IRS Releases Final Regulations on Requirements for Tax-Exempt Hospitals Under Section 501(r)

On December 29, 2014, final regulations were released under Internal Revenue Code section 501(r). Enacted as part of the Patient Protection and Affordable Care Act in 2010 (the "ACA"), section 501(r) requires tax-exempt hospital organizations to have certain policies and procedures in place for each hospital facility, including the creation and implementation of a community health needs assessment, a financial assistance policy for low-income patients, written policies for the provision of emergency care, and limitations on charges and collection activities for individuals eligible for the financial assistance policy.

As described in our 2012 and 2013 Alerts, tax-exempt hospitals should by now have developed and be following section 501(r) policies and procedures that are based on the statutory language, assisted by the two prior sets of proposed regulations. While the final regulations retain many of the elements of the proposed regulations – and in some respects provide greater flexibility than the proposed regulations – in certain other respects the final regulations are more restrictive. To ensure their continued section 501(c)(3) status and to avoid penalty taxes, tax-exempt hospital organizations should re-examine and make appropriate changes to their section 501(r) policies and procedures in light of the final regulations.

The final regulations apply to taxable years beginning after December 29, 2015; until then, the final regulations provide that hospital organizations may rely on a reasonable, good faith interpretation of section 501(r), with a hospital facility deemed to meet this requirement if it has complied with either the proposed or final regulations.

The following is an overview of the requirements of section 501(r) and certain key changes reflected in the final regulations.

Community Health Needs Assessment

One of the most significant obligations imposed on tax-exempt hospitals by the ACA is the requirement to conduct a community health needs assessment ("CHNA"). Under section 501(r)(3) and the proposed regulations, a hospital organization meets the CHNA requirement with respect to a hospital facility it operates only if the facility has conducted a CHNA in such taxable year or in either of the two immediately preceding taxable years and an authorized body of the hospital facility has adopted an implementation strategy to meet the community health needs identified in the CHNA. The final regulations, among other things:

- allow a hospital facility merely to "solicit" input from three specified categories of persons when developing a CHNA and take into account the input received (replacing the requirement to "obtain" input from those persons under the proposed regulations);
- expand the kinds of health needs a hospital facility may consider in its CHNA to include the need to prevent illness, to ensure adequate nutrition, and to address social, behavioral, and environmental factors that influence the community's health;
- eliminate the requirement to identify potential "measures" available to address the significant health needs of the community (while retaining the requirement that the hospital identify "resources" that address significant health needs);
- clarify and elaborate on provisions allowing a hospital facility to conduct its CHNA in collaboration with other organizations and facilities, including producing a joint CHNA; and
- provide hospital facilities with an additional four-and-a-half-month period after the close of the taxable year in which a CHNA is conducted to adopt an implementation strategy.

Financial Assistance and Emergency Medical Care Policies

Under section 501(r)(4) and the proposed regulations, a tax-exempt hospital organization is required to have a written financial assistance policy ("FAP") that applies to all emergency and medically necessary care. The FAP must include eligibility criteria for financial assistance and indicate whether such assistance includes free or discounted care, the basis for calculating amounts charged to patients, the method for applying for financial assistance, the actions the organization may take in the event of non-payment, and measures to widely publicize the policy. The hospital organization is also required to have a written policy requiring the organization to provide emergency medical care to individuals without regard to their eligibility under the FAP. The final regulations, among other things:

- clarify that multiple hospital facilities may have identical FAPs, billing and collection policies, and/or emergency medical care policies established for them (or may share one policy document), provided that the information in the policy is accurate for all such facilities and any joint policy clearly states that it is applicable to each facility;
- require the FAP to specify which providers in the hospital facility are covered by the hospital's FAP and which are not (the preamble to the regulations indicates that if emergency room operations are outsourced to a third party that is not covered by a FAP, this could prevent the ER from counting as a favorable factor in meeting the "community benefit standard" for obtaining tax exemption described in Revenue Ruling 69-545);
- require the FAP to describe any information from sources other than individuals seeking assistance that the hospital facility uses in determining whether individuals are FAP-eligible;
- require that the required plain language summary of the FAP include information about how to apply for financial assistance;
- eliminate the requirement that the FAP list the measures taken to widely publicize the FAP and instead require only that a hospital facility implement such measures; and
- eliminate the requirement that the plain language summary of the FAP be included with billing statements (instead requiring only that the billing statements include a conspicuous written notice and directions on how to obtain further information about the FAP).

