A detailed discussion of recent proposed regulations on Community Health Needs Assessments under Section 501(r)

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In brief

As reported in a prior EOTS NewsFlash, the IRS recently issued proposed regulations on the requirements for tax-exempt hospitals to conduct Community Health Needs Assessments (CHNA) under IRC Section 501(r)(3), as well as certain other aspects of IRC Section 501(r).

These proposed regulations supersede prior guidance on the conduct of CHNAs under IRS Notice 2011-52. However, hospital organizations may continue to rely on Notice 2011-52 for CHNAs completed, and implementation strategies adopted, before October 5, 2013. Organizations that have not yet completed a CHNA or adopted an implementation strategy will have to decide whether to rely on Notice 2011-52 or implement provisions of the proposed regulations.

Public comments on the proposed regulations are due by July 5, 2013. A detailed discussion of the proposed regulations follows.

In detail

Background

IRC Section 501(r), which was enacted on March 23, 2010, as part of the Affordable Care Act, provides that hospitals must comply with certain requirements to be tax exempt under IRC Section 501(c)(3). Section 501(r) requires hospitals to conduct a community health needs assessment (CHNA) every three years, establish financial assistance and emergency medical care policies, limit the amount they charge for certain care provided to individuals eligible for financial assistance, and avoid engaging in extraordinary collection actions before making reasonable efforts to determine whether an individual is eligible for financial assistance.

The recently issued proposed regulations primarily address the CHNA requirements under Section 501(r)(3), which requires a hospital organization to conduct a CHNA at least once every three years and adopt an implementation strategy to meet the community health needs identified through the CHNA. A $50,000 excise tax is imposed on a hospital organization that fails to meet the CHNA requirements in any year.

As noted below, the proposed regulations also address the definition of a hospital facility, operating a hospital facility through a partnership, and consequences for failure to comply with IRC Section 501(r).

Prior IRS guidance related to Section 501(r)

In May 2010, the IRS issued Notice 2010-39, which solicited comments regarding the application of the requirements imposed by Section 501(r). In July 2011, the Treasury Department and the IRS issued Notice 2011-52, which addressed the CHNA requirements of Section 501(r)(3). Notice 2011-52 provided that hospital organizations could rely on the provisions described in the notice for any CHNA made widely available to the public, and any implementation strategy adopted, on or before the date that is six months after the date further guidance regarding the CHNA requirements is issued.

In June 2012, the IRS issued proposed regulations regarding the requirements of Section 501(r)(4), Section 501(r)(5), and Section 501(r)(6) (the 2012 proposed regulations). The 2012 proposed regulations also defined "hospital organization," "hospital facility," and other key terms.

The April 2013 proposed regulations

As summarized below, the recently issued proposed regulations modify certain definitions in the 2012 proposed regulations, supersede Notice 2011-52 and provide additional guidance on additional matters not addressed in prior guidance.

Definition of a hospital facility

The 2012 proposed regulations provided that multiple buildings operated by a hospital organization under a single license may be considered a single hospital facility. The recently issued proposed regulations make this definition mandatory. The proposed regulations provide that multiple buildings operated by a hospital organization under a single state license "are" (rather than "may be") considered a single hospital facility.

Operating a hospital facility through a partnership

The proposed regulations provide that a hospital organization "operates" a hospital facility that is subject to the requirements of Section 501(r) if the hospital organization is a partner in a joint venture, limited liability company, or other entity treated as a partnership for federal income tax purposes that operates the hospital facility. Responding to concerns that an organization that has a minority interest in a hospital facility may lack sufficient control to ensure that the facility complies with Section 501(r), the 2013 proposed regulations contain two exceptions to this general rule.

First, the proposed regulations provide that if a tax-exempt partner of a partnership that operates a hospital facility does not have control over the operation of the hospital facility sufficient to ensure that the operation of the hospital facility furthers an exempt purpose described in Section 501(c)(3) and therefore treats the operation of the hospital facility as an unrelated trade or business, the organization will not be considered to "operate" the hospital facility for purposes of Section 501(r).

