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Nonprofit Hospitals, Tax Benefits, and Charity Care

Congress has had a continuing interest in the tax benefits for nonprofit hospitals over the years, as indicated in a Senate Finance Committee investigation in 2005, a Government Accountability Office (GAO) study in 2020, and a hearing by the House Ways and Means Subcommittee on Oversight in 2025. A consistent focus is whether nonprofit hospitals offer sufficient community benefits, with a specific interest in providing charity care, to justify their tax-exempt status.

Requirements For Tax-Exempt Status

For private nonprofit hospitals to be eligible for tax-exempt status, they must meet a *community benefit standard*. Health care is not by itself a stated objective in the tax provisions determining charitable (501(c)(3)) status. As a result, the requirement for nonprofit status for hospitals has been set by the Internal Revenue Service (IRS). Its 1969 ruling initiated the community benefit standard, while dropping a previous requirement to provide charity care. This ruling followed the enactment of Medicare and Medicaid in 1965, which substantially reduced the need for charity care by hospitals due to increased insurance coverage.

Generally, the community benefit standard requires the hospital to show that it has provided benefits that promote the health of a broad class of persons in the community. One way hospitals may demonstrate that they have met the community benefit standard is by providing charity care, also referred to as financial assistance (free or discounted services to eligible patients). Other types of community benefit include participation in means-tested programs such as Medicaid, providing health professions education, conducting health services research, providing subsidized health services, funding community health improvement, and donating cash or in-kind contributions to other health-related community groups. Community-building activities (such as for housing and the environment) may qualify if a link to community health can be shown. The IRS does not count shortfalls associated with Medicare or bad debts from those not qualifying for charity care as part of the community benefit standard.

The Patient Protection and Affordable Care Act, P.L. 111-148, added additional requirements for 501(c)(3) tax-exempt hospitals as part of the tax code. Specifically, Section 501(r) requires these hospitals to conduct community health needs assessments, establish a written financial assistance policy, limit charges to financial-assistance-eligible patients to amounts billed to insured patients, and not engage in extraordinary billing collections until an effort is made to determine eligibility for financial assistance.

The community standard benefit does not require a minimum percentage of spending or net income to be devoted to community care.

Value of Federal Tax Benefits

Nonprofit hospitals receive four federal tax benefits: exemption from the federal income tax, deductibility of charitable contributions to these hospitals, savings from the availability of tax-exempt bond financing, and exemption from the federal unemployment insurance tax. Because of lags in data, current estimates for the fiscal cost of all benefits are not available. The Joint Committee on Taxation provides projections for two items for FY2026: deductions of charitable contributions to the hospitals, which are projected to reduce revenues by \$7.6 billion, and tax-exempt bond financing, which will reduce revenues by \$1.8 billion. An industry-sponsored estimate of three provisions for 2022 estimated the benefits of income tax exemption (\$9.7 billion), tax-exempt bond financing (\$3.4 billion), and exemption from the federal unemployment tax (\$0.2 billion). An estimate by academic researchers for all four benefits for 2021 indicated the following total benefits: income tax exemption (\$11.5 billion), charitable contributions (\$3.2 billion), tax-exempt bond financing (\$2.1 billion), and exemption from the unemployment tax (\$0.2 billion). These total \$17 billion. The authors also indicate that adding benefits of state and local tax exemptions for income, sales, and property resulted in additional state and local benefits of \$20.4 billion, for a total benefit to hospitals of \$37.4 billion.

Another academic study indicated that the value of tax-exempt bond financing is much larger, \$9.4 billion for 2022, if it includes tax arbitrage profits: profits generated by hospitals that have significant assets, but issue debt at lower tax-exempt bond rates to finance projects while retaining investments that earn higher return. That estimate suggests a value of federal tax benefits of around \$24 billion in 2021 if tax arbitrage profits are added.

Value of Charity Care

Different studies have attempted to estimate the value of charity care that nonprofit hospitals provide, either as an aggregate level or relative to an income or tax benefit measure. One study estimated that in 2021 nonprofit hospitals spent \$15.7 billion on charity care, which accounted for 17% of total spending on community benefits of \$94 billion. They also spent \$41 billion on unreimbursed Medicare (45%) and \$1.26 billion on other unreimbursed means-tested programs (1%).

