id.* Furthermore, the IRS itself requires facilities to keep employment tax records for four years after the tax is due. 26 C.F.R. § 31.6001 (2010).

242. FORM 990, *supra* note 9, at pt. VI, question 14.

243. Fishman, *supra* note 13, at 573–74.

244. Calloway, *supra* note 240, at 1.

profit hospitals. Thus, it is unnecessary for the IRS to be concerned with document retention for nonprofit hospitals.

5. *Office of Inspector General-Department of Health and Human Services Guidelines*

Entities participating in Medicare or Medicaid, including all non-profit, tax-exempt hospitals, are governed by OIG-HHS guidelines.<sup>245</sup> Specifically, the OIG-HHS strongly encourages these entities to institute voluntary corporate compliance programs.<sup>246</sup> These programs must include: (1) written compliance and practice standards, (2) a compliance officer and compliance committee, (3) employee training and education, (4) an anonymous hotline for complaints and a system for timely response to detected problems, and (5) internal audits that are well-publicized and enforced.<sup>247</sup> Consequently, these guidelines serve as the ultimate gap-filler to nonprofit hospital governance oversight. The guidelines provide for specific standards of internal controls and internal monitoring and detection of fraud and abuse.

Part VI of the Form 990 asks, among other things, an array of questions relating to the independence of directors, contemporaneous documentation of governing board meetings, and specifics relating to governance policies.<sup>248</sup> Nonprofit hospital compliance programs are compelled to capture all of these information points through the internal audit process pursuant to the OIG-HHS guidelines or face harsh penalties up to and including exclusion from federal health care programs like Medicare and Medicaid.<sup>249</sup> From a risk management standpoint, nonprofit hospitals are more likely to have a compliance program in place than not.<sup>250</sup> Thus, it is unclear whether the IRS governance questions reveal anything not already part of the internal compliance program of nonprofit hospitals. Even if the IRS can justify duplicating oversight of these governance factors, would the answers to the questions in Part VI of the form bear any relationship to the nonprofit hospital's tax compliance? Any proposed relationship is tenuous at best.

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245. See Compliance Program Guidance for Hospitals, 63 Fed. Reg. 8987, 8987 (Feb. 23, 1998).

246. *Id.* at 8989. It is important to note that although the regulation does not "require" organizations to put in place a corporate compliance program, those organizations that have a compliance program may be able to mitigate penalties, assessments, and exclusions in the event the organization becomes a target of an OIG investigation. *Id.* at 8998.

247. *Id.* at 8989.

248. See FORM 990, *supra* note 9.

249. Compliance Program Guidance for Hospitals, 63 Fed. Reg. at 8986. It is important to note that an organization can considerably reduce its risk of exposure to fraud and abuse penalties if a proper compliance program is in place. *Id.* at 8987. Furthermore, a poor compliance program will do very little to reduce organizational risk. See *id.* at 8988. Thus, most nonprofit hospitals have some sort of compliance program in place.

250. See *id.* at 8987.

## 6. *State Nonprofit Integrity Acts*

Several states have adopted nonprofit integrity acts that reflect the core principles of the SOX regarding internal controls, active oversight, independence, and accountability.<sup>251</sup> Such integrity acts typically require audit committees, audited financial statements, and compensation reviews.<sup>252</sup> The statutes generally impose civil penalties for noncompliance at the state-level.<sup>253</sup> Furthermore, nonprofit hospitals in states with nonprofit integrity acts are subject to their provisions necessarily increasing the internal compliance and oversight required of their respective compliance programs.<sup>254</sup>

For these states, the Form 990 governance questions simply add nothing to governance oversight. As explained above, although on the short term the lack of resources may justify the overlap of IRS oversight of governance, ultimately the IRS's corporate governance initiative impermissibly preempts the state's power to regulate in the governance arena.<sup>255</sup> Thus, in states where nonprofit corporations are closely regulated, the questions of Part VI are duplicative.

