TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Vague and Outdated Guidance Creates Challenges for Tax-Exempt Hospital Oversight

May 15, 2025

Report Number: 2025-100-019

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HIGHLIGHTS: Vague and Outdated Guidance Creates Challenges for Tax-Exempt Hospital Oversight

Final Audit Report issued on May 15, 2025 **Report Number 2025-100-019**

Why TIGTA Did This Audit

In August 2023, four U.S. Senators requested that we evaluate concerns surrounding tax-exempt hospitals meeting their tax-exempt requirements.

This audit was initiated to assess the IRS's oversight of tax-exempt hospitals to ensure that they are compliant with providing community benefits and other requirements.

Impact on Tax Administration

To obtain and maintain status as a tax-exempt organization, a hospital must satisfy three sets of requirements: organizational and operational requirements, the community benefit standard, and Patient Protection and Affordable Care Act (PPACA) requirements.

The PPACA requires the IRS to review the community benefit activities of each tax-exempt hospital at least once every three years. The IRS created a group to conduct compliance reviews, referred to as Community Benefit Activity Reviews (CBAR), for the tax-exempt hospital organizations to which the PPACA requirements apply.

PPACA Requirements for Tax-Exempt Hospitals

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

What TIGTA Found

Revenue Ruling 69-545 outlines the community benefit standard applicable to tax-exempt hospitals and provides examples of six factors that may demonstrate a tax-exempt hospital's community benefit. However, the vague definition of community benefit makes it difficult for both hospitals and the IRS to determine if hospitals are providing sufficient community benefits to justify their tax exemption. IRS management stated that the community benefit standard provides flexibility, but the lack of clarity makes oversight challenging.

Additional factors, such as whether a hospital provides financial assistance to those unable to pay, are relevant in determining whether a hospital is providing a benefit to the community. However, the Internal Revenue Code does not specify what eligibility criteria or level of assistance provided is adequate for a financial assistance policy to meet the statutory requirements. Vague or unclear eligibility criteria could potentially cause confusion for patients and inconsistent application of the requirements across hospitals.

In April 2022, the IRS revised the scope of its CBARs to focus solely on the PPACA's statutorily required community benefit standard. As a result, examination referrals dropped 98 percent from Fiscal Years 2022 through 2024. To address the reduced oversight the streamlined CBAR process provides, the IRS implemented a compliance strategy that is intended to identify potential noncompliance by tax-exempt hospitals.

Using the IRS's data, we performed an analysis of available filing information to identify tax-exempt hospitals potentially subject to the CBARs and compared it to the IRS's population of tax-exempt hospitals. We identified 142 missing tax-exempt hospitals that the IRS should have included in its population but were not identified or reviewed. In addition, the IRS excluded 14 governmental unit and 13 church-affiliated hospitals from the population for other reasons.

What TIGTA Recommended

We made four recommendations including that the Commissioner, Tax Exempt and Government Entities Division, share this report and recommendations with the Department of the Treasury Office of Tax Policy to consider a legislative proposal to amend Internal Revenue Code § 501 and any other required provisions of law to define the community benefit standard and establish baseline criteria for tax-exempt hospital financial assistance policy eligibility. We also recommended that the IRS update guidance to include reasons for excluding dual status governmental unit and certain church-affiliated hospitals from the CBARs because they are statutorily mandated.

The IRS agreed with all four recommendations and plans to implement corrective actions.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20024

May 15, 2025

MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

FROM: Diana M. Tengesdal
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Vague and Outdated Guidance Creates Challenges for Tax-Exempt Hospital Oversight (Audit No.: 2024100017)

This report presents the results of our review to assess the Internal Revenue Service's oversight of tax-exempt hospitals to ensure that they are compliant with providing community benefits and other requirements. This review is part of our Fiscal Year 2025 Annual Audit Plan and addresses the major management and performance challenge of *Tax Compliance and Enforcement*.

Management's complete response to the draft report is included as Appendix III. If you have any questions, please contact me or Bryce Kisler, Assistant Inspector General for Audit (Taxpayer Services and Operational Support).

Table of Contents

Background

The law defines a hospital organization as an entity that operates a facility which is required by a state to be licensed, registered, or similarly recognized as a hospital. To obtain and maintain status as a tax-exempt organization, a hospital must satisfy three sets of requirements:

- **Organizational and operational requirements** – Internal Revenue Code (I.R.C.) § 501(c)(3) requires an organization to be both organized and operated exclusively for one or more exempt purposes, such as religious, charitable, scientific, literary, or educational, to qualify for tax-exempt status. To meet the organizational test, the organization's articles of organization must limit its purposes to one or more exempt purposes and must not empower the organization to engage, other than as an insubstantial part of its activities, in activities not in furtherance of its exempt purposes.[1] To meet the operational test, an organization will be regarded as operated exclusively for one or more exempt purposes if it engages primarily in activities which accomplish one or more of such exempt purposes.[2] If the organization does not satisfy both the organizational and operational requirements, it is not exempt.[3]
- **Community benefit standard** – In the context of operating a tax-exempt hospital, it is not enough for a hospital to state that it operates exclusively to promote health. Like all I.R.C. § 501(c)(3) organizations, hospitals must be operated to benefit the public, rather than private interests. For a hospital, this requirement means that a hospital must demonstrate that it operates to promote the health of a class of persons that is broad enough to benefit the community. This is known as the community benefit standard. In Calendar Year 1969, the Internal Revenue Service (IRS) issued Revenue Ruling 69-545 outlining six factors (described later in Figure 2) that may demonstrate a tax-exempt hospital's community benefit.[4] In addition to those six factors, the Revenue Ruling states that the IRS will weigh all other facts and circumstances. The IRS uses these factors to evaluate whether a hospital is meeting the community benefit standard by serving its community as a whole and providing a broad public benefit, rather than benefiting private individuals or parties.
- **Patient Protection and Affordable Care Act (PPACA) requirements**[5] – The PPACA, enacted in March 2010, added I.R.C. § 501(r), which imposes four requirements that hospitals must meet to qualify as a tax-exempt organization. Figure 1 explains the PPACA requirements in further detail.

[1] 26 C.F.R. § 1.501(c)(3)-1(b)(1)(i).

