



American Hospital
Association®

Legal Advisory

January 23, 2014

IRS, TREASURY ISSUE GUIDANCE FOR TAX-EXEMPT HOSPITALS

AT A GLANCE

The Issue:

The Department of the Treasury and Internal Revenue Service (IRS) on Dec. 30 posted two notices on their websites announcing additional guidance for tax-exempt hospitals regarding Section 501(r) requirements under the *Patient Protection and Affordable Care Act*.

[Notice 2014-2](#) confirmed that hospitals may continue to rely on 2012 and 2013 proposed regulations (addressing the requirements for financial assistance policy, limitation on charges, limitation on collection practices, and community health needs assessments, as well as the consequences for failing to satisfy any of the requirements), pending the publication of final regulations or other applicable guidance. The agencies noted that hospitals will not be required to comply with the proposed regulations until they are finalized. The agencies gave no indication of when final regulations will be issued.

[Notice 2014-3](#) is a follow-up to the 2013 proposed regulations regarding the consequences for noncompliance with Section 501(r) requirements. Under the proposed regulations, infractions that are more than minor or inadvertent, but not willful or egregious, may be eligible for “excused noncompliance” if corrected and disclosed according to certain procedures. The notice describes the proposed correction and disclosure procedures that must be followed, as well as offers some examples of this type of noncompliance.

The agencies request comments on the proposed procedures as well as potential need for additional examples. Comments are due March 14.

Our Take:

The 2013 proposed regulations regarding sanctions responded to the concerns of hospitals that revocation of exemption is an extraordinary remedy and adopted a calibrated approach that excuses certain levels of infractions and reserves loss of exemption for extreme circumstances. The AHA urged IRS to provide further guidance to illustrate the various types of noncompliance, as well as when and how such noncompliance should be remedied to avoid sanctions. The AHA believes the notice regarding proposed correction and disclosure procedures is a start at providing what is needed. We will urge IRS to include additional examples; in particular to address more complex factual situations to assist hospitals in determining when a situation may be remedied through these procedures. We also will continue to urge that when a hospital has followed the correction and disclosure procedures there should be a rebuttable presumption that the failure was not willful and egregious.

What You Can Do:

Share this advisory with your leadership team, and carefully review the implications of the proposed “correction and disclosure” procedures. Provide input to AHA on your key concerns and suggest specific examples for the guidance that would assist you in determining when a situation may be remedied through the new procedures.

Further Questions:

Please contact Maureen Mudron, deputy general counsel, at (202) 626-2301 or mmudron@aha.org.



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BACKGROUND

The Department of the Treasury and Internal Revenue Service (IRS) on Dec. 30 posted two notices on their websites announcing additional guidance for tax-exempt hospitals regarding Section 501(r) requirements under the *Patient Protection and Affordable Care Act*.

[Notice 2014-2](#) confirmed that hospitals may continue to rely on the 2012 and 2013 proposed regulations (addressing the requirements for financial assistance policy (FAP), limitation on charges, limitation on collection practices, and community health needs assessments (CHNA), as well as the consequences for failing to satisfy any of the requirements), pending the publication of final regulations or other applicable guidance. The agencies noted that hospitals will not be required to comply with the proposed regulations until they are finalized. The agencies gave no indication of when final regulations will be issued.

[Notice 2014-3](#) is a follow-up to the 2013 proposed regulations regarding the consequences for noncompliance with Section 501 (r) requirements. Under the proposed regulations, infractions that are more than minor or inadvertent, but not willful or egregious, may be eligible for “excused noncompliance” if corrected and disclosed according to certain procedures. The notice describes the proposed correction and disclosure procedures that must be followed, as well as offers some examples of this type of noncompliance.

The agencies request comments on the proposed procedures as well as potential need for additional examples. Comments are due March 14.

RELIANCE ON PROPOSED REGULATIONS

The purpose of Notice 2014-2 is to clarify that all provisions of the 2012 and 2013 proposed regulations may be relied on pending the issuance of final regulations or other applicable guidance. IRS commented that while the 2012 proposed regulations explicitly said that, the 2013 proposed regulations included that statement only with respect to CHNA provisions. In this notice, IRS confirms that the 2013 provisions

regarding the consequences for failure to comply with Section 501(r) requirements may also be relied on pending final regulations or other applicable guidance. Regarding the minor modifications to the definitions of “hospital facility” and “hospital organization” that were made in the 2013 proposed regulations, IRS states that a hospital may rely on either the modified definitions or the original definitions in the 2012 proposed regulations.