### C. *Does Good Governance Have Any Relationship with Tax Compliance?*

There is simply no evidence that good governance practices lead to better tax compliance.<sup>256</sup> The Advisory Committee on Tax-Exempt and Government Entities concluded that "there is little or no empirical evidence to date that supports the efficacy of any specific governance practices by nonprofit organizations, much less compliance with the requirements for maintaining tax exemption."<sup>257</sup> If the primary concern of the IRS is to ensure that only those deserving tax-exemption are granted this status, how does good corporate governance play a role in this analysis? The IRS suggests that good governance will ultimately allow an organization to adhere to its charitable mission.<sup>258</sup> Again, there is no empirical

251. See, e.g., Nonprofit Integrity Act of 2004, 2004 Cal. Stat. 919; 2005 Conn. Acts 101 (Reg. Sess.); N.H. Rev. Stat. Ann. 7:28 (2004); see also Jamieson Baker, *Nonprofits, Sarbanes-Oxley, and the States*, GUIDESTAR.ORG, <http://www2.guidestar.org/rxa/news/articles/2005/nonprofits-sarbanes-oxley-and-the-states.aspx?articleId=779> (last visited Nov. 13, 2010).

252. Hardy, *supra* note 60, at 35.

253. See, e.g., CAL. GOV'T CODE § 12591.1 (West 2005).

254. The OIG recommended compliance program coupled with state requirements, theoretically, should adequately monitor governance.

255. See Fishman, *supra* note 13, at 587–88.

256. Miller, *supra* note 10, at 4 ("We have been saying that good governance is a leading indicator of good tax compliance. In reply, some say: 'Prove it.' We are going to try. It seems like a logical inference, but it's reasonable to test the point.")

257. ADVISORY COMM. ON TAX EXEMPT & GOV'T ENTITIES, *supra* note 83, at 1.

258. Ingram, *supra* note 149, at 3–4.

They are not expressly laid out in the Code, nor do they need to be, but the principles of governance that are of concern to the IRS should derive from the requirements for tax exemption, and should aid an organization in meeting them. . . .

evidence that good governance positively or negatively affects charitable mission outcome.<sup>259</sup> Though it may seem like a logical inference, there is simply no evidence to support the assertion. Even if the assertion is supportable, it would seem that this would pose little problem for nonprofit hospitals. The charitable mission of tax-exempt nonprofit hospitals as defined by the IRS is to provide health care to those who will pay for it.<sup>260</sup> Given the many statutes that govern the provision of health care and monitor governance of nonprofit hospitals, it will be difficult for nonprofit hospitals to stray from their charitable missions without serious penalty regardless of any governance initiatives set forth by the IRS.

The better question for the IRS with respect to nonprofit hospital tax compliance is whether nonprofit hospitals deserve their tax-exemption at all. The answer to this question has little to do with the corporate governance of nonprofit hospitals and has more to do with whether nonprofit hospitals are doing anything that for-profit hospitals are not already doing.<sup>261</sup> And yet, the IRS has recently based decisions regarding tax-exemption on corporate governance factors.<sup>262</sup> Furthermore, as Professor Fishman points out, the IRS may have been justified in using governance factors only as criteria to filter organizations out of the tax-exempt sector.<sup>263</sup> As described above, however, the governance questions in the Form 990 informational return amounts to effective regulation of governance for nonprofit organizations who have already obtained tax-exempt status.<sup>264</sup>

It is true that given the landscape of corporate scandal, good governance and transparency of nonprofit hospitals is beneficial, necessary, and should be encouraged. States and other arms of the federal government traditionally have the authority to regulate in the area of governance.<sup>265</sup> The IRS's corporate governance initiative impermissibly preempts state regulatory power over governance.<sup>266</sup> Furthermore, many state and federal statutes address governance issues specific to health care.<sup>267</sup> Nonprofit hospitals are subject to a complex regulatory structure that necessitates internal corporate compliance programs.<sup>268</sup> Therefore, even if it were appropriate for the IRS to regulate in the area of corpo-

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A foundational principle is that the organization should clearly understand and publicly express its mission. This helps assure that the organization provides a public benefit and does not drift away from a charitable purpose. It helps an organization avoid practices that are inconsistent with tax-exempt status.

