

Health Reform Alert

IRS Addresses Participation in ACOs by Tax-Exempt Health Care Entities

April 4, 2011

On March 31, 2011, the Internal Revenue Service (IRS) issued Notice 2011-20, which considers the federal income tax implications to those hospitals and other health care organizations described in Code Section 501(c)(3) that seek to participate in the Medicare Shared Savings Program through an accountable care organization (ACO). This update summarizes the most significant conclusions of Notice 2011-20 for tax-exempt organizations and highlights some areas where additional guidance may be most needed.

What We Know From Notice 2011-20

In Notice 2011-20, the IRS provided tax-exempt organizations with initial guidance regarding the circumstances under which their participation in the Medicare Shared Savings Program through an ACO would not put at risk their tax-exempt status and would not cause any income they may receive from the ACO to be treated as unrelated business taxable income (UBTI). In particular, the IRS provided the following guidance—

- *Private Inurement and Private Benefit:* The IRS “expects that it will not consider a tax-exempt organization’s participation in the Medicare Shared Savings Program through an ACO to result in inurement or impermissible private benefit” if the following conditions are satisfied: the ACO has been admitted into, and not been terminated from, the Medicare Shared Savings Program; the tax-exempt organization’s ownership interest in the ACO, if any, is proportional to the exempt organization’s capital contributions; allocations, distributions and returns of capital are in proportion to ownership interests; the exempt organization’s share of losses does not exceed its share of income or gain; and contracts and other transactions between an ACO and its tax-exempt and taxable participants are at fair market value.
- *Unrelated Business Taxable Income:* The IRS expects that any Medicare Shared Savings Program payments received by a tax-exempt organization from an ACO will be deemed to be from activities substantially related to the performance of the charitable purpose of lessening the burdens of government (i.e., relieving the government of its burden of providing Medicare to those in need) and will not be treated as UBTI if the ACO meets all of the eligibility requirements established by CMS.

While this initial guidance from the IRS provides some assurance that tax-exempt organizations generally will be able to participate in the Medicare Shared Savings Program through an ACO without adverse federal income tax consequences, Notice 2011-20 leaves a number of important questions unanswered.



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Open Issues

Most significantly, the IRS generally declined to identify when a tax-exempt health care organization's participation in non-Medicare Shared Savings Program activities through an ACO (i.e., ACO shared savings activities with payors other than Medicare) would be substantially related to the health care organization's tax-exempt purposes. If such activities were deemed not to be substantially related to the tax-exempt organization's tax-exempt purposes, income from such activities could be treated as UBTI, and, if those activities were a substantial part of a tax-exempt organization's activities, they could potentially jeopardize the organization's tax-exempt status.

Although Notice 2011-20 strongly implies that a shared savings program involving fee-for-service Medicaid patients would further tax-exempt purposes because it would involve "relieving the poor," the Notice otherwise asks for comments about how CMS and IRS could help ensure that participation by tax-exempt organizations in other shared savings programs would further exempt purposes.

IRS Request for Comments

In Notice 2011-20, the IRS points out that it has issued public rulings on the federal income tax consequences to tax-exempt health care organizations from their participation in joint ventures with taxable entities, but it has asked for comments regarding what additional guidance, if any, is needed to facilitate participation by tax-exempt organizations in the Medicare Shared Savings Program through ACOs.

In particular, the IRS requested comments on the following topics—

- If additional guidance is required, which criteria or requirements should be analyzed in determining whether participation by a tax-exempt organization in the Medicare Shared Savings Program through an ACO is consistent with tax-exempt status under Code Section 501(c)(3) and whether the tax-exempt organization is receiving unrelated business income?
- How a tax-exempt organization's participation in certain non-Medicare Shared Savings Program activities through an ACO furthers or is substantially related to an exempt purpose, and which criteria, requirements or safeguards would ensure the furtherance of such exempt purposes (especially in the absence of regulatory safeguards similar to those present in the Medicare Shared Savings Program—e.g., regulatory requirements imposing quality performance and other standards on non-Medicare Shared Savings Program activities—and any governmental monitoring and oversight of non-Medicare Shared Savings Program activities)?

Areas for Comments by Tax-Exempt Organizations

When providing comments to the IRS, tax-exempt organizations may want to request that the IRS provide guidance in connection with the following issues—

- On March 31, 2011, the Centers for Medicare & Medicaid Services (CMS) issued a Notice of Proposed Rulemaking that sets forth a number of requirements regarding the governance and structure of ACOs. Some of the requirements set forth in that Notice, including the requirements regarding shared governance and the necessity of legal entities to operate ACOs, may have significant impact on the ability of tax-exempt organizations to participate in ACOs. Comments asking for guidance on how the IRS will interpret its existing rulings in light of the governance and structural requirements applicable to ACOs could be extremely valuable in providing direction for tax-exempt organizations seeking to participate in the Medicare Shared Savings Program through ACOs.
- Tax-exempt organizations may also want to request guidance from IRS on whether certain structural elements for ACOs called for by CMS in the March 31 Notice (e.g., mechanisms to ensure quality, transparency, accountability and other "patient-centeredness" criteria) may be deemed to provide sufficient assurance that a tax-exempt

organization's participation in an ACO will be in furtherance of its tax-exempt purposes without requiring either that the exempt organization have a majority interest on the ACO's governing body or that the ACO have other contractual or governance safeguards to ensure that tax-exempt purposes are fulfilled.

CONTACT INFORMATION

If you have any questions regarding this alert, please contact —

Kenneth D. Alderfer
kalderfer@akingump.com
202.887.4059
Washington, D.C.

Brendan M. Wilson
brwilson@akingump.com
202.887.4349
Washington, D.C.