

IRS Fact Sheet

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Tax-Exempt Organizations Participating in the Medicare Shared Savings Program through Accountable Care Organizations

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The Centers for Medicare & Medicaid Services (CMS) has released [final regulations](#) describing the rules for the Medicare Shared Savings Program (Shared Savings Program) and accountable care organizations (ACOs).

[Notice 2011-20](#), 2011-16 I.R.B. 652 (April 18, 2011), summarized how the IRS expects existing IRS guidance may apply to § 501(c)(3) tax-exempt organizations (charitable organizations), such as charitable hospitals, participating in the Shared Savings Program through ACOs. This fact sheet confirms that Notice 2011-20 continues to reflect IRS expectations regarding the Shared Savings Program and ACOs, and provides additional information for charitable organizations that may wish to participate in the Shared Savings Program.

Shared Savings Program and ACOs

Q1) What is the Shared Savings Program?

A) Section 1899 of the Social Security Act (the Act), as amended by section 3022 of the Patient Protection and Affordable Care Act, establishes the Shared Savings Program that promotes accountability for care of Medicare beneficiaries, improves the coordination of Medicare fee-for-service items and services, and encourages investment in infrastructure and redesigned care processes for high quality and efficient service delivery. Under this program, groups of providers of services and suppliers that meet criteria specified by CMS may work together to manage and coordinate care for Medicare fee-for-service beneficiaries through an ACO. If an ACO meets quality performance standards and demonstrates that it has achieved savings against a benchmark established by CMS, it will be eligible to receive a payment from CMS equal to a portion of the total savings (Shared Savings). During the term of its initial agreement with CMS, an ACO may elect to participate in one of two Tracks. Under Track 1 (one-sided model), the ACO may share in savings but is not at risk for sharing in losses. Under Track 2 (two-sided model), the ACO agrees to take on the risk of sharing in losses (Shared Losses) in exchange for a greater share in savings. All ACOs will operate under a two-sided risk model during subsequent Shared Savings Program agreement periods.

For more information about the program, see the [CMS website](#).

Q2) What is an ACO?

A) Under the CMS final regulations, an ACO must be a legal entity formed under applicable state, federal, or tribal law by one or more Medicare-enrolled health care service providers or suppliers

that meet specified requirements.

For more information about ACOs, see the [CMS website](#).

Q3) Must an ACO be structured as a particular type of legal entity (for example, a corporation or partnership) to participate in the Shared Savings Program?

A) No. The CMS final regulations do not require an ACO to be any particular type of legal entity. The CMS final regulations generally require an ACO to be organized as a legal entity separate from its participants; however, a single, clinically-integrated organization — for example, a hospital employing physicians — may qualify as an ACO under the Shared Savings Program. The tax consequences for the ACO and its tax-exempt participants will vary depending on the type of entity.

Q4) How does the structure of the ACO affect the tax consequences for its tax-exempt participants?

A) An ACO structured as a corporation for federal tax purposes generally will be treated as a separate taxable entity from its participants. See Moline Properties, Inc. v. Commissioner, 319 U.S.436 (1943). On the other hand, if an ACO is structured as a partnership for federal tax purposes, its activities will generally be attributed to its partners. See, e.g., Rev. Rul. 2004-51; Rev. Rul. 98-15. An ACO structured as an LLC generally may choose to be treated as a corporation or as a partnership or an entity that is disregarded for tax purposes.

Participation by Charitable Organizations in an ACO

Q5) Can charitable organizations participate in the Shared Savings Program through an ACO?

A) Yes. If charitable organizations participate in the Shared Savings Program through an ACO along with private parties, the charitable organization must be sure that it continues to meet the requirements for tax exemption to avoid adverse tax consequences. For example, its participation must:

- not result in its net earnings inuring to the benefit of private shareholders or individuals, and
- not result in its being operated for the benefit of private parties participating in the ACO.

The IRS determines whether prohibited inurement or impermissible private benefit has occurred based on all the facts and circumstances.

Q6) Are there any special federal income tax rules relating to participation by charitable organizations in the Shared Savings Program through an ACO?

