

Regulators Examining Interested Party Transactions in Healthcare and in other Nonprofits

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State attorneys general, the IRS, and other regulators are focused on "interested party" (conflict-of-interest) transactions in the healthcare and nonprofit sectors. While these transactions are generally permissible and may often be in the organization's best interest, nonprofits and other regulated organizations should adhere to important best practices that will stand up to regulatory scrutiny.

Recently, the Minnesota Attorney General's Office sent requests for information to many nonprofit health care providers and other nonprofit organizations regarding conflict-of-interest transactions. The requests focus on a section of the organization's annual Form 990 that discloses transactions between the organization and the organization's "interested" or "disqualified" persons (such as its officers, directors, key employees, their family members, and businesses in which they own more than a 35% interest).

The AG's office and other regulators, including the IRS, want to ensure that these interested-party transactions are on fair market value terms or better for the nonprofit organization (or other regulated entity). Most nonprofit organizations may enter a transaction that involves a conflict-of-interest so long as it is fair and reasonable—and there may be good reasons to do so, including an interested party's special expertise.^[1] Still, nonprofits should adopt some important best practices to protect the organization's mission and assets and put the regulators examining these conflict-of-interest transactions at ease. These best practices include adopting a well-drafted conflict-of-interest policy, ensuring each member of the Board of Directors regularly reviews and understands that policy, and following the IRS-recommended "rebuttable presumption procedure" when evaluating a conflict-of-interest transaction.

When an organization follows the "rebuttable presumption procedure," the IRS will presume that a compensation arrangement or other transaction with a "disqualified person" is reasonable and fair market value. The procedure requires the following:

- The arrangement must be approved in advance by the Board of Directors or a committee composed entirely of individuals who do not have a conflict of interest with respect to the transaction or compensation arrangement (the person with the conflict may answer questions, but should not be present for the discussion or vote);



- The authorized body must obtain and rely upon appropriate data as to comparability (e.g., multiple bids, competitive offers, appraisals, etc.) prior to making its determination; and
- The authorized body must adequately document the basis for its determination concurrently with making that determination. This is generally done in board or committee minutes.

For assistance with conflict-of-interest transactions or responding to inquiries from regulators regarding these transactions, contact Wade Hauser or any member of Lathrop GPM's Health Law or Nonprofit & Tax-Exempt Organizations teams.

[1] Some types of organizations, including private foundations, are prohibited from entering certain transactions with their "disqualified persons" even if the terms are fair to the foundation. Notwithstanding the foregoing, private foundations may pay reasonable compensation to disqualified persons for necessary services.