Limitation on Charges

Under section 501(r)(5) and the proposed regulations, a tax-exempt hospital organization is required to limit amounts charged for emergency or other medically necessary care provided to individuals eligible for assistance under the FAP to not more than the amounts generally billed ("AGB") to individuals who have insurance covering such care; and it must prohibit the use of "gross charges," which is the full, undiscounted charge for the services. The final regulations, among other things:

- allow hospital facilities to base AGB on Medicaid rates, either alone or in combination with other rates;
- clarify that a FAP-eligible individual is considered to be "charged" only the amount he or she is personally responsible for paying, after all deductions and discounts have been applied and less any amounts reimbursed by insurers;
- provide that a hospital facility may change the method it uses to determine AGB at any time, so long as its FAP is first updated to describe the new method;
- make certain changes to the calculation and implementation of the "AGB percentage"; and
- clarify that if a hospital organization's FAP covers medical care beyond emergency and medically necessary care, it must limit amounts charged for other medical care to less than gross charges.

Billing and Collection

Under section 501(r)(6) and the proposed regulations, a tax-exempt hospital organization is prohibited from engaging in extraordinary collection actions ("ECAs") before the organization has made reasonable efforts to determine whether the individual is eligible for assistance under the FAP. The final regulations, among other things:

- provide that placing liens on certain personal injury recoveries from a third party is not an ECA;
- provide that the sale of an individual's debt is not an ECA if prior to the sale the hospital facility enters into a written agreement with the purchaser containing certain protections;
- include as an ECA the practice of deferring or denying or requiring payment before providing medically necessary care because of nonpayment of prior bills for care covered under the FAP;
- make certain changes relating to the "reasonable efforts" requirement, including the requirement of providing notice to an individual about the FAP and potential ECAs and the requirement of observing an "application period" during which a hospital facility is required to process any FAP application submitted by the individual;
- make certain changes to the provisions relating to incomplete FAP applications; and
- provide that a hospital facility may in some circumstances presumptively determine that an individual is eligible for less than the most generous assistance available under the FAP based on information other than that provided by the individual.

Consequences of Failing to Satisfy Section 501(r)

A hospital organization's failure to comply with section 501(r) may result in the organization's section 501(c)(3) status being revoked. If a hospital organization operating more than one hospital facility fails to comply with section 501(r) with respect to a particular hospital facility, even if the organization's section 501(c)(3) status is not revoked, the net income from the noncompliant facility may be subject to tax. Additionally, a $50,000 excise tax may be imposed with respect to each hospital facility that has failed to meet the CHNA requirements. The proposed regulations further provided exceptions for minor or disclosed errors.

The final regulations, among other things:

- provide that errors that are minor and either inadvertent "or" (replacing "and" under the proposed regulations) due to reasonable cause may be corrected without disclosure;
- provide guidance regarding the meaning of "minor," "inadvertent" and "reasonable cause"; and
- provide that a hospital facility failing to meet the CHNA requirements "will" (replacing "may, in the discretion of the IRS" under the proposed regulations) be subject to the excise tax (unless meeting the exception for minor errors).

If you have any questions with respect to section 501(r) or the final regulations, please do not hesitate to contact Kendi Ozmon, Lorry Spitzer, Peter Serreze, or another member of Ropes & Gray's tax or health care groups.

Kendi E. Ozmon
A. L. (Lorry) Spitzer
Peter Serreze