

**Client Newsletter**

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**OIG Issues Draft Corporate Compliance Guidance**

On June 8, 2004, the Department of Health and Human Services Office of Inspector General (“OIG”) published Draft Supplemental Compliance Program Guidance for Hospitals (“Guidance”). The Guidance supplements the OIG’s original Hospital Compliance Guidance which was issued in 1998. The OIG states that the two documents “collectively” represent “a set of guidelines that hospitals should consider when developing and implementing a new compliance program or evaluating an existing one.” The new Guidance differs from the original Guidance in the following respects: (1) greater emphasis on practices that create risk under Federal fraud and abuse statutes (i.e. Stark, Anti-Kickback) as opposed to traditional compliance concerns, such as coding and cost reporting; and (2) new focus on accountability of corporate leadership for compliance programs and how hospitals should assess the effectiveness of each element of a compliance program.

The Guidance addresses several specific high risk areas of concern which should be scrutinized by hospital compliance programs:

Stark Law:

The Stark Law prohibits hospitals from submitting any claim for payment for a designated health service, if the referral comes from a physician with whom the hospital has a prohibited financial relationship. The Guidance suggests that hospitals should undertake frequent and thorough reviews of physician contracts and the overall contracting process. Hospitals should also make sure there are appropriate processes in place for making and documenting reasonable, consistent and objective determinations of fair market value for physician services.

Anti-Kickback Statute:

The Anti-Kickback Statute prohibits payments which are intended to induce or reward referrals or generation of federal health care program business. The Guidance suggests that hospitals should focus on the following to assure that particular arrangements do not violate the Anti-Kickback Statute: (1) joint ventures; (2) compensation arrangements with physicians; (3) relationship with other health care

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entities; (4) recruiting arrangements; (5) discounts; (6) medical staff credentialing; and (7) malpractice insurance subsidies.

#### EMTALA:

The OIG emphasizes that hospitals should have a clear understanding of their obligations under the Emergency Medicare Treatment and Active Labor Act.

#### Gainsharing Arrangements:

Gainsharing Arrangements are arrangements in which a hospital gives physicians a percentage share of any reduction in the hospital's costs for patient care attributable in part to the physicians' efforts. The Guidance reminds hospitals that gainsharing arrangements must be closely scrutinized to make sure they do not violate the Civil Monetary Penalty (CMP) of the Social Security Act. The CMP prohibits a hospital from knowingly making a payment directly or indirectly to a physician as an inducement to reduce or limit services to Medicare or Medicaid beneficiaries under the physician's care.

#### Substandard Care:

The Guidance reminds hospitals that the OIG has the authority to exclude hospitals from participation in federal health care programs if they fail to meet professionally recognized standards of care.

The Guidance urges compliance officers to be a member of senior management and have direct access to the hospital's Board of Directors, senior management and legal counsel. The OIG also recommends that in addition to a detailed set of substantive policies, the hospital should develop a general statement of ethical and compliance principles to guide the hospital's operations.

The Guidance only contains "suggestions" for corporate compliance programs. The suggestions are not mandatory. The OIG will publish a supplemental Guidance once it has reviewed all of the comments it has received regarding the Guidance.

## **IRS Proposed Regulations for FICA Tax Exemption**

On February 25, 2004, the Internal Revenue Service ("IRS") issued proposed regulations, which if adopted, subject medical residents to the provisions of the Federal Insurance Contributions Act ("FICA") and the Federal Unemployment Tax Act ("FUTA"). The regulations will apply FICA and FUTA taxes to medical residents for services performed after February 25, 2004.

According to current IRS regulations, services performed in the employ of a school, college or university are exempted from FICA and FUTA if such service is performed by a student who is enrolled and regularly attending classes at such school, college or university. The IRS has long held the position that medical residents are employees and not students. The IRS, however, has been unable to convince the courts to accept this position. In the recent case of United States v. Mayo Foundation for Medical Education and Research, 282 F. Supp. 2d 997 (D. Minn. 2003), the District Court held that the student exception to FICA tax on wages did apply to stipends paid by the Mayo Foundation to Residents participating in its Medical Residency Programs. The Court held that the Mayo Foundation is a school, college or university and medical

residents are “employed” by the Mayo Foundation. Therefore, according to the U.S. District Court of Minnesota, medical residents fall outside the purview of the FICA tax program.

The proposed regulations issued by the IRS seek to establish that as of February 25, 2004, medical residents are not exempt from FICA or FUTA. In this regard, the proposed regulations provide that the primary function of an institution is the primary determinant as to whether that institution qualifies as a “school, college or university.” Thus, carrying on educational activities is not, under the proposed regulations, enough to qualify as a school, college or university. According to the commentary which accompanies the regulations, the “primary function” test is to be applied to the institution as a whole.

