

IRS ISSUES CHNA PROPOSED REGULATIONS AND GUIDANCE ON 501(R) NONCOMPLIANCE PENALTIES

The Internal Revenue Service ("IRS") published proposed regulations ("Proposed Regulations") on April 5, 2013 that expand upon and provide clarification for the community health needs assessment ("CHNA") requirements of Section 501(r)(3) of the Internal Revenue Code (the "Code"). The Proposed Regulations also provide guidance on how and when penalties may be imposed for failing to comply with the requirements of Section 501(r).

BACKGROUND

Under Code Section 501(r), which was enacted as part of the Patient Protection and Affordable Care Act of 2010 ("ACA"), tax-exempt hospital organizations are required to (i) periodically conduct a community needs assessment; (ii) establish a financial assistance policy; (iii) limit charges for emergency or other necessary care; and (iv) refrain from engaging in extraordinary collection efforts. Since 2010, the IRS has been working to establish guidelines for compliance with these new requirements. In 2011, Notice 2011-52 was issued, which outlined anticipated regulatory provisions for the implementation and administration of the CHNA requirements and a summary of which is available [here](#). The IRS issued its first set of proposed regulations in June 2012, which addressed the other requirements of Code Section 501(r). For more information about the June 2012 proposed regulations, please see our four-part article series: [Part I](#) (Overview), [Part II](#) (Financial Assistance Policies), [Part III](#) (Limitations on Charges) and [Part IV](#) (Billing and Collection).

CHNA CLARIFICATIONS AND NEW REQUIREMENTS

The Proposed Regulations respond to and incorporate comments received in connection with Notice 2011-52. While the Proposed Regulations are largely consistent with Notice 2011-52, the Proposed Regulations contain several important clarifications and changes, including:

- *Penalties for Failing to Conduct a CHNA.* The Proposed Regulations clarify that a Hospital Organization could potentially face a \$50,000 excise tax for each Hospital Facility it operates. The Proposed Regulations also clarify that the \$50,000 excise tax applies in sequential years, so that a Hospital Organization failing to conduct a CHNA for each of 2011, 2012 and 2013 could also face a \$50,000 excise tax in 2014 for failing to conduct a CHNA for each of 2012, 2013 and 2014. For reference purposes, "Hospital Organization" is defined as a Code Section 501(c)(3) organization that operates one or more Hospital Facilities, and a "Hospital Facility" refers to a facility that is required by a state to be licensed, registered or similarly recognized as a hospital.
- *"Operating a Hospital Facility" Defined.* In the Proposed Regulations, the IRS addressed comments received relating to the operation of a Hospital Facility through a joint venture, limited liability company or other entity treated as a partnership under the Code. The IRS concluded that, as a general rule, any 501(c)(3) organization operating a Hospital Facility jointly or in partnership with one or more other entities or owning a capital or profits interest in a Hospital Facility will be considered a Hospital Organization for Section 501(r) purposes for that Hospital Facility and must comply with the requirements of Code Section 501(r). This rule would apply without regard to the size of the 501(c)(3) organization's investment or ownership percentage in the joint venture. However, the IRS did provide two exceptions in which a 501(c)(3) organization will not be subject to Code Section 501(r) with respect to a joint venture that operates a Hospital Facility:
 - The 501(c)(3) organization does not have sufficient control over the Hospital Facility to ensure 501(r) compliance and the 501(c)(3) organization treats the Hospital Facility as an unrelated trade or business; or
 - At all times since March 23, 2010, the 501(c)(3) organization (i) must have been organized and operated primarily for educational or scientific purposes; (ii) must not have engaged primarily in the operation of one or more Hospital Facilities; (iii) must have entered into the applicable partnership agreement prior to March 23, 2010; and (iv) must meet certain criteria with respect to control and ownership.
- *Two-Report Posting Requirement.* Going forward, Hospital Facilities must retain links to prior CHNA reports on the Hospital Facilities' websites until at least two subsequent CHNA reports have been posted.

