Washington Law Review

Volume 73 | Number 1

1-1-1998

Preventing Insider Misappropriation of Not-for-Profit Health Care Provider Assets: A Federal Tax Law Prescription

John F. Coverdale

PREVENTING INSIDER MISAPPROPRIATION OF NOT-FOR-PROFIT HEALTH CARE PROVIDER ASSETS: A FEDERAL TAX LAW PRESCRIPTION

John F. Coverdale*

Abstract: Not-for-profit health care providers are converting to for-profit status on an unprecedented scale. Directors and officers have too frequently taken advantage of the conversions to misappropriate the organizations' assets. Common law remedies have proven inadequate, and many states have no specific statutory remedies. The state statutory remedies that have been enacted range from fairly comprehensive to quite inadequate. Not-for-profit health providers are generally also subject to the federal tax rules governing tax-exempt organizations. Until recently, however, the only sanction available to the Internal Revenue Service (IRS) was to revoke the organization's tax-exempt status. The IRS rarely invoked this remedy both because it seemed drastic and because it punished the organization rather than those who had misappropriated the funds. In 1996, Congress enacted penalty taxes called intermediate sanctions, which come into play when an insider derives an "excess benefit" in a transaction with the organization. Intermediate sanctions range from twenty-five percent to two hundred percent of the excess benefit. If energetically enforced, intermediate sanctions will discourage abuse. It is unlikely, however, that the IRS will devote the resources necessary to enforce them adequately. This Article proposes permitting qui tam actions modeled after the Civil False Claims Act to be brought in the Tax Court to enforce intermediate sanctions. Private citizens or community groups acting as relators could sue on behalf of the United States to enforce intermediate sanctions. If successful, they would recover attorney's fees from the defendant as well as a share of the tax imposed. The threat of facing such an action should greatly deter insiders from abusing their positions during conversion transactions. The ability of the IRS to dismiss complaints that lack merit and defendants' abilities to recover attorney's fees from relators whose complaints are clearly frivolous or vexatious should provide considerable protection against the filing of qui tam intermediate sanction actions that lack merit.

I. INTRODUCTION

Not-for-profit hospitals and other health care organizations are converting to for-profit status on an unprecedented and accelerating scale.[1] These conversions involve mammoth transfers of assets and can

* Associate Professor of Law, Seton Hall University School of Law, Newark, New Jersey. The author wishes to thank Maurice Napolitano for research assistance and John Jacobi for helpful comments. The research for this Article was supported by a grant from Seton Hall University School of Law.

1. As used in this Article, the term "not-for-profit organization" refers to an entity that under state law may in fact make a profit, but has no stockholders or other owners and is not permitted to distribute its profits (net earnings) to those who control it or financially support it. Many but not all not-for-profit organizations are also tax-exempt under federal law. *See* Bruce R. Hopkins, *The Law of Tax-Exempt Organizations* § 1.1, at 4–5 (6th ed. 1992). For purposes of this Article, the two most important categories of tax-exempt organizations are charitable organizations exempt from tax under

provide unscrupulous insiders with opportunities to enrich themselves at the expense of the not-for-profit organizations and ultimately of the communities they serve. In the face of mounting evidence that insiders have been doing precisely that, states have begun to increase their efforts to police conversions. Federal action is also needed, both because of the inadequacy of many state responses and because of the distinctive federal interest in preserving not-for-profit assets.

Congress responded to this need in 1996 by passing new tax legislation in the form of intermediate sanctions.[2] These penalty taxes on insiders who take undue advantage of not-for-profit organizations are, however, likely to prove ineffective without further enforcement mechanisms because the Internal Revenue Service (IRS) will probably not dedicate sufficient resources to policing these transactions. This Article proposes allowing private parties to bring intermediate sanction actions on behalf of the United States in much the same way that private citizens can now bring qui tam[3] actions for violations of the Civil False Claims Act.[4]

Part II summarizes recent developments in the conversion of not-for-profit health care providers to for-profit status, the problem of private enrichment of insiders in the course of such conversions, the state legislative responses to the problem, and the need for a federal solution. Part III explains the existing intermediate sanction legislation and argues that these provisions will be ineffective without significant enforcement efforts. Part IV proposes that citizen enforcement through qui tam actions be authorized. Qui tam enforcement of intermediate sanctions would help prevent misappropriation of not-for-profit assets without obstructing desirable conversions.

I.R.C. § 501(c)(3), and social welfare organizations exempt from tax under I.R.C. § 501(c)(4). Most not-for-profit hospitals are 501(c)(3) organizations. Most not-for-profit health maintenance organizations are 501(c)(4) organizations.

2. I.R.C. § 4958 (West 1997).

3. Actions brought by relators on behalf of the government as well as themselves are called "qui tam" actions, from the Latin phrase *qui tam pro domino rege quam pro seipso*, referring to persons who bring actions both for their own interests and those of the King. *See* Note, *The History and Development of Qui Tam*, 1972 Wash. U. L.Q. 81, 83 (citing 3 W. Blackstone, *Commentaries on the Laws of England* 160 (1st ed. 1768)). Qui tam actions became popular in thirteenth century England because they opened to private parties the doors of the royal courts in which it was necessary to allege the King's interest. *See* John T. Boese, *Civil False Claims and Qui Tam Actions* 1-7 (1998).

4. 31 U.S.C. §§ 3729–3733 (1994).

II. BACKGROUND

A. Conversions of Not-For-Profit Health Care Providers to For-Profit Status

Driven by increasing competition and the need to raise large amounts of capital, not-for-profit health care providers have been converting to for-profit status at a dizzying rate. After a decade in which about ten hospitals a year converted to for-profit status,[5] thirty-one hospital conversions took place in 1994, and fifty-nine in 1995.[6] Conversions of Blue Cross & Blue Shield plans, though less numerous, involve huge amounts of assets.[7] Health maintenance organizations (HMOs) have also been converting to for-profit status. Originally most HMOs were not-for-profit organizations, but over the last decade, for-profit HMOs have become dominant both because of conversions and because of the creation of new for-profit HMOs. In 1981, eighty-two percent of HMOs, comprising eighty-eight percent of total membership, were not-for-profit. By 1995, only twenty-nine percent of HMOs, with forty-one percent of total HMO membership, were not-for-profit.[8]

Conversions of not-for-profit health care providers to for-profit status have effected the largest transfer of charitable assets in history, approximately nine billion dollars,[9] including \$1.6 billion in 1995 alone.[10] Individual transactions can be very large. The 1996 restructuring of Blue Cross & Blue Shield of California into WellPoint Health Network, Inc., led to the creation of two foundations with combined assets of three billion dollars.[11] The failed sale of Blue Cross & Blue

5. *See* Jack Needleman et al., *Hospital Conversion Trends*, Health Aff., Mar.–Apr. 1997, at 187, 190.

