

Legislative Council Service

Information Memorandum

DATE: October 21, 2015

TO: Members of the Legislative Health and Human Services Committee

FROM: Taylor Smith, Law Student Extern

SUBJECT: THE FEDERAL INTERNAL REVENUE SERVICE FINALIZED REGULATIONS
ON NONPROFIT HOSPITALS' CHARITABLE CARE

You have requested information relating to the federal Patient Protection and Affordable Care Act (PPACA) requirements for nonprofit hospitals' provision of charity care. The following memorandum is submitted in compliance with that request. Any opinions expressed are those of the author and do not necessarily reflect the opinions of the New Mexico Legislative Council or any other member of its staff.

Introduction

Under the PPACA, nonprofit hospitals are required to conduct community health needs assessments, make financial assistance policies widely available, notify patients of financial assistance policies and restrict charges of uninsured indigent patients. In the past several years, concerns surrounding tax exemptions and indigent care policies of nonprofit hospitals have grown. Nonprofit hospitals receive tax exemptions based on their efforts to provide community benefit. However, there have been reports that show a disparity in the monetary value of community benefit offered and the monetary value that the hospital receives in tax exemptions. For example, the 109th Congress conducted a study on the differences between the amounts of uncompensated care that nonprofit hospitals provide in comparison to what for-profit hospitals provide.¹ The findings showed that nonprofits provided more uncompensated care than for-profit

hospitals, but only marginally.² The PPACA has increased requirements, and the federal Internal Revenue Service (IRS) increased its regulations to scrutinize nonprofit hospital's charitable care to ensure that greater community benefit is provided.

In December 2014, the IRS, the agency charged with enforcement of the PPACA community benefit provisions, issued its final regulations on requirements for nonprofit hospitals.³

This memorandum will discuss the PPACA provisions relating to hospital community benefit requirements, agency regulations relating to the community benefit requirements and New Mexico's experience with implementing the community benefit.

General Overview of IRS Final Regulations for Nonprofit Hospitals

Under the PPACA, nonprofit hospitals are required to:

1. establish written financial assistance policies (FAPs);⁴
2. limit the amounts charged for patients that qualify under the hospital's FAP;⁵
3. make reasonable efforts to see if patients are eligible for FAPs before engaging extraordinary collection actions against the individual;⁶ and
4. conduct community health needs assessments (CHNAs) and adopt an implementation strategy once every three years.⁷

If a hospital fails to meet these requirements, that hospital may be subject to two different penalties. For non-minor errors, a hospital will be subject to a \$50,000 excise tax.⁸ For noncompliance, where the IRS finds that a hospital acted in bad faith, the penalty could result in a hospital's loss of nonprofit status.⁹

Hospitals Requirements for Written FAPs

An FAP is a policy created and adopted by a hospital that lays out eligibility requirements, application processes, charging procedures and information for patients who wish to apply for discounted or free care.¹⁰ FAPs are for indigent and low-income patients; however, a hospital must make it available to all patients.¹¹

A hospital's FAP must include:

1. the eligibility criteria for financial assistance and if the assistance includes free or discounted care;¹²
2. the basis for the amount charged to patients;¹³
3. the method for applying for financial assistance;¹⁴
4. what actions the hospital will take in the event of nonpayment;¹⁵ and
5. a list of providers delivering medical and other medically necessary care in the hospital that are covered by the FAP.¹⁶

Lastly, hospitals are required to widely publicize their FAPs. To comply with the requirements for wide publication, a nonprofit hospital must:

1. post the FAP and the application on the hospital website in a conspicuous manner;¹⁷
2. provide a copy of the FAP, application and plain language explanation of the FAP upon request;¹⁸
3. provide notification and information of the FAP to the community served,¹⁹ including those who receive care;²⁰ and
4. make the FAP available in languages spoken in the community.²¹

CHNA Requirements

A nonprofit hospital is required to conduct a CHNA and create implementation strategies in order to address particular needs of the population it serves. Each hospital must:

1. define the community that it serves;²²
2. identify and assess the needs of that community;²³
3. solicit input from the community as to what is needed;²⁴
4. adopt an implementation strategy to address those needs;²⁵ and
5. make the CHNA report widely available to the public.²⁶

Failure to Comply

During review of an omission or error, the IRS looks to all relevant facts and circumstances surrounding the error or omission to determine the intent of the hospital. This is measured by the size of the error or omission, how many errors were present and if the hospital acted with intent.²⁷ The IRS describes and has defined three levels of noncompliance: (1) a minor or inadvertent error or omission; (2) aggregated minor or inadvertent errors or omissions; and (3) willful omissions or errors.