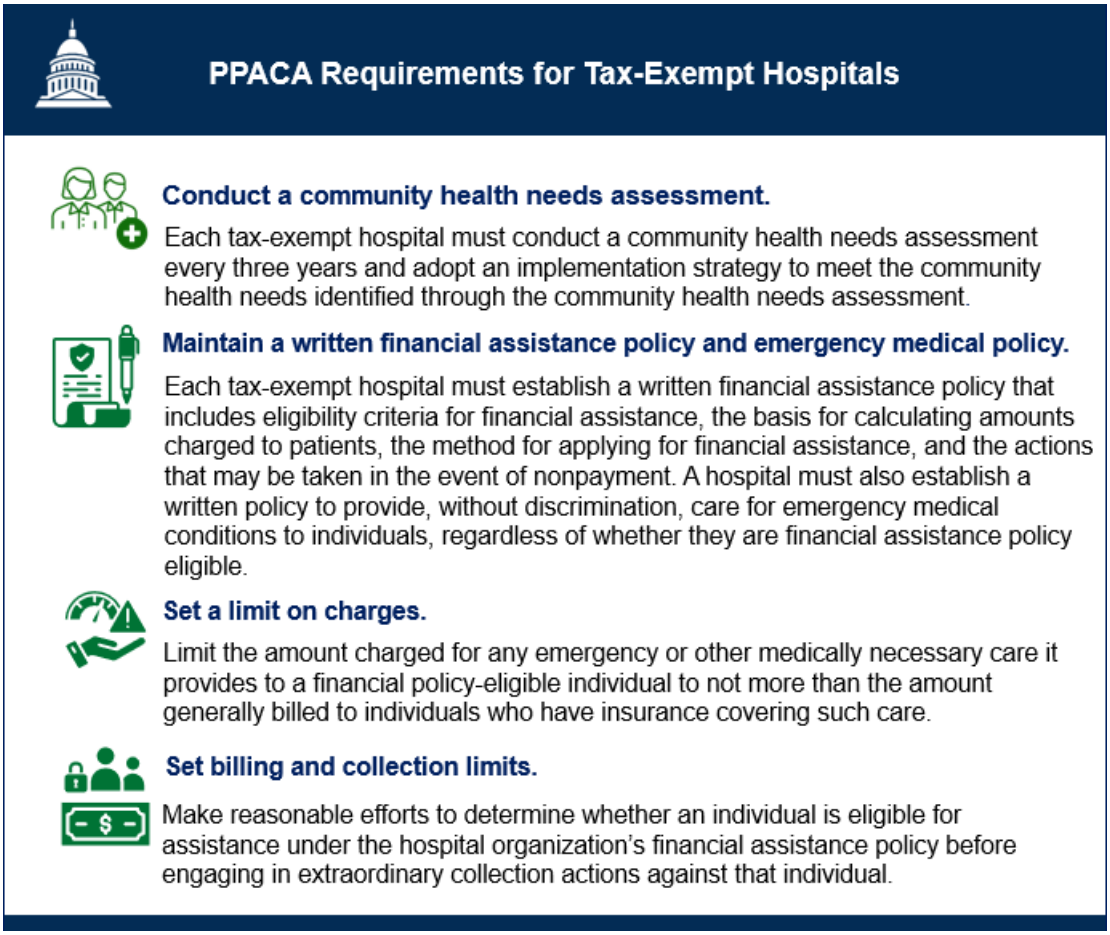
[2] 26 C.F.R. § 1.501(c)(3)-1(c)(1).

[3] 26 C.F.R. § 1.501(c)(3)-1(a)(1).

[4] Rev. Rul. 69-545, 1969-2 C.B. 117.

[5] Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended in scattered sections of 26 and 42 U.S.C.), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029.

Figure 1: Tax-Exempt Hospital PPACA Requirements



Source: I.R.C. § 501(r)(3) through (r)(6).

In Calendar Year 2022, 2,987 (49 percent) of 6,120 hospitals nationwide were nongovernment, nonprofit hospitals.[6] According to an analysis of Medicare cost reports, 2,927 nonprofit hospitals received $37.4 billion in tax benefits in Calendar Year 2021.[7] However, in Calendar Year 2023, the Lown Institute reported that, "…out of 1,773 nonprofit hospitals [it] evaluated, 77 percent spent less on charity care and community investment than the estimated value of their tax breaks — what we [the Lown Institute] call a 'fair share' deficit."[8]

In August 2023, four U.S. Senators requested that we evaluate concerns surrounding the IRS's oversight of tax-exempt hospitals in ensuring their compliance with tax-exempt requirements.[9] Specifically, we were requested to:

[6] Health Forum LLC, *Fast Facts on U.S. Hospitals, 2024* (January 2024), available at https://www.aha.org/system/files/media/file/2024/01/fast-facts-on-us-hospitals-2024-20240112.pdf.

[7] Journal of the American Medical Association, *Estimation of Tax Benefit of U.S. Nonprofit Hospitals* (September 2024), available at https://jamanetwork.com/journals/jama/article-abstract/2824116. Nonprofit hospitals' total tax benefit equals the sum of federal and state income tax, sales tax, property tax, the fair market value of charitable contributions from donors, savings from tax exemptions on issued bonds, and federal unemployment tax.

[8] The Lown Institute is a tax-exempt organization that describes itself as a nonpartisan think tank advocating ideas for health care. Lown Institute Hospitals Index, *Fair Share Spending, How much are hospitals giving back to their communities?*, available at https://lownhospitalsindex.org/2023-fair-share-spending/ (last visited Dec. 6, 2024).

[9] *Letters on Nonprofit Hospitals,* available at https://www.warren.senate.gov/imo/media/doc/Letters%20on%20Nonprofit%20Hospitals.pdf.

1. Determine whether the IRS is effectively ensuring that nonprofit hospitals comply with tax-exempt requirements and are providing sufficient community benefit.
2. Evaluate the IRS's process for identifying hospitals at risk for noncompliance with the community benefit standard and its resolution process to ensure future compliance.
3. Assess the effectiveness of the IRS's controls to detect and prevent hospitals underinvestment in improving community health.
4. Review and assess the effectiveness of the community benefit standard, as outlined in Revenue Ruling 69-545, in its ability to determine whether a hospital is organized and operated for the charitable purpose of promoting health.
5. Evaluate the adjustments the IRS made to Form 990, *Return of Organization Exempt from Income Tax,* Schedule H (Form 990), *Hospitals*, instructions for transparency, consistency, and comprehensiveness in reporting.
6. Evaluate the existing standards for financial assistance policies (FAP) and practices that reduce unnecessary medical debt from patients who qualify for free or discounted care.
7. Review the effectiveness of the IRS's efforts to ensure that hospitals make reasonable efforts to determine whether individuals are eligible for financial assistance before initiating extraordinary collection actions.
8. Identify the pervasiveness of nonprofit hospitals billing patients with gross charges.
9. Identify the challenges the IRS faces in its ability to oversee tax-exempt hospitals.

IRS oversight of tax-exempt hospitals

The Tax Exempt and Government Entities (TE/GE) Division's Exempt Organizations function conducts examinations of hospitals, while its Compliance, Planning, and Classification (CP&C) function oversees the examination case selection, quality case reviews, PPACA hospital reviews, and case closings. The PPACA requires the IRS to review the community benefit activities of each tax-exempt hospital at least once every three years. As a result of this mandate, the TE/GE Division created a group in its CP&C function to conduct compliance reviews, referred to as Community Benefit Activity Reviews (CBAR), for the hospital organizations to which PPACA requirements apply.

CP&C revenue agents complete CBAR surveys, which consist of 17 questions related to how hospitals comply with the community benefit standard. The CBARs include checking for FAP requirements because whether a hospital provides financial assistance to those unable to pay is relevant to determine if the hospital is providing a benefit to the community. CP&C revenue agents determine each hospital's compliance by using information reported on Schedule H (Form 990) as well as information from public sources, such as Medicare, and state and hospital websites. Hospitals are not contacted during a CBAR. The CP&C function completes the CBARs for approximately 3,000 tax-exempt hospitals on a rolling 3-year basis.

If the CP&C revenue agent cannot verify a hospital's compliance with the community benefit or FAP requirements, the hospital is referred for a compliance check or examination.[10] Compliance checks are conducted by tax examiners in the TE/GE Division's Tax-Exempt Compliance Unit (TECU). CP&C revenue agents recommend a compliance check when the CBAR only identifies issues related to a hospital's FAP. If the TECU tax examiner determines that the hospital is following FAP requirements, they close the case. In Fiscal Year (FY) 2023, the TECU completed 64 compliance checks from CBAR referrals, and a majority (78 percent) resulted in an agreed corrective action (*e.g.*, the hospital agreed to correct their noncompliance with the FAP requirements, such as by including eligibility criteria). In FY 2024, 75 compliance checks were completed based on CBAR referrals, and 85 percent were closed resulting in an agreed corrective action.

