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## Questions or Assistance?

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## IRS Releases Further Guidance for Tax-Exempt Hospitals

On December 30, 2013, the Internal Revenue Service (“IRS”) published a pair of notices providing further interim guidance regarding the additional requirements set forth in section 501(r) of the Internal Revenue Code (“Code”) for a hospital to be exempt from federal income taxation. IRS Notices 2014-2 and 2014-3 were published in the Internal Revenue Bulletin 2014-3 on January 13, 2014.

### **Background**

The Patient Protection and Affordable Care Act (2010) added sections 501(r) and 4959 to the Code. These provisions affect organizations that operate one or more hospital facilities and that are exempt (or seeking exemption) from federal income tax because they are described in Code section 501(c)(3) (“Charitable Hospitals”). Code section 501(r)(1) provides that a Charitable Hospital will not be treated as described in Code section 501(c)(3) unless the organization meets the requirements of Code sections 501(r)(3) - (6), including the conduct of a community health needs assessment (“CHNA”) at least once every three years [501(r)(3)], the maintenance of a qualified financial assistance policy and emergency medical care policy [501(r)(4)], compliance with certain limitations on the amounts that can be charged for emergency or medically necessary care and the prohibition on the use of gross charges [501(r)(5)], and adherence to certain billing and collection requirements [501(r)(6)]. Code section 4959 imposes an excise tax of \$50,000 for each taxable year a Charitable Hospital fails to satisfy the requirement to develop and adopt a CHNA and implementation strategy. The requirements of section 501(r) generally were effective commencing with an organization’s first taxable year starting after March 23, 2010; however, the CHNA requirement was made applicable to taxable years beginning after March 23, 2012.

The Department of the Treasury (“Treasury”) and the IRS previously issued a number of items of interim guidance regarding the new Code section 501(r) requirements, including two notices of proposed rulemaking. On June 26, 2012, proposed regulations under Code sections 501(r)(4) - (6) were published addressing what constitutes a qualified financial assistance policy and emergency medical care policy, and the requirements relating to the limitation on charges and billing and collection procedures (“2012 Proposed Regulations”). On April 5, 2013, proposed regulations were published regarding the CHNA requirement, related reporting requirements under Code section 6033, and the imposition of the excise tax under Code section 4959 (“2013 Proposed Regulations”).

### **Notice 2014-2**

The preamble to the 2013 Proposed Regulations provides that Charitable Hospitals may rely on Proposed Treasury Regulation section 1.501(r)-3 pending the publication of final or temporary regulations. In response, the IRS received a number of questions

regarding whether Charitable Hospitals could rely on other sections of the 2013 Proposed Regulations which added definitions, provided guidance on the consequences of failing to comply with Code section 501(r) and addressed effective dates. Notice 2014-2 was issued to confirm that Charitable Hospitals may rely on all of the provisions of both the 2012 Proposed Regulations and the 2013 Proposed Regulations pending the publication of final or temporary regulations or other applicable guidance. Although Charitable Hospitals technically are not required to comply with the proposed regulations until they are published as final or temporary regulations, Notice 2014-2 further states that the 2012 Proposed Regulations and 2013 Proposed Regulations represent, in the view of Treasury and the IRS, a reasonable interpretation of the statute. Where the two sets of proposed rules are inconsistent (for example, the 2013 Proposed Regulations made minor changes to the definition of “hospital facility” in the 2012 Proposed Regulations), a Charitable Hospital may rely on either set of regulations.

### **Notice 2014-3**

The 2013 Proposed Regulations provide an incentive for Charitable Hospitals to take steps both to avoid section 501(r) compliance failures and to remedy and disclose them when they occur. In particular, the 2013 Proposed Regulations specify that, for purposes of Code sections 501(r)(1) and 501(r)(2)(B), a Charitable Hospital’s failure to meet one or more of the requirements described in section 501(r) and section 1.501(r)-3 through 1.501(r)-6 that is neither willful nor egregious will be excused if the Charitable Hospital corrects the failure and makes disclosure in accordance with a revenue procedure, notice or other guidance to be published by the IRS. Notice 2014-3 sets forth for comment a proposed revenue procedure that, if adopted, would contain the promised guidance on how to make the appropriate correction and disclosure.

The proposed revenue procedure published as part of Notice 2014-3 generally provides that, in order for a Charitable Hospital to qualify for relief relating to non-willful, non-egregious failure to comply with section 501(r), the Charitable Hospital must have begun correcting the failure, and, if the Form 990 for the year in which the failure was discovered is already due, to have disclosed the failure in accordance with the revenue procedure before the IRS contacts the Charitable Hospital. Although correction and disclosure will not cure a willful or egregious failure, it will be considered as a factor as to whether the error was willful or egregious.

According to the proposed revenue procedure, the correction of a failure must be made in accordance with the following principles:

- To the extent reasonably feasible, each correction should restore each affected person to the position they would have been in had the failure not have occurred.
- Each correction should be reasonable and appropriate.
- Each correction should be made promptly after discovery as is reasonable given the nature of the failure.
- The Charitable Hospital should establish or revise, as applicable, practices and procedures that are reasonably designed to achieve compliance with the section 501(r) requirements.

A failure will be deemed to be disclosed properly for purposes of the proposed revenue procedure if the Charitable Hospital reports the following information on Schedule H to its



Form 990 for the tax year in which the failure is discovered:

- A description of the failure, including the type of failure, the facility or facilities where it occurred, the date(s) of the failure, the number of occurrences and, in the case of a failure to comply with the limitations on charges or billing and collection requirements, the number of persons affected and dollar amounts involved. There also must be a description of the cause of the failure and what practices and procedures, if any, were in place prior to the occurrence to detect or prevent the type of failure that occurred.
- A description of the discovery of the failure, including how it was made and the timing of the discovery.
- A description of the correction made, including the method of the correction, the date of the correction and whether all persons were restored to the position they would have been in had the failure not occurred and, if not, the reasons why.
- A description of the practices and procedures, if any, that were revised or newly established to minimize the likelihood of the type of failure recurring, and to promptly identify and correct any such failures that do occur.

The proposed revenue procedure sets forth examples of compliance failures and how they may be corrected, including the untimely completion of a CHNA, the failure to implement a qualified financial assistance policy and the over-charging of individuals who would qualify for assistance under a qualified financial assistance policy.

Although compliance with the correction and disclosure rules outlined above will be considered in connection with a determination as to whether a Charitable Hospital's section 501(c)(3) status should be continued, Charitable Hospitals are reminded that a proper correction and disclosure may not prevent the imposition of the excise tax under Code section 4959 for a failure to comply with the CHNA requirement.

The public can submit comments regarding the proposed revenue procedure to the IRS on or before March 14, 2014. Specifically requested are comments on additional examples to be added to the revenue procedure and whether disclosure should be required in ways other than on an organization's Form 990.

### **Conclusion**

Notices 2014-2 and 2014-3 serve as a good reminder to Charitable Hospitals to review and confirm that they have established programs and procedures to implement the Code section 501(r) requirements. With Charitable Hospitals under increased IRS and public scrutiny, the time to correct any failure to comply with Code section 501(r) is now.

Should you have any questions about this alert or any other federal tax requirements for Charitable Hospitals, please contact Alan E. Lieberman, Ryan V. Leichsenring or any member of Shipman & Goodwin's **Health Law Practice Group**.

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