According to the current regulations, an employee will be given the status of a “student” if the services performed by that employee, are performed “incident to and for the purpose of pursuing a course of study” at the institution. The new regulations provide clarification in three respects to the definition of a student. First, the regulations provide that in order to be considered “enrolled and regularly attending classes”, an individual’s activities must present the opportunity to acquire new skills and knowledge, and those activities must be led by a knowledgeable faculty member. Second, the regulations provide that in order to be pursuing “a course of study” an individual must be involved in courses that, upon completion, will entitle that individual to receive an educational credential granted by the institution. Third, the proposed regulations provide that the test for whether or not services performed are “incident to and for the purpose of pursuing a course of study” is a facts and circumstances based test. The relevant factors include:

- Status as a “professional employee” – individuals whose service requires knowledge of an advanced type in a field requiring substantial exercise of discretion and judgment are typically considered employees;
- Hours worked – individuals serving full-time hours (40 hours or more) would typically be considered employees and not students;
- Terms of employment – any of the enumerated terms, such as vacation and sick pay, retirement plan participation, tuition reduction plans, and other benefits associated with full-time employment will signify a career employee relationship; and
- Whether the individual is required to be licensed – an individual is a career employee if that individual is required to be licensed under state or local law to work in the field.

If the proposed regulations are adopted in their present form, academic medical centers and other institutions operating residency programs will be required to withhold and pay FICA taxes for all services performed by their medical residents after February 25, 2004. The proposed regulations established a comment period which concluded on May 25, 2004. It is anticipated that the IRS will soon issue final or temporary regulations based upon the comments it receives regarding the proposed regulations. It is important to note that the IRS has indicated that concurrent with the promulgation of temporary or final regulations, it will announce a “Settlement Program”, which will allow hospitals and residents to obtain FICA refunds for periods prior to the February 25, 2004.

## **Taylor's Law**

On May 21, 2004, Governor Romney enacted "Taylor's Law" which makes several amendments to Massachusetts General Law, c. 112, §5, which provides for adjudicatory hearings by the Board of Registration in Medicine. The amendments provide that the victim (or his/her representative) whose case is the subject of the disciplinary proceeding, shall be entitled to attend all disciplinary hearings for that physician which are conducted by the Board of Registration in Medicine. (Prior to enactment of this legislation, patients and their families were prohibited from attending disciplinary hearings.)

Taylor's Law also allows the victim or his representative to have counsel present at the hearing for the purpose of "advisement". Before the Board's vote on a final disposition, the victim or his representative shall be given an opportunity to be heard through an oral or written "victim impact statement" regarding the impact of the injury on the victim and his/her family and on a recommended sanction.

Although earlier versions of this legislation expanded the Board of Registration in Medicine's data-base to include letters of reprimand received by physicians, the final legislation did not include this provision. Therefore, only suspensions and revocations of licenses will be listed in the Board's public data-base.

These new amendments to the adjudicatory hearings will become effective on August 19, 2004.

## **IRS Initiative on Compensation for Tax Exempt Entities**

The United States Internal Revenue Service recently announced a new initiative which is designed to explore the high compensation paid to individuals associated with tax-exempt organizations. This summer, the IRS will contact hundreds of tax-exempt organizations on the basis of employee compensation reported on their annual Form 990 returns. The IRS will require that select tax-exempt organizations provide detailed support for the compensation and benefits provided to its highest paid employees reported on their Form 990. (It is believed that the IRS will select tax-exempt organizations whose Form 990 indicates that an employee has received \$1 million dollars or more in compensation.) Organizations will also be asked for details concerning the independence of the governing body that approved the compensation.

The Initiative was announced by IRS Commissioner Mark Everson during his recent testimony before the Senate Finance Committee. Commissioner Everson expressed concern that the governing boards of tax-exempt organizations are not exercising sufficient diligence as they set executive compensation. Commissioner Everson stated that the Initiative is designed to help the IRS become more familiar with the practices that exempt organizations are using to set compensation and how exempt organizations are reporting compensation to the IRS and to the public.

## **New DPH Autopsy Requirements**

The Massachusetts Department of Health's recently promulgated regulatory amendments for how hospitals perform autopsies. These amendments, which became effective on June 18, 2004, were the result of a public campaign by a Massachusetts family whose 18 month old son died from a rare immunization reaction.

After their son had been buried, the family learned that Children's Hospital had kept their son's heart, liver, kidneys and other vital organs after an autopsy was ordered by the Office of the Chief Medical Examiner. The family sued Children's Hospital in Superior Court as a result of the hospital's failure to inform the family of the organ harvesting. A jury, however, ruled against the family. (An appeal is presently pending.)

