

## IRS Ruling Sounds Alarm over Tax-Exempt Status of Nonprofit ACOs Operating Outside of Medicare Shared Savings Program

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On April 8, 2016, the **IRS** released private letter ruling 201615022 denying tax-exempt section 501(c)(3) status to a nonprofit accountable care organization (“ACO”) that did not participate in the **Medicare Shared Savings Program** (“MSSP”).<sup>1</sup> This adverse determination raises questions about the ability of an ACO outside of the MSSP to qualify for tax-exempt status under section 501