

A Hospital's Not-For-Profit Status Remains At Risk As The IRS Confirmed Its First Revocation Under 501(r)



John W. Kaveney

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In the wake of the New Jersey Tax Court's decision in AHS Corp., d/b/a Morristown Memorial Hospital v. Town of Morristown, the certainty of a hospital's tax-exempt status has been placed into question. Now, with the first confirmed revocation by the IRS of tax-exempt status under Section 501(r), hospitals have one more reason to be particularly diligent in their efforts to comply with the IRS requirements to ensure that their tax-exempt status won't be challenged.

What Is Section 501(r)?

As part of the Patient Protection and Affordable Care Act (ACA), the federal government instituted Section 501(r) of Internal Revenue Code and thereby imposed new requirements applicable to charitable tax-exempt hospitals. Section 501(r) created new requirements for hospitals to maintain their 501(c)(3) tax-exempt status. In particular, it requires that the hospital meet the (1) community health needs assessment requirements, (2) financial assistance policy requirements, (3) requirements on charges and (4) billing and collection requirements, all of which are further defined in the ACA.

For purposes of the community health needs assessment, Section 501(r) requires a hospital to have conducted a community health needs assessment in that taxable year or in either of the two preceding taxable years and adopt an implementation strategy to meet the community health needs identified through the assessment. Moreover, the community health needs assessment must take "into account input from persons who represent the broad interests of the community served by the hospital facility,

including those with special knowledge of or expertise in public health" and be "made widely available to the public."

With regard to the financial assistance policy, the hospital must establish a written financial assistance policy that includes eligibility criteria for financial assistance, the basis for calculating amounts charged to patients, the method for applying financial discounts, the actions taken in the event of non-payment and measures to publicize the policy within the community. There must also be a written policy requiring the hospital to provide, without discrimination, care for emergency medical conditions to individuals regardless of their eligibility for financial assistance.

A hospital meets the requirements to limit charges by ensuring that there is a prohibition on gross charges and that the amounts charged for emergency or other medically necessary care provided to those eligible for assistance under the hospital's financial assistance policy is limited to no more than the amounts generally billed to individuals who have insurance covering such care.

Finally, with regard to the billing and collection requirements,

a hospital is in compliance if it does not engage in extraordinary collection actions before making reasonable efforts to determine whether the individual is eligible for assistance under the financial assistance policy of the hospital.

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The IRS's Recent Action Against One Unidentified Hospital

On February 14, 2017, the IRS issued a tax status letter¹

revoking the tax-exempt status of a “dual status” 501(c)(3) hospital operated by a “local county governmental agency.” The letter was only recently made public on the IRS website in August 2017 and does not identify the particular hospital’s name. However, the determination is likely to result in a loss by the hospital of the use of certain employee benefit plans, a bar on the receipt of tax-deductible contributions, disallowance of any tax-exempt bonds and likely property, income and other tax liabilities.

Among the reasons for the IRS’s action against the unidentified hospital was the facility’s failure to make its community health needs assessment widely available through its website. Furthermore, the unidentified hospital conceded that it had not drafted nor adopted an implementation for at least some of the recommendations included in its implementation strategy report. Ultimately the IRS deemed the unidentified hospital’s conduct to be egregious, though the tax status letter suggested the unidentified hospital was not too concerned about maintaining its tax-exempt status.

The IRS’s actions should come as no surprise to anyone in the healthcare industry. The IRS’s 2017 Work Plan identified the Internal Revenue Code Section 501(r) as an emerging issue on which the IRS intended to begin focusing in its examinations.² In the Work Plan, the IRS identified how as of September 30, 2016 it has already reviewed 968 hospitals and referred 363 hospitals for field examination. Surprisingly, the most common issues noted by the IRS warranting a field examination were not hyper-technical violations or obscure regulations but instead basic deficiencies such as the lack of a community health needs assessment, the failure to create financial assistance and/or emergency medical care policies, and the failure to meet the billing and collection requirements.

How Does This Impact My Hospital?

Although the unidentified hospital may not have been concerned about maintaining its tax-exempt status, the many hospitals that do wish to maintain such status must be vigilant and diligent in ensuring that they have the requisite written policies, procedures and statements in place to comply with the specific requirements of Section 501(r). In addition, with the IRS’s issuance of final regulations clarifying certain requirements set forth under Section 501(r), hospitals must also be well aware of those proposed regulatory requirements.³

Although it may be less likely that the IRS intends to re-

voke a hospital’s tax-exempt status if it appears that the hospital is making a good-faith effort to comply with Section 501(r), that does not mean that, in certain circumstances, the IRS will not seek to either levy fines or take the drastic step of revoking the institution’s tax-exempt status. As more time passes, and arguably hospitals have more time to become fully compliant, there is a distinct and real possibility that the IRS will lose patience with anything short of full compliance and could begin to place a more skeptical eye toward performing 501(r) reviews.

In a 2016 letter by then IRS Commissioner John Koskinen to Senator Charles Grassley,⁴ Commissioner Koskinen stated that the IRS is looking at hospital websites to identify institutions with the highest degree of likely non-compliance. Consequently, it is critical for hospitals to place their policies, procedures and statements in a location on their website that is widely accessible and easily located to assist in ensuring that the IRS, if it were to perform a review, could easily locate and assess the materials. By not doing so, the hospital leaves itself susceptible to further scrutiny by the IRS.

Hospitals should be diligent in ensuring not only that they meet the requirements set forth in Section 501(r) and its corresponding regulation, but they must also ensure that the materials are adequately posted on their websites. Careful attention should be placed on ensuring that all of the requirements are appropriately met as the IRS will be unlikely to ignore a deficiency somewhere in a hospital’s compliance efforts.

About the Author

John W. Kaveney is Of Counsel in the healthcare practice of McElroy, Deutsch, Mulvaney & Carpenter, LLP. He can be contacted at jkaveney@mdmc-law.com.

Footnotes

¹<https://www.irs.gov/pub/irs-wd/201731014.pdf>

²https://www.irs.gov/pub/irs-tege/tege_fy2017_work_plan.pdf

³<https://www.federalregister.gov/documents/2014/12/31/2014-30525/additional-requirements-for-charitable-hospitals-community-health-needs-assessments-for-charitable>

⁴<http://src.bna.com/i8H>

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