Second, the proposed regulations contain a grandfather rule providing that an organization will not be considered to operate a hospital facility through a partnership if the organization holds less than 35% of an interest in a partnership entered into before March 23, 2010 and certain other conditions are satisfied.

Failure to comply with Section 501(r)

The proposed regulations provide that, in general, if a hospital organization fails to meet one or more requirements of Section 501(r) with respect to a hospital facility it operates, its tax exemption may be revoked as of the first day of the tax year in which the failure occurs. The IRS will consider all facts and circumstances in determining whether to continue to recognize the tax exemption of such a hospital organization. In addition, minor, inadvertent errors will not be considered failures to meet the requirements of Section 501(r) if they are due to reasonable cause and promptly corrected. The IRS intends to issue further guidance that will establish rules under which a hospital facility's failure to meet one or more of the requirements described in Section 501(r) will be excused, provided the failure is neither wilful nor egregious and the hospital facility discloses and corrects the failure.

The proposed regulations provide that if a hospital organization operating more than one hospital facility fails to meet one or more of the requirements of Section 501(r) separately with respect to a hospital facility during a taxable year, but the hospital organization continues to be recognized as described in Section 501(c)(3), the net income derived from the noncompliant hospital facility during the year will be subject to tax as if the noncompliant hospital facility were an unrelated trade or business. The hospital facility would be subject to tax only if the compliance failure would not be excused under the procedures and standards described in the preceding paragraph.

In response to questions regarding the impact of noncompliance on tax-exempt bonds, the proposed regulations clarify that if a hospital organization operating a noncompliant hospital facility continues to be recognized as described in Section 501(c)(3) the fact that a facility-level tax is imposed as a

result of the facility's failure to comply with Section 501(r) will not itself cause the interest on tax-exempt bonds to become taxable.

Community Health Needs Assessment

When a CHNA is "conducted"

The proposed regulations provide that in order to conduct a CHNA, a hospital facility must complete all the following steps:

- define the community it serves;
- assess the health needs of that community;
- take into account input from persons who represent the broad interests of that community, including those with special knowledge of or expertise in public health;
- document the CHNA in a written report ("CHNA report") that is adopted for the hospital facility by an authorized body of the hospital facility; and
- make the CHNA report widely available to the public.

Definition of community served

Consistent with Notice 2011-52, the proposed regulations permit a hospital facility to take into account all of the relevant facts and circumstances in defining the community it serves, including the geographic area served by the hospital facility, target populations served, and principal functions.

The proposed regulations also clarify that a hospital facility may define its community to include populations in addition to its patient populations and geographic areas outside of those in which its patient populations reside. For example, a hospital facility collaborating with other hospital facilities in its MSA in conducting a CHNA may define its community as the entire MSA in which all of the collaborating hospital facilities are located, even if the hospital facility itself only generally serves and draws its patients from a portion of that MSA.

A hospital facility may not define its community in a way that excludes medically underserved, low-income, or minority populations who are part of its patient populations, live in geographic areas in which its patient populations reside (unless they are not part of the hospital facility's target populations or affected by its principal functions), or otherwise should be included based on the method used by the hospital facility to define its community.

Assessing community health needs

In contrast to Notice 2011-52, which indicated that the IRS would require a hospital facility to prioritize all of the community health needs identified through the CHNA, the proposed regulations clarify that a CHNA need only identify significant health needs and need only prioritize those significant health needs identified. A hospital facility may determine whether a health need is significant based on all of the facts and circumstances present in the community it serves, and a hospital facility may use any criteria to prioritize significant health needs.

Persons representing the broad interests of the community

Modifying the requirements set forth in Notice 2011-52, the proposed regulations require a hospital facility to take into account input from, at a minimum: (1) at least one state, local, tribal, or regional governmental public health department (or equivalent department or agency) with knowledge, information, or expertise relevant to the health needs of the community; (2) members of medically underserved, low-income, and minority populations in the community, or individuals or organizations serving or representing the interests of such populations; and (3) written comments received in response to the hospital facility's most recently conducted CHNA and most recently adopted implementation strategy.

