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REPORT CONCERNING
POSSIBLE ROLE OF MINISTRY OF HEALTH
OF THE CZECH REPUBLIC IN
TRANSFORMATION OF HEALTH SECTOR INSTITUTIONS
AND OWNERSHIP OF RELATED PROPERTY

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Ministry of Health of the Czech Republic

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Report to Ministry of Health

The Ministry of Health of the Czech Republic (MOH) has requested a brief summary of the role it could play in the transformation of government health care institutions from public bodies to private non-profit entities and the ownership of related properties. This Report lists the major legal matters relating to transformation of the Czech health care sector in which the MOH could become involved if deemed appropriate by the Czech government and discusses alternative property ownership arrangements. In those instances where the founders of health care NPOs may be districts or municipalities, the MOH might provide direction on many of the subjects noted in this Report.

I. Potential Role of MOH.

The role of MOH will be influenced by whether the Czech government (i) adopts a non-profit organization (NPO) law, (ii) relies upon some other new transformation law that authorizes the government to transfer health care institutions and property to NPOs even though no consideration is paid to the government in return for such transfer or (iii) relies upon existing property transfer laws. However, under any of these alternatives the MOH can play a significant role in the transformation process. The major activities in which the MOH could participate are discussed below.

1. Identify classes of institutions to be transferred, e.g., acute-care hospitals, polyclinics, nursing homes, etc.
2. Identify specific health care institutions within each class that will be transformed.

3. Determine structure of receiving entities.
 - a. Determine whether one institution or more than one institution will be transferred to a single receiving entity?
 - b. Determine whether a group of receiving entities, all controlled by a single parent entity, will be used for one or more institutions in some cases.
4. Determine the governance structure of the receiving NPO.
 - a. Determine how many (none, some, most or all) of the members of the governing board will be appointed by the founder and for what period of time (limited, extended or open-ended time period).
 - b. Determine whether and to what extent the founder will be involved in any other aspect of the governance of the NPO.
5. With respect to the transfer of each institution:
 - a. Identify the assets and liabilities to be transferred, how property will be owned after the transfer and the conditions of transfer. (Also see part II which discusses alternative ownership approaches.).
 - b. Identify the employees to be transferred.
 - c. Determine, through financial projections, whether the transferred institution will be financially viable. If not, determine how to solve this problem (e.g., through government subsidies for a limited period of time or during a transition period).

- d. Determine the extent of any continuing responsibility of the government for the transferred liabilities and for any later discovered liabilities that arose before the transfer date or relate to activities occurring before the transfer date.
 - e. Determine the extent of indemnification that the government is willing to give to the receiving entity.
 - f. Determine the impact that the transfer of employees will have on existing employee health, retirement, disability and other benefit arrangements and resolve all issues so that benefits continue without loss or at acceptable levels.
 - g. Make sure that the proper liability, property, malpractice, and other insurance covers the receiving entities and their assets and activities.
6. Make sure that the transferred institutions obtain all required government approvals needed to permit them to operate in a private (rather than a governmental) setting. This would include obtaining, for example, any required hospital license, health and/or safety approvals, certain medical equipment approvals, pharmacy approvals, etc.
 7. Determine what laws should be adopted in order to properly regulate a private health care sector. The following types of laws should be considered for adoption and application:
 - a. Institutional licensing (e.g., hospitals, nursing homes, polyclinics, etc.)

- b. Professional licensing (e.g., doctors, dentists, nurses, physical therapists, etc.)
- c. Health and safety rules.
- d. Environmental rules concerning toxic materials and radiation creating equipment.
- e. Accreditation rules relating to minimum standards for various aspects of the operation of health care institutions.
- f. Certificate of need cost containment rules that require government approval for adding new health services, major capital improvements, new beds, expensive equipment, etc.
- g. Rules that (i) prohibit doctors and other health care providers from making patient referrals to other health care entities in which the referrer has a financial interest and (ii) prohibit patient referrals in return for money or other consideration.
- h. Rules that require health care NPOs to file annual reports with the MOH.
- i. Rules that permit the MOH to actively monitor or, in some cases, to temporarily manage the operations of an NPO under certain serious circumstances or upon the happening of certain events, such as failure to carry out the purposes of the NPO, attempts to use NPO assets to benefit private individuals, fraud, etc. Until laws are adopted, the subject matter might be governed by MOH rules or regulations or by prescribing conditions in the founding document.