*Id.*

259. Fishman, *supra* note 13, at 586.

260. Rev. Rul. 69-545, 1969-2 C.B. 117.

261. Colombo, *supra* note 5, at 53.

262. Fishman, *supra* note 13, at 563 n.58.

263. *Id.* at 563.

264. *See supra* Part III.A.

265. *See supra* Part III.A.

266. Fishman, *supra* note 13, at 583.

267. *See supra* Part III.B.

268. *See supra* Part III.B.5.

rate governance, its initiative is duplicative and largely unnecessary with respect to nonprofit hospitals. Finally, there is no data to support that any of the corporate governance questions listed in Part VI of the Form 990 actually have any relationship with favorable tax compliance.<sup>269</sup> The IRS has provided no solid data. To date, there is no data to suggest that good governance is an effective measure or predictor of tax compliance. The IRS can only hope that the recent 2008 filing will reveal data to support its initial assertion. Thus, the Form 990 is the IRS's experiment with governance regulation. It is an experiment that will no doubt impose great unnecessary burdens to nonprofit hospitals and will probably have little effect on encouraging better governance or tax compliance.

#### IV. RECOMMENDATION

It is too early to know what impact the new Form 990 corporate governance requirements will have on nonprofit hospitals.<sup>270</sup> But it is foreseeable that, if anything, the new governance requirements will result in more bureaucracy.<sup>271</sup> More bureaucracy will lead to inefficiencies and will inevitably increase institutional costs.<sup>272</sup> Implementing the form as is, without better data, may be unnecessarily burdensome to nonprofit hospitals.<sup>273</sup> Does it make sense to divert these resources when they would be best used to further a nonprofit hospital's charitable mission? Given that many of the governance related Form 990 disclosures for nonprofit hospitals are covered, enforced, and monitored by other federal statutes, these governance disclosure requirements must either be eliminated or revised in scope. In order to manage the inherent issues, discussed previously, the following solutions may help create a balance between the IRS's interest in managing tax-exemption and efficiency of compliance by nonprofit hospitals: (1) suspend the Part VI disclosure requirements for hospitals, at least until some concrete data correlates good corporate governance with tax compliance; (2) truncate the disclosure requirements in the form to provide nonprofit hospitals with the choice of either filling out Part VI or, alternatively, submitting a copy of their annual corporate compliance reports; and (3) wait for Congress or courts to clarify the IRS's authority in response to litigation by nonprofit hospitals. The following Sections evaluate the efficacy of each solution.

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269. See *supra* Part III.C.

270. The IRS required the first filing for tax year 2008. Patrick Ferraro, *Unveiled: The IRS Introduces the Redesign Form 990*, GUIDESTAR.ORG (Jan. 2008), <http://www2.guidestar.org/rxa/news/articles/2008/unveiled-the-irs-introduces-the-redesigned-form-990.aspx?articleId=1195>.

271. See FORM 990 INSTRUCTIONS, *supra* note 130; Fred, *supra* note 131.

272. Dana Brakman Reiser, *There Ought to Be a Law: The Disclosure Focus of Recent Legislative Proposals for Nonprofit Reform*, 80 CHI.-KENT L. REV. 559, 596–97 (2005).

273. Although Professor Fishman suggests that “[t]his burden may be a mere cost of business for larger organizations—hospitals, educational institutions or major social services organizations,” it is foreseeable that the costs to hospital business can be significant in light of all of the other additional disclosures required by the hospital under Schedule H. Fishman, *supra* note 13, at 589.



*A. Phasing-in Part VI Disclosure Requirements*

The IRS should suspend Part VI requirements until it can define the connection between good governance and tax compliance. Specifically, it should also define what “good governance” means for purposes of tax compliance based on evidence. There is no reason why the IRS could not suspend requirements of Part VI until it has the requisite data to support its authority to monitor governance. In fact, the IRS has already followed a phase-approach by only requiring those organizations with gross receipts of over \$1 million and assets of less than \$2.5 million to file a Form 990 for tax year 2008 and gradually tightening the threshold in the next two tax years.<sup>274</sup> A similar approach to phasing-in Part VI of the Form 990 would give the IRS time to gather the sufficient information and tailor the scope of the governance disclosures to tax compliance.

