Revocation 2017-31014: First revocation for failure to comply with Section 501(r)

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In August 2017, the Internal Revenue Service (IRS) released its first published revocation of a hospital's 501(c)(3) status for failing to comply with section 501(r) of the Internal Revenue Code. While hospitals and practitioners will undoubtedly scrutinize this ruling for insight on the IRS's current 501(r) enforcement policy, the revocation's unusual factual circumstances limit its utility in this respect.

Section 501(r) was added to the Code by the Affordable Care Act to ensure that 501(c)(3) hospitals operate in a manner that is consistent with their charitable status. The centerpiece of section 501(r) is the requirement that hospitals conduct a Community Health Needs Assessment (CHNA) every three years. Hospitals must make the CHNA publicly available, and they must adopt an implementation policy targeting the needs identified by the CHNA. Section 501(r) also includes a number of other requirements, such as the establishment and dissemination of a financial assistance policy and limitations on collection practices.

In Revocation 2017-31014, the hospital at issue was a dual status 501(c)(3) organization operated under the management and control of a county governmental agency. The hospital was described as small and located in a rural area, and its status as a 501(c)(3) organization had been obtained prior to the time it came under the control the county.

During the course of the IRS's examination, hospital officers explained that they had conducted a CHNA, but "the project was not undertaken with the intent of complying with the Affordable Care Act." Instead, they explained that the CHNA was conducted to qualify as a "critical care access facility" for Medicare purposes. The officers further admitted that no formal implementation policy

was ever adopted by the hospital and that, while the CHNA was available in hard copy upon request, the hospital did publish it to the organization's website.

The IRS ultimately revoked the hospital's status as a 501(c)(3) organization due to its failure to comply with section 501(r). Underpinning this revocation, however, was a number of additional comments made by officers during the IRS examination of the hospital. The hospital's officers described 501(c)(3) status not as a benefit but as a hindrance to the hospital's activities. Officers also made it clear that "as a small rural facility, [the hospital] had neither the financial wherewithal nor the staffing to devote to the specific requirements of Treasury Regulation § 1.501(r)-3 for conducting a proper Community Health Needs Assessment every three years."

These unusual circumstances make it difficult to rely on Revocation 2017-31014 as a guide for when the IRS will revoke a hospital's exempt status, as opposed to imposing a less severe penalty, such as the excise tax under section 4959 of the Code. For example, in Revocation 2017-31014, the IRS explained that revocation was appropriate in the present case "[e]specially in light of the fact that the organization expressed on several occasions that they did not need to be exempt under IRC § 501(c)(3) and that this status at times actually got in the way of their ability to be involved in various Medicare reimbursement programs."

In the end, Revocation 2017-31014 represents the best guidance hospitals and practitioners have received to date. But the IRS's 501(r) enforcement policy still remains largely unclear. Undoubtedly, however, IRS audits of charitable hospitals' compliance with 501(r) requirements will continue and the complexities of the 501(r) requirements pertaining to CHNAs, financial assistance, and billing and collection policies create several traps for the unwary. Even if sound compliance policies have been adopted, charitable hospitals must be vigilant in ensuring those policies are implemented appropriately in order to protect against IRS review.

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