6. *See* Thom Wilder, *Non-Profit Conversions: Conversion of Not-For-Profit Hospitals to For-Profit Status Stirs Up Concerns*, 4 Health Care Pol'y Rep. (BNA) 1354 (Aug. 19, 1996).

7. *See infra* notes 11–12 and accompanying text.

8. Gary Claxton et al., *Public Policy Issues in Nonprofit Conversions: An Overview*, Health Aff., Mar.–Apr. 1997, at 9, 12 (citing InterStudy, *The InterStudy Competitive Edge, Part II: Industry Report* (Apr. 1996)).

9. Tamar Lewin & Martin Gottlieb, *Health Care Dividend—A Special Report: In Hospital Sales, an Overlooked Side Effect*, N.Y. Times, Apr. 27, 1997, at A1.

10. *NAAG Advocates Role for Attorneys General in Nonprofit Conversions*, 6 Health L. Rep. (BNA) 468 (Mar. 27, 1997).

11. *See Blue Cross of California: For-Profit Status Is Final with Donation to Charities*, Wall St. J., May 21, 1996, at B5.

Shield of Ohio to Columbia/HCA involved a proposed price of nearly \$300 million.[12]

Conversions take many forms, but until recently the not-for-profit organization usually divested itself of its operating assets and ceased to be actively involved in providing health care. The operating assets were sometimes sold to an existing for-profit corporation in exchange for cash, stock, notes, or other property. The proceeds were either held by the selling not-for-profit corporation (which became a charitable foundation with investment assets, but which no longer operated a health care facility) or contributed to another not-for-profit organization to be used for charitable purposes. At other times, the not-for-profit corporation formed a new for-profit corporation, to which the not-for-profit corporation contributed its operating assets in exchange for cash, stock, notes, or other property. Again, the proceeds were held by the not-for-profit corporation or contributed to another not-for-profit organization to be used for charitable purposes. Both types of transactions were sometimes followed by a merger between the for-profit corporation involved in the conversion and another for-profit corporation.[13]

Recent conversions of not-for-profit health care organizations have frequently taken a third form in which the not-for-profit remains involved in providing health care, albeit in a passive role. These conversions involve joint ventures between the acquiring corporation and the not-for-profit organization. In these transactions, the not-for-profit health care provider contributes its operating assets to a for-profit partnership or limited liability company in return for an interest in the partnership or limited liability company and cash, stock, notes, or other property from the acquiring corporation. The partnership or limited liability company operates the hospital or health care provider. The acquiring corporation usually controls the partnership or limited liability company, with the not-for-profit organization as a passive investor.[14]

Conversions raise important questions about the role of not-for-profit organizations in health care. Are not-for-profit health care providers more or less efficient than for-profit providers? What benefits, if any, do they provide that for-profit health care organizations do not provide? Do

12. *See* Diane Solov, *Insurance Dept. Hires Adviser To Help Review Blue Cross Sale Plan*, Plain Dealer (Cleveland), Aug. 27, 1996, at 4C.

13. *Cf.* Thomas Silk, *Conversions of Tax-Exempt Nonprofit Organizations: Federal Tax Law and State Charitable Law Issues*, 13 Exempt Org. Tax Rev. 745, 745 (1996) (presenting slightly more complex typology on which this description is based).

14. *See* Volunteer Trustees Found. for Research & Educ., *When Your Community Hospital Goes Up for Sale* 8–9 (1996).

they, for instance, offer significantly more free or discounted health care than for-profits? Does the absence of a profit motive enable not-for-profit health care providers to give greater weight to the needs of patients in their decisions? If they do provide distinctive benefits, do those benefits justify continuing tax-exempt status? Lack of data and philosophical differences make these and similar issues the subjects of passionate debate in the legal and health care communities.[15]

There is no debate, however, over the fact that the public has an interest in the assets of not-for-profit organizations. Many of the assets were contributed by charitable donors. Governments facilitated the accumulation of assets through charitable contribution deductions, exemptions from federal, state, and local taxes, favorable financing through tax-exempt bonds, and direct grants. The public, therefore, has an interest in these assets.

Both state law and federal tax law protect the public's interest in the assets of not-for-profit organizations. State law typically requires that the proceeds from the disposition of the assets of a not-for-profit entity continue to be dedicated to charitable purposes. A not-for-profit organization that disposes of its operating assets must either use the proceeds of the disposition for charitable purposes itself or contribute them to another not-for-profit organization that will.[16] Federal tax law requires organizations exempt from tax under section 501(c)(3) of the Internal Revenue Code to be organized and operated "exclusively" for exempt purposes.[17] Treasury regulations specify that to meet this requirement, either the organization's by-laws or state law must require that upon dissolution any assets not used directly for an exempt purpose be distributed to the government or to another not-for-profit organization.[18] Organizations qualify for exemption under section 501(c)(4) only if no part of their net earnings inures to the benefit of any private shareholder or individual.[19]

15. An excellent brief introduction to the literature on these subjects is found in Claxton et al., *supra* note 8, at 15–20.

16. *See, e.g.*, Cal. Rev. & Tax. Code § 23701d(a) (West 1992).

17. I.R.C. § 501(c)(3) (West 1997).

18. *See* Treas. Reg. § 1.501(c)(3)-1(b)(4) (as amended in 1990).

19. I.R.C. § 501(c)(4)(B) (West 1997).

B. *The Problem of Private Enrichment of Insiders*

A not-for-profit entity has no shareholders to whom the board of directors or trustees is responsible. Neither is it subject to the disclosure requirements of a publicly traded corporation. Conversions to for-profit status, therefore, present ample opportunities for private enrichment of officers and/or directors at the expense of the not-for-profit entity, and ultimately of the community it serves. Anecdotal evidence strongly suggests that insiders have taken advantage of those opportunities in a significant number of cases.

In at least a half-dozen publicized cases, the officer who negotiated the sale of assets of a not-for-profit health care provider ended up running a newly-formed foundation and enjoying the substantial salary and the prestige and power associated with controlling a sizable foundation.[20] Board members of not-for-profit organizations that have converted to for-profit status often end up with seats on the boards of new foundations established with assets contributed by the not-for-profit entities.[21] The CEO of the Cape Fear Memorial Hospital in Wilmington, North Carolina, for example, negotiated the sale of the hospital. Although he had no experience in grant-making, and although there was no formal search to fill the position, he was paid $90,000 per year to run the resulting forty-million-dollar foundation whose only other employee was a secretary.[22] The general counsel of Goodlark Hospital in Dickson, Tennessee (population 7900), whose father and uncles had founded the hospital, negotiated the hospital's sale in 1995. He became the $200,000-a-year president of the resulting foundation.[23] The prospect of an attractive position in a foundation may tempt officers and directors to accept a lower price for the assets of a not-for-profit organization than they might otherwise demand.