If the TECU tax examiner cannot determine compliance with FAP requirements, they refer the case for examination. Examinations are conducted by revenue agents in the Exempt Organizations function's Examination unit. Revenue agents follow normal examination procedures and consider the issues identified during the CBAR or compliance check as well as any other issues identified during examination planning. Cases are generally resolved as a no-change, a change due to correction of operations, or a tax assessment (*e.g.*, excise, income).[11] Rarely, cases are resolved by revoking an organization's tax-exempt status. In FY 2023, the Examination unit completed 22 examinations of organizations referred after a CBAR, and more than half resulted in a no-change. In FY 2024, nine examinations were completed based on CBAR referrals, and six of them were closed as a no-change.

Results of Review

Guidance for the Community Benefit Standard Is Vague

Revenue Ruling 69-545 does not provide clear criteria for determining community benefit

According to the IRS, I.R.C. § 501(c)(3) provides exempt status for organizations that, in general, are religious, charitable, scientific, literary, or educational. The promotion of health is not a specifically enumerated purpose within I.R.C. § 501(c)(3). However, it is one of the purposes in the general law of charity that is deemed to be beneficial to the community as a whole. Therefore, to qualify as an organization described in I.R.C. § 501(c)(3), a hospital must:

- Demonstrate that it provides benefits to a class of persons that is broad enough to benefit the community.

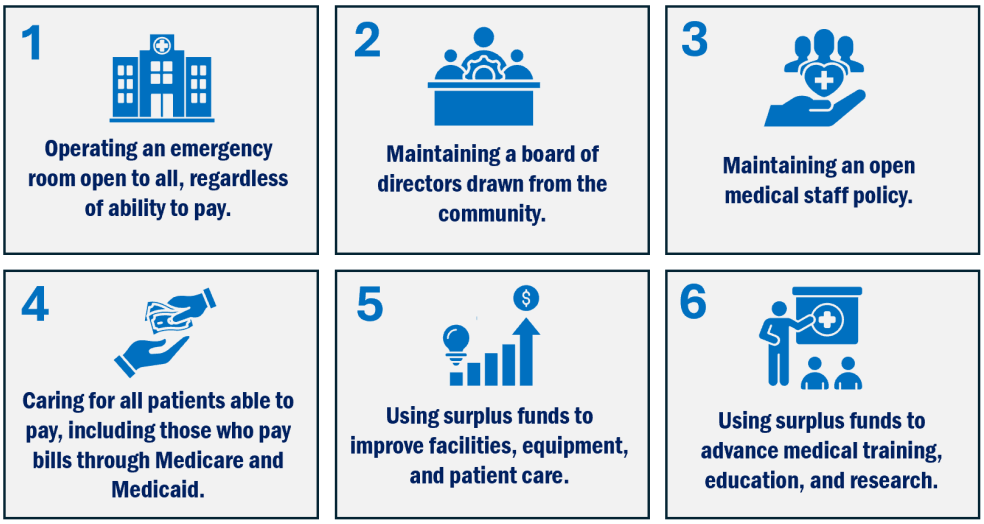
[10] The IRS conducts a compliance check to determine whether an organization is adhering to record keeping and information reporting requirements and whether an organization's activities are consistent with its stated tax-exempt purpose. It does not directly relate to determining any tax liability for any period or the verification that a response on the return coincides with the books and records of the organization. An examination consists of the systematic inspection of the books and records of an organization for determining the correct tax liability.

[11] A change due to a correction of operations occurs when the tax-exempt organization took corrective actions during the examination that result in a correction of operational or compliance issues.

- Operate to serve a public rather than a private interest.

Revenue Ruling 69-545 outlines the community benefit standard applicable to tax-exempt hospitals. It provides examples of six factors that demonstrate community benefit by comparing two hypothetical hospitals to illustrate how one satisfies the standard, and one does not. Figure 2 describes the six factors listed in Revenue Ruling 69-545 that demonstrate community benefit.

Figure 2: Factors That Demonstrate Community Benefit



Source: IRS.gov.[12]

Although no single factor is determinative in considering whether a tax-exempt hospital meets the community benefit standard, the IRS weighs all the relevant facts and circumstances in evaluating these factors. Per IRS management, additional factors, such as whether a hospital provides financial assistance to those unable to pay, are relevant in determining whether the hospital is providing a benefit to the community. However, there are no clear criteria to weigh these various additional factors against other criteria when determining a hospital's compliance with the community benefit standard. IRS management also stated that the Department of the Treasury's Office of Tax Policy indicated that there is no universal approach because each hospital's community needs are unique.

The community benefit standard, as outlined in Revenue Ruling 69-545, lacks clarity and specificity. It does not explicitly define community benefit or include clear criteria for what services and activities are sufficient to meet the community benefit standard. In September 2020, the Government Accountability Office (GAO) reported that, "the standard only provides examples and does not establish requirements or expectations of services and activities that can demonstrate a hospital's community benefits."[13] The GAO recommended that Congress consider specifying in the I.R.C. what services and activities it considers to be a sufficient community benefit.

[12] An open medical staff policy does not restrict medical staff privileges to a limited group of physicians. A hospital that restricts its medical staff privileges to a limited group of physicians is likely to be operating for the private benefit of the staff physicians rather than for the public interest.

[13] GAO, GAO-20-679, *Tax Administration: Opportunities Exist to Improve Oversight of Hospitals' Tax-Exempt Status* (September 2020).

We spoke with representatives from two nationally recognized hospital associations, both of which support the flexibility of the current community benefit standard. However, industry stakeholders and industry reports have expressed concerns about the lack of explicit criteria for community benefits.

- Industry stakeholders and state regulators we interviewed agreed that the revenue ruling contains outdated and irrelevant standards. For example, having an open medical staff policy and participating in Medicare and Medicaid are now common features of tax-exempt and taxable hospitals, rather than distinguishing factors.
- A scientific research organization published an article that discussed the compliance challenges associated with the limitations of the community benefit standard. It suggested that the IRS could adopt quantitative standards for the amount and composition of a hospital's community benefit expenditures required in exchange for tax exemption. However, it also cautioned that explicit quantitative standards represent a one-size-fits-all approach. There is a risk that hospitals would focus their efforts on the activities that count for the purpose of tax exemption rather than the ones that are most needed in the community.[14]

IRS management stated that the community benefit standard has advantages, such as flexibility, but also has disadvantages, such as difficulty identifying noncompliance, because the tax law does not specify any activity or level of charity care. IRS management agreed that the lack of clarity makes oversight challenging. However, they maintain that because the law has not changed, the revenue ruling is sufficient and that whether, and how, the law should be changed is a policy consideration that they would defer to the Department of the Treasury and Congress.

However, Revenue Ruling 69-545 is more than 55 years old and the health care industry has changed significantly. For example, closures and mergers have changed the hospital industry and management oversight, which may affect community benefit policies. Further, some of the community benefits included in the guidance may be irrelevant. For example, operating emergency rooms that provide emergency treatment to all, regardless of ability to pay, is now a common feature of hospitals.

The vague definition of community benefit makes it difficult for both hospitals and the IRS to determine if hospitals are providing sufficient community benefits to justify their tax exemption. We agree with the GAO's determination that Congress should consider specifying in the I.R.C. what services and activities it considers sufficient community benefit to improve the IRS's ability to oversee tax-exempt hospitals. This action would also enable the IRS to issue updated regulations that provide more specific guidance that would not only help the industry comply with the community benefit standard but also assist the IRS during its statutorily required reviews of community benefit activities.