Studies indicate considerable variability across hospitals in spending on community benefits and charity care. For charity care, a study of spending in 2017 indicated that

charity care of all hospitals equaled 30% of net income, but the top 25% of hospitals ranked by net income had charity care equal to 16%. A study for 2021 found aggregate hospital spending on community benefits averaged 3.84% of hospital budgets, and ranged from 0.25% to 8.84% across hospitals. Tax benefits averaged 5.9%. The study also found that 80% of hospitals spent less on total community benefits than the value of tax benefits.

Comparison to For-Profit Hospitals

Some studies have found that for-profit hospitals spend more on charity care relative to resources than nonprofit hospitals. One study reported that for every \$100 in expenses, nonprofit hospitals spent \$2.3 on charity care, compared to \$4.1 for government hospitals and \$3.8 for for-profit hospitals. Testimony before the House Ways and Means Committee indicated that nonprofit hospitals spent 2% of operating revenues on charity care while for-profit hospitals spent 3.2%, and, respectively, 19% and 24% of the operating margin (operating revenues minus operating costs).

When controlled for teaching hospital status, hospital size, and geographic location, another study found no statistically significant difference between for-profit and nonprofit hospitals. The study also found no significant differences for medium-sized hospitals or by median area income, but did find that small nonprofit hospitals spent 3.1% of expenses compared to 1.8% by small for-profits, while large hospitals had the reverse: 2.6% by nonprofits and 3.7% by for-profits.

Options for Revision

Policy debates related to the tax treatment of hospitals often involve questions over whether nonprofit qualifying criteria and tax benefits are producing the desired level of community benefits, and whether the nonprofit exemption is being well implemented. Several options for revision to address concerns in these areas are discussed below. Other tax changes, such as the implementation of an excise tax, could also be considered.

A Minimum Charity Care Requirement

A number of states have set requirements for hospitals to provide charity care. A national requirement of this standard could be imposed.

A number of states impose financial assistance requirements on hospitals or require certain levels of assistance to expand or receive reimbursement from state indigent care funds. Generally, these require assistance based on patients' income and, in some cases, on insurance status. For example, Texas requires 5% of net patient revenues (payments from patients and their insurers) to be for community benefits, including 4% for charity care.

Another alternative is to provide a minimum level of charity care based on the value of the tax exemption. H.R. 3019 proposes this requirement, covering federal, state, and local tax exemptions.

Some stakeholders express concerns that minimum standards will cause safety-net hospitals (hospitals that serve low-income, uninsured, and vulnerable patients) and hospitals in underserved communities to fail. To protect these hospitals, minimum standards could apply only to hospitals with sufficient profits to cover them.

Legislative Clarity About Community Benefits

A GAO report recommended that Congress consider a legislative definition of community benefits. H.R. 3019 would establish a community benefit standard that would be met if a hospital (1) has its board drawn from the community; (2) treats Medicare and Medicaid patients with no limits on their number; and (3) spends an amount at least equal to the value of federal, state, and local tax exemptions on training, education, and research to improve patient care; improvement to facilities (with improvement to facilities equal to no more than 50% of the value of tax benefits); and free or discounted charity care. Spending on improvement to facilities does not include acquisitions.

Improvements in IRS Reporting, Oversight, and Enforcement

The GAO study also recommended improving Form 990 used to report community benefits, considering the benefits and costs of reporting on a hospital-by-hospital basis by hospital systems, establishing a process for identifying hospitals at risk of not meeting the community benefit standard, and establishing an audit code to identify this issue. The IRS adopted the last two recommendations, decided against hospital-by-hospital reporting, and has not made the adjustments to the form to fully meet the recommendations.

An Excise Tax on Financial Assets

Hospitals have significant investment assets estimated at \$447 billion in 2022. Universities with large endowments per student are subject to an excise tax, so some observers have suggested a similar tax could be imposed on hospitals. For comparison, universities had \$907 billion in endowments at the end of FY2023. A tax could also be imposed on hospital endowment income. Under such a tax, the revenue from hospitals could be used to assist in charity care for safety-net hospitals.

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