In some cases, the path by which assets of a not-for-profit health care provider are diverted to insiders is clearer and more direct. In 1991, Health Net, a California not-for-profit health plan with more than 800,000 members, proposed a conversion to for-profit status. Salomon Brothers appraised the value of Health Net at between approximately $250 million and $300 million. Outsiders made offers ranging from $130 million to $300 million. The Board, nonetheless, accepted an offer of

20. Lewin & Gottlieb, *supra* note 9, at A1.

21. *Id.*

22. *Id.*

23. *Id.*

$127 million, of which only $1.5 million was in cash, from a group of insiders, including the chairman of the board, other board members, and key management personnel.[24] In another case, the directors of a not-for-profit psychiatric hospital purchased its assets for $6.3 million and sold them two years later for $29.6 million.[25] Other cases are even more shocking. Inland Health Care purchased not-for-profit assets in 1984. A year later those assets were valued at more than fifty times the amount Inland paid for them.[26] Similarly, a year after PacifiCare purchased not-for-profit health care assets, they were valued at 125 times the amount PacifiCare paid.[27]

C. *State Responses and the Need for a Federal Solution*

Widespread publicity and concern over conversions of not-for-profit health care facilities has caught the attention of state legislatures and officials. At its spring 1997 meeting, the National Association of Attorneys General passed a resolution endorsing legislation to improve notice to the public and attorneys general of proposed conversions.[28] As of November 1997, twelve states and the District of Columbia had passed legislation intended to ensure greater state control over such transactions.[29] This year, similar legislation or regulations were also considered in twenty other states, of which twelve are either continuing to consider such legislation or are expected to reconsider it in 1998.[30]

Some of the new legislation is quite strong. Under the California Not-For-Profit Public Benefit Corporation Act,[31] enacted in 1996, before a California not-for-profit health care facility can dispose of a material amount of its assets or transfer control of them to a for-profit corporation, it must notify the state attorney general and obtain his or her consent.[32] The attorney general may require whatever information he or

24. 139 Cong. Rec. E3057 (daily ed. Nov. 24, 1993) (statement of Rep. Stark introducing Exempt Organization Reform Act of 1993).

25. Anclote Psychiatric Ctr., Inc. v. Commissioner, 70 T.C.M. (CCH) 1577, 1578 (1995).

26. Daniel M. Fox & Phillip Isenberg, *Anticipating the Magic Moment: The Public Interest in Health Plan Conversions in California*, Health Aff., Spring 1996, at 202, 203.

27. *Id.*

28. *NAAG Advocates Role for Attorneys General in Nonprofit Conversions*, *supra* note 10, at 468.

29. *See* Federation of Am. Health Sys., *Pending Hospital Conversion Legislation: State-by-State Summaries* tab 1 (Nov. 1997).

30. *See id.* tab 2.

31. 1996 Cal. Stat. ch. 1105 (codified at Cal. Corp. Code §§ 5913–5919 (West Supp. 1997)).

32. Cal. Corp. Code § 5914(a).

she determines is appropriate,[33] and may hire experts and consultants at the expense of the not-for-profit corporation.[34] Prior to consenting or not consenting to the transaction, the attorney general must hold at least one public meeting in the county in which the health care facility is located.[35] In determining whether to consent, conditionally consent, or refuse to consent to a transaction, the attorney general must consider a wide range of factors, such as whether private individuals will benefit at the cost of the institution, whether the market value of the assets has been artificially depressed, and whether there has been any breach of trust.[36]

Despite movement at the state level toward more effective regulation of conversions, there is a need for a federal response. State laws on the subject continue to be spotty and irregular. Many states have not enacted legislation and continue to rely entirely on common law remedies, whose efficacy is very much open to question. Even in states where the legislature has taken an interest in the problem, an adequate legislative response is far from certain as evidenced by the fact that conversion bills in twelve states have either died in the legislature or on the governor's desk.[37] Not all states that have enacted legislation have followed California's example of adopting comprehensive solutions. Virginia, for example, has enacted a skeletal statute that leaves open many questions, including the extent of the attorney general's powers of enforcement to require information.[38]

---

33. Cal. Corp. Code § 5914(b).

34. Cal. Corp. Code § 5919.

35. Cal. Corp. Code § 5916.

36. Cal. Corp. Code § 5917. Specifically, the attorney general is to consider whether (1) the terms and conditions of the agreement are fair and reasonable; (2) the agreement will result in inurement to a private individual or entity; (3) the price is the fair market value of the assets; (4) the market value has been manipulated by the parties' actions, causing the value of the assets to decline; (5) the proposed use of the proceeds is consistent with the purposes of the charitable trust holding the assets; (6) the agreement involves or constitutes a breach of trust; (7) sufficient information has been provided; (8) the agreement or transaction may have a significant effect on the availability or accessibility of health care services in the community; and (9) the agreement or transaction is in the public interest. Cal. Corp. Code § 5917.

These criteria were expanded in a review protocol issued by the California Attorney General in January 1997. The guidelines contained in the protocol stress the importance of determining whether the assets have been "marked to market" and "aggressively marketed." They also require the not-for-profit organization to show that it has "thoroughly considered all realistic alternatives, including mergers and/or strategic alliances with other non-profit entities—[both locally and regionally based] and transaction alternatives (e.g. sales of assets, leases, joint ventures, etc.) with for-profit partners." *Review Guidelines Established for Nonprofit Conversions*, 6 Health L. Rep. (BNA) 104–05 (Jan. 16, 1997).

37. *See* Federation of Am. Health Sys., *supra* note 29, tab 2.

38. *See* Va. Code Ann. §§ 55-531 to 55-533 (Michie Supp. 1997).

Also, states that enact adequate legislation may lack the resources and personnel to oversee conversions effectively. Conversions of not-for-profit health care providers to for-profit status are often very complex transactions, particularly when they involve joint ventures. Staff attorneys often lack the time and expertise to handle such transactions.[39] The roles of the various state officials who could potentially intervene are often unclear and overlapping.[40] Furthermore, successful state oversight of conversions depends critically on the "philosophy, . . . political independence, aggressiveness, commitment, and willingness to take risks" of the state officials charged with regulating the conversions.[41] Large transactions that get a lot of coverage in statewide media may capture the attention of an attorney general's office, but smaller transactions that do not receive statewide media attention may go forward without significant review from state authorities, even though they may have a major impact on a local community.

Apart from the problem of inadequate state enforcement, conversions implicate clear federal interests whose protection ought not be left entirely to the vagaries of state law. The federal government has made a significant contribution to the accumulation of the assets of tax-exempt not-for-profit entities by providing an exemption from federal income tax,[42] a deduction to donors,[43] and in some cases financing at a favorable rate through tax-exempt bonds[44] or various types of aid to the institution.[45] The federal government, therefore, has a distinct interest in preserving the assets for charitable purposes and preventing appropriation by private parties.

