TAX-EXEMPT HOSPITAL INDUSTRY
COMPLIANCE WITH COMMUNITY BENEFIT
AND COMPENSATION PRACTICES IS BEING
STUDIED, BUT FURTHER ANALYSES ARE
NEEDED TO ADDRESS ANY NONCOMPLIANCE

Issued on March 29, 2007

Highlights

Highlights of Report Number: 2007-10-061 to the
Internal Revenue Service Commissioner for the
Tax Exempt and Government Entities Division.

IMPACT ON TAXPAYERS

According to the Congressional Budget Office, nonprofit
hospitals received more than $6 billion in Federal tax
exemptions in 2002. The Exempt Organizations (EO)
function of the Tax Exempt and Government Entities
Division is responsible for ensuring organizations
exempt from Federal income tax comply with applicable
Internal Revenue Code sections and regulations.

EO function management is conducting a project to
assess how tax-exempt hospitals believe they provide a
community benefit in exchange for tax-favored status.
Management stated that project information may assist
them in differentiating tax-exempt hospitals from
for-profit hospitals and could result in regulatory
changes or a Revenue Ruling.

WHY TIGTA DID THE AUDIT

The more recent of the 2 most significant Revenue
Rulings related to tax-exempt hospitals was issued by
the Internal Revenue Service (IRS) almost 40 years
ago. The Government Accountability Office has stated
there is often little to no difference between for-profit and
tax-exempt hospitals when it comes to charity care and
community benefits provided. The IRS Commissioner
has commented that some tax-exempt health care
providers may not differ markedly from for-profit
providers in their operations, their attention to the
benefit of the community, or their levels of charity care.
Also, both the Senate Finance Committee and the House
Ways and Means Committee have voiced concerns
related to whether taxpayers receive a public benefit in
exchange for the billions of dollars of tax subsidies
received by tax-exempt hospitals each year. The
objective of our audit was to determine the purpose and
scope of the EO function’s tax-exempt hospital
compliance project and how management intends to
use the results to address potential noncompliance in
the industry.

WHAT TIGTA FOUND

As part of this compliance project, the IRS sent a
9-page questionnaire to 544 tax-exempt hospitals
soliciting information on compensation practices and
the community benefit standard. At the time of our
fieldwork, the EO function was still analyzing the
questionnaire responses and identifying potential
examinations of organizations based on the manner
in which executive compensation was determined. If
information gathered in the compliance project shows
hospitals are performing only minimum actions in
exchange for exemption from paying taxes, the
function will consider initiating examinations in this
area. Management stated that project information
also may assist them in differentiating tax-exempt
hospitals from for-profit hospitals and in determining
whether legislative action would improve the IRS’
ability to administer tax laws in the tax-exempt
hospital industry. Additionally, the compliance project
will gather information about the practices and
procedures tax-exempt organizations use to assign
compensation to executives and other outsiders and
enhance compliance in this area, if necessary. When
the analyses are completed, management will prepare
two reports (interim and final) summarizing the
results of the analyses of the questionnaires and
related examinations.

WHAT TIGTA RECOMMENDED

TIGTA recommended the Director, EO, ensure the
interim report includes an assessment of how tax-exempt
hospitals are providing a community benefit (in exchange
for exemption from paying taxes), as well as any planned
actions management determines are necessary to
address the community benefit standard. In addition,
management should develop plans to prepare a
separate final report on community benefit if all
necessary actions will not be completed for inclusion in
the final compliance report scheduled for issuance in
September 2008.

In their response to the report, IRS officials stated they
generally agreed with the recommendation. Specifically,
IRS officials stated the interim report will contain the
above detailed community benefit information pertaining
to tax-exempt hospitals. IRS officials also stated it is too
early in the process to determine if a supplemental
report on community benefit is needed or what the
precise next steps will be, but agreed to issue such a
report if they determine it is necessary.

READ THE FULL REPORT

To view the report, including the scope, methodology,
and full IRS response, go to