



## IRS Revokes Hospital's Tax Exemption: A Shot Across the Bow

**IRS' Stepped-Up Enforcement Efforts.** The IRS recently posted its first published letter revoking the tax-exempt status of a hospital due to failure to comply with section 501(r) of the Internal Revenue Code. (Revocation 2017-31014 at <https://www.irs.gov/pub/irs-wd/201731014.pdf>.) This revocation is the IRS' stark reminder that the multi-faceted compliance requirements of 501(r), enacted in 2010 as part of the Patient Protection and Affordable Care Act (P.L. 111-148), are mandatory for tax-exempt hospitals.

The IRS letter is not entirely surprising given that IRS' 2017 Workplan included 501(r) as an emerging area of focus, and is a result of its recent step up in auditing nonprofit hospitals for compliance in this area. The facts of this case were particularly egregious, as the rural, cash-strapped hospital admitted during audit that it did not attempt to comply with 501(r).<sup>1</sup> Nonetheless, the revocation was a particularly strong message sent by the IRS, which took the position that the failure to comply with certain 501(r) requirements was "willful," thus resulting in revocation of exemption. Under section 501(r), Section 501(c)(3) hospitals are required to perform mandatory assessments of the healthcare-related needs of a hospital's communities every three years (Community Health Needs Assessments ("CHNAs")), and to follow detailed rules governing financial assistance policies, limitations on charges, and billing and collection. In addition to these federal requirements, hospitals must also comply with state charity laws, which in some cases may be more restrictive than the 501(r) requirements.

The IRS revoked the hospital's tax exemption for failure to adopt an implementation strategy for its CHNA and to make it widely available to the public. The "widely available" requirement means that much of the information must be posted on a website, and is thereby readily accessible by IRS agents and the general public. The IRS did not release the identity of the hospital, but did note that it was a dual status government/501(c)(3) hospital. While governmental hospitals are exempt from taxation, many seek additional 501(c)(3) exemption as it provides certain additional benefits including the ability to get particular pension plans and raise funds more easily. Those hospitals receiving dual bases for exemption are referred to as dual-status.

In determining whether to revoke Section 501(c)(3) status or instead to merely impose an excise tax, the IRS considers all facts and circumstances, including the significance of and reason for the failure, and the practices and procedures at the organization both prior to and after the failure. Curiously, the letter did not note whether a \$50,000 excise tax was also imposed, which is the more typically-expected sanction for failing to meet CHNA requirements under Section 4959 of the Code.

**Implications of Revocation.** Once exemption is revoked, there can be significant repercussions impacting the financial soundness of a hospital. First, contributions to an organization are no longer deductible. Moreover, there could be significant tax exposure to a partner seeking to merge or undergo a joint transaction with such an entity. Finally, if a hospital has tax-exempt bonds outstanding they can become immediately callable.

<sup>1</sup> According to the ruling, the hospital told the IRS during audit that it was a "small rural facility" and "had neither the financial wherewithal nor the staffing to devote to the specific requirements of Treasury Regulation § 1.501(r)-3 for conducting a proper Community Health Needs Assessment every three years."

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**Importance of Reviewing Compliance Policies.** In short, this ruling is a wake-up call that the IRS will consider failures to comply with 501(r) “egregious” or “willful” even in the face of financial difficulties. The IRS found the hospital’s failure “egregious” because its leaders had “neither the will, the resources, nor the staff to follow through with the 501(r) requirements.” Accordingly, it is important to ensure that policies are not merely fill-in templates but instead appropriately reviewed for legal accuracy.

While a comprehensive analysis of the complicated federal regulations (summarized below) and local state laws is beyond the scope of this note, suffice it to say that hospitals should carefully review their compliance policies given the IRS’ increased focus in this area. The applicability of 501(r) is complex and varies based on an organization’s structure, i.e., whether there are captive PCs or affiliated physician practices. Moreover, hospitals must also be wary of increased scrutiny on the state level as to whether they are eligible for property tax exemptions, given that many states are becoming increasingly vigilant in this area in the wake of expanding budget deficits.

**Summary of Section 501(r) Requirements.** Section 501(r) and its regulations build upon previous historic requirements for tax-exempt hospitals, including the need for open emergency rooms and acceptance of patients regardless of ability to pay. Section 501(r) imposes the following requirements on Section 501(c)(3) hospitals:

- **CHNA.** Conducting a CHNA (Community Health Needs Assessment) at least once every three years, adopting an implementation strategy to meet the needs identified, and making the CHNA publicly available on a website.
- **FAPs.** Adopting a financial assistance policy and widely publicizing it, including on a website.
- **AGBs.** Limiting the amounts charged to individuals eligible for financial assistance for emergency or other medically necessary care to “amounts generally billed,” or AGB, rather than gross charges.
- **ECAs.** Making reasonable efforts to make individuals aware of the financial assistance policy prior to engaging in extraordinary collection actions (“ECAs”).

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