III. THE FEDERAL SOLUTION: INTERMEDIATE SANCTIONS

A. *Origin of Intermediate Sanctions*

Until intermediate sanctions were enacted, the only federal tax remedy for private inurement was revocation of the tax-exempt status of the not-

39. *See* Donald Shriber, *State Experience in Regulating a Changing Health Care System*, Health Aff., Mar.–Apr. 1997, at 48, 58.

40. *See id.* at 59–60.

41. *Id.* at 61.

42. *See* I.R.C. § 501 (West 1997).

43. *See* I.R.C. § 170 (West 1997).

44. *See* I.R.C. § 145 (West 1997).

45. *See, e.g.*, 42 U.S.C. § 300e-4 (1994).

for-profit organization.[46] This was not an effective remedy for several reasons. It did not directly affect insiders who diverted to themselves the funds of not-for-profit organizations, and therefore did little to dissuade them from raiding not-for-profit organizations' assets. It did nothing to recover the assets for the community, and in fact only made it more difficult for affected not-for-profit organizations to continue to carry on their mission by forcing them to take on a tax burden they did not have before. Finally, the IRS viewed revocation as an extreme penalty, to be invoked only in egregious cases. According to the Assistant Commissioner of Internal Revenue for Employee Plans and Exempt Organizations, IRS agents were "reluctant to propose revocation of exemption because the sanction of revocation of a hospital's exempt status greatly outweighs the private gain of a few individuals."[47] In fact, the IRS revoked exempt status very rarely. Although as of 1990 there were over 400,000 public charities exempt from tax under section 501(c)(3),[48] and 30,000 new organizations were joining the ranks of public charities each year,[49] the IRS revoked the tax-exempt status of only about twenty-five to thirty charities a year.[50]

In the early 1990s, as flagrant cases of siphoning off assets of not-for-profit health care providers began to receive media attention, the Treasury, the IRS, and Congress all began to look for more effective federal sanctions to prevent this abuse. Eventually their efforts led to the intermediate sanction provisions enacted in 1996 as a revenue offset to other provisions of the Taxpayer Bill of Rights 2.[51]

46. *See U.S. Department of the Treasury's Proposals To Improve Compliance by Tax-Exempt Organizations: Hearing Before the Subcomm. on Oversight of the House Comm. on Ways and Means*, 103d Cong. 9 (1994) (statement of Leslie B. Samuels, Assistant Secretary for Tax Policy, Department of the Treasury); *cf.* Anclote Psychiatric Ctr., Inc. v. Commissioner, 70 T.C.M. (CCH) 1577 (1995) (noting that IRS had revoked not-for-profit hospital's tax-exempt status as result of egregious case of appropriation by officers and directors of large part of value of not-for-profit's assets).

47. *Tax-Exempt Status of Hospitals, and Establishment of Charity Care Standard: Hearing on H.R. 790 and H.R. 1374 Before the House Comm. on Ways and Means*, 102d Cong. 112 (1992) (statement of John E. Burke, Assistant Commissioner for Employee Plans and Exempt Organizations, IRS).

48. *Federal Tax Laws Applicable to the Activities of Tax-Exempt Charitable Organizations: Hearing Before the Subcomm. on Oversight of the House Comm. on Ways and Means*, 103d Cong. 8 (1993) (statement of Margaret M. Richardson, Commissioner, IRS).

49. *Id.* at 6 (statement of J.J. Pickle, Committee Chairman).

50. *Id.* at 59 (statement of John E. Burke, Assistant Commissioner for Employee Plans and Exempt Organizations, IRS).

51. *See* Taxpayer Bill of Rights 2, Pub. L. No. 104-168, §§ 1311–1314, 110 Stat. 1452, 1475–81 (1996) (codified at I.R.C. § 4958 and scattered sections of 26 U.S.C.).

The intermediate sanctions enacted in 1996 comprise penalty taxes on "excess benefit transactions" between insiders (described as "disqualified persons"[52]) and section 501(c)(3) and (c)(4) organizations that are not private foundations.[53] The key to the provisions is the concept of an "excess benefit transaction," which the statute defines as:

> any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit.[54]

Unlike the self-dealing provisions applicable to private foundations, which flatly prohibit specific kinds of transactions between private foundations and certain insiders,[55] the intermediate sanctions provided in section 4958 come into play only if the disqualified person receives in the transaction a benefit that exceeds the benefit received by the not-for-profit entity.[56] An insider can, for example, sell property to a tax-exempt organization without triggering intermediate sanctions provided that the consideration received for the property does not exceed its fair market value. By contrast, sales by insiders to private foundations are prohibited even if the price is not excessive.[57]

The simplest excess benefit transactions are payments to a disqualified person of excess salary or sales of assets for less than their fair market value. In these transactions, part of the not-for-profit organization's assets goes directly to the disqualified person without a corresponding benefit to the not-for-profit entity. The statute, however, also includes in the concept of excess benefit transactions more complex transactions in which the economic benefit is provided "indirectly" by the not-for-profit

52. For the definition of disqualified persons, see *infra* notes 62–66 and accompanying text.

53. Private foundations continue to be subject to their own special regime.

54. I.R.C. § 4958(c)(1)(A) (West 1997). Congress also authorized the Secretary to include by regulation in the concept of excess benefit transaction:

> any transaction in which the amount of any economic benefit provided to or for the use of a disqualified person is determined in whole or in part by the revenues of one or more activities of the organization but only if such transaction results in inurement not permitted under paragraph (3) or (4) of section 501(c), as the case may be.

I.R.C. § 4958(c)(1)(A). Thus far, no regulations have been issued. This type of excess benefit is likely to occur primarily in ongoing operations rather than in conversion transactions. It will not, therefore, be considered in this Article.

55. I.R.C. § 4941 (West 1997).

56. I.R.C. § 4958(c)(1)(A).

57. I.R.C. § 4941(d)(1)(A).

organization.[58] The Ways and Means Committee report describes excess benefit transactions as involving an "economic benefit provided directly by the organization (or indirectly through a controlled entity)."[59] In a footnote, the report explains:

> A tax-exempt organization cannot avoid the private inurement proscription by causing a controlled entity to engage in an excess benefit transaction. Thus, for example, if a tax-exempt organization causes its taxable subsidiary to pay excessive compensation to an individual who is a disqualified person with respect to the parent organization, such transaction would be an excess benefit transaction.[60]

Indirect excess benefit transactions are not restricted to transactions that involve a subsidiary of the not-for-profit entity. The report of the Ways and Means Committee focuses on a particular type of indirect benefit, but the statutory language is much broader and should not be read narrowly to exclude types of indirect benefits not mentioned in the report.[61] The statutory definition of excess benefit transactions should cover, for instance, situations in which an officer or director causes a not-for-profit organization to sell assets for less than fair market value and later receives a benefit from the acquirer, for instance in the form of an above-market salary.