8. Determine whether the transfer process should also be used to reorganize or restructure the health care system. If so, determine how this is to be done.

II. Asset Ownership.

The Czech government now owns real and personal properties ("Properties") that are used for providing health care services through some Budgetary Organizations (BOs) and Contributory Organizations (COs). The Properties include hospitals, nursing homes, institutes, and other health care facilities. This Report discusses several alternative ways in which the Properties could be owned, held or used if the activities related to the Properties are moved from the government to an NPO. It may be that because of the circumstances relating to a specific BO or CO, one alternative is best applied to the assets used by that BO or CO while a different alternative is best applied to the assets used by another BO or CO. When making this determination, it will be important to weigh the goals to be achieved through the transformation process against the risks to be avoided or diminished.

Alternative 1. Transfer of Outright Ownership to NPO. Under this alternative, legal title to the Properties needed to provide health care services at a particular facility would be transferred from the government to an NPO. Presumably, no consideration would be paid by the NPO to the government for the transferred Properties since (i) the Properties would continue to be dedicated to charitable health care uses in the hands of the NPO just as they were in the hands of the government, (ii) the transfer would relieve the government of the burden of operating, managing and maintaining the Properties and of planning and conducting the health care services related to the Properties and (iii) an NPO

transferee would have great difficulty raising funds to be used to purchase the Properties.

Alternative 1 has the following advantages:

1. Ownership of the Properties by the NPO gives the NPO and its governing board greater control over the operations of the NPO and, therefore, greater incentive to provide for adequate maintenance of the facilities and to undertake high quality services and innovative practices that benefit the public.
2. If a private NPO (rather than the government) owns the Properties needed to provide health care services, this enhances the ability of the NPO to act like a private organization rather than a government operated organization. This is important because:
 - a. It puts the NPO in a better position to attract and retain competent governing board members and administrative staff.
 - b. Volunteers involved in governance of a private NPO have a greater sense of responsibility and initiative than they would if they were involved with a government operated institution.
 - c. It will attract users of health care services who wish to avoid what is perceived to be government bureaucracy and service delivery.
 - d. Individuals, businesses and other organizations are likely to provide more financial and advocacy support and place more trust in a non-profit institution than it does in what is perceived to be a government operated bureaucratic organization.

3. Assets can generally be used more efficiently if they are owned by a private entity rather than a government because they are much less subject to the political process and governmental restrictions and because a private entity generally has more flexibility and can react more quickly to changing needs than can a government.
4. It would be easier for an NPO to obtain capital financing if it owns the Properties.
5. There would be more incentive to properly maintain, repair and improve the Properties if they are owned by the NPO user of the property.

If Alternative 1 is used, the risk that an NPO will transfer valuable Properties to individuals or to for-profit legal entities for little or no consideration can be protected against in a variety of ways, including:

1. by requiring government consent to the sale or transfer of Properties to third persons;
2. by placing reversionary clauses (causing ownership to revert to the state) or restrictions in the legal documents that convey any Property interest to an NPO, whether a deed, lease, contract or otherwise;
3. by placing reversionary clauses or restrictions in the NPO founding document and governing instrument;
4. by authorizing a government official to commence court action (i) to restrain any improper transfer of Properties, (ii) to cause the operation of the NPO to temporarily be placed under the direction of the government or officer appointed by the government, and/or (iii) to

remove the existing governing board and replace it with individuals designated by the government;

5. by imposing penalties and/or taxes on NPOs for the unauthorized transfer of Properties;
6. by requiring a certain number of NPO governing board members to be appointed by the government for a limited or extended period of time;
7. by requiring continual monitoring of NPO activities by government appointed advisory boards; and/or
8. by requiring annual reporting to the government by NPOs.