Documentation of a CHNA

The proposed regulations provide that a hospital facility must document its CHNA in a report that is adopted by an authorized body of the hospital facility and includes:

- a definition of the community served by the hospital facility and a description of how the community was determined;
- a description of the process and methods used to conduct the CHNA;
- a description of how the hospital facility took into account input from persons who represent the broad interests of the community it serves;
- a prioritized description of the significant health needs of the community identified through the CHNA, along with a description of the process and criteria used in identifying certain health needs as significant and prioritizing such significant health needs; and
- a description of potential measures and resources identified through the CHNA to address the significant health needs.

Description of the process used to conduct the CHNA

The proposed regulations provide that a hospital facility's CHNA report will be considered to describe the process and methods used to conduct the CHNA if the report:

- describes the data and other information used in the assessment;
- the methods of collecting and analyzing this data and information; and
- identifies any parties with whom the hospital facility collaborated, or with whom it contracted for assistance, in conducting the CHNA.

The proposed regulations clarify that the CHNA report may summarize, in general terms, how the facility took into account input from persons who represent the broad interests of the community and over what time period input was provided. The CHNA need not provide a detailed description of each instance of feedback.

Input from persons who represent the broad interests of the community

The proposed regulations provide that the CHNA should provide the names of organizations providing input and summarize the nature and extent of the input, and describe the medically underserved low income or minority populations represented by the organizations and individuals providing input. In contrast to Notice 2011-52, the proposed regulations specify that the CHNA need not name or otherwise identify any individuals who participated in community forums, focus groups, survey samples or similar groups.

Collaboration on CHNAs; Joint CHNA reports

Consistent with Notice 2011-52, the proposed regulations provide that a hospital facility may conduct its CHNA in collaboration with other facilities and organizations. The proposed regulations clarify that if a facility collaborates with other facilities and organizations, or if another organization has conducted a CHNA for all or part of the facility's community, portions of the hospital facility's CHNA report may be substantively identical to portions of the CHNA report of a collaborating facility or other organization conducting a CHNA if appropriate.

The proposed regulations also permit the authorized body of a hospital facility to adopt a joint CHNA report if the hospital facility collaborates with other hospital facilities in conducting its CHNA, and all of the facilities define their community to be the same and conduct a joint CHNA process. The joint CHNA report must also clearly identify each hospital facility to which it applies.

Making the CHNA report widely available to the public

Notice 2011-52 generally provided that a hospital organization would be considered to have made a hospital facility's CHNA widely available to the public by posting the CHNA report to the hospital facility's website, the website of the hospital organization (if the hospital facility does not have its own website) or a third party website, if the hospital facility or organization website provides a link to the CHNA report on the third-part website. Notice 2011-52 also provided that a hospital facility must make a CHNA report widely available to the public until the date on which it makes a subsequent CHNA report widely available to the public.

The proposed regulations make several changes and clarifications with respect to these requirements. The proposed regulations provide:

- A CHNA report must be "conspicuously" posted on a website to be considered widely available to the public.
- A CHNA report must remain widely available until two subsequent CHNA reports have been made widely available.
- Individuals must be able to access, view, download and print the CHNA report without paying a fee, creating an account, or providing personally identifiable information.
- A hospital facility must make a paper copy of its CHNA report available for public inspection without charge at the hospital facility at least until the date the hospital facility has made available for public inspection a paper copy of its two subsequent CHNA reports.
- If a hospital facility makes widely available a version of the CHNA report that is expressly marked as a draft, it will not be considered to have made the CHNA report widely available to the public for purposes of determining the date on which the hospital facility has conducted the CHNA.

This last rule is intended to permit a hospital facility to make available a draft CHNA report for public review and comment, if it chooses, without starting the next three-year CHNA cycle.

