

How IRS Guidance Addresses ACO Participation for Exempt Hospitals and Other Health Care Organizations

The seventh advisory in our series on the newly proposed ACO regulations implementing Section 3022 of the PPACA

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The Patient Protection and Affordable Care Act of 2010 (PPACA) provides for the creation of accountable care organizations (ACOs) to enter into a Medicare Shared Savings Program (MSSP) agreement with the Centers for Medicare & Medicaid Services. Participation in ACOs by an organization exempt from federal income taxation under Section 501(c)(3) of the Internal Revenue Code raises issues related to the organization's tax-exempt status. (Please also see our September 2010 advisory "[Health Care Reform: Accountable Care Organizations and Exempt-Organization Participants.](#)")

The Internal Revenue Service recognizes these issues in [Notice 2011-20](#) (released March 31, 2011). This Notice is the IRS' first guidance on exempt organization participation in ACOs. In the Notice, the IRS solicits comments as to what additional guidance is needed, if any, for an exempt hospital or other health care organization to participate in an ACO in either MSSP or non-MSSP activities. On the same day that the Notice was released, CMS issued proposed regulations on the formation and operation of ACOs. (This advisory concludes with links to our series of advisories on the proposed regulations.)

Guidance on tax issues

Notice 2011-20 addresses three important tax issues for exempt hospital and other health care organizations participating in the MSSP through ACOs: private inurement, private benefit, and unrelated business income. The Notice, however, does not identify how these issues would apply to exempt organizations participating in ACOs for non-MSSP activities, such as shared savings arrangements with Medicaid.

Private inurement/private benefit

The net earnings of an organization exempt from federal income tax under Section 501(c)(3) cannot inure to the benefit of private shareholders or individuals who have a personal and private interest in the activities of the organization, i.e., "insiders." Further, a Section 501(c)(3) organization must not be organized or operated for the benefit of private interests.

The IRS anticipates that ACOs will typically be organized with the participation of both exempt organizations and private parties, including insiders, through ownership or membership interests in nonprofit corporations, for-profit corporations, partnerships or

limited liability companies, or through contractual arrangements. An exempt organization participant must ensure that participation in an ACO with private parties does not result in either private inurement or private benefit. Whether an arrangement causes private inurement or private benefit would be determined by the IRS on a case-by-case basis, considering all the facts and circumstances.

The IRS expects that exempt organization participation in an ACO will not result in either private inurement or private benefit if the following requirements are met:

- The terms of participation in the ACO are set forth in advance in a written agreement negotiated at arm's length.
- CMS has accepted the ACO into the MSSP, and the ACO is still in the program.
- The exempt organization's ownership interest in the ACO is proportional to the exempt organization's capital contributions.
- Allocations, distributions, and returns of capital are in proportion to ownership interests.
- Allocation of losses, including MSSP losses, does not exceed the exempt organization's share of ACO benefits.
- All contracts and transactions between the exempt organization and the ACO and other ACO participants, and between the ACO and ACO participants and other parties, are at fair market value.

Unrelated business income

Exempt organizations are subject to federal income tax on unrelated business income, which can result from an activity that is not substantially related to the performance of the exempt organization's exempt purpose. The Notice states that, if there is no private inurement or private benefit and the ACO meets all of the CMS eligibility requirements for participation in the MSSP, payments received by an exempt organization from an ACO would be considered as related to the performance of the charitable purpose of lessening the burdens of government.

Unanswered questions

Notice 2011-20 is a first step in addressing tax issues for exempt organizations that wish to participate in ACOs. The Notice does, however, leave many unanswered tax questions, including whether an ACO itself can be an exempt organization, whether the exempt organization must control the ACO where there are for-profit participants, and what requirements would ensure that an exempt organization's exempt purpose is furthered for participation in non-MSSP ACOs.

Request for comments

The Notice solicits comments regarding what additional guidance is needed for exempt organizations to participate in the MSSP through ACOs, particularly what requirements there should be for determining whether participation in an ACO is consistent with exempt status and whether there is unrelated business income. The IRS also requests comments on what guidance is needed regarding an exempt organization's participation in an ACO for non-MSSP activities. Comments are due on or before May 31, 2011.

In our ongoing series on the newly proposed ACO regulations, we will be issuing a number of separate advisories focusing on specific topics raised by the regulations and the affiliated guidance and requests for comments including:

- Shared savings calculations
- State law restrictions
- When things go wrong or circumstances change

Please also see our past installments in this series:

["The New ACO Regs: They're Here \(Well, Sort of ...\)"](#) (04.05.11)

["Antitrust Enforcement Agencies Issue Proposed Guidance on ACOs"](#) (04.06.11)

["What the Proposed ACO Regulations Say About Legal Structures and Governance"](#)
(04.11.11)

["ACOs: The Fraud & Abuse Waivers – Finding a Path Through the Maze"](#) (04.15.11)

["Proposed Quality Measures for ACOs"](#) (04.18.11)

["If You Build It, Who Will Come?"](#) (05.02.11)

Stay tuned ... and in the meantime, if you have any questions, please contact us.

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