Specifically, during the suspension period, the IRS should continue to dialogue with organizations regarding governance and should continue to study the relationship between good governance and tax compliance. Further study and dialogue has proven effective in the context of the other revisions of Form 990 during the public comment period of the final form.<sup>275</sup> Continued dialogue can eliminate some of the inherent difficulties with Part VI of the current form. The IRS, for example, could design and implement a study to determine the relationship between good corporate governance issues and whether adherence to specific enumerated governance measures improves a nonprofit organization’s adherence to its mission.<sup>276</sup> Based on these results, the IRS could then reorganize the form and ask only those questions that yield specific responses related to tax compliance. It would also be helpful for the IRS to detail how the answers to the question relate to tax compliance.

By having good data before instituting corporate governance disclosure, the IRS can avoid any state preemption problems.<sup>277</sup> If the IRS can find a link between corporate governance and tax compliance, it can tailor the questions in Part VI to only those questions that bear some relationship to tax compliance. Therefore, there would be no question of the IRS’s authority to regulate in the area of governance.

Furthermore, because nonprofit hospitals are governed by health care statutes that address the major concerns covered within the current Part VI of the Form 990, suspension of the form would have little negative effect on governance monitoring of nonprofit hospitals. Given the backdrop of the penalty-ridden health care statutes, nonprofit hospitals

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274. Ferraro, *supra* note 270. For example, in tax year 2009, the threshold for filing will be \$500,000 and assets of less than \$1.25 million. *Id.*

275. The IRS “received over 650 comments, amounting to more than 3,000 pages, much of which was reflected in the revised redesigned Form 990 released in December of 2007. The result is a substantially better form . . . .” ADVISORY COMM. ON TAX EXEMPT & GOV’T ENTITIES, *supra* note 83, at 47.

276. *Id.* at 38.

277. *See supra* Part III.A.

are already compelled by their internal corporate compliance programs to ensure that they have the proper checks and balances regarding corporate governance.<sup>278</sup> Thus, a temporary hiatus from requiring governance reporting on the Form 990 will unlikely impact nonprofit hospital compliance to governance standards, because, theoretically, nonprofit hospitals should already be motivated to encourage and monitor governance.

Moreover, the IRS simply does not have the kind of staffing needed to scrutinize Part VI and its accompanying Schedule O to the extent necessary to properly enforce corporate governance in a way that is meaningful.<sup>279</sup> Thus, by taking a step back to evaluate not only the correlation between good governance and tax compliance but also to evaluate whether different types of organizations present greater risks of tax non-compliance based on their governance issues might result in a tiered approach to governance disclosure. For example, the IRS may decide to require different levels of disclosure depending on the type and size of nonprofit organization.<sup>280</sup> After all, the IRS currently differentiates between organization types in other parts of the Form 990. For example, it only requires large hospital organizations to fill out Schedule H.<sup>281</sup>

Thus, by temporarily suspending the required disclosures under Part VI, the IRS can continue to study the specific details of the relationship between tax compliance and good corporate governance. Once it has the required data, it should examine Part VI and revise the scope of the questions to ensure that only those questions relating to tax compliance are included on the Form 990. Furthermore, the IRS should consider whether the data suggests that the size and type of organization matter. If so, then the form should be tailored to different categories of 501(c)(3) organizations that are required to file a Form 990. Nevertheless, given the IRS's strong stance on corporate governance, suspension of Part VI is unlikely.<sup>282</sup> Ironically, the IRS will most likely try to use the information gathered from these first filings to support its bald assertion that good governance is related to tax compliance—a classic cart-before-the-horse problem.

### B. *Truncating Part VI Requirements*

The IRS has admitted that it has no statutory authority relating to governance, and yet it forged ahead with its Part VI disclosures—this focus is unlikely to change. If the IRS makes no changes to the actual questions in Part VI of the Form 990, then it should at least consider

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278. See *supra* Part III.B.5.