- *Joint CHNA Reports.* The Proposed Regulations permit Hospital Facilities to collaborate and produce a joint CHNA report, provided that the Hospital Facilities share the same definition of "community" and the CHNA report clearly applies to the Hospital Facility. Additionally, a joint CHNA report must be adopted by the authorized body of each Hospital Facility.
- *CHNA Process Clarifications.* The Proposed Regulations contain several clarifications regarding CHNA process and report requirements, including prioritization of significant community health needs and required sources of input for the CHNA. The Proposed Regulations also provide Hospital Facilities with some flexibility regarding the deadlines to adopt implementation strategies by permitting Hospital Facilities limited control over the date on which a CHNA is deemed "conducted."
- *New Hospital Facilities.* The Proposed Regulations explain that new Hospital Organizations and/or new Hospital Facilities must meet the requirements of Code Section 501(r)(3) by the last day of the second taxable year beginning after the date, respectively, the Hospital Facility is acquired; licensed, registered or similarly recognized by its state as a hospital; or newly subject to the requirements of Code Section 501(r) as a result of the Hospital Organization operating it being recognized as described in Code Section 501(c)(3).
- *Compliance Deadline.* In the commentary to the Proposed Regulations, the IRS established a deadline on which Hospital Organizations must be in full compliance with these Proposed Regulations. After October 5, 2013, Hospital Organizations can no longer rely on Notice 2011-52. A Hospital Organization desiring to conclude its CHNA and adopt implementation strategies consistent with the Notice 2011-52 guidance would need to do so prior to October 5, 2013.

PENALTIES FOR NONCOMPLIANCE WITH CODE SECTION 501(R)

The Proposed Regulations also provide penalties applicable to 501(c)(3) organizations failing to comply with any of the requirements of Code Section 501(r). Most notably, the IRS has indicated that revocation of 501(c)(3) status is reserved for willful or egregious violations of Code Section 501(r). The Proposed Regulations require a facts and circumstances test to determine whether the violations warrant revocation of the organization's 501(c)(3) status. The Proposed Regulations also excuse violations that are minor or inadvertent and are promptly corrected, as well as violations that are not willful or egregious and are promptly disclosed and corrected.

Additionally, the IRS has proposed that, for Hospital Organizations operating one or more Hospital Facilities, the failure of one or more Hospital Facilities to comply with Code Section 501(r) will not jeopardize the Hospital Organization's tax-exempt status. Instead, the noncompliant Hospital Facility's income will be treated as taxable during the applicable tax year. The Proposed Regulations also prohibit the ability of a Hospital Organization to aggregate such taxable income with other unrelated business activities that might generate offsetting losses. Lastly, the imposition of such tax on a Hospital Facility will not affect applicable tax-exempt bonds.

GOVERNMENTAL/COUNTY HOSPITALS

In commentary to the Proposed Regulations, the IRS continues to maintain its position with respect to tax-exempt governmental/county hospitals that have also obtained recognition of 501(c)(3) status from the IRS. In summary, such organizations that have been excused from filing Form 990 under Revenue Procedure 95-48 will continue to be exempt from filing Form 990. However, such organizations have not been excused from complying with the substantive requirements of Code Section 501(r).

CONCLUSION/PRACTICAL TAKEAWAYS

Hospital Organizations will want to study the Proposed Regulations very closely to determine the potential effect. Hospital Organizations should review their plans for conducting a CHNA in light of the additional guidance concerning the CHNA requirements. In addition, particular attention should be given to the provisions concerning joint ventures, which, as drafted, could trigger unrelated business income tax if the Hospital Organization does not have sufficient control in its Hospital Facility joint ventures to ensure compliance with Code Section 501(r).

The deadline for submitting comments on the Proposed Regulations is July 5, 2013, and a public hearing on the Proposed Regulations may be scheduled in the coming months. Hospital Organizations may wish to coordinate with each other or with their state hospital associations in preparing and submitting comments. The Proposed Regulations can be accessed [here](#). The IRS has expressed an intent to finalize these Proposed Regulations and the June 2012 proposed regulations addressing the other 501(r) requirements at the same time.

Should your organization require assistance in evaluating the Proposed Regulations or would like assistance in preparing comments, please contact Jeffrey L. Carmichael at 317-977-1443 or jcarmichael@hallrender.com, Calvin R. Chambers at 317-977-1459 or cchambers@hallrender.com, Megan L. Snow at 414-721-8613 or msnow@hallrender.com or your regular Hall Render attorney.