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## For-profit Medicare Providers to Face 3% Tax Withholding from Medicare & Other Government Payments

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Payment Group

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For-profit health care entities such as physician practices and hospitals may soon see their Medicare payments subject to a 3% withholding for taxes. On December 5, 2008, the IRS issued a proposed rule to implement a tax withholding requirement of section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (Section 511). Under Section 511, payments by government entities (including federal, state and local government) are subject to a 3% income tax withholding. The *American Recovery and Reinvestment Act of 2009*, signed by President Obama on February 17, 2009, delays implementation of Section 511 for one year, so it is now slated to apply to payments made after December 31, 2011.

Certain payments are exempt from the withholding requirement, including payments made in connection with a public assistance/welfare program for which eligibility is determined based on needs or income, but not age. Therefore, while Medicaid payments are exempt, Medicare payments would be subject to the withholding requirements. In addition, the withholding requirement does not apply to payments made to tax-exempt entities. Therefore, payments made to for-profit health care providers, including physician practices and joint ventures, would be subject to the withholding requirement and payments made to tax-exempt health care providers, such as tax-exempt hospitals and long term care facilities, would be exempt.

The following highlights aspects of the proposed rules most applicable to health care providers:

- **\$10,000 Threshold Amount.** The withholding requirements will not apply to any payment that is less than \$10,000. Furthermore, multiple payments made by a government entity would not be aggregated to determine whether the payment threshold amount has been met (unless the primary purpose of multiple payments is to avoid the required withholding). On the other hand, if a government entity makes a single payment of \$10,000 or more that relates to separate transactions (i.e., bundles payments for its own convenience), the withholding requirement would apply.

Since most payments to health care providers are individually less than \$10,000, such payments should be exempt from the required withholding.

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However, certain Medicare contractors, pursuant to their own policies, pay providers on an aggregated basis in amounts greater than \$10,000, which could trigger the withholding requirement. Document hosted at JDSUPRA™  
http://www.jdsupra.com/post/documentViewer.aspx?id=5a1135fa-e35a-439f-b655-6292432ad651

- **Transitional Relief.** Payments made under written contracts that are in effect as of the effective date of the withholding requirements are exempt from withholding, until such contracts are "materially modified". Thus, payments to health care providers who have in effect an "Agreement" under the Medicare program and/or other federal programs would not be subject to the withholding requirement. The Treasury Department and IRS are considering whether contracts that contain the option of renewal should be considered new contracts as of the date of renewal. It would also be helpful if the IRS clarified whether automatic renewals of such agreements or changes to the agreements made by applicable law (e.g., changes in payment rates) would trigger the withholding requirements.

**Ober|Kaler's Comments:** If not changed substantially by final regulations, the withholding requirements under the proposed regulations may be very burdensome for health care providers. The withholding requirements will likely result in cash flow issues and new administrative costs associated with tracking and reconciling government payments. Health care providers, especially physician practices, often have limited operating budgets to address such issues. For this reason (and others), medical associations in particular are strongly advocating for an exemption from Section 511 for payments made to physicians and other health care providers under government health care programs. The comment period for the proposed regulations ended on March 5, 2009.

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