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Mostly Good News For Qualified 501(C)(3) Bonds Under ACA Regulations

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The Patient Protection and Affordable Care Act ("ACA") imposes several new requirements on charitable hospitals. Charitable hospitals that benefit from tax-exempt qualified 501(c)(3) bonds were concerned that violations of these ACA requirements would either result in a loss of the charitable hospital's 501(c)(3) status, or result in excessive private business use, either of which would convert the 501(c)(3) bonds into taxable bonds.

ACA Requirements: The ACA requirements are set forth in Section 501(r) of the Internal Revenue Code ("501(r)"). The goal behind these requirements is to both encourage each charitable hospital to work to improve the health of the community it serves, and to protect patients from abusive collection practices by such charitable hospital. Under these requirements, each charitable hospital: (1) must complete a community health needs assessment ("CHNA") once every three years, and also adopt a strategic plan to address the needs identified in the CHNA; (2) must establish financial assistance policies that are widely publicized in the relevant community; (3) must establish policies for emergency medical care that treat all patients the same irrespective of a patient's ability to pay; (4) is prohibited from charging patients who qualify for financial assistance any more than the hospital charges insured patients for emergency and/or medically necessary medical care; and (5) must determine whether a patient is eligible for financial assistance before the hospital engages in extraordinary collection actions.

Mostly Good News: Under the newly issued final regulations, only egregious violations by a charitable hospital of the requirements imposed under the ACA should negatively impact the tax-exempt status of the qualified 501(c)(3)bonds from which the hospital benefits. For minor errors or omissions that are either inadvertent or due to reasonable cause, the final regulations provide that charitable hospitals may correct these failures without having to disclose them. This provision even applies to minor errors related to the CHNA requirement, which is noteworthy because Section 4959 of the Internal Revenue Code imposes a $50,000 excise tax on a charitable hospital that fails to meet the CHNA requirement. Accordingly, the excise tax will only apply to more egregious errors or omissions involving the CHNA.

At the next level, more significant errors or omissions that are neither willful nor egregious will be excused if the charitable hospital both corrects and discloses the error or omission. Errors or omissions resulting from gross negligence, reckless disregard or willful neglect will not qualify for this

treatment.

The IRS will consider all relevant facts and circumstances when determining whether revocation of a charitable hospital's 501(c)(3) status is warranted due to one or more failures to comply with the ACA. Not surprisingly, the relevant facts include the size, scope and nature of the error or omission, the reason for the error or omission, the number of times the error or omission has happened and whether the charitable hospital promptly corrected the error or omission. Thus, it appears that a charitable hospital would have to commit a fairly serious offense (i.e., one that is willful or egregious) or repeated offenses under the ACA before its 501(c)(3) status was revoked (thus converting the qualified 501(c)(3) bonds into taxable bonds).

If a charitable hospital operates more than one hospital facility and has a noncompliant facility, the charitable hospital is not likely to lose its 501(c)(3) status. Rather, if the IRS determines that the noncompliant facility would lose its 501(c)(3) status under the facts and circumstances test if it was analyzed on a stand-alone basis, a facility-level tax will be applied to the income from the noncompliant facility. The good news though is that the imposition of this tax does not convert the income from the noncompliant facility into unrelated trade or business income of the charitable hospital. Accordingly, this type of violation of the ACA will not in and of itself increase the amount of private business use occurring in a hospital facility that was financed with qualified 501(c)(3) bonds.

Some Bad News: Unfortunately, there is some bad news for governmental hospitals that also have 501(c)(3) status. Although 501(r) appears to apply to all 501(c)(3) hospitals, many governmental hospitals with 501(c)(3) status had been hoping that, under the final regulations, they would be exempt from having to comply with all or some of the ACA requirements. In this regard, they argued that because governmental hospitals are often the safety net health care providers in the communities in which they operate, these hospitals generally provide care irrespective of a patient's ability to pay and also treat a disproportionate number of patients who are uninsured. Unfortunately, no such exemption was created. However, Treasury did kindly point out that if governmental hospitals are not happy about having to comply with the ACA requirements, they are free to voluntarily terminate their 501(c)(3) status (and even pointed them to Section 7.04(14) of Revenue Procedure 2014-4, which describes how this voluntary termination of 501(c)(3) status is done).

Effective Date: The final regulations under 501(r) apply to a 501(c)(3) hospital's first taxable year that begins after December 29, 2015. Prior to that time, a 501(c)(3) hospital may rely on a reasonable, good faith interpretation of 501(r) to comply with the ACA requirements.

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