Recommendation 1: The Commissioner, TE/GE Division, should share this report and recommendation with the Department of the Treasury Office of Tax Policy to consider a legislative proposal to amend I.R.C. § 501 and any other required provisions of law to clearly

[14] Rubin, Daniel B., *et al. Tax-Exempt Hospitals and Community Benefit: New Directions in Policy and Practice,* available at https://doi.org/10.1146/annurev-publhealth-031914-122357 (March 2015). Annual Reviews is an I.R.C. § 501(c)(3) tax-exempt organization that describes itself as dedicated to synthesizing and integrating knowledge for the progress of science and the benefit of society.

and specifically define community benefit, including the level of services and activities that are sufficient to meet the community benefit standard in the current industry.

> **Management's Response:** The IRS agreed with the recommendation and will share this report and recommendation with the Department of the Treasury Office of Tax Policy to consider a legislative proposal to amend I.R.C. § 501 and any other required provisions of law to clearly and specifically define community benefit, including the level of services and activities that are sufficient to meet the community benefit standard in the current industry.

FAP guidelines are not adequately defined

Although maintaining a FAP is not a requirement for community benefit, the IRS reviews the FAPs as part of its CBAR surveys because financial assistance is one of the factors the IRS considers when determining whether a hospital's community benefits are sufficient to support qualification for tax exemption. During the CBARs, the IRS determines: 1) if a FAP is in place and available, and 2) that it includes eligibility criteria along with the method for determining the amount of assistance provided.

I.R.C. § 501(r)(4) FAP Requirements

- Eligibility criteria for financial assistance, and whether such assistance includes free or discounted care.
- The basis for calculating amounts charged to patients.
- The method for applying for financial assistance.
- The actions an organization may take in the event of nonpayment, including collection actions and reporting to the credit agencies for an organization that does not have a separate billing and collection policy.
- Measures to widely publicize the policy within the community to be served by the organization.

I.R.C. § 501(r)(4)(A) requires that each tax-exempt hospital have a written FAP with certain information. However, the I.R.C. does not specify what eligibility criteria or level of assistance provided is adequate for a FAP to meet PPACA statutory requirements.[15] Instead, the statute requires only that each tax-exempt hospital have a written FAP that includes eligibility criteria for an individual to receive financial assistance and the method the hospital uses to determine amounts charged.

Industry stakeholders have raised concerns about the lack of specific criteria hospitals have to determine financial assistance eligibility and stated that the FAP requirements should be strengthened. For example, in Calendar Year 2019, KFF Health News reported that 45 percent of nonprofit hospitals routinely sent bills to patients whose incomes were low enough to qualify for financial assistance. They estimated that hospitals billed $2.7 billion to patients who probably would have qualified for financial assistance under the hospitals' own policies if the patients had filled out FAP applications.[16] Stakeholders have suggested that the IRS could mandate the use of

[15] I.R.C. § 501(r)4.

[16] KFF Health News, *Patients Eligible For Charity Care Instead Get Big Bills* (October 2019), available at https://kffhealthnews.org/news/patients-eligible-for-charity-care-instead-get-big-bills/. According to its website, KFF [formerly known as the Kaiser Family Foundation or the Henry J. Kaiser Family Foundation] Health News is a national newsroom that produces in-depth journalism about health issues and is one of the core operating programs at KFF — the independent source for health policy research, polling, and journalism.

Federal Poverty Levels as a baseline criterion for FAP eligibility, as is done in some states, such as California, New York, and Oregon. For example, federal requirements could be revised to require that hospitals provide full charity care to patients with incomes below 200 percent of the Federal Poverty Level and sliding scale discounts for those between 200 and 400 percent. In addition, Form W-2, *Wage and Tax Statement*, could be used to verify a patient's income.

Vague or unclear eligibility criteria could potentially cause confusion for patients and inconsistent application of the requirements across hospitals. The eligibility criteria should be clear, specific, and easily understandable by an average patient. More specific criteria would also enable the IRS to better evaluate whether the eligibility criteria or minimum levels of assistance are sufficient when conducting the CBARs, compliance checks, or examinations. The I.R.C. stipulates that the Secretary of the Treasury could issue regulations and guidance as necessary to carry out the provisions of I.R.C. § 501(r) pertaining to tax-exempt hospitals, including guidance related to what constitutes reasonable efforts to determine the eligibility of a patient under a FAP.[17] Additional guidance would create a more consistent approach across hospitals, ensure a minimum level of assistance for low-income patients, and allow the IRS to determine if eligibility criteria and the level of assistance being provided are adequate.

Recommendation 2: The Commissioner, TE/GE Division, should share this report and recommendation with the Department of the Treasury Office of Tax Policy to consider a legislative proposal to amend I.R.C. § 501 and any other required provisions of law to establish baseline criteria for tax-exempt hospital FAP eligibility.

Management's Response: The IRS agreed with the recommendation and will share this report and recommendation with the Department of the Treasury Office of Tax Policy to consider a legislative proposal to amend I.R.C. § 501 and any other required provisions of law to establish baseline criteria for tax-exempt hospital FAP eligibility.

Schedule H (Form 990) reporting lacks clear and easily accessible information to assess community benefits

Certain tax-exempt organizations, including hospitals, are required to file Form 990 annually.[18] In addition, an organization that operates one or more hospital facilities must complete and attach Schedule H (Form 990) to its Form 990, which includes six parts. Schedule H (Form 990) provides information to the IRS and the public on a tax-exempt hospital's policies and activities, including community benefits. In September 2020, the GAO reported that:

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

[17] I.R.C. § 501(r)(7).

[18] 26 U.S.C. § 6033.

[Form 990], solicits information inconsistently, resulting in a lack of clarity about the community benefits hospitals provide.[19]