For intermediate sanctions to apply, the transaction must involve a "disqualified person."[62] The statute defines a disqualified person as "any person who was, at any time during the 5-year period ending on the date of [the excess benefit] transaction, in a position to exercise substantial influence over the affairs of the organization,"[63] a family member,[64] or a

58. I.R.C. § 4958(c)(1)(A).

59. *See* H.R. Rep. No. 104-506, at 56 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1143, 1179 (emphasis added).

60. *Id.* at 56 n.3, *reprinted in* 1996 U.S.C.C.A.N. at 1179 n.3.

61. *Cf.* National Treasury Employees Union v. Federal Labor Relations Auth., 810 F.2d 295, 299 (D.C. Cir. 1987) (refusing to give narrow reading on basis of legislative history to broad language of statute); Manocchio v. Commissioner, 78 T.C. 989, 994 (1982) (same).

62. I.R.C. § 4958(a)(1).

63. I.R.C. § 4958(f)(1)(A).

64. I.R.C. § 4958(f)(1)(B). Family members include a taxpayer's spouse, ancestors, brothers and sisters (by whole or half blood), children, grandchildren, great grandchildren, and the spouses of brothers and sisters, children, grandchildren, and great grandchildren. I.R.C. §§ 4958(f)(4), 4946(d) (West 1997).

controlled entity.[65] The definition deliberately sweeps broadly to catch transactions that benefit even indirectly any person who is in a position to influence the not-for-profit entity's decision making. The focus is on actual authority to influence decisions. A disqualified person includes not only organization managers, but also other employees and even persons who are not employees of the not-for-profit organization if they can in fact influence the organization's decision making.[66]

An excess benefit transaction triggers an initial tax on the disqualified person equal to twenty-five percent of the excess benefit.[67] If an officer, director, or trustee of the organization participated in the transaction knowing that it was an excess benefit transaction, that person is subject to a tax equal to ten percent of the excess benefit, but not more than $10,000.[68]

By the earlier of the date on which a notice of deficiency with respect to the initial tax is mailed or the initial tax is assessed,[69] the excess benefit transaction must be "corrected."[70] If it is not corrected within that time, a tax equal to two hundred percent of the excess benefit is imposed on the disqualified person.[71] "Correcting the transaction" means undoing it to the extent possible and taking any additional measures necessary to put the not-for-profit organization in a financial position that is "not

65. I.R.C. § 4958(f)(1)(C). A controlled entity means a corporation in which a disqualified person or a family member owns more than 35% of the total combined voting power, a partnership in which such persons own more than 35% of the profits interest, and a trust or estate in which such persons own more than 35% of the beneficial interest. I.R.C. § 4958(f)(3)(A). In determining ownership, rules similar to the attribution rules of § 4946(a)(3)–(4) apply. I.R.C. § 4958(f)(3)(B).

66. *See* H.R. Rep. No. 104-506, at 58 & n.10 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1143, 1181 & n.10. Although an IRS General Counsel Memorandum had treated all physicians as insiders for purposes of applying the private inurement proscription to hospitals, the House Ways and Means Committee clarified that physicians are disqualified persons for purposes of § 4958 only if they are in fact in a position to influence substantial control. *See id.* at 58 n.12, *reprinted in* 1996 U.S.C.C.A.N. at 1181.

67. I.R.C. § 4958(a)(1).

68. I.R.C. § 4958(a)(2), (d)(2); *see also* I.R.C. § 4958(f)(2) (defining organization manager as officer, director, or trustee of organization).

69. I.R.C. § 4958(f)(5)(A). A notice of deficiency is a letter stating the amount of tax over and above the amount shown on the return that the IRS believes the taxpayer owes. Notices of deficiency are generally known as "90 Day Letters" because their mailing starts the running of the 90-day period during which the taxpayer can petition the Tax Court for a redetermination of tax liability. *See* Michael I. Saltzman, *IRS Practice and Procedure* ¶ 10.03[2][a] (2d ed. 1991).

70. I.R.C. § 4958(b).

71. I.R.C. § 4958(b).

worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards."[72]

B. Need for Enforcement

Two leading commentators on the new intermediate sanction legislation, Hopkins and Tesdahl, suggest that the intermediate sanction provisions will be largely self-enforcing.[73] They believe that the new rules will work like the private foundation self-dealing rules, where a few well-publicized cases proved sufficient to bring most private foundations into voluntary compliance.[74] This overlooks, however, an essential difference between the two provisions. The self-dealing penalties are based on objective and easily determinable criteria. The transactions that constitute self-dealing are objectively defined without regard to the fairness of the price involved.[75] They are easily detected on audit, and there is little room for argument as to whether a particular transaction falls into the forbidden category or not. Similarly, disqualified persons are defined by objective and easily determinable criteria.[76] By contrast, the crucial definitions for purposes of intermediate sanctions require an examination of all facts and circumstances. For example, a transaction constitutes an excess benefit transaction not because it falls into an objectively defined category of transactions, but because it takes place at a price different from the fair-market price.[77] It is notoriously difficult to determine fair-market value in complex transactions involving multiple assets, including intangibles such as good will and going concern value.[78] Furthermore, a person is disqualified for purposes of intermediate sanctions not because he or she occupies an objectively identified position or has made contributions of a certain amount, but rather because he or she is actually in a position to influence the organization's decisions.[79]

---

72. I.R.C. § 4958(f)(6).

73. Bruce R. Hopkins & D. Benson Tesdahl, *Intermediate Sanctions: Curbing Nonprofit Abuse* 44 (1997).

74. *Id.*

75. I.R.C. § 4941(d) (West 1997) (listing transactions that constitute self-dealing).

76. I.R.C. § 4946(a)–(d) (West 1997) (defining "disqualified person" for private foundation rules, including self-dealing rules).

77. *See supra* notes 54–61 and accompanying text.

78. *See, e.g.*, Ithaca Indus. v. Commissioner, 17 F.3d 684, 687 (4th Cir. 1994) (noting difficulty of valuing goodwill and going concern value).

79. *See supra* notes 63–66 and accompanying text.

