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501(R) COMPLIANCE: CORRECTING FAILURES UNDER REVENUE PROCEDURE 2015-21

Hospital organizations that are tax exempt pursuant to Code Section 501(c)(3) can face significant penalties for failures to comply with Code Section 501(r) and the related final regulations. Fortunately, in drafting the final regulations, the IRS and Treasury Department acknowledged that even the most diligent hospital organizations may experience unintentional failures due to the detailed and operational nature of many of the requirements, and they described certain situations where such failures can be self-corrected. As additional clarification, the IRS and Treasury Department recently issued Revenue Procedure 2015-21, which explains when and how certain failures can be corrected and disclosed. As part of their 501(r) compliance efforts, hospital organizations should become familiar with these procedures in order to properly identify failures and the applicable method for correction.

BACKGROUND

Code Section 501(r) includes four key elements: the community health needs assessment ("CHNA") and implementation strategy; the financial assistance policy ("FAP") and emergency care policy; limitations on charges; and restrictions pertaining to extraordinary collection actions. On December 29, 2014 the IRS and Treasury Department published final regulations that interpret these elements and establish a comprehensive set of requirements. For detailed information about these requirements, we invite you to visit www.hallrender.com/501r.

THE FRAMEWORK FOR EVALUATING FAILURES

On its face, Code Section 501(r) does not include intermediate penalties for noncompliance aside from an excise tax for failures to meet the CHNA requirements. Thus, uncertainty has existed concerning how hospital organizations should handle mistakes, errors and omissions. Prior guidance had indicated that not every situation would threaten a hospital organization's 501(c)(3) status, and this approach has been confirmed in the final regulations. To address this issue, a three-tier framework has been adopted that the IRS, as well as hospital organizations, can apply when evaluating the severity of possible failures and the resulting implications.

- *Willful or Egregious Failures*. The most significant types of failures are those that are considered willful or egregious. A willful failure includes a failure due to gross negligence, reckless disregard or willful neglect. An egregious failure includes only a very serious failure, taking into account the severity of the impact and the number of affected persons. In evaluating whether a failure is willful or egregious, the final regulations require that all facts and circumstances be considered and include a listing of potentially relevant facts and circumstances. For hospital organizations with only one hospital facility, the resulting penalty would be the revocation of Code Section 501(c)(3) status. For hospital organizations with multiple hospital facilities, the resulting penalty would be the imposition of income tax on the hospital facility(ies) where the willful or egregious error occurred.

- *Failures That Are Neither Willful nor Egregious*. If a failure is not considered willful or egregious but it is more than a minor omission or error (as explained below), then the failure must be corrected and disclosed as provided in Revenue Procedure 2015-21.

- *Minor Omissions and Errors*. Lastly, certain omissions and errors can be corrected without disclosure. To qualify, the omission or error must be minor (in the aggregate) and either inadvertent or due to reasonable cause, and the omission or error must be corrected as promptly after discovery as is reasonable given the nature of the omission or error. The correction must include establishment (or review and, if necessary, revision) of practices or procedures that are reasonably designed to promote and facilitate overall compliance with Code Section 501(r) and the final regulations.

REVENUE PROCEDURE 2015-21

Under the provisions of Revenue Procedure 2015-21, which clarifies and builds upon the correction concepts first announced in early 2014 with Notice 2014-3, certain failures will not be deemed a violation of Code Section 501(r) if they are corrected and disclosed by the hospital organization as directed by the Revenue Procedure. Several aspects of the Revenue Procedure warrant specific mention:

- *Correction.* There are several principles that must be followed for a correction to be valid under the Revenue Procedure:
    - The correction should be made with respect to all affected individuals and should restore any affected individual to the position in

which he or she would have been had the failure not occurred, regardless of whether the harm suffered by the individual occurred in a prior year and regardless of whether such prior year is a closed taxable year. However, refunds of less than $5 are not required.

- The correction should be reasonable and appropriate for the failure. Depending on the nature of the failure, there may be more than one reasonable and appropriate correction, which should provide hospital organizations with some flexibility.
- The correction should occur as promptly after discovery as is reasonable given the nature of the failure.
- The correction should include establishment (or review and, if necessary, revision) of practices or procedures that are reasonably designed to promote and facilitate overall compliance.

- *Disclosure*. The hospital organization must disclose the matter on its Form 990, pursuant to the instructions for that form, for the tax year in which the failure is discovered. The disclosure must include the following information:
  - A description of the failure, including the type of failure, the cause of the failure, the hospital facility or facilities where the failure occurred, the date(s) of the failure and its discovery and the number of occurrences. Information about multiple errors of the same type should be reported in the aggregate in a summary that includes the time period over which the errors occurred and, if applicable, an estimate of the number of individuals affected and the dollar amounts involved.
  - A description of the correction of the failure (multiple errors of the same type can be described in the aggregate), including the method of correction, the date of correction, and, if applicable, a description of how affected individuals were restored to the position in which they would have been had the failure not occurred. If affected individuals were not restored, then an explanation should be provided.
  - A description of the practices or procedures, if any, that the hospital organization revised or newly established to minimize the likelihood of the same type of failure recurring and to facilitate the prompt identification and correction of any such future failures that do occur, or, if no changes were made, an explanation of why no changes were necessary.
- The Revenue Procedure clarifies, consistent with the final regulations, that a failure to meet the CHNA requirements will result in a $50,000 tax being imposed on the organization under Code Section 4959, notwithstanding the organization's correction and disclosure of the failure in accordance with the Revenue Procedure. Meanwhile, minor omissions and errors that can be self-corrected without disclosure pursuant to the final regulations will not be subject to the $50,000 tax.
- A hospital organization's correction and disclosure of a failure in accordance with the Revenue Procedure is considered a factor tending to show that the failure was not willful. Thus, a hospital organization's use of the correction and disclosure procedures can reduce the risk that a failure will jeopardize the hospital organization's Code Section 501(c)(3) status.

PRACTICAL TAKEAWAYS

The final regulations and Revenue Procedure 2015-21 provide clear incentives for hospital organizations to develop a robust 501(r) compliance program because the IRS will view such efforts as a factor indicating failures are not willful or egregious. Absent a compliance program, significant failure(s), whether in terms of people effected or financial impact, could jeopardize a hospital organization's 501(c)(3) status. Moreover, hospital organizations must understand the Revenue Procedure to properly identify failures, implement corrections and make disclosures in a timely and reasonable manner.

Should you have questions or require further information, please contact:

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For more information on 501(r) compliance, please visit: www.hallrender.com/501r. Please visit the Hall Render Blog at http://blogs.hallrender.com/ for more information on topics related to health care law.