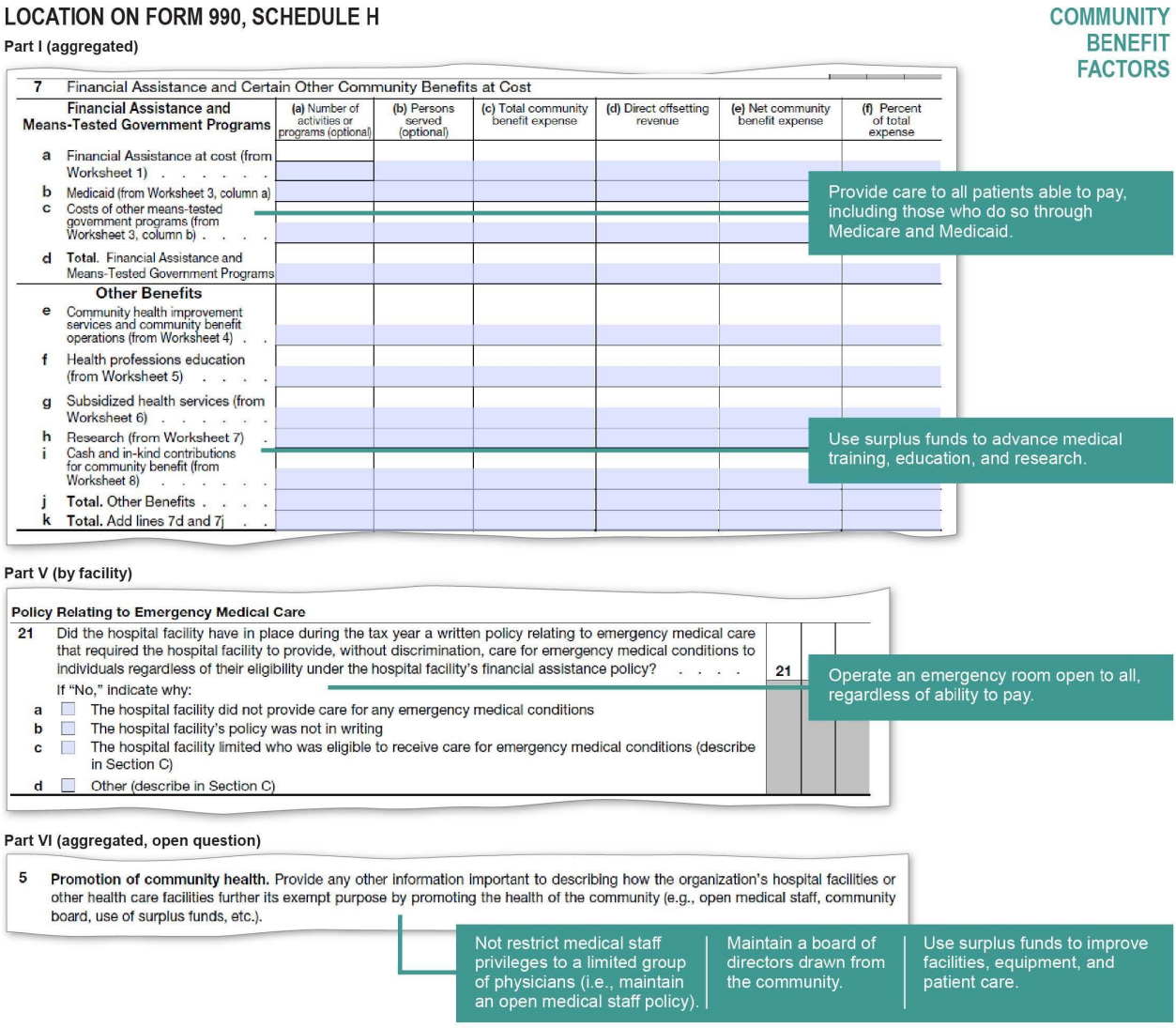
Schedule H (Form 990) is intended to reflect reporting on each of the six community benefit factors outlined in Revenue Ruling 69-545. However, the line items to address these factors are scattered across different parts of the schedule. Further, some of the factors are meant to be addressed by identifying specific costs associated with certain activities, while other factors are addressed in a narrative format. The narrative responses, which address three of the community benefit factors, are not part of the quantitative, machine-readable files that the IRS releases to the public, which makes the available responses inconsistent and difficult to obtain. Figure 3 shows the GAO's analysis of the locations where the community benefit factors are reported on Schedule H (Form 990).

The Six Parts of Schedule H (Form 990)

- ✓ Part I, Financial Assistance and Certain Other Community Benefits at Cost
- ✓ Part II, Community Building Activities
- ✓ Part III, Bad Debt, Medicare, and Collection Practices
- ✓ Part IV, Management Companies and Joint Ventures
- ✓ Part V, Facility Information
- ✓ Part VI, Supplemental Information

[19] GAO, GAO-20-679, *Tax Administration: Opportunities Exist to Improve Oversight of Hospitals' Tax-Exempt Status* (September 2020).

Figure 3: Location of Community Benefit Factors on Schedule H (Form 990)



Source: GAO, GAO-20-679, Tax Administration: Opportunities Exist to Improve Oversight of Hospitals' Tax-Exempt Status (September 2020).

In September 2020, the GAO recommended that the IRS update Form 990, including Schedule H (Form 990) and instructions, where appropriate, to ensure that information describing the community benefits a hospital provides is clear and easily identifiable. In response to this recommendation, the IRS made minor changes to the Schedule H (Form 990) instructions. However, the IRS did not make any changes to Schedule H (Form 990), stating that the schedule appropriately provides flexibility to report information on all relevant facts and circumstances regarding community benefit. According to the GAO, the changes the IRS made did not fully address its original recommendation.[20]

Some stakeholders also agree that the community benefit information collected by the IRS is challenging to access, review, and analyze. The narrative text limits opportunities for researchers and stakeholders, including state and local governments, to evaluate community benefit information, share best practices, and hold hospitals accountable. Revising Schedule H

[20] GAO, GAO-23-106777, *Tax Administration: IRS Oversight of Hospitals' Tax-Exempt Status* (April 2023).

(Form 990) would make it easier for the IRS and other stakeholders to assess a hospital's community benefits and whether they sufficiently justify a tax exemption. Since we agree with the GAO's recommendation to revise Schedule H (Form 990) to provide more specificity, we are not making a similar recommendation.

Potential Noncompliance Case Identification Can Be Improved

The streamlined review process has resulted in few referrals

CP&C revenue agents conduct the CBARs without contacting the organization. Information gathered for review is instead obtained from an organization's filed Schedule H (Form 990) and other public sources, such as Medicare and the internet. CP&C revenue agents review all available information, complete a CBAR survey, and weigh all relevant facts and circumstances to decide if further review is required. If a hospital meets all requirements except for the FAP, it is referred for a compliance check. Any other issues should be referred for examination.

In April 2022, the CP&C function worked with subject matter experts and the IRS Office of Chief Counsel to review the CBAR process and identify updates and improvements. As a result, CP&C management revised the scope of the CBARs to focus solely on the PPACA's statutorily required community benefit standard review. According to the Director, CP&C function, many of the former survey questions were beyond that scope and included other PPACA requirements such as performing community health needs assessments once every three years as well as other non-PPACA issues, such as unrelated business income. Consequently, the CBAR survey was reduced from 207 to 17 questions beginning in FY 2023. Figure 4 shows the number of CBARs resulting in referrals for examinations dropped substantially from FY 2022 to FY 2024.

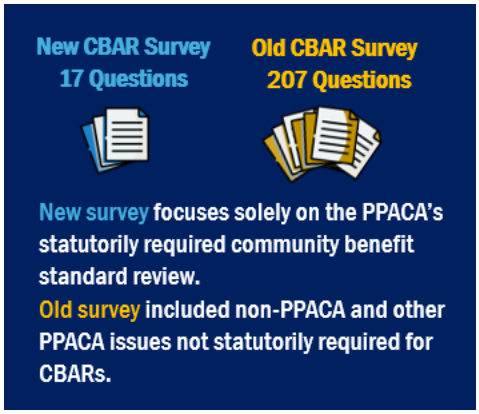
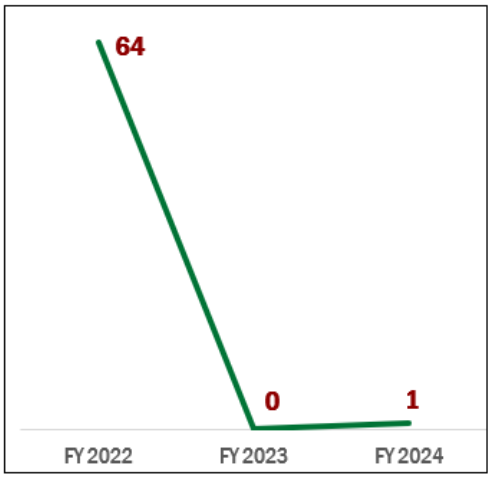


Figure 4: FYs 2022 Through 2024 CBAR Referrals for Examination



98%

Examination referrals dropped from **64** in FY 2022 to **1** in FY 2024 after the CP&C function implemented the streamlined CBAR process.