The complex inquiry often required for application of the intermediate sanctions suggests they will not be self-enforcing. In the absence of significant enforcement efforts, not-for-profit organizations and their officers and directors will have far less incentive to comply voluntarily with the intermediate sanction provisions than with the much more straightforward prohibitions against self-dealing by private foundations. The success of intermediate sanctions in curbing financial abuses by officers and directors will, therefore, depend in large degree on the energy with which they are enforced.[80]

Unfortunately, it seems unlikely that the IRS will mount the kind of enforcement effort that would be required for intermediate sanctions to succeed in curbing abuses during conversions of not-for-profit health care providers. Between fiscal year 1991 and fiscal year 1997, the budget of the IRS increased by only 1.6%,[81] far less than the rate of inflation. Total IRS staff declined in size during that period from approximately 116,000 to 103,000.[82] The IRS requested only a 2.2% budget increase with respect to 1997 and projected that total employment would decline from 102,926 to 102,385 full-time equivalents.[83] Nothing in the current political climate, in which IRS bashing has become the preferred indoor sport of both parties and many journalists, would lead one to expect that the IRS is likely to receive a significant increase in resources in the near future.[84]

As a result of budget difficulties, the IRS had fewer employees monitoring not-for-profits organizations in 1993 than in 1980, despite the fact that 30,000 new public charities were registered each year.[85] In recent years, the Employee Plans and Exempt Organizations Division has been relatively fortunate. Its total staff increased by about ten percent in

---

80. *See* H. Thomas Davis, Jr. & M. Antoinette Thomas, *New Penalties Unlikely To Cut Abuse at Charities*, 8 Chron. Philanthropy 52 (1996) (arguing that IRS's lack of enforcement resources will probably render intermediate sanctions ineffective).

81. *See* General Accounting Office, *IRS' Fiscal Year 1998 Budget Request: Testimony Before the Subcomm. on Treasury and General Government, Senate Comm. on Appropriations* 17 (GAO/T-GGD/AIMD-97-130 1997) (statement of James R. White, Associate Director, Tax Policy and Administration Issues, General Government Division).

82. *Id.*

83. *Id.* at 16.

84. *Cf., e.g.*, Michael Hirsh & Fred Goldberg, *Infernal Revenue Disservice*, Newsweek, Oct. 13, 1997, at 32, 33 (highlighting abuses in IRS collection practices).

85. *See Federal Tax Laws Applicable to the Activities of Tax-Exempt Charitable Organizations*, *supra* note 48, at 6 (statement of J.J. Pickle, Committee Chairman).

fiscal year 1995 and has declined only slightly since.[86] Nonetheless, the number of tax-exempt audits performed by the IRS has declined sharply with respect to earlier years.[87] The Employee Plans and Exempt Organizations Division has been concentrating its limited resources on small numbers of coordinated examinations of large exempt organizations.[88] The Special Assistant for Health Care to the Assistant Commissioner of the IRS for Employee Plans and Exempt Organizations complained recently, "We have declining resources, at the same time that the amount of work in this area is exploding."[89] Given these constraints, the IRS will not be able to pursue excess benefit transactions with the vigor that would be required to give intermediate sanctions the *in terrorem* effect they were designed to produce.

IV. THE REMEDY: CITIZEN ENFORCEMENT THROUGH QUI TAM

The problems stemming from inadequate enforcement activity by the IRS would be solved by allowing qui tam actions[90] in which private parties would act as relators bringing suit on behalf of the United States for excess benefit transactions.[91] Qui tam actions are already well-known in the health care field,[92] but new legislation would be required to

86. Letter from Jane Beniewicz, Staff Assistant, EP/EO Division, IRS, to John F. Coverdale 2 (Aug. 1, 1997) (on file with author).

87. *See Edited Transcript of the May 19, 1995 Breakfast Session of the Subcomm. on Health Care Organizations of the ABA EO Committee: Sullivan Holds Forth on Health Care Tax Topics*, 12 Exempt Org. Tax Rev. 87, 96 (1995) [hereinafter *Edited Transcript*].

88. *Cf.* Peter L. Faber, *How to Handle an IRS Audit of a Tax-Exempt Organization*, 16 Exempt Org. Tax Rev. 753 (1997) (discussing coordinated examination program audits); *IRS Moving Ahead on Exempt Organization Issues, Owen Says*, 12 Exempt Org. Tax Rev. 1141 (1995) (citing Marcus Owens, Exempt Organizations Division Director, as stating that IRS is channeling more of its resources into coordinated examination program).

89. *See Edited Transcript*, *supra* note 87, at 90.

90. For a definition of qui tam actions, see *supra* note 3.

91. Lack of resources to prosecute fraud vigorously in government contracting was one of the reasons advanced by the Senate Committee on the Judiciary for strengthening the qui tam provisions of the Civil False Claims Act in 1986. S. Rep. No. 99-345, at 7 (1986), *reprinted in* 1986 U.S.C.C.A.N. 5266, 5272 (stating that "perhaps the most serious problem plaguing effective enforcement is a lack of resources on the part of Federal enforcement agencies").

92. Relators have brought increasing numbers of qui tam civil false claims actions involving Medicare fraud and other false claims against the United States by health care providers. In 1992, relators filed 17 health care qui tam cases. In 1996, they filed 178. *Court Hears Arguments on Boundaries for Qui Tam 'Whistleblower' Cases*, 6 Health L. Rep. (BNA) 361 (Mar. 6, 1997). A number of these cases have involved large amounts. On February 24, 1997, SmithKline Beecham Clinical Laboratories, Inc. announced a $325 million settlement of a qui tam case. *See id.*

authorize qui tam actions based on the intermediate sanction provisions of the Internal Revenue Code.[93]

New legislation could be patterned on the existing qui tam provisions of the Civil False Claims Act[94] with appropriate modifications. This Part, therefore, first describes the existing qui tam provisions and then suggests the modifications that would be needed to make them workable for intermediate sanction actions.[95]

A. *Qui Tam Action Under the Civil False Claims Act*

The Civil False Claims Act[96] authorizes a private party to bring civil actions in the name of the government "for the person and for the United States Government" for false claims against the government.[97] Such suits must be filed under seal.[98] Congress required filing under seal to allow the government to ascertain whether it is already investigating the claims and to decide whether to intervene.[99] Filing under seal also prevents wrongdoers from being tipped off to the fact that they are under investigation, and protects the defendant's reputation from the taint of being ostensibly sued by the United States when the United States has not yet decided to intervene.[100] At the same time that the relator files the complaint, the relator must serve it on the government together with all the information and evidence the relator possesses.[101] Within sixty days—or such longer period as the court may authorize for good cause—the government may elect to intervene and proceed with the action, in which case it conducts the action, or may notify the court that it declines to take over the action.[102] The government may also elect to

---

93. The legislation currently authorizing qui tam actions permits them to be brought only under the Civil False Claim Act. 31 U.S.C. § 3730(b) (1994) (authorizing qui tam actions under Civil False Claims Act).

94. 31 U.S.C. §§ 3729–3733 (1994).