CORRECTION AND DISCLOSURE PROCEDURES FOR EXCUSED NONCOMPLIANCE

The 2013 proposed regulations addressed for the first time how IRS would use its enforcement authority if a hospital failed to meet a Section 501(r) requirement. The proposed regulations responded to the concerns of hospitals that revocation of exemption is an extraordinary remedy and reserves loss of exemption for extreme circumstances.

An error or omission that is minor, inadvertent and due to reasonable cause (“tier 1”) will be excused, provided it is corrected as promptly after discovery as is reasonable given the nature of the infraction. Infractions that are more than minor or inadvertent but are not willful or egregious (“tier 2”) will be excused only if the hospital corrects and discloses the noncompliance pursuant to certain procedures. Notice 2014-3 describes the proposed procedures that must be followed for tier 2-type noncompliance to be excused.

Correction and Disclosure Procedures

A hospital may rely on these procedures for excused noncompliance provided it has begun correcting the failure and has disclosed the failure before IRS begins an examination of the hospital. If the annual return for the tax year in which the failure is discovered is not yet due (with extensions), then the hospital needs only have begun correcting the failure.

A hospital’s correction and disclosure does not create a presumption that the failure was not willful or egregious. However, following the procedures will be considered as a factor and may tend to indicate that an error or omission may not have been willful or egregious.

Note that a hospital may be subject to the excise tax for failure to meet CHNA requirements, even if it qualifies for excused noncompliance under these procedures.

Correction Procedures

Restoration of affected persons. To the extent reasonably feasible, the correction should be made with respect to each affected person, if any, and restore them to the position they would have been in had the failure not occurred, regardless of whether the harm occurred in a prior year and whether it is a closed taxable year.

Reasonable and appropriate correction. The correction should be reasonable and appropriate for the failure. Depending on the nature of the failure, there may be more than one approach for correction.

Timing. The correction should be made as promptly after discovery as is reasonable given the nature of the failure.

Implementation/modification of safeguards. If the hospital does not have practices and procedures (whether formal or informal) that are reasonably designed to achieve compliance with Section 501(r), they should be established as part of the correction. If existing procedures failed to anticipate the particular type of failure that occurred, the hospital should determine if changes are needed to reduce the likelihood of a recurrence and assure prompt identification and correction if such failures occur in the future, and implement needed changes.

IRS offers some examples to illustrate corrective actions. For each, IRS assumes that the failure was corrected with respect to all affected persons as promptly after discovery as is reasonable given the nature of the failure and that the hospital put in place any needed revisions to existing procedures or established new ones to minimize the likelihood of the failure recurring. Below are some examples.

- Failure to adopt a CHNA report with all of the required elements may be corrected by preparing and adopting a report containing the required elements and making it widely available on a website consistent with the 2013 proposed regulations.
- Failure to adopt a FAP with all of the required elements may be corrected by establishing a FAP containing all of the required elements and making the FAP widely available on a website consistent with the 2012 proposed regulations.
- Charging FAP-eligible individuals more than an amount permitted due to processing errors that are discovered during the month-end accounting period closing, may be corrected by providing all affected individuals with an explanation of the error, a corrected billing statement, and a refund of any payments the individuals made to the hospital (or third party) in excess of the amount they are determined to owe as FAP-eligible individuals.
- Failing to properly implement a FAP that does not involve over-charging a FAP-eligible individual or engaging in an extraordinary collection action (e.g., failing to widely publicize the FAP), may be corrected by beginning to implement the policy correctly and taking reasonable action to compensate for such failure (e.g., doing additional outreach or advertising of the FAP in local media).

Disclosure Procedures

Disclosure of the failure should be made on the Schedule H for the tax year in which the failure is discovered. The disclosure must include:

Description of the failure. This must include the type of failure, the hospital or hospitals where the failure occurred, the date(s) of the failure, number of occurrences, and the number of persons affected and the dollar amounts involved for failures to limit the amounts charged to FAP-eligible individuals or make reasonable efforts to determine eligibility for FAP before engaging in extraordinary collection efforts.

Description of the discovery. This must include how it was made and the timing of the discovery.

Description of the correction made. This must include the method of correction, the date of correction, and whether all persons were restored to the position they would have been in had the failure not occurred and, if not, the reasons why.

Description of the practices and procedures revised or added. This must be included, if applicable, to minimize the likelihood of a recurrence and to promptly identify and correct such failures. If no changes were made, include an explanation why.

FURTHER QUESTIONS

AHA welcomes your input as we develop our comment letter and urge you to identify any key concerns as well as suggest examples that would assist you in determining when a situation may be remedied through these procedures.

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