Source: Analysis of Reporting Compliance Case Management System data.[21]

Examination referrals dropped 98 percent from FY 2022 through FY 2024. The reduction in the number of CBAR survey questions has also reduced the average time spent on each case review from 7.5 hours in FY 2021 to 3.8 hours in FY 2024. This has allowed CP&C revenue agents to work on other casework, such as referrals, once the CBARs allocated for each fiscal year are completed.

To address the reduced oversight the streamlined CBAR process provides, the CP&C function developed a tax-exempt hospitals examination compliance strategy that includes identifying potential noncompliance with the four PPACA requirements. The strategy uses a data-driven approach to identify potential compliance issues for "at risk" organizations subject to I.R.C. § 501(r) requirements.[22]

The compliance strategy will identify potential noncompliance with the PPACA requirements, ensuring that hospitals report required items on their Schedules H (Form 990), including:

- Information on billings and collections processes (including efforts made before initiating extraordinary collection activities).
- Charges to individuals eligible for assistance under an FAP.
- Implementation strategy to meet the community health needs identified through their community health needs assessment.

The CP&C function identified 45 organizations for examination under this compliance strategy. As of November 2024, the Examination unit had started 36 of these examinations, none of which

[21] The Reporting Compliance Case Management System is an application to support data analytics, querying, and report generating needs of business users for the TE/GE Division.

[22] As part of this strategy, the IRS is currently using the Federal Poverty Level when identifying the population of hospitals subject to examination selection.

were completed, and the remaining 9 cases did not have expected start dates. We believe that these examinations will accomplish both a presence of enforcement and improve voluntary compliance with I.R.C. § 501(r) and the community benefit standard.

The IRS did not identify or review all tax-exempt hospitals subject to the CBARs

We identified 142 tax-exempt hospitals that should have been included in the IRS's CBAR population but were not identified or reviewed. The PPACA requires the IRS to review the community benefit activities of each tax-exempt hospital at least once every three years. The CP&C function maintains a list of tax-exempt hospitals by using a hospital indicator code as well as other information, such as state research to identify newly licensed hospitals.[23] The CP&C function's Planning and Monitoring unit is responsible for updating the list of tax-exempt hospitals subject to the CBARs annually.

The list of tax-exempt hospitals subject to the CBARs changes constantly due to mergers, consolidations, terminations, and additions of new hospitals. The CBAR population is obtained at the beginning of the three-year review period and divided into three segments to ensure that all tax-exempt hospitals are reviewed once every three years. The prior 3-year cycle contained 2,645 tax-exempt hospitals subject to review for FYs 2022 through 2024.

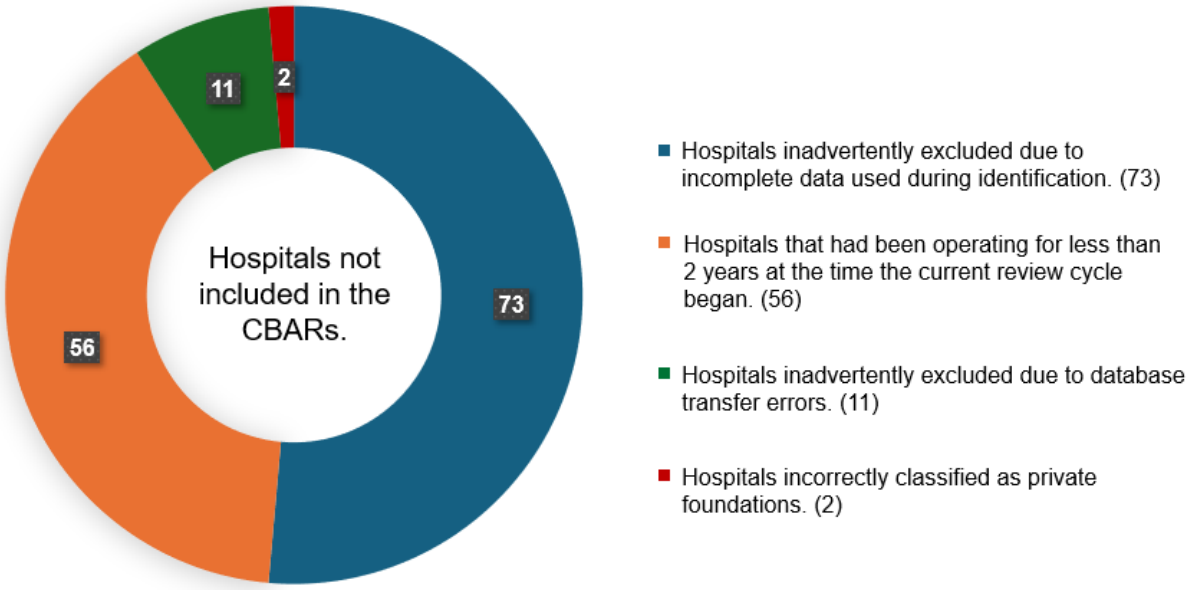
Using the IRS's data, we performed an analysis of Schedule H (Form 990) filings to identify tax-exempt hospitals potentially subject to the CBARs and compared it to the CP&C function's list of tax-exempt hospitals.[24] Figure 5 shows that we identified 142 tax-exempt hospitals that should have been included in the IRS's CBAR population but were not identified or reviewed.[25]

[23] This total does not include governmental unit or church-affiliated hospitals.

[24] We obtained exempt organization and Form 990 data extracts from the IRS's Business Return Transaction File and the Exempt Organizations Master File for FYs 2021 through 2023.

[25] See Appendix II.

Figure 5: Hospitals Missing From the IRS's CBAR Population for the FYs 2022 Through 2024 Review Cycle



Source: Analysis of FYs 2021 through 2023 tax-exempt hospital Schedule H (Form 990) filings for the FYs 2022 through 2024 CBAR cycle.

CP&C management stated that 11 hospitals were missing from the universe due to human error when transferring information between databases, and 2 were incorrectly classified as private foundations instead of hospitals. CP&C management also stated that they inadvertently excluded 73 hospitals because they used a hospital indicator code on the entities' accounts and not Schedule H (Form 990) filing data when identifying the population.

In addition, CP&C management explained that some of the hospitals we identified as missing from their population were due to a timing issue. The Planning and Monitoring unit made its determination on which hospitals would be subject to the CBARs for FYs 2022 through 2024 in November 2021 and did not update the list in Calendar Years 2022 and 2023 while it attempted to automate the process of identifying hospitals, which was unsuccessful.

At the time the Planning and Monitoring unit determined the population, 58 of the hospitals had been operating for 2 years or less and were not yet subject to a CBAR per internal procedures. According to CP&C management, excluding newer hospitals from the CBARs allows them to establish operations and have available information for CP&C revenue agents to review. For example, a new hospital organization does not have to meet community health needs assessments requirements until the last day of the second taxable year.[26] However, CP&C management acknowledged that all hospitals should meet the other PPACA requirements for tax-exemption, such as having a FAP in place. We determined that 56 of the 58 new hospitals were not included in the CBARs because they were less than 2 years old but could have been added if the CP&C function updated the population on a yearly basis as required. Because the streamlined CBAR process no longer assesses compliance with community health needs

[26] An organization that becomes newly subject to the requirements of I.R.C. § 501(r) must meet the community health needs assessment requirements by the last day of the second taxable year. After this initial assessment, hospitals are required to conduct community health needs assessments every three years.

assessments requirements, there is no reason to delay including new hospitals every year. The IRS plans to update the tax-exempt hospital population subject to the CBARs annually going forward.