The proposed regulations also clarify that the same definition of "widely available on a website" will apply to both a hospital facility's CHNA reports and to its financial assistance policy and related documents.

Implementation Strategy

The proposed regulations provide that a hospital facility need only address significant health needs identified through the CHNA in its implementation strategy.

The proposed regulations provide that a hospital facility's implementation

strategy must, with respect to each significant health need identified through the CHNA, either describe how the hospital facility plans to address the health need or explain why the hospital facility does not intend to address the health need.

In describing how a hospital facility plans to address a significant health need, the implementation strategy must describe the following:

- actions the hospital facility intends to take to address the health need, the anticipated impact of these actions, and a plan to evaluate such impact;
- the programs and resources the hospital facility plans to commit to address the health need; and
- any planned collaboration between the hospital facility and other facilities or organizations in addressing the health need.

The proposed regulations provide that a brief explanation of why a hospital facility does not intend to address the significant health need is sufficient. The reasons a hospital facility might offer for not addressing a health need, may include (but are not limited to), resource constraints, other facilities or organizations in the community addressing the need, relative lack of expertise or competencies to effectively address the need, a relatively low priority assigned to the need, and/or a lack of identified effective interventions to address the need.

Joint implementation strategy

Consistent with Notice 2011-52, the proposed regulations state that a hospital facility may develop an implementation strategy in collaboration with other facilities and organizations. In general, a hospital facility that collaborates in developing its implementation strategy must document its implementation strategy in a separate written plan that is tailored to the hospital facility, taking into account its specific programs and resources.

However, the proposed regulations provide that a hospital facility that adopts a joint CHNA report may also adopt a joint implementation strategy, provided the joint implementation strategy meets three requirements:

- The joint implementation strategy must be clearly identified as applying to the hospital facility;
- The joint implementation strategy must clearly identify the hospital facility's particular role and responsibilities in taking the actions described in the implementation strategy and the programs and resources the hospital facility plans to commit in taking those actions; and
- The joint implementation strategy must include a summary or other tool that helps the reader easily locate those portions of the joint implementation strategy that relate to the hospital facility.

When an implementation strategy must be adopted

Consistent with Notice 2011-52, the proposed regulations provide that an authorized body of the hospital facility must adopt the implementation strategy by the end of the same taxable year in which the hospital facility completes the final step required to conduct the CHNA (typically, by making the CHNA report widely available to the public). The proposed regulations also clarify that if a hospital facility begins working on a CHNA in one taxable year but completes the final required step for the CHNA in the subsequent taxable year, it is not required to adopt the implementation strategy until the taxable year in which the CHNA process is considered conducted, not the year it began.

Special rule for new hospital facilities

The proposed regulations provide that if a hospital facility becomes newly subject to Section 501(r) the hospital facility must conduct a CHNA and adopt an implementation strategy to meet the community health needs identified through that CHNA by the last day of the second taxable year beginning after the date the hospital facility becomes subject to Section 501(r).

Special transition rules for initial implementation strategies

Transition rules in the proposed regulations provide additional time for hospital facilities to adopt implementation strategies in connection with their first CHNAs required under Section 501(r)(3).

The proposed regulations provide that a hospital facility that conducted a CHNA in either of its first two taxable years beginning after March 23, 2010 (fiscal year 2011 or fiscal year 2012), does not need to meet the requirements of Section 501(r)(3) again until the third taxable year following the taxable year in which the hospital facility conducted the CHNA. To qualify for this transition relief, the hospital facility must adopt an implementation strategy to meet the community health needs identified through the CHNA on or before the 15th day of the fifth calendar month following the close of its first taxable year beginning after March 23, 2012.

If a hospital facility conducts a CHNA in its first taxable year beginning after March 23, 2012 (fiscal year 2013), the hospital facility must adopt an implementation strategy on or before the 15th day of the fifth calendar month following the close of its first

taxable year beginning after March 23, 2012.

