



First denial of tax-exempt status to a non-Medicare Shared Savings Program ACO

April 29, 2016

On April 8, 2016, the Internal Revenue Service (the “Service”) released a final adverse determination letter denying tax-exempt status under section 501(c)(3) of the Internal Revenue Code to an Accountable Care Organization (“ACO”) comprised of a clinically integrated network of providers (“CIN”). The denial letter is the Service’s first ruling on whether an ACO that does not participate in the Medicare Shared Savings Program (“MSSP”) furthers charitable 501(c)(3) purposes so as to be eligible for 501(c)(3) status. Thus, this ruling represents critical guidance to hospitals and health care systems on the timely and important issue of the tax consequences of forming and/or participating in non-MSSP ACOs. It calls into question whether non-MSSP ACOs can qualify for tax exempt status, and also whether 501(c)(3) entities involved in non-MSSP ACOs may suffer adverse tax consequences.

Background

The non-MSSP ACO operated through a CIN, addressed in this ruling, was formed as a separate entity by a nonprofit health care system (the “System”) that was exempt from tax under section 501(c)(3). The ACO asserted that its efforts furthered the “Triple Aims” of health care reform under the Patient Protection and Affordable Care Act (“PPACA”), which are to reduce health care costs for individuals, improve access to and quality of care for individuals, and improve population health and patient experience. To further the Triple Aims, the ACO established a mechanism to share clinical data and provide financial incentives for providers meeting performance goals. One of the primary activities of the ACO was negotiation of contracts with third-party payors on behalf of all participating providers. While the network included providers employed by the System, approximately fifty percent of the providers were members of independent practice groups or employed by unaffiliated hospitals.

IRS Analysis

The Service's denial of tax-exempt status to the ACO elucidates the following bases for the Service's legal position, that the activities of non-MSSP ACOs do not generally further charitable 501(c)(3) purposes.

- First, the Service rejected the argument that the ACO lessened the burdens of government, concluding that there was no objective manifestation that the government considers non-MSSPs to fulfill a governmental burden under PPACA. It did so despite the fact that ACO may have in fact furthered certain Triple Aims of PPACA.
- Second, the Service noted that merely promoting the Triple Aims, without proving the ACO does so in a charitable manner, does not qualify the ACO for exemption based on the promotion of health.
- Third, the Service found that the ACO conferred an excess private benefit on the physicians not employed by the System. It emphasized that the ACO's negotiations with third-party payors provided a private benefit to the non-System physicians that was not "qualitatively or quantitatively incidental or insubstantial in comparison to the community benefit produced by [the ACO's] activities."

Implications for ACOs and CINs

Although this denial letter sets forth a difficult path, under the Service's current position, for non-MSSP ACOs to be viewed as organizations that further 501(c)(3) purposes, it should be noted that the letter does not constitute binding legal precedent. This means that in the future the Service could grant another non-MSSP ACO tax-exempt status if it found its activities were charitable under the circumstances. Furthermore, an ACO that also participates in the MSSP and/or is primarily comprised of providers employed by entities within a 501(c)(3) health care system that established the ACO may have a greater chance at being more favorably viewed. It should also be noted that if an ACO is formed as a partnership (or an LLC taxed as a partnership), any tax-exempt partners will be treated as engaging directly in the ACO's activities, which could result in unrelated business income to the tax-exempt partners. In light of the denial letter, tax-exempt entities participating in non-MSSP ACOs, or MSSP ACOs that also have some commercial activity, should consider whether their involvement could result in unrelated business income or could jeopardize their tax-exempt status.

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