It is necessary for the IRS to appropriately identify all hospitals subject to I.R.C. § 501(r) requirements so that these hospitals can be included in the three-year cycle of the CBARs. If the IRS is excluding hospitals from the CBARs, it is not meeting its statutory requirement of reviewing community benefit activities once every three years and missing an opportunity to identify potential noncompliance.

We also identified 14 governmental unit hospitals and 13 church-affiliated hospitals that were excluded from the IRS's CBAR population. Governmental unit hospital organizations are described as "dual status" entities when they have both received a determination from the IRS that they are tax-exempt under I.R.C. § 501(c)(3), and they qualify as an affiliate of a governmental unit not required to file Form 990.[27] Church-affiliated hospitals that claim to be churches are also generally excluded from the Form 990 filing requirement. However, despite a lack of a filing requirement for Form 990, both types of organizations are still subject to the provisions of the PPACA because the law applies to every hospital organization that has been (or seeks to be) recognized as an organization described in I.R.C. § 501(c)(3). The PPACA makes no exceptions for governmental unit or church-affiliated hospitals.

The CP&C function excludes governmental unit and church-affiliated hospitals from the CBAR process.

IRS procedures state that because governmental units and church entities do not usually file Forms 990 or Schedule H (Form 990), CP&C revenue agents should review external sources of publicly available information, such as the websites of government entities, health care industries, and the hospital organizations, to gather evidence regarding compliance with the community benefit standard. However, the IRS does not follow these procedures because CP&C management excludes governmental unit and church-affiliated hospitals from the CBARs.

Although dual status governmental unit hospitals are subject to the CBAR, the IRS does not include them in its reviews because regardless of whether or not they maintain their I.R.C. § 501(c)(3) status, they are still entitled to exclude their income from tax.[28] Subjecting dual status governmental unit hospitals to the CBARs would be an inefficient use of the IRS's resources because even if they were found to be noncompliant with the community benefit standard, no additional income from these hospitals would be subject to tax.

In addition, CP&C management stated that they have stopped reviewing church-affiliated hospitals that claim to be churches as part of the CBAR process due to resource constraints. To begin an inquiry into a church, the IRS must obtain special permissions and comply with certain statutory criteria.[29] Although the CBARs are not considered an inquiry because contact with the

[27] Rev. Proc. 95-48, 1995-2 C.B. 418.

[28] I.R.C. § 115(1).

[29] I.R.C. § 7611. The IRS may begin a church tax inquiry only when an appropriate high-level Department of the Treasury official reasonably believes, on the basis of facts and circumstances recorded in writing, that the organization 1) may not qualify for tax exemption as a church; 2) may be carrying on an unrelated trade or business (within the meaning of I.R.C. § 513); or 3) may be otherwise engaged in activities subject to tax.

organization is not made, anything beyond the CBAR, such as a compliance check or examination, would require meeting the unique legal requirements for churches before contacting the organization. However, the minimal level of proof obtained during a CBAR may not reach the requirements necessary to pursue potential noncompliance.

The Commissioner, TE/GE Division, should:

Recommendation 3: Update processes to ensure the proper identification and review of all tax-exempt hospitals subject to a CBAR.

> **Management's Response:** The IRS agreed with the recommendation and will update the processes to ensure the proper identification and review of all tax-exempt hospitals subject to a CBAR.

Recommendation 4: Update guidance to include reasons for excluding dual status governmental unit and certain church-affiliated hospitals from the CBARs because they are statutorily mandated.

> **Management's Response:** The IRS agreed with the recommendation and will update guidance to include reasons for excluding dual status governmental unit and certain church-affiliated hospitals from the CBARs.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this audit was to assess the IRS's oversight of tax-exempt hospitals to ensure that they are compliant with providing community benefits and other requirements. To accomplish our objective, we:

- Determined whether the IRS is effectively ensuring that tax-exempt hospitals comply with tax-exempt requirements and are providing sufficient community benefit.
    - Identified and reviewed the legal requirements for tax-exempt hospitals as outlined in the PPACA, Revenue Procedures, Revenue Rulings, Treasury Regulations, and the I.R.C.
    - Reviewed and assessed the effectiveness of the community benefit standard, as outlined in Revenue Ruling 69-545, in its ability to determine whether a hospital is organized and operated for the charitable purpose of promoting health.
    - Evaluated the existing standards for the FAPs and the IRS's procedures for ensuring that tax-exempt hospitals meet the legal requirements set forth in the PPACA for maintaining adequate FAPs. We identified the criteria the IRS used to verify that hospitals maintain an adequate FAP.
- Evaluated how the IRS identifies tax-exempt hospitals for the CBARs and the IRS's process for identifying hospitals "at risk" for noncompliance with the community benefit standard and its resolution process to ensure future compliance.
    - Interviewed CP&C management to determine how the IRS identifies the population of hospitals subject to the CBARs.
    - Identified any queries or compliance strategies that focus on community benefit.
    - Identified the adjustments the IRS made to Schedule H (Form 990) instructions compared with the prior version of instructions and evaluated whether the new instructions increase transparency, consistency, and comprehensive reporting of tax-exempt hospitals.
    - Identified the population of tax-exempt hospitals subject to the CBARs for FYs 2022 through 2024 and compared it to the universe identified by the IRS.
- Determined the effectiveness of the CBAR referral process by evaluating procedures and analyzing compliance check and examination results (no change, agreed tax or penalty change, *etc.*) for tax-exempt hospitals for FYs 2022 through 2024.
    - Determined the number of CBARs completed for FYs 2022 through 2024, analyzed the data, and determined how many were referred for a compliance check or an examination.
    - Evaluated the procedures for reviewing tax-exempt hospitals referred for an examination or a compliance check by interviewing Exempt Organizations management and reviewing procedures, training, and guidance.

- Obtained Reporting Compliance Case Management System data for all compliance checks and examinations closed during FYs 2022 through 2024 and assessed the effectiveness of the IRS's controls to detect and prevent hospitals' underinvestment in improving community health by determining compliance check and examination outcomes.

Performance of This Review

This review was performed with information obtained from the TE/GE Division's CP&C function located in Washington, D.C.; the Exempt Organizations Examination unit located in Cincinnati, Ohio; and the TECU located in Ogden, Utah, during the period October 2023 through December 2024. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Data Validation Methodology

We obtained CBAR, Exempt Organizations examination, and compliance check data from IRS-provided data extracts of the Reporting Compliance Case Management System for FYs 2022 through 2024. We also obtained exempt organization and Form 990 data extracts from the Business Return Transaction File and the Exempt Organizations Master File for FYs 2021 through 2023. These data sets were available on TIGTA's Data Center Warehouse.[1] We performed tests to assess the reliability of data from all three sources. We evaluated the data by 1) performing electronic testing of required data elements, 2) reviewing existing information about the data and the system that produced them, and 3) interviewing agency officials knowledgeable about the data. We determined that the data were sufficiently reliable for purposes of this report.

Internal Controls Methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: the policies, procedures, and practices related to the CBARs, examinations, and compliance checks. We evaluated these controls by reviewing source documents, interviewing IRS management and employees, and conducting data analyses.

[1] A collection of IRS databases containing various types of taxpayer accounts as well as IRS and TIGTA employee information that we maintain for the purpose of analyzing data for ongoing audits.

Appendix II

Outcome Measure

This appendix presents detailed information on the measurable impact that our recommended corrective action will have on tax administration. This benefit will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Reliability of Information – Potential; 142 tax-exempt hospitals that the IRS should have included in its CBAR population but were not identified or reviewed (see Recommendation 3).