A) No, the general tax rules relating to charitable organizations apply. On March 31, 2011, the IRS released [Notice 2011-20](#), which summarized how the IRS expects existing IRS guidance may apply to charitable organizations participating in the Shared Savings Program through ACOs. See Q&A 18. Notice 2011-20 was based on proposed regulations issued by CMS on March 31, 2011 (76 FR 19528).

Q7) Can charitable organizations still rely on Notice 2011-20 even though the CMS final regulations are different from the proposed regulations?

A) Yes. Although the CMS final regulations differ from the proposed regulations in some respects, the discussion in Notice 2011-20 continues to reflect IRS expectations regarding the application of existing IRS guidance to charitable organizations participating in the Shared Savings Program through ACOs.

Shared Savings Program Activities

Q8) Can a charitable organization's participation in the Shared Savings Program through an ACO further charitable purposes?

A) Yes. As noted in Notice 2011-20, the IRS expects that participation in the Shared Savings Program (Shared Savings Program activities) through an ACO generally will further the charitable purpose of lessening the burdens of government within the meaning of Treas. Reg. § 1.501(c)(3)-1(d)(2).

Q9) Must the tax-exempt participant(s) in an ACO treated as a partnership have control over the ACO in order to ensure that the ACO's participation in the Shared Savings Program furthers a charitable purpose?

A) Not necessarily. Control by tax-exempt participants generally is relevant to determining whether participation in an ACO treated as a partnership will further the tax-exempt participants' charitable purposes. However, in the case of an ACO that has been accepted into (and not terminated from) the Shared Savings Program, the IRS expects that CMS's regulation and oversight of the ACO will be sufficient to ensure that the ACO's participation in the Shared Savings Program furthers the charitable purpose of lessening the burdens of government. Tax-exempt participants in ACOs treated as partnerships that plan to engage in activities other than participation in the Shared Savings Program should consult IRS guidance regarding joint ventures. See Q&A 12.

Q10) Will a tax-exempt participant's share of an ACO's Shared Savings payments be subject to the unrelated business income tax (UBIT)?

A) Generally, no. The IRS expects that, absent inurement or impermissible private benefit, any Shared Savings payments received by a tax-exempt participant from an ACO would derive from activities that are substantially related to the performance of the charitable purpose of lessening the burdens of government.

Non-Shared Savings Program Activities

Q11) Can an ACO conduct activities unrelated to the Shared Savings Program (non-Shared Savings Program activities) without jeopardizing the status of its tax-exempt participants?

A) Yes, in some circumstances. Whether an ACO's conduct of non-Shared Savings Program activities will jeopardize the status of a tax-exempt participant is analyzed under the general tax rules applicable to charitable organizations and will depend on all of the facts and circumstances. Some facts and circumstances to be considered include whether the non-Shared Savings Program activities:

- further an exempt purpose described in § 501(c)(3) (charitable purpose) (see Q&A 12),
- are attributed to the tax-exempt participant (see Q&A 14), or
- represent an insubstantial part of the participant's total activities (see Q&A 14), and

- do not result in inurement of the tax-exempt participant's net earnings or in the participant conferring impermissible private benefit.

Q12) Are there circumstances in which an ACO's non-Shared Savings Program activities can further a charitable purpose?

A) Yes. The IRS recognizes that certain non-Shared Savings Program activities may further a charitable purpose. For example, an ACO's activities related to serving Medicaid or indigent populations might further the charitable purpose of relieving the poor and distressed or the underprivileged. However, if an ACO is treated as a partnership, the ACO and its tax-exempt participants should consult IRS guidance regarding joint ventures — specifically, [Rev. Rul. 2004-51](#) and [Rev. Rul. 98-15](#) — for examples of partnerships conducting activities that further a charitable purpose of a tax-exempt participant.

Q13) Will every activity undertaken by an ACO, including non-Shared Savings Program activities, always further charitable purposes?

A) No. Although activities that promote health further charitable purposes in some circumstances, not every activity that promotes health supports tax exemption under § 501(c)(3). See, e.g., Federation Pharmacy Services, Inc. v. Commissioner, 72 T.C. 687, 691-92 (1979), aff'd, 625 F.2d 804 (8th Cir. 1980).