95. A thorough treatment of qui tam actions under the Civil False Claims Act is found in Boese, *supra* note 3. Also of interest is James B. Helmer, Jr. & Robert Clark Neff, Jr., *War Stories: A History of the* Qui Tam *Provisions of the False Claims Act, the 1986 Amendments to the False Claims Act, and Their Application in the* United States *ex rel.* Gravitt v. General Electric Co. *Litigation*, 18 Ohio N.U. L. Rev. 35 (1991).

96. 31 U.S.C. §§ 3729–3733.

97. 31 U.S.C. § 3730(b)(1).

98. 31 U.S.C. § 3730(b)(2).

99. *See* Boese, *supra* note 3, at 4-79.

100. *Id.*

101. 31 U.S.C. § 3730(b)(2).

102. 31 U.S.C. § 3730(b)(3)–(4).

pursue the claim through any alternate remedy, including administrative proceedings to determine a civil monetary penalty.[103] The government may dismiss the action even over the relator's objection after a hearing on the motion to dismiss.[104] Finally, the government may settle the action over the relator's objection if the court determines after a hearing that the proposed settlement is fair, adequate, and reasonable under the circumstances.[105]

If the government does not intervene and proceed with the action, courts have no jurisdiction to hear qui tam actions for civil false claims brought on the basis of "public disclosure of allegations or transactions in a criminal, civil, or administrative hearing, in a congressional, administrative, or Government Accounting Office report, hearing, audit, or investigation, or from the news media, unless . . . the person bringing the action is an original source of the information."[106] Nor may a person bring an action that is based on "allegations or transactions which are the source of a civil suit or an administrative civil money penalty proceeding in which the Government is already a party."[107] These bars on qui tam actions were designed to avoid parasitic suits in which the qui tam relator adds nothing of value.[108]

If the government intervenes, the relator is entitled to at least fifteen percent and not more than twenty-five percent of the proceeds of the action or settlement, depending on the importance of the relator's contribution.[109] In addition, the relator in a successful action is entitled to recover from the defendant reasonable expenses plus reasonable attorney's fees and costs.[110] If the government does not intervene, a successful relator is entitled to not less than twenty-five percent and not more than thirty percent of the proceeds.[111] As in cases in which the

---

103. 31 U.S.C. § 3730(c)(5).

104. 31 U.S.C. § 3730(c)(2)(A). A relator may dismiss the action only if the Attorney General and the court consent in writing. 31 U.S.C. § 3730(b)(1).

105. 31 U.S.C. § 3730(c)(2)(B).

106. 31 U.S.C. § 3730(e)(4)(A). An "original source" is "an individual who has direct and independent knowledge of the information on which the allegations are based and has voluntarily provided the information to the Government before filing an action under [the Civil False Claims Act] which is based on the information." 31 U.S.C. § 3730(e)(4)(B).

107. 31 U.S.C. § 3730(e)(3).

108. *See* Boese, *supra* note 3, at 4-29 to 4-35.

109. 31 U.S.C. § 3730(d)(1). If the action is based primarily on public information, the court may award the relator up to 10% of the recovery. 31 U.S.C. § 3730(d)(1).

110. 31 U.S.C. § 3730(d)(1).

111. 31 U.S.C. § 3730(d)(3).

government proceeds with the action, the successful relator is entitled to recover from the defendant reasonable expenses and attorney's fees.[112] If the government elects to pursue the claim through an alternate remedy, the relator is entitled to the same reward as if the action had gone forward in court.[113] If the government does not intervene and the relator conducts the action, the court may award expenses and attorney's fees to a prevailing defendant if the court finds that the claim was "clearly frivolous, clearly vexatious, or brought primarily for purposes of harassment."[114]

B. *Qui Tam Actions Based on Intermediate Sanction Provisions*

A qui tam provision for intermediate sanctions could be closely patterned on the existing qui tam provisions, with some modifications. An essential first step would be to establish jurisdiction.[115] The most desirable court for such cases is the U.S. Tax Court. The principal reason for preferring the Tax Court is its expertise in valuation issues, which would be central to all intermediate sanction cases.[116] In addition, the Tax Court's discovery rules make Tax Court discovery less burdensome to litigants than discovery in the district courts.[117]

The qui tam provisions of the Civil False Claims Act provide that the government can pursue a remedy through administrative proceedings.[118]

112. 31 U.S.C. § 3730(d)(3).

113. 31 U.S.C. § 3730(c)(5); *cf.* Stinson, Lyons & Bustamante, P.A. v. United States, 33 Fed. Cl. 474, *aff'd*, 79 F.3d 136 (1996) (holding that where United States had pursued its claim in alternate proceeding, qui tam relator was not entitled to share in settlement if relator could not have gone forward with action after Government chose not to intervene, because relator was not original source and, therefore, court lacked jurisdiction if Government did not intervene). For a discussion of this case, see Boese, *supra* note 3, at 4-114 to 4-116.

114. 31 U.S.C. § 3730(d)(4).

115. In a qui tam case, the taxpayer would be the defendant. This differentiates qui tam cases from ordinary Tax Court cases in which the taxpayer sues the Commissioner of Internal Revenue for a redetermination of deficiencies determined by the Commissioner of Internal Revenue. *See, e.g.*, Marshall W. Taylor et al., *Tax Court Practice* 13–38 (8th ed. 1993) (discussing jurisdiction of Tax Court).

116. *See* Sheryl Stratton, *Estate Tax Valuation Proposal Makes Judge Tannenwald Cringe*, 69 Tax Notes 1442 (1995) (noting that Tax Court hears many valuation cases).

117. *See* Leo P. Martinez, *The Summons Power and Tax Court Discovery: A Different Perspective*, 13 Va. Tax Rev. 731, 732, 745–50 (1994) (discussing Tax Court's "streamlined" discovery process). Although discovery in the Tax Court has in recent years become more similar to discovery in the district courts, some residual advantage remains. *See* Fred Stokeld, *More Civility Needed in Tax Practice, Specialists Say*, 72 Tax Notes 817 (1996) (noting difficulties with informal discovery in Tax Court, but extolling its merits).

118. *See supra* note 103 and accompanying text.

In the case of a qui tam intermediate sanction proceeding, the IRS should have the possibility of pursuing the matter through its ordinary audit and settlement procedures.

The intermediate sanction provisions of the Internal Revenue Code provide that the initial twenty-five percent tax will increase to two hundred percent if the excess benefit has not been corrected by the earlier of the date on which a notice of deficiency is mailed or the date on which the tax is assessed.[119] These provisions seem designed to encourage prompt voluntary correction of excess benefit transactions by sharply increasing the penalty in cases in which the taxpayer does not refund the excess payment until after a notice of deficiency has been issued or the tax has been assessed. If a qui tam intermediate sanction action is filed in the Tax Court, and the IRS does not choose to pursue the matter through its usual administrative procedures, no notice of deficiency will issue and no assessment will be made until the Tax Court renders its decision. In such cases, the trigger date for the increased penalty should be the date on which discovery closes in the Tax Court. On that date, the Tax Court proceeding will have reached a point that is functionally similar to the point at which a notice of deficiency is sent, because the information gathering process will have reached a conclusion. Taxpayers who correct the situation by refunding excess payments before the proceedings go beyond this point should be rewarded by being subject only to the twenty-five percent penalty. Taxpayers who refuse to refund the excess payments even after the completion of discovery and who are found to have received an excess benefit should face the entire two hundred percent penalty.