Methodology Used to Measure the Reported Benefit:

We analyzed Schedule H (Form 990) filings during FYs 2021 through 2023 to identify tax-exempt hospitals potentially subject to the CBAR. We compared our population to the CP&C function's population and identified 142 tax-exempt hospitals that the IRS should have included in its CBAR population but were not identified or reviewed:

- 73 hospitals were inadvertently excluded due to using a hospital indicator code on the entities' account and not Schedule H (Form 990) filing data when identifying the population.
- 56 hospitals were operating for less than 2 years at the time the current review cycle began but could have been added if the CP&C function updated the population on a yearly basis as required.
- 11 hospitals were inadvertently excluded due to database transfer errors.
- 2 hospitals were incorrectly classified as private foundations.

Appendix III

Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER
TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

MEMORANDUM FOR DIANA M. TENGESDAL
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Robert Choi
Acting Commissioner,
Tax-Exempt and Government Entities Division (TE/GE)
Robert Choi Digitally signed by Robert Choi Date: 2025.05.05 13:17:52 -04'00'

SUBJECT Draft Audit Report – Vague and Outdated Guidance Creates Challenges for Tax-Exempt Hospital Oversight (Audit #2024100017)

Thank you for the opportunity to review and comment on the subject draft audit report: Vague and Outdated Guidance Creates Challenges for Tax-Exempt Hospital Oversight, Audit #2024100017. This audit was initiated to assess the Internal Revenue Service's (IRS's) oversight of tax-exempt hospitals to ensure that they are compliant with providing community benefits and other requirements. The IRS appreciates TIGTA's analysis and the opportunity to consider improvements to the tax administration of tax-exempt hospitals.

TIGTA notes that administration of the community benefit standard, as discussed in Revenue Ruling 69-545, is challenging because it requires consideration of "all of the relevant facts and circumstances in each case," and "the absence of particular factors or the presence of other factors will not necessarily be determinative." *See* Rev. Rul. 69-545, 1969-2 C.B. 117. TIGTA recommends sharing this report and recommendations with the Department of the Treasury Office of Tax Policy to consider a legislative proposal to amend the Internal Revenue Code.

As you noted on page 6 of the report, both the Government Accountability Office (GAO) and your office have acknowledged that clarity regarding the community benefit standard should be addressed by Congress:

> "We agree with the GAO's determination that Congress should consider specifying in the I.R.C. what services and activities it considers sufficient community benefit to improve the IRS's ability to oversee tax-exempt hospitals. This action would also enable the IRS to issue updated regulations that provide more specific guidance that would not only help the industry comply with the community benefit standard, but also assist the IRS during its statutorily required reviews of community benefit activities."

New legislation could clarify or provide authority for the IRS (through Counsel) and Treasury to update or promulgate regulations clarifying both the community benefit standard and baseline criteria for financial assistance policies (FAP). Therefore, we agree with Recommendations 1 and 2. Specifically, we agree to share this report and recommendations with the Department of the Treasury Office of Tax Policy.

We appreciate your evaluation of our hospital compliance program and your comments to improve our oversight of tax-exempt hospital organizations.

We agree with Recommendations 3 and 4 related to our process for determining the universe of hospitals included in our community benefit reviews. We have refined the steps we take to identify hospitals for review, and we are thoroughly documenting the changes to ensure a consistent method for identifying hospitals for review now and in the future.

Attached is our response to your recommendations. If you have any questions, please contact Steven Martin, Acting Director, Exempt Organizations/Government Entities, TE/GE at Stephen.A.Martin@irs.gov, and/or Adrian Gonzalez, Director, Compliance, Planning and Classification, TE/GE at Adrian.F.Gonzalez@irs.gov.

Attachment

Attachment

Recommendation 1:
The Commissioner, TE/GE Division, should share this report and recommendation with the Department of the Treasury Office of Tax Policy to consider a legislative proposal to amend I.R.C. § 501 and any other required provisions of law to clearly and specifically define community benefit, including the level of services and activities that are sufficient to meet the community benefit standard in the current industry.

Planned Corrective Action:
We agree. TE/GE will share this report and recommendation with the Department of the Treasury Office of Tax Policy to consider a legislative proposal to amend I.R.C. § 501 and any other required provisions of law to clearly and specifically define community benefit, including the level of services and activities that are sufficient to meet the community benefit standard in the current industry.

Implementation Date:
August 15, 2025

Responsible Official(s):
Director, Exempt Organizations and Government Entities

Corrective Action Monitoring Plan:
The IRS will monitor this corrective action as part of our internal management system of controls.

Recommendation 2:
The Commissioner, TE/GE Division, should share this report and recommendation with the Department of the Treasury Office of Tax Policy to consider a legislative proposal to amend I.R.C. § 501 and any other required provisions of law to establish baseline criteria for tax-exempt hospital FAP eligibility.

Planned Corrective Action:
We agree. TE/GE will share this report and recommendation with the Department of the Treasury Office of Tax Policy to consider a legislative proposal to amend I.R.C. § 501 and any other required provisions of law to establish baseline criteria for tax-exempt hospital FAP eligibility.

Implementation Date:
August 15, 2025

Responsible Official(s):

Director, Exempt Organizations and Government Entities

Corrective Action Monitoring Plan:
The IRS will monitor this corrective action as part of our internal management system of controls.

Recommendation 3:

The Commissioner, TE/GE Division, should update processes to ensure the proper identification and review of all tax-exempt hospitals subject to a CBAR.

Planned Corrective Action:
We agree. TE/GE, CP&C will update the processes to ensure the proper identification and review of all tax-exempt hospitals subject to a CBAR.

Implementation Date:
August 15, 2025

Responsible Official(s):
Director, Compliance, Planning and Classification, TE/GE

Corrective Action Monitoring Plan:
The IRS will monitor this corrective action as part of our internal management system of controls.

OUTCOME MEASURE:

Type and Value of Outcome Measure (Reliability of Information)—Potential; 142 tax-exempt hospitals that should have been included in the IRS's CBAR population but were not identified or reviewed. (see Recommendation 3).

IRS RESPONSE:
We agree there were 142 hospitals that were not identified and should have been considered for inclusion in the IRS's CBAR population.

Recommendation 4:
The Commissioner, TE/GE Division, should update guidance to include reasons for excluding dual status governmental unit and certain church-affiliated hospitals from the CBARs because they are statutorily mandated.

Planned Corrective Action:
We agree. TE/GE, CP&C will update guidance to include reasons for excluding dual status governmental unit and certain church-affiliated hospitals from the CBARs.

Implementation Date:
August 15, 2025

Responsible Official(s):
Director, Compliance, Planning and Classification, TE/GE

Corrective Action Monitoring Plan:
The IRS will monitor this corrective action as part of our internal management system of controls.

Appendix IV

Abbreviations

CBAR	Community Benefit Activity Review
CP&C	Compliance, Planning, and Classification
FAP	Financial Assistance Policy
FY	Fiscal Year
GAO	Government Accountability Office
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
PPACA	Patient Protection and Affordable Care Act
TECU	Tax-Exempt Compliance Unit
TE/GE	Tax Exempt and Government Entities Division
TIGTA	Treasury Inspector General for Tax Administration

To report fraud, waste, or abuse,
contact our hotline on the web
at https://www.tigta.gov/reportcrime-misconduct.

To make suggestions to improve IRS policies, processes, or systems affecting taxpayers, contact us at www.tigta.gov/form/suggestions.

Information you provide is confidential, and you may remain anonymous.