Despite the ruling in Superior Court, the family pressed State officials for new regulations pertaining to how hospital's perform autopsies. As a result, on June 7, 2004, the Massachusetts Department of Public Health promulgated amendments to 105 CMR130.000 (the Hospital Licensing Regulation) regarding procedures required for a consent to an autopsy. The amendments require hospitals to do the following:

- Obtain consent in order to conduct an autopsy (unless ordered by the Medical Examiner's Office);
- Use a consent form that meets the minimum requirements set forth in the regulations;
- Return any organs removed during the autopsy (except for those organs for which prolonged fixation or detailed examination is required to complete the autopsy) with the body, unless the person authorizing the autopsy directs otherwise. This will also apply to an autopsy performed at a hospital on behalf of the Medical Examiner's Office, once the Medical Examiner's Office has released the body and organs;
- Provide a copy of the consent form to the person who authorized the autopsy; and
- Establish written policies and procedures for obtaining and documenting consent to an autopsy and disposition of organs.

The regulations set forth detailed requirements for the content of autopsy consent forms. Furthermore, the regulations require hospitals to establish written policies and procedures for obtaining and documenting consent to an autopsy and the disposition of organs. The regulations also allow for hospitals to obtain telephonic consent to autopsies under certain circumstances. The regulations also set forth a list of categories of individuals authorized to provide consent for an autopsy. The list is organized by descending order of priority (i.e. (1) spouse of decedent; (2) adult son or daughter of the decedent . . . ). If a member of the highest priority class available to give consent opposes the autopsy and makes such opposition known to the hospital prior to the autopsy, the hospital shall not perform an autopsy on the decedent.

All hospitals are encouraged to review their current autopsy policies and procedures to ensure full compliance with these new DPH regulations.

## **Class Action Charity Care Litigation**

Several class action lawsuits have been filed in United States District Courts across the country over the past two months by uninsured patients against not-for-profit hospitals and healthcare systems. The lawsuits allege that these various not-for-profit hospitals and healthcare systems render insufficient amounts of charity care to justify their federal, state and local tax exemption. There have been forty of these class action lawsuits filed in more than twenty states over the last month. The lawsuits represent a coordinated effort by nationally known Plaintiffs' law firms who have substantial experience in mass tort litigation. The most recent of these

lawsuits was filed on July 27, 2004, in the United States District Court in Boston against Baystate Medical Center (Springfield, Mass.) (Harrington, et al v. Baystate Medical Center, et al).

The lawsuits allege that the Defendant hospitals and healthcare systems are retaining hundreds of millions of dollars annually as a result of their tax exemption, in exchange for which they should be providing charity care. Some of the specific charges in the litigation include: breach of express or implied contract with the Federal government and local governments to provide charity care; breach of contract with the patient-plaintiffs by requiring the patients to agree to pay hospital charges, but failing to provide care for a fair and reasonable price; breaches of good faith and fair dealing; breaches of their charitable trust obligations by accepting tax exemptions without providing affordable medical care; consumer fraud and deceptive business practices; violations of EMTALA – for requiring patients, before they are treated, to sign a form contract promising to pay the hospital in full for unspecified medical charges set by the hospital at its sole discretion; unjust enrichment – improperly retaining millions of dollars based on misuse of their tax-exempt status and holding millions of dollars in off-shore bank accounts that are “located in havens which are known for secrecy, and where no taxes on these funds can be levied”; civil conspiracy; and conspiring with the American Hospital Association. The American Hospital Association has been named as a defendant in many of these lawsuits. The plaintiffs allege that the American Hospital Association advises its members to charge their uninsured and underinsured patients more than patients who are covered by Medicare, Medicaid or private insurance.

The class action lawsuits seek actual and consequential damages. The lead Plaintiffs’ Counsel, Richard Scruggs of Mississippi, has further indicated that his goal is to force a national standard dictating how much charity care hospitals must provide, and to prohibit hospitals from charging uninsured patients more than they charge the Medicare Program. Mr. Scruggs has indicated that he considers suing hospitals that have the following characteristics: (1) significant amounts of cash and assets; (2) use highly aggressive collection techniques; and (3) charge uninsured patients more for medical care than they do with patients who have private insurance or Medicare or Medicaid. In the Baystate Medical Center suit, the lead Plaintiff, Diane Harrington, was treated at Baystate Medical Center after falling down a set of stairs. Ms. Harrington, who does not have health insurance, could not pay Baystate Medical Center’s bill of \$2,983.04. According to the Complaint, Baystate Medical Center tacked on 12% annual interest to Ms. Harrington’s bill and threatened to seize her personal property.