279. Since 1974 the number of charitable organizations has doubled and yet the size of the IRS staff has increased by only three percent. PANEL ON THE NONPROFIT SECTOR, *supra* note 11, at 13.

280. See FORM 990, *supra* note 9, at pt. IV.

281. See *id.*

282. Fishman, *supra* note 13, at 589–90.

simply allowing for a tiered system of reporting. In light of the limited resources of the IRS, it would be more efficient for the IRS to piggyback on reporting schemes required under other statutes that cover substantially the same information. For example, most hospitals have compliance programs that have developed compliance policies and procedures including standards of conduct.<sup>283</sup> Board oversight via a compliance committee along with internal auditing and monitoring ensures that hospitals will not submit incorrect claims to federal health care program payers.<sup>284</sup> The results of these audits, however, are contained within an overall review of the compliance program—the hospital’s annual compliance report.<sup>285</sup> The report also contains a summary of the governance structure and is submitted and approved by the compliance committee of the hospital.<sup>286</sup> Given the existence of a compliance program at most hospitals, it would be more efficient for the IRS to tailor Part VI to hospitals by adding a threshold question as to whether the hospital has a compliance committee with an annual report. If so, the hospital should have the choice to submit the compliance committee report in lieu of Part VI of the Form 990 and its accompanying Schedule O.

The advantage to this approach is that it would curb duplication of resources and material and capitalize on material already distilled by compliance programs for the purpose of other statutory reporting requirements. Thus, it would be more efficient. The main disadvantage is that each of the compliance reports submitted would differ in quality. Finding the information and ensuring all the governance measures are covered in each report would prove time consuming. The IRS will still have to sort through the reports and decipher what constitutes good governance. Given the tight staffing, this might add more work for the IRS. Specific OIG guidance on compliance program requirements, however, coupled with certification of compliance professionals through organizations like the Health Care Compliance Association illustrates movement toward uniformity in standards for compliance programs.<sup>287</sup> Moreover, Part VI with Schedule O is not much shorter. In addition, the IRS has no apparent criteria for determining what answers should be considered indicative of good governance. Thus, evaluation of compliance reports in lieu of Part VI will not be any less efficient for IRS review. Given that the IRS has not indicated the specific governance measures that are tied to tax compliance, the mere existence of a compliance program that monitors governance should be enough to meet the

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283. See *supra* Part III.B.5.

284. See Compliance Program Guidance for Hospitals, 63 Fed. Reg. 8987, 8996 (Feb. 23, 1998).

285. OFFICE OF INSPECTOR GEN. & AM. HEALTH LAWYERS ASS’N, CORPORATE RESPONSIBILITY AND CORPORATE COMPLIANCE: A RESOURCE FOR HEALTH CARE BOARDS OF DIRECTORS 5 (2003), <http://oig.hhs.gov/fraud/docs/complianceguidance/040203CorpRespRseeGuide.pdf>.

286. *Id.* at 4.

287. See *Corporate Compliance for the Health Care Professional*, HEALTH CARE COMPLIANCE ASS’N, <http://hcca-info.org/Content/NavigationMenu/ComplianceResources/ComplianceBasics/default.htm> (last visited Nov. 13, 2010).

IRS's governance initiative goal. Therefore, the submission of a hospital board-approved compliance report should serve as a proxy for the Part VI disclosure.

Second, this approach would weed out the hospitals that have not implemented either a corporate compliance program or a comprehensive program from those that have. For those hospitals that have no compliance report, Part VI of the Form 990 could serve as their annual compliance report, because such hospitals would have to fill out the entire Part VI with the accompanying Schedule. Ultimately, there would be very few hospitals in this position, given that hospitals that do not have a formal compliance program face greater penalties than just a threat of IRS audit and public scrutiny.<sup>288</sup>

Of course, nonprofit hospitals may find this solution disconcerting since their compliance reports would be a matter of public record on the Form 990. There is precedent to suggest that a possible solution is to ensure that these reports are publicly unavailable.<sup>289</sup> If the IRS were willing to make assurances of nonpublic disclosure, such compliance reports would serve as a good governance measure and do away with the need to answer the Part VI questions.