Q14) If an ACO conducts non-Shared Savings Program activities that do not further a charitable purpose, will the status of its tax-exempt participants be in jeopardy?

A) Not necessarily, but the answer will depend upon all of the relevant facts and circumstances. For example, an ACO's conduct of activities that do not further a charitable purpose will not jeopardize the tax-exempt status of one of its participants if the ACO's activities are not attributed to that participant. Even if the ACO's activities are attributed to a tax-exempt participant (for example, because the ACO is treated as a partnership for tax purposes), the participant's tax-exempt status will not be jeopardized if the ACO's non-charitable activities represent no more than an insubstantial part of the participant's total activities. On the other hand, the presence of a single, non-exempt purpose, if substantial in nature, may jeopardize a participant's tax exempt status. See Better Business Bureau of Washington, DC v. United States, 326 U.S. 279 (1945).

Q15) Will an ACO's non-Shared Savings Program activities always generate unrelated business income (UBI) for its tax-exempt participants?

A) No. The IRS recognizes that certain non-Shared Savings Program activities may be substantially related to the exercise or performance of a charitable purpose. For examples of such charitable purposes, see Q&A 12. Generally, non-Shared Savings Program activities that are substantially related to a tax-exempt participant's charitable purposes will not generate UBI for that participant. Tax-exempt participants in ACOs treated as partnerships should consult IRS guidance regarding joint ventures and UBI. See, e.g., Rev. Rul. 2004-51.

Whether an ACO's activities that are not substantially related to a charitable purpose will generate UBI for its tax-exempt participants will depend on a variety of factors. For example, certain kinds of income from the ACO, including dividends and interest, may be excluded from UBI under one of the modifications described in § 512(b) of the Code. In addition, if the ACO is treated as a partnership, whether a tax-exempt partner of the ACO will have to include its share of income derived from an activity in UBI will depend on such factors as whether the activity constitutes a

trade or business, is regularly carried on, or is specifically excluded from the definition of an unrelated trade or business under § 513 of the Code.

Tax Status of ACOs

Q16) Can an ACO engaged exclusively in Shared Savings Program activities qualify for tax-exemption under § 501(c)(3)?

A) Yes, provided that it meets all of the requirements for tax-exemption under § 501(c)(3). One requirement for tax-exemption is that the organization engages exclusively in activities that accomplish one or more charitable purposes. See Treas. Reg. § 1.501(c)(3)-1(c). As noted in Notice 2011-20, the IRS expects that Shared Savings Program activities generally will further the charitable purpose of lessening the burdens of government within the meaning of Treas. Reg. § 1.501(c)(3)-1(d)(2). Thus, an ACO engaged exclusively in Shared Savings Program activities could qualify for tax-exemption under § 501(c)(3), as long as the ACO also meets all of the other requirements for tax-exemption under that section. Note, however, that an ACO that is treated as a partnership or is disregarded for federal tax purposes (see Q&A 4) is not eligible to apply for tax-exempt status under § 501(c)(3).

Q17) Can an ACO engaged in both Shared Savings Program and non-Shared Savings Program activities qualify for tax-exemption under § 501(c)(3)?

A) Yes, provided it engages exclusively in activities that accomplish one or more charitable purposes and meets all of the other requirements for tax-exemption under § 501(c)(3). The IRS recognizes that certain non-Shared Savings Program activities conducted by an ACO may further a charitable purpose (see Q&A 12). If an ACO engages exclusively in Shared Savings Program and non-Shared Savings Program activities that accomplish charitable purposes, it may qualify for tax-exemption under § 501(c)(3), as long as the ACO also meets all of the other requirements for tax-exemption under that section.

Clarification of Notice 2011-20

Q18) Must a charitable organization always satisfy all five factors described in Notice 2011-20 to avoid inurement or impermissible private benefit?

