Hospitals, Community Benefit and the L3C

How the L3C may offer a sustainable solution to uphold the charitable purpose of traditional nonprofit hospitals.

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Nonprofit Hospitals and the Social Mission

- Historically, in the U.S., hospitals were formed as charitable institutions – to serve the sick and poor who could not afford private health care.
- As hospitals were formed, they were provided tax-exempt status based on this charitable purpose.
- As of March 2010, nonprofit hospitals are now required to report, in detail, how they are meeting their charitable purpose and thus maintaining their tax-exempt status.

The Patient Protection and Affordable Health Care Act (March, 2010)

- Nonprofit hospitals are now required to report to the IRS, on their annual I-990, community benefit numbers.
- Community benefit is categorized into three broad areas including: charity care, government-sponsored healthcare and community benefit services.
- Hospitals are also required to conduct a community health needs assessment every three years and adopt an implementation strategy to address those needs.

Community Benefit Numbers

- The amount each hospital spends on community benefit varies considerably and an acceptable threshold has yet to be established.
- Nevertheless, most nonprofit hospitals are able to show through their annual community benefit dollars that they are earning their tax-exempt status.
- Above and beyond the dollar amount, nonprofit hospitals play a critical role in community health improvement efforts through screenings, health education, research, and other public health programs.
- The additional requirement of the community health needs assessment now requires nonprofit hospitals to strategically address the most pressing health needs of their communities.

The Rising Cost of Health Care

- The nonprofit health care sector is already struggling due to rising costs and cutbacks in reimbursement rates for government-sponsored health care programs.
- The increasing cost of health care, in addition to the expenses of these new requirements, has also increased the cost of providing community benefit.
- A rising trend of nonprofit hospital mergers, for-profit buy-outs, as well as hospital closings has illustrated the struggle of the modern nonprofit hospital.

The For-Profit Venture into Hospitals

- The national trend of for-profit mergers and acquisitions of nonprofit hospitals took off in the 1990s.
- However, for-profit entities, are not legally bound to uphold the traditional charitable purpose of the nonprofit hospital.
- In fact, an October, 2005 study funded by the Robert Wood Johnson Foundation found that uncompensated care levels dropped when a nonprofit hospital converted to for-profit ownership.
- For-profit take-over of nonprofit hospitals threatens the critical role they have traditionally played in community health improvement and health care services for the disadvantaged.

The Creation of a Conversion Foundation

- Conversion foundations are created when charitable community hospitals are sold to a for-profit buyer.
- More than 200 healthcare conversion foundations exist as of 2009.
- They are formed under the legal principle that tax-advantaged charitable assets should stay in local communities in perpetuity.
- Generally, when a nonprofit is sold, federal and virtually all state laws require that it dedicate the full value of its assets to a similar charitable purpose.

Issues with Conversion Foundations

- Although the charitable assets remain within the community, the newly created for-profit hospital may no longer be a recipient of those funds.
- Some of the funds may be transferred to another local nonprofit hospital while other funds remain with a newly formed private foundation.
- An October, 2005 study funded by the Robert Wood Johnson Foundation found that conversion foundations, formed from the sale of nonprofit hospitals, sometimes maintained or exceeded the nonprofit's financial contribution, but they did not substitute for the hospital's role as a community partner.

Other Issues with Conversion Foundations

- Conversion foundations have been plagued by perceived conflicts of interest.
- Some conversion foundations serve as watch dogs and are charged with monitoring agreements to maintain charity care policies and have had to initiate legal action when these commitments have not been fulfilled.
- In other cases, the nonprofit hospital's debt and need for capital improvements does not leave excess funds from the purchase deal to create a foundation.
- Finally, some communities outright oppose a for-profit take-over of their nonprofit hospital, regardless of whether a foundation would be formed.

The L3C Option: The Benefits

- Rather than a for-profit buy-out, nonprofit hospitals are also entering into joint ventures with for-profit partners.
- For these hybrid entities, a L3C would be a good option as it would require community benefit to be written directly into the articles of organization.
- The newly created L3C hospital would be able to attract the necessary capital from for-profit investors to address the rising costs of health care and, most importantly, fund its community benefit program.

The L3C Option: The Benefits

- Unlike the for-profit hospital model, the entity would be driven first and foremost by its socially beneficial purpose (community benefit).
- In addition to transferring its operational assets to the newly formed L3C, the new conversion foundation would be able to reinvest any remaining charitable assets into the new entity through Program Related Investments.
- Most notably, the local community would not lose an important leader and partner in community health improvement initiatives.
- The L3C hospital would continue to be a community partner through charity care and its contribution to community health improvement efforts such as a community health needs assessment and community benefit services such as screenings, health education, research, and other public health programs.