For the first category of noncompliance, the IRS will not impose the excise tax or revocation of the hospital's nonprofit status.²⁸ The IRS looks at the actions taken by the hospitals to remedy the error or omission as evidence that the error or omission was inadvertent or unintended.²⁹ If an error is remedied in a reasonable amount of time after its discovery, it will not be considered a failure to comply.³⁰ The IRS will determine what a "reasonable amount of time" is by the error or omission itself.³¹ Further, if a hospital corrects an error and discloses the error to the IRS, the IRS will deem that hospital not to have acted willfully or in bad faith.³²

Under the second category of noncompliance, if there are multiple errors, the IRS will review all errors as one omission or error.³³ If the error is determined to be minor, the IRS will not impose the excise tax.³⁴ However, if the error is deemed as being greater than minor, then the hospital is subject to the \$50,000 excise tax but not the removal of its nonprofit status unless the IRS has found the hospital acted willfully.³⁵

Under the third and final category, if the hospital acted willfully, then the hospital is subject to the excise tax as a willful omission or intentional error. It will also be subject to loss of its nonprofit status.³⁶

Hospitals in New Mexico

Although hospitals are not required to be in compliance with Section 501(r) of the Internal Revenue Code (IRC) until December 29, 2015, hospitals were required to conduct CHNAs and participate in implementation strategies beginning on March 23, 2012. In recent research of hospitals' websites, many hospitals made available both CHNAs and FAPs on their websites.

Conclusion

These recent regulatory changes have the potential to be costly to hospitals if not followed. On December 29, 2015, the regulations will be enforceable, and hospitals that are noncompliant are subject to the discretion of the IRS. By following the permanent regulations, hospitals may avoid costly excise taxes and retain nonprofit status.

ENDNOTES

1. Congressional Budget Office, "Nonprofit Hospitals and the Provision of Community Benefits", (2006), *available at* <https://www.cbo.gov/sites/default/files/109th-congress-2005-2006/reports/12-06-nonprofit.pdf> (last visited October 16, 2015).
2. *Id.*
3. As required by the PPACA, Section 501(r) of the IRC was added in March 2010. While awaiting final adoption, the IRS communicated to hospitals that the CHNAs are required to be filed once every three years — beginning after March 23, 2012. After a long process of reviewing and receiving comments from hospitals and the public on the temporary regulations, the final regulations were adopted and finalized on December 29, 2014. After the regulations were finalized, the IRS required that nonprofit hospitals comply with the final regulations by December 29, 2015.
4. IRC §501(r)(4)(A).
5. IRC §501(r)(5)(A).
6. IRC §501(r)(6).
7. IRC §501(r)(3)(A)(i)-(ii).
8. 26 U.S.C. § 4959.
9. IRC §501(r)(2)(B)(ii).
10. 26 C.F.R. 1.501(r)(A)-(B).
11. 26 C.F.R. 1.501(r)(B).
12. 79 Fed. Reg. 78972 (hospitals have the discretion to develop their own specific eligibility requirements; the regulations only require that they are specified within the FAP); 26 C.F.R. 1.501(r)-4(b)(2)(i)(A) (if the financial assistance under the FAP includes a percentage discount, the FAP must specify the amount to which the percentage discount will apply).
13. 26 C.F.R. 1.501(r)-4(b)(2)(i)(c) (the basis for what will be charged to patients is based on what amounts are generally billed to patients with insurance covering emergency or medically necessary treatment); 26 C.F.R. 1.501(r)-5(b) (describes how a hospital calculates the amounts generally billed (AGB)); 26 C.F.R. 1.501(r)-4(b)(2)(i)(C) (strictly sets out that those who qualify for FAPs will not be charged more than AGB).

14. 26 C.F.R. 1.501(r)-4(b)(3)(i) (the FAP must describe the process to apply and also include any other documentation or information that may be required).
15. 26 C.F.R. 1.501(r)-4(b)(4)(ii) (the FAP must describe its actions in the FAP or in a document that is referenced in the FAP, and if it is not included in the FAP itself, it must describe how a person can obtain a free copy of the policy).
16. 79 Fed. Reg. 78992 (hospitals may use other means to determine eligibility for FAP assistance; like Medicaid enrollment); 26 C.F.R. 1.501(r)-6(c)(2) (if the hospital determines eligibility through this method but determines that the individual did not meet the needs for the highest financial assistance amount, the hospital must then provide for the opportunity for the individual to apply for the highest amount).
17. 26 C.F.R. 1.501(r)-4(b)(5)(i)(A); 26 C.F.R. 1.501(r)-1(b)(29)(i); 26 C.F.R. 1.501(r)-1(b)(29)(ii)(A)-(C) (the FAP must be accessible on the website and must be able to be downloadable, viewable and printable without requirements for special hardware or software and without payment, membership, account creation or any personally identifiable information).
18. 26 C.F.R. 1.501(r)-4(b)(5)(i)(B).
19. 26 C.F.R. 1.501(r)-4(b)(5)(i)(C).
20. 26 C.F.R. 1.501(r)-4(b)(5)(i)(D).
21. 26 C.F.R. 1.501(r)-4(b)(5)(i)(D).
22. 79 Fed. Reg. 78954.
23. 79 Fed. Reg. 78962.
24. 79 Fed. Reg. 78962.
25. IRC §501(r)(3)(A)(ii).
26. IRC §501(r)(3)(B)(ii).
27. 26 C.F.R. 1.501(r)-2.
28. 26 C.F.R. 1.501(r)-2(b)(1)(ii).
29. C.F.R. 1.501(r)-2(b).
30. C.F.R. 1.501(r)-2(b).
31. C.F.R. 1.501(r)-2(b).

32. 26 C.F.R. 1.501(r)-2(b).
33. 79 Fed. Reg. 78960.
34. 79 Fed. Reg. 78960.
35. 79 Fed. Reg. 78961.
36. 26 C.F.R. 1.501(r)-2(b).