Alternative 2. Ownership of Property by Government with Lease of Property to NPO and Operation and Use of Property by NPO. Under this alternative, legal title to the Properties would remain with the government and the government would lease the Properties to the NPO for a nominal amount. The NPO would occupy the Properties as a tenant and conduct the related health care services. A considerable degree of regulation of the use of property and the conduct of the institution could be provided for in the lease agreement to the extent appropriate for the particular institution. Advantages 1 - 3 under Alternative 1 could also be realized under the lease approach to a greater or lesser degree, depending upon the extent of controls retained by the government under the terms of the lease. Advantages 4 and 5 would be diminished.

Alternative 3. Ownership of Property by the Government and Management of the Operations of the Health Care Institution by an NPO Under a Management Agreement. Under this alternative, legal title to the Properties remains with the government and the health care service operations are managed by an NPO under a management contract. The management team would be employed by the NPO. The operational employees would be

employed either by the government or by the NPO or both. This would result in essentially a government institution with private management and, therefore, would lose most of the advantages described under Alternative 1. This approach would also suffer from conflicts between government policy and NPO policy.

Alternative 4. Property Owned and Operated by a "Public NPO." Under this alternative the government would create an NPO that it controlled through the appointment of the entire governing board and through the application of government rules and policies to the operation of the NPO and to its employees, including wage regulations. This alternative would be little different than the current operation of health care institutions by BOs and COs, except that legal title to property would be owned by the public NPO rather than directly by the government.

Reasons for Granting Tax Preferences to Charitable NPOs

A. Income Tax Exemption.

1. If an NPO assumes the expense and burden of providing a social service that was formerly provided by the government, the NPO should be allowed to apply its full revenues to the provision of such service without reduction for income taxes as was the case when the service was provided by the government. The conditions for granting the exemption would be that the revenues are so applied, that all compensation paid by the NPO is reasonable and that the managers and their families are not benefited by contracts of the NPO.
2. The tax savings amount resulting from exemption would be devoted to the charitable purposes of the NPO and would not be used to benefit private persons.
3. If there was no income tax exemption, the government would probably have to give the tax revenues back to NPOs in the form of operating subsidies.
4. Profits from the unrelated business activities of NPOs would remain subject to the income tax in order to avoid giving such activities an unfair competitive advantage against competing for-profit businesses.
5. The amount of tax revenue lost by the government would not be great since most NPO public benefit service activities operate at a loss or generate a relatively small net surplus after expenses. (Despite the existence of an exemption, NPOs could be required to file annual information returns with the Czech Republic.)

B. Deduction for Contributions by Donors.

1. This deduction would provide an incentive to donors to make charitable contributions. The larger the amount of charitable contributions made to NPOs, the smaller would be the requirement for government subsidies to NPOs.
2. The amount of tax revenue that would be lost by the government (i.e. the income tax rate times the amount of the contribution deduction) would be a smaller amount than the amount of the added benefit indirectly returned to the government through the ability of the government to reduce subsidies to NPOs by the entire value of the gift to the NPO.
3. If donors were not permitted to deduct their charitable contributions, this would cause a reduction in such contributions and, in turn, would put greater pressure on the government to increase subsidies to NPOs. In other words, the government would collect increased tax revenues but then probably would be required to pay that amount and more over to NPOs to make up for their loss in contributions received.

C. Exemption from Income Tax for Interest Received by the Holders of Bonds Issued by Health Care NPOs.

1. The exemption would encourage investment in capital improvements for health care facilities.
2. The exemption would assist health care NPOs to compete for capital dollars in the debt market of the Czech Republic (which has added importance since NPOs have no equity fundraising alternative).

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3. The cost to the government in lost taxes might be small compared to the savings the government would derive from reduced future subsidies to NPOs that could compete more successfully due to their ability to obtain modern infrastructure, buildings and equipment through borrowed funds.

D. Property Tax.

1. Points A. 1-3 also apply to the property tax.
2. Property owned and not used for charitable purposes (e.g., vacant land or office space rented to others) would be taxed.

E. VAT Tax.

Points A.1 - 4 also apply to the VAT tax.