These class action lawsuits are in the initial stages of litigation. Although the Plaintiffs’ claim that the Defendants’ “breached an implied contract” to provide charity care, the IRS, in Revenue Ruling 69.545, removed the charity care requirement from the hospital tax-exemption standard in favor of the more flexible community benefit standard. The ruling stated that a hospital which operated a full-time emergency room and did not deny emergency care to those who could not afford to pay, qualified for exemption. In Revenue Ruling 83.157, the IRS stated that operating a full-time emergency room open to all, regardless of a person’s ability to pay, “is strong evidence that a hospital is operating to benefit the community.”

## **Non-Profit Joint Ventures with For Profit Entities**

There has been a significant amount of attention in the health care industry on the matter of St. David’s Health Care System v. United States, which addresses a non-profit’s tax-exempt status by reason of a joint venture with a for-profit entity. The Internal Revenue Service concluded that the partnership of St. David’s Health Care System (“St. David’s”) with Columbia/HCA, a for-profit health care system, no longer qualified St.

David's as a tax-exempt organization. The Fifth Circuit Court of Appeals overturned the District Court's granting of summary judgment for St. David's and remanded the case back to District Court for a determination of whether St. David's actually had control over the joint venture with Columbia/HCA. On remand, the District Court ruled in favor of St. David's, finding that it retained its tax-exempt status and was entitled to a refund of taxes assessed by the IRS.

On May 6, 2004, the IRS issued Revenue Ruling 2004-51 ("Ruling"), which provides long-awaited IRS guidance on the tax impact of ancillary joint ventures between tax-exempt and for-profit entities. The Ruling addresses the situation in which a Section 501(c)(3) university enters into a joint venture with an unrelated for-profit company to offer summer seminars for teachers. The two parties formed a Limited Liability Company ("LLC") that will offer teacher training seminars at off-campus locations using interactive video technology. The university's activities conducted through the LLC comprise only an insubstantial part of the university's activities. Each entity will own 50% of the LLC, proportionate to the value of their capital contributions. The LLC will be managed by a six-person board, with three chosen by the university and three by the for-profit. The governing documents of the LLC provide that the university has the exclusive right to approve the curriculum, training materials, and instructors and to determine the standards for successful completion of the seminars. The for-profit entity will arrange and conduct all the seminars, including advertising, enrolling participants, arranging for facilities, distributing course materials and broadcasting the seminar to various locations.

In reviewing the underlying facts, the IRS was asked the following questions: 1) whether the university continues to qualify for exemption from federal income tax as an organization described in Section 501(c)(3) of the Internal Revenue Code when it contributes a portion of its assets to and conducts a portion of its activities through a Limited Liability Corporation formed with a for-profit corporation; and 2) whether the organization is subject to unrelated business income tax under Section 511, on the distribute share of the LLC's income.

Addressing the first question regarding the university's tax-exempt status, the IRS concluded that the university continues to qualify under Section 501(c)(3) as a tax-exempt organization. The IRS found that the activities of the university, which are conducted through the LLC, are not a substantial portion of the university's activities within the meaning of Section 501(c)(3), which provides that activities which do not further exempt purposes must be an insubstantial part of the organization's activities. See Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283 (1945) (holding that presence of single non-exempt purpose, if substantial nature, will destroy exemption regardless of number of importance of truly exempt purposes.)

In response to the question of whether or not the university is subject to unrelated business income tax (UBIT) under Section 511 on its distributive share of the LLC's income, the IRS concluded that the university is not subject to Unrelated Business Income Tax under Section 511 on its distributive share of the LLC's income. In the Ruling, the IRS noted that if an LLC conducts a trade or business that is not substantially related to the exercise or performance of the university's exempt purposes or functions, it may be subject to Unrelated Business Income Tax. In view of the underlying facts of this matter, however, the IRS concluded that the manner in which the LLC conducts the teacher training seminars contributes importantly to the accomplishments of the university's educational purposes and that the activities of the LLC are substantially related to the university's educational purposes. In particular, the IRS noted that the university alone approved the curriculum, training materials and instructors and determined the standards for successfully completing the seminars.

The Ruling provides helpful guidance in that an exempt organization may engage in an insubstantial amount of activities that are unrelated to its purposes. The Ruling confirms that it is immaterial whether an activity is carried on directly or through an LLC in which a for-profit is a member. If the activity is insubstantial, then it will not, taken alone, affect tax-exempt status. It should be noted that the facts of the Ruling are such that they avoid raising issues of private enurement and private benefit that could adversely affect an organizations' tax-exempt status. As to the IRS' Ruling on the Unrelated Business Income Tax, the Ruling indicates that the central issue is the related nature of the LLC's activities to the university's purposes. The Ruling concludes that the seminar activity is related, based on the university's power to control the content and educational standards of the classes.

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