HEALTH CAPITAL Topics

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IRS Publishes Final Regulations Regarding Relationship Between Intermediate Sanctions and Revocation of Exemption under Section 501(c)(3) of IRS Code

Healthcare organizations may be considered *"tax-exempt"* under Section 501(c)(3) of the Internal Revenue Code if they operate exclusively for *exempt* purposes and no earnings *inure* to the benefit of any private shareholder or individual, i.e., the tax-exempt organization may not be operated in the pursuit of private interests. Should the IRS become aware that an exempt organization has engaged in an excess benefit transaction with a party who could exert influence with the organization (shareholders or private individuals), the IRS may impose as punishment an excise tax on the individual and/or the organization.

In the *Final Regulations* published on March 28, 2008,[1] the IRS addressed this prohibition of private benefit, as well as the relationship between intermediate sanctions in contrast to *revocation* of tax-exempt status. In the newly revised regulations, the IRS presented examples of situations which violate the prohibition of exempt organizations serving private interests, including those situations in which the benefit may be *non-economic.* Additionally, a prohibited private benefit may occur even in the event that the transaction is conducted at *fair market value*.While past violations violations were subject to revocation of exempt status as the sole remedy,under the new regulations, an exempt organization which is found to have violated such prohibitions may have to pay intermediate excise taxes, which constitute a penalty short of revocation of exempt status. The IRS has identified five factors to be considered when determining whether the organization should be subject to intermediate excise tax or whether exempt status should be revoked: (1) the size and scope of the organizations ongoing activities; (2) the size and scope of the excess benefit transaction in relation to regular activities; (3) whether excess benefit transactions had happened in the past; (4) whether the organization has implemented safeguards against this type of transaction; and, (5) whether the excess benefit transaction has been corrected, or there has been a good faith effort to do so. These last two factors are given a greater weight of consideration toward the continuation of exempt status in those cases where the organization has taken steps to remedy the situation.

The final regulations included six examples illustrating how the factors would be applied, including how the IRS considers the manner by which executives are compensated, as well as the role of the board before and after the transaction. These examples illustrate how the implementation of safeguards (especially those which create a presumption of *reasonableness*) is viewed as a factor that would significantly contribute to continued tax-exempt status.

[1] Standards for Recognition of Tax-Exempt Status if Private Benefit Exists of if an Applicable Tax-Exempt Organization Has Engaged in Excess Benefit Transaction(s), 73 Fed. Reg. 61, 16519 (March 28, 2008) (to be codified at 26 C.F.R. pts. 1 and 53), http://www.irs.gov/pub/irs-tege/td9390.pdf (Accessed April 14, 2008).

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HEALTH CAPITAL CONSULTANTS (HCC) is an established, nationally recognized healthcare financial and economic consulting firm headquartered in St. Louis, Missouri, with regional personnel nationwide. Founded in 1993, HCC has served clients in over 45 states, in providing services including: valuation in all healthcare sectors; financial analysis, including the development of forecasts, budgets and income distribution plans; healthcare provider related intermediary services, including integration, affiliation, acquisition and divestiture; Certificate of Need (CON) and regulatory consulting; litigation support and expert witness services; and, industry research services for healthcare providers and their advisors. HCC's accredited professionals are supported by an experienced research and library support staff to maintain a thorough and extensive knowledge of the healthcare reimbursement, regulatory, technological and competitive environment.

Robert James Cimasi, MHA, ASA, FRICS, MCBA, AVA, CM&AA, serves as President of **HEALTH CAPITAL CONSULTANTS** (HCC), a nationally recognized healthcare financial and economic consulting firm headquartered in St. Louis, MO, serving clients in 49 states since 1993. Mr. Cimasi has over thirty years of experience in serving clients, with a professional focus on the financial and economic aspects of healthcare service sector entities including: valuation consulting and capital formation services; healthcare industry transactions including joint ventures, mergers, acquisitions, and divestitures; litigation support & expert testimony; and, certificate-of-need and other regulatory and policy planning consulting.

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