

## 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,<sup>1</sup> 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 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.

<sup>1</sup> Standards for Recognition of Tax-Exempt Status if Private Benefit Exists 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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**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.

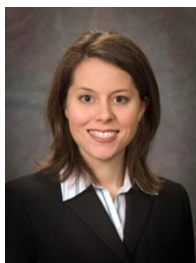
Mr. Cimasi holds a Masters in Health Administration from the University of Maryland, as well as several professional designations: Accredited Senior Appraiser (ASA – American Society of Appraisers); Fellow Royal Intuition of Chartered Surveyors (FRICS – Royal Institute of Chartered Surveyors); Master Certified Business Appraiser (MCBA – Institute of Business Appraisers); Accredited Valuation Analyst (AVA – National Association of Certified Valuators and Analysts); and, Certified Merger & Acquisition Advisor (CM&AA – Alliance of Merger & Acquisition Advisors). He has served as an expert witness on cases in numerous courts, and has provided testimony before federal and state legislative committees. He is a nationally known speaker on healthcare industry topics, the author of several books, the latest of which include: *“The U.S. Healthcare Certificate of Need Sourcebook”* [2005 - Beard Books], *“An Exciting Insight into the Healthcare Industry and Medical Practice Valuation”* [2002 – AICPA], and *“A Guide to Consulting Services for Emerging Healthcare Organizations”* [1999 John Wiley and Sons].

Mr. Cimasi is the author of numerous additional chapters in anthologies; books, and legal treatises; published articles in peer reviewed and industry trade journals; research papers and case studies; and, is often quoted by healthcare industry press. In 2006, Mr. Cimasi was honored with the prestigious *“Shannon Pratt Award in Business Valuation”* conferred by the Institute of Business Appraisers. Mr. Cimasi serves on the Editorial Board of the Business Appraisals Practice of the Institute of Business Appraisers, of which he is a member of the College of Fellows.



**Todd A. Zigrang**, MBA, MHA, ASA, FACHE, is the Senior Vice President of **HEALTH CAPITAL CONSULTANTS (HCC)**, where he focuses on the areas valuation and financial analysis for hospitals and other healthcare enterprises. Mr. Zigrang has significant physician integration and financial analysis experience, and has participated in the development of a physician-owned multi-specialty MSO and networks involving a wide range of specialties; physician-owned hospitals, as well as several limited liability companies for the purpose of acquiring acute care and specialty hospitals, ASCs and other ancillary facilities; participated in the evaluation and negotiation of managed care contracts, performed and assisted in the valuation of various healthcare entities and related litigation support engagements; created pro-forma financials; written business plans; conducted a range of industry research; completed due diligence practice analysis; overseen the selection process for vendors, contractors, and architects; and, worked on the arrangement of financing.

Mr. Zigrang holds a Master of Science in Health Administration and a Masters in Business Administration from the University of Missouri at Columbia, and is a Fellow of the American College of Healthcare Executives. He has co-authored *“Research and Financial Benchmarking in the Healthcare Industry”* (STP Financial Management) and *“Healthcare Industry Research and its Application in Financial Consulting”* (Aspen Publishers). He has additionally taught before the Institute of Business Appraisers and CPA Leadership Institute, and has presented healthcare industry valuation related research papers before the Healthcare Financial Management Association; the National CPA Health Care Adviser's Association; Association for Corporate Growth; Infocast Executive Education Series; the St. Louis Business Valuation Roundtable; and, Physician Hospitals of America.



**Anne P. Sharamitaro**, Esq., is the Vice President of **HEALTH CAPITAL CONSULTANTS (HCC)**, where she focuses on the areas of Certificate of Need (CON); regulatory compliance, managed care, and antitrust consulting. Ms. Sharamitaro is a member of the Missouri Bar and holds a J.D. and Health Law Certificate from Saint Louis University School of Law, where she served as an editor for the *Journal of Health Law*, published by the American Health Lawyers Association. She has presented healthcare industry related research papers before Physician Hospitals of America and the National Association of Certified Valuation Analysts and co-authored chapters in *“Healthcare Organizations: Financial Management Strategies,”* published in 2008.