JANUARY 13, 2015

501(R) COMPLIANCE: NOTEWORTHY FINAL REGULATIONS TAKEAWAYS – PART ONE

Through the recently released Final Regulations, the IRS and Treasury Department have provided a road map for tax-exempt hospitals as they move toward full compliance with Code Section 501(r). As Hall Render previously reported, these Final Regulations track the prior guidance in many respects, but they also make numerous significant changes that hospital organizations must factor into their compliance strategies.

In this two-part series, Hall Render will highlight ten of the most noteworthy pronouncements from the Final Regulations. Here are the first five (which are described in the order in which they are encountered in the Final Regulations):

- *Government Hospitals*. In prior guidance, the IRS and Treasury Department have stated that government hospitals that also have been recognized as tax-exempt under Code Section 501(c)(3) generally must comply with Code Section 501(r). The Final Regulations reaffirm this and verify that, if such a hospital is exempt from filing Form 990, then it is not required to report separately on matters covered by that Form, either through a Form 990 or any alternative filing. This means that a government hospital does not have to file a copy of its implementation strategy or its audited financial statements. As one other notable addition, a government hospital that does not wish to comply with Code Section 501(r) may instead submit a request to voluntarily terminate its Code Section 501(c)(3) status (while retaining tax exemption as a governmental entity), which is an alternative some government hospitals may wish to consider.
- *Hospital Systems with Multiple Facilities*. In various ways, the Final Regulations allow and even encourage cooperation between related hospitals, such as between separate hospital facilities operated by a single hospital organization or between hospital organizations with a common parent. The critical takeaway, however, is that compliance ultimately is monitored at the hospital facility level. For example, a hospital organization with multiple hospital facilities may adopt an identical financial assistance policy ("FAP") for each facility but only if the policy satisfies applicable law with respect to each facility. Similar analysis applies for the community health needs assessment ("CHNA") and implementation strategy. As a further extension of the emphasis on hospital facilities, the IRS and Treasury Department expressly refused to allow hospital organizations to calculate the amount generally billed ("AGB") on a system-wide basis, finding that such calculations could result in AGB percentages that do not accurately reflect amounts billed at the various hospital facilities within the system. Careful attention to the specific requirements of the Final Regulations will allow hospital organizations to achieve efficiencies without sacrificing compliance.
- *Disregarded Entities and Partnerships*. After early guidance soliciting comments about whether a hospital organization should be considered to "operate" a hospital that it only partially owns, such as through a joint venture or partnership, the IRS and Treasury Department generally have adhered to the tax principle that activities of partnership-type entities are attributable to their partners or members. Accordingly, the Final Regulations state that a hospital facility is subject to Code Section 501(r) if it is operated by a hospital organization through a partnership-type entity or, for that matter, through a disregarded entity wholly owned by the hospital organization. Limited exceptions do apply, including for situations where the hospital organization both lacks sufficient control over the hospital facility to ensure that it furthers exempt purposes and treats operation of the hospital facility as subject to unrelated business income tax. Because past authority has suggested that hospitals could jeopardize their Code Section 501(c)(3) status if they enter into joint ventures without retaining some measure of control, however, it appears probable that most joint venture hospital facilities have not been structured in a way that will fit an exception and that they will have to satisfy Code Section 501(r) in some way. As an additional significant development, the Final Regulations amplify the pass-through reasoning to provide that any disregarded entity or partnership-type entity owned in whole or in part by a hospital organization is a "substantially related entity" and as such is subject to the FAP, AGB and billing and collection provisions of the Final Regulations. Hospital organizations thus must identify such entities and consider carefully how they will fit into the hospital facility's compliance strategy.
- *Correction, Reporting and Exemption Risk*. The Final Regulations revise and refine, but do not drastically change, the provisions from the proposed regulations relating to correction (and, in more serious cases, disclosure) of omissions and errors in Code Section 501(r) compliance. While hospital organizations should appreciate this safety net, they also must recognize that strict compliance with Code Section 501(r) remains essential. This point is underscored by the Final Regulations, which state (for example) that the fact a hospital

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facility has previously made the same omission or error is a factor that tends to show that the omission or error is not inadvertent. Repeated omissions or errors thus will raise red flags and ultimately may subject a hospital facility's income to federal income tax or even jeopardize the hospital organization's Code Section 501(c)(3) status. On a more positive note, the Final Regulations view the establishment, review and, if necessary, revision of practices and procedures as a positive factor, and hospital organizations certainly should focus their energies upon developing effective practices and procedures that will promote compliance.

- *Community Health Needs Assessments and Implementation Strategies*. Given the prior timetable for Code Section 501(r) compliance, all hospital organizations should have completed and approved their first CHNAs and implementation strategies. Accordingly, the most immediate question under the Final Regulations is what should hospital organizations be doing during the interval before their next CHNAs and implementation strategies are due? Thankfully, the Final Regulations confirm that the IRS and Treasury Department anticipate that hospital organizations will "build upon previously conducted CHNAs" rather than create an entirely new CHNA every three years. The Final Regulations also confirm that hospital organizations must take into account comments that they receive from the public about their CHNAs and report on such comments in their next CHNAs, so hospital organizations should ensure that they have channels for receiving such comments. In addition, hospital organizations must report annually through the Form 990 about how they are addressing the needs identified through their CHNAs, which demands ongoing attention to the CHNA and implementation strategy. Finally, the Final Regulations strongly emphasize the value of collaboration between hospital organizations. For their first CHNAs, many (if not most) hospital organizations opted to "go it alone." In light of the IRS and Treasury Department's continued focus on cooperation, a hospital organization would be prudent to consider whether its charitable purposes might be better served through partnering with another organization to identify community health needs and develop a joint implementation strategy that enables them to accomplish together what neither could achieve separately.

Later this week, Hall Render will publish the second part of this article series, which will address the most significant developments regarding FAPs, the AGB and billing and collection practices. Hospital Organizations should continue to familiarize themselves with the Final Regulations as they review and revise their compliance strategies.

Your questions about the final regulations and the requirements of Code Section 501(r) can be directed to:

- Jeff Carmichael at 317-977-1443 or jcarmichael@hallrender.com;
- Calvin Chambers at 317-977-1459 or cchambers@hallrender.com; or
- Your regular Hall Render attorney.

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