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Hospital Tax Alert

This Alert is sent exclusively to our clients and friends in the healthcare industry

The Internal Revenue Service is about to release two Notices concerning the complex regulations associated with the new rules governing hospitals under the Affordable Care Act. Compliance with these regulations is required for hospitals to retain their tax exempt status and the IRS has been receiving information as to just how many hospitals are having difficulty complying with the law. Already, over 1700 hospitals are under IRS review.

These new Notices provide important clarification of the proposed regulations and, perhaps more important, announce proposed exemptions for hospitals that find themselves inadvertently failing to comply with the new law.

Background

The Affordable Care Act added new Section 501(r), which, in turn, requires hospitals to meet a series of rules under Sections 501(r)(3) through 501(r)(6) in order to keep their tax exempt status under Section 501(c)(3). In particular, the new rules require:

- Hospital organizations (as defined in the rules) to conduct a community health needs assessment (CHNA) every three years and adopt an implementation strategy to meet the community health needs identified through the assessment. There is a $50,000 excise tax under Code Section 4959 for any hospital that fails to meet the CHNA rules
- Code Section 501(r)(4) requires a hospital to establish a financial assistance policy (FAP) and a policy relating to emergency medical care
- Hospital organizations are limited by new Section 501(c)(5) in the amounts they can charge for emergency or other medically necessary care provided to individuals eligible under the organization's FAP to not more than the amounts generally billed to individuals with insurance covering such care. It also prohibits the use of gross charges
- Code Section 501(r)(6) requires a hospital to make reasonable efforts to determine whether an individual is FAP eligible before using extraordinary collection actions (also described in the regulations) against the individual.

The first requirement is effective for a hospital organization's first tax year beginning after March 23, 2012. The remaining requirements became effective for hospital organizations in their first tax year beginning after March 23, 2010.

In June of 2012, the IRS published proposed regulations concerning the requirements of the last 3 requirements on the foregoing list. These rules are proposed to apply for tax years beginning on or after the date the regulations are finalized or temporary regulations are issued.

In April of 2013, the Service published the proposed regulations concerning the CHNA requirements of Code Section 501(r)(3) and the consequences for failing to meet any of the 501(r) requirements. These proposed regulations provide, importantly, that a hospital facility may rely on Section 1-501(r)-3 of the proposed

regulations for any CHNA conducted or implementation strategy adopted on or before a date six months after the date the proposed regulations are published as either final or temporary regulations. That is, so long as the hospital conducts its CHNA or adopts its implantation strategy on or before 6 months after the final regulations are published, then the hospital may rely on Section 1-501(r)-3 of the Proposed Regulations. This is likely in response to the requests from the American Hospital Association for transitional relief.

The New Announcements

Reliance on Proposed Regulations

The upcoming IRS Notices address the transitional reliance issues raised by these (and other similar) new rules. Because the preamble to the 2013 proposed regulations did not expressly state that taxpayers could rely on proposed regulation sections other than §1.501(r)-3 pending the publication of final or temporary regulations, Notice 2014-2 eliminates the resulting uncertainty in confirming that tax-exempt organizations may rely on all the provisions of both the 2012 and the 2013 proposed regulations pending publication of final guidance. This Notice also states that tax-exempt hospital organizations may rely on the definitions of "hospital facility" and "hospital organization" as presented in either the 2012 proposed regulations or (with minor amendments) the 2013 proposed regulations.

Proposed Rules for Simplified Correction and Disclosure

Given the complexity and the rigor of the new rules, and the general lack of infrastructure and process within most hospitals to effectively accomplish compliance, the loss of a non-complying hospital's tax exemption looms as a draconian penalty. To both ameliorate the impact of non-compliance resulting from misunderstanding of the new rules or inadvertence and to encourage remedy and disclosure, the proposed regulations provide for excusal from penalty for certain circumstances in which the failure to comply is neither willful nor egregious so long as the hospital organization corrects the error and makes disclosure. Notice 2014-3 proposes a new Revenue Procedure that will excuse a hospital organization's failure to meet a requirement of Code Section 501(r) as a failure within the meaning of Code §§ 501(r)(1) and 501(r)(2)(b) if all of the following tests are met:

1. The failure is not willful or egregious. Observe that neither of these test elements is adequately defined in the rules and, we submit, will likely be evaluated by the Service using its traditional "totality of the circumstances" method. More on this in the highlighted text, below;
2. The organization has begun to correct the failure; and
3. The organization properly disclosed the failure before it is first contacted by the IRS concerning an examination of the organization.

We observe that Section 5 of the proposed Revenue Procedure includes elements of an acceptable correction mechanism including restoration of every affected person to the position they would have been in but for the error, the correction must be made promptly and, most importantly, the existence of practices and procedures to assure compliance with the law.

It is the establishment and maintenance of adequate practices and procedures to assure compliance that the IRS often considers to determine if a violation of the law was willful or egregious. Put another, way, absent suitable procedures, a taxpayer is likely to appear to have behaved without regard for its obligations. We can assist you with development of practices and procedures that may be shown to the IRS as part of your effort to avoid inadvertent violations of this new law. Needless to say, establishment of such practices and procedures after the violation is discovered is of considerably less help in a challenge to your tax exemption.