### C. *Wait for Clarity from Congress or the Courts*

If corporate governance is really tied to tax compliance, Congress can always condition tax-exemption upon the showing of a “good” governance structure. The inherent issue is defining what “good” governance means for the purpose of tax-exemption. Again, without further studies on the correlation between good governance in relation to tax compliance, such action from Congress is unlikely. Furthermore, the universe of nonprofits would shrink considerably and skew toward larger nonprofits—because larger nonprofits are more likely to have the corporate structure and resources to institute good governance structures.<sup>290</sup> If the rationale behind tax-exemption is to allow for tax-exemption to those organizations that are gap-filling organizations, then many of the smaller, donation-based nonprofits would be cut from tax-exemption if the IRS monitored governance using a one-size-fits-all approach.<sup>291</sup> Thus, it is unlikely that Congress will enact any governance related requirements for tax-exemption.

Alternatively, the courts might have the opportunity to clarify the role of the IRS and its authority to require governance disclosures if a

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288. See *supra* Part III.B.

289. Fishman, *supra* note 13, at 590 (stating that there is precedent for the IRS to redact certain information from public scrutiny, such as names of donors that are included on the Form 990 but that are not published).

290. PANEL ON THE NONPROFIT SECTOR, *supra* note 11, at 14–15.

291. *Id.* at 4. “Demonstrations of compliance with high standards of ethical conduct should be commensurate with the size, scale, and resources of the organization.” *Id.*

nonprofit hospital decides to legally challenge the IRS's authority.<sup>292</sup> The success of such litigation would be uncertain at best, and certainly expensive.<sup>293</sup> Thus, it is unlikely that hospitals will get clarity from the courts anytime soon.

Of the three options, suspension of Part VI would make the most practical sense given that more data is needed to provide clarity and cogency to the assertion that good governance bears some relationship to tax compliance. It is unlikely that the IRS is going to suspend these disclosure requirements, however, because it will probably have the data it needs from this first set of filings. The second option may be more appealing to the IRS. By permitting nonprofit hospitals to submit their compliance reports while assuring nonpublic disclosure in lieu of completing Part VI of the Form 990, the IRS can evaluate whether governance is a priority for those hospitals. Only hospitals that do not require formal compliance reporting will bear the administrative burden of collecting and cataloguing all the information as required under the current form.

## V. CONCLUSION

Against the backdrop of high-profile corporate scandals, monitoring corporate governance of hospitals and health care organizations has become not only desirable but necessary. Many state statutes and health care statutes address measures to protect against corporate wrongdoing. The IRS, however, has taken it upon itself to monitor corporate governance based upon an unsupported assumption that good governance bears some relationship to tax compliance. Furthermore, the IRS admits that it has no statutory authority to monitor governance. Finally, any justification of filling a regulatory gap does not apply in the context of nonprofit hospitals, because nonprofit hospitals are already compelled through other statutory schemes to have good governance structures. Until there is better data, the IRS should suspend the governance disclosure requirements under the Form 990. To be sure, given the IRS's current focus on good governance in response to the national focus on fraud and abuse, it is unlikely that the IRS will retreat from its goal. Thus, the IRS should be mindful of its own limited resources and capitalize on the existing governance reporting schemes required under statutes and allow nonprofit hospitals to submit their annual compliance reports free from public reporting in lieu of requiring disclosure under Part VI of the Form 990. In the end, the IRS should focus its energies on ensuring that organizations are fulfilling their charitable mission, not diverting resources away from it.

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<sup>292</sup>. Fishman, *supra* note 13, at 589–90. Professor Fishman, however, suggests that given the IRS's broad authority to request information in order to determine tax liability, it is unlikely that litigation to determine IRS authority may be futile. *Id.* at 590 n.166.

<sup>293</sup>. *Id.* at 590.