A) No. A charitable organization participating in an ACO must ensure that its participation does not result in inurement or impermissible private benefit. Whether inurement or impermissible private benefit results from its participation will depend on all the facts and circumstances. Following existing IRS guidance, Notice 2011-20 indicates that, as a general matter, the IRS expects that it will not consider a charitable organization's participation in the Shared Savings Program through an ACO to result in inurement or impermissible private benefit to the private party ACO participants where the ACO has been structured in accordance with these five factors:

Factor 1. The terms of the tax-exempt organization's participation in the Shared Savings Program through the ACO (including its share of Shared Savings or Losses and expenses) are set forth in advance in a written agreement negotiated at arm's length.

Factor 2. CMS has accepted the ACO into, and has not terminated the ACO from, the Shared Savings Program.

Factor 3. The tax-exempt organization's share of economic benefits derived from the ACO

(including its share of Shared Savings payments) is proportional to the benefits or contributions the tax-exempt organization provides to the ACO. If the tax-exempt organization receives an ownership interest in the ACO, the ownership interest received is proportional and equal in value to its capital contributions to the ACO and all ACO returns of capital, allocations and distributions are made in proportion to ownership interests.

Factor 4. The tax-exempt organization's share of the ACO's losses (including its share of Shared Losses) does not exceed the share of ACO economic benefits to which the tax-exempt organization is entitled.

Factor 5. All contracts and transactions entered into by the tax-exempt organization with the ACO and the ACO's participants, and by the ACO with the ACO's participants and any other parties, are at fair market value.

However, no particular factor must be satisfied in all circumstances to prevent inurement or impermissible private benefit.

Q19) For purposes of Factor 1, does the written agreement need to specify the charitable organization's precise share or exact amount of any Shared Savings payments distributed by the ACO?

A) No. It is sufficient for the written agreement to set forth the *methodology* for determining an ACO's allocation of Shared Savings payments to the tax-exempt participant and the other Medicare-enrolled providers and suppliers participating in the Shared Savings Program through the ACO.

Q20) For purposes of Factor 2, will termination of an ACO from the Shared Savings Program automatically jeopardize the status of a tax-exempt participant?

A) No. Whether an ACO's termination from the Shared Savings Program jeopardizes the status of a tax-exempt participant will depend on all the facts and circumstances. Relevant facts include whether the ACO's activities after termination further a charitable purpose and whether the ACO's activities are attributed to the tax-exempt participant (for example, where the ACO is treated as a partnership). After the termination, all of the ACO's activities will be non-Shared Savings Program activities. See Q&As 11-15 for more information on charitable organizations participating in ACOs engaged in non-Shared Savings Program activities.

Q21) For purposes of Factor 3, must any ownership interests in an ACO be directly proportional to capital contributions, and must an ACO always distribute Shared Savings payments in proportion to such ownership interests?

A) Not necessarily. Factor 3 looks to whether, in the totality of circumstances, the tax-exempt participant's share of economic benefits derived from the ACO (including its share of Shared Savings payments) is proportional to the benefits or contributions the tax-exempt participant provides to the ACO. Factor 3 includes an example of proportionality based on existing IRS guidance. In the example, the charitable organization receives an ownership interest in the ACO; the ownership interest it receives is proportional and equal in value to its capital contributions to the ACO; and all ACO returns of capital, allocations, and distributions are made in proportion to ownership interests. However, not all ACOs need to conform to this example for purposes of Factor 3. Factor 3 takes into account all contributions made by the charitable organization and other ACO participants to the ACO, in whatever form (cash, property, services), and all economic benefits received by ACO participants (including shares of Shared Savings payments and any

ownership interests).

Electronic Health Records Technology

Q22) Does the 2007 IRS memorandum relating to electronic health records (EHRs) apply to a charitable organization participating in the Shared Savings Program through an ACO?

A) Yes. A [May 2007 Memorandum](#) from the Director of Exempt Organizations to the Directors of EO Examinations and EO Rulings and Agreements states that the IRS will not treat the benefits a hospital provides to its medical staff physicians as inurement or impermissible private benefit if (a) the benefits fall within the range of EHR software and technical support services that are permissible under certain regulations issued by the U.S. Department of Health and Human Services and (b) the hospital meets certain other specified requirements. The IRS will continue to follow this 2007 Memorandum with respect to all hospitals described in § 501(c)(3), including those participating in an ACO.