Reporting requirements related to CHNAs

Notice 2011-52 would have required a hospital organization to attach to its annual information return (Form 990) to the most recently adopted implementation strategy for each hospital facility it operates. In contrast, the proposed regulations allow a hospital organization either to attach to its Form 990 a copy of the most recently adopted implementation strategy for each hospital facility it operates or to provide on the Form 990 the URL(s) of the website(s) on which it has posted each implementation strategy.

In addition, the proposed regulations require a hospital organization to provide annually on the Form 990 a description of the actions taken during the taxable year to address the significant health needs identified through its most recent CHNA for each hospital facility it operates or, if no actions were taken with respect to one or more of these health needs, the reason or reasons why no actions were taken.

Consistent with prior guidance, the proposed regulations also require a hospital organization attach to its Form 990 a copy of its audited financial statements for the taxable year and to disclose the amount of the excise tax imposed on the organization under Section 4959 during the taxable year for failures to meet the requirements of Section 501(r)(3).

Excise tax on failure to meet CHNA requirements

Section 4959 imposes a $50,000 excise tax on a hospital organization that fails to meet the requirements of Section 501(r)(3) for any taxable year. The proposed regulations also adopt the approach in Notice 2011-52 of applying the excise tax on a facility-by-facility basis; thus, if a hospital organization operates multiple hospital facilities and fails to meet the requirements of Section 501(r)(3) with respect to more than one facility it operates, the $50,000 excise tax is imposed on the hospital organization separately for each hospital facility's failure. The tax imposed by this section may be imposed on noncompliant hospital facility income or as a result of revocation of a hospital organization's Section 501(c)(3) status. The proposed regulations clarify that the Section 4959 excise tax will apply to a hospital organization that fails to meet the Section 501(r)(3) requirements during a taxable year in which its Section 501(c)(3) status is revoked.

Consistent with Notice 2011-52, the proposed regulations also impose the $50,000 excise tax with respect to a failure by a hospital facility to satisfy Section 501(r)(3) in any three-year period, making it possible for the excise tax to apply in sequential years.

Effective dates and reliance

The 2012 proposed regulations under Section 501(r)(4) through (r)(6) were proposed to apply for taxable years beginning on or after the date those rules are published in the Federal Register as final or temporary regulations. The April 2013 proposed regulations modify this effective date and provide that both the April 2013 proposed regulations and the 2012 proposed regulations will generally be effective on the date that the rules are adopted as final or temporary regulations. The IRS has indicated that it intends to finalize the recent proposed regulations in conjunction with finalization of the 2012 proposed regulations

A hospital organization may rely on the proposed regulations relating to the CHNA requirements under Section 501(r)(3) for any CHNA conducted or any implementation strategy adopted on or before the date that is 6 months after the proposed regulations are published as final or temporary regulations.

As provided in Notice 2011-52, hospital organizations may rely on the interim rules described in Notice 2011-52 for any CHNA conducted or implementation strategy adopted on or before October 5, 2013, which is the date that is six months after the proposed regulations were published. After October 5, 2013, Notice 2011-52 is obsolete.

The takeaway

While generally consistent with prior guidance, the proposed regulations make a number of clarifications and changes to the CHNA requirements under Section 501(r). Hospital organizations may begin to rely on the proposed regulations now, but may also rely on Notice 2011-52 for any CHNA conducted or implementation strategy adopted on or before October 5, 2013.

Hospital organizations that have not completed their first CHNA or adopted an implementation strategy should closely review the interaction of the two sources of guidance. Taking into account timing changes permitted by the transition rules for adopting an implementation strategy in the proposed regulations, hospital organizations should consider to what extent they should rely on Notice 2011-52 or conform to the proposed regulations.

Click here to access the proposed regulations for IRC Section 501(r).

Click here to access PwC's prior NewsFlash concerning the recently issued proposed regulations for IRC Section 501(r).

Click here to access PwC's NewsFlash discussing the 2012 proposed regulations on IRC Section 501(r).

Click here to access PwC's NewsFlash discussing Notice 2011-52.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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