The Taxpayer Bill of Rights 2,[120] which established intermediate sanctions, requires 501(c)(3) and 501(c)(4) organizations to provide whatever information the Secretary may require concerning any excess benefit transaction and with respect to disqualified persons.[121] To facilitate enforcement of intermediate sanctions, Congress should enact further legislation requiring information with respect to transactions between disqualified persons and entities that directly or indirectly acquire substantial assets of a not-for-profit organization or control over substantial assets of a not-for-profit organization. Any person or entity that directly or indirectly acquires ownership of or control over more

119. *See supra* notes 67–71 and accompanying text.

120. Pub. L. No. 104-168, § 1312, 110 Stat. 1452, 1479 (1996) (codified at I.R.C. § 6033 (West 1997)).

121. *See* I.R.C. § 6033(b)(12)–(13), (f).

than twenty percent of the assets of a not-for-profit organization should be required to report annually all transactions—including employment, consulting, and similar contracts entered into during a period beginning two years before the acquisition and ending five years after the acquisition—with disqualified persons of the not-for-profit entity during the period beginning two years before the date of the acquisition and ending at the date of the acquisition.[122] This information should be reported to the not-for-profit organization or its successor in interest.[123] The not-for-profit organization or its successor in interest should in turn be required to include the information on its Form 990,[124] which is available to members of the public on demand.[125] In addition, the Secretary should require full disclosure on Form 990 of the terms under which assets constituting more than twenty percent of the assets of a not-for-profit entity were sold, leased, or otherwise transferred to the control of a for-profit entity. Such information would provide a factual basis for determining whether an excess benefit transaction had occurred and would give community groups and other interested private parties the information needed for filing an intermediate sanction action.

Information disclosed on Form 990 would not be publicly disclosed for purposes of the provisions of the Civil False Claims Act, which deny courts jurisdiction over qui tam actions brought on the basis of publicly disclosed information.[126] Public interest groups and other interested parties could, therefore, bring qui tam actions based on that information even if the relators had no other independent source of information.

If the only reason for proposing qui tam enforcement of intermediate sanctions were a desire to stimulate insiders to reveal information about

122. This suggestion might seem to raise privacy concerns. Officers and directors of not-for-profit organizations who enter into transactions with entities that acquire a major stake in the assets of the not-for-profit organization do not, however, have a legitimate expectation of privacy regarding the nature of their personal dealings with the acquirer. Full details of the compensation they receive from the not-for-profit organization are currently required to be reported on Form 990. *See* Form 990, pt. U (1996) (requiring detailed information on compensation of officers, directors, trustees, and regular employees). The public has a legitimate right to know the financial details of the not-for-profit organization's personal dealings with other entities to which a substantial portion of the organization's assets are transferred.

123. For these purposes, successor in interest should be defined broadly to include, in the case of a not-for-profit organization that has liquidated following the sale of its assets, the entity that received the largest contribution from the not-for-profit organization in the period beginning with the disposition of not-for-profit assets and ending with the liquidation of the not-for-profit entity.

124. The Secretary of the Treasury could require this information under I.R.C. § 6033(a), (b)(12)–(13), and (f).

125. *See* I.R.C. § 6104(e)(1)(A) (West 1997).

126. *See supra* note 106 and accompanying text.

fraud that might otherwise go unnoticed, it would be inappropriate to allow qui tam actions in such cases. My proposal to allow qui tam actions in this area is also based, however, on a concern that the IRS will not dedicate sufficient resources to imposing intermediate sanctions even when the information is relatively easily available. In this light, qui tam actions should be allowed even where the allegations are based on information contained in Form 990 that is accessible to the public. For the same reason, courts should have jurisdiction over qui tam intermediate sanctions where the allegations are based on information disclosed in the news media, contrary to the protections of the Civil False Claims Act, which denies courts jurisdiction over such actions unless the relator is the original source of the information.[127]

To avoid rewarding relators for bringing actions that the IRS would have brought in any case, courts should have no jurisdiction over actions based on information contained in Form 990 or published in the media until eighteen months after the due date for the first return in which the intermediate sanction should have been included or the date on which the information was reported on Form 990 or in the media, whichever comes later. This will give the IRS sufficient time in which to act independently if it intends to do so.

V. CONCLUSION

My goal in proposing qui tam actions is solely to protect the assets of not-for-profit hospitals and health care providers, not to prevent their conversion to for-profit status. Conversion may at times be the only way to permit a hospital or other health care provider to continue to operate, and in other cases may be a desirable solution to problems faced by not-for-profits.[128] There would, therefore, be reason for concern if it seemed that qui tam actions were likely to prove an obstacle to conversions in which no abuse were present.

That, however, seems unlikely. In the first place, no action could be filed until after the conversion had taken place. There is, therefore, no danger of pre-conversion qui tam actions obstructing the conversion process. Nor does it appear that there is much reason for concern about parties who oppose a conversion for reasons other than excess benefits trying to derail it with threats of future qui tam litigation. If officers and directors follow proper procedures and do not in fact derive excess

127. *Id.*

128. *See* Claxton et al., *supra* note 8, at 13–15.

benefits, they have little reason to take such threats seriously, especially in light of the IRS' right to dismiss the action and the defendants' ability to collect expenses and attorney's fees from relators who bring frivolous qui tam actions.[129]

Permitting qui tam actions would not impose excessive administrative burdens on the parties to conversion transactions. The only administrative burden on the not-for-profit organization would be the requirement that it include on its federal tax return information about salary and other benefits received by its disqualified persons from the acquiring entity. The not-for-profit organization would, under my proposal, receive that information from the acquirer.[130] The acquirer would be required to provide this information to the not-for-profit, but it is information that is readily available to the acquirer.[131] Administrative burdens would, therefore, be minimal.[132] Allowing qui tam actions to enforce intermediate sanctions would give community groups the tools they need to prevent the raiding of the assets of not-for-profit organizations in the course of conversions. The benefits of so doing more than offset the costs.

---

129. *See supra* notes 104, 114 and accompanying text.

130. *See supra* note 122 and accompanying text.

131. *See supra* note 125 and accompanying text.

132. Questions of privacy are discussed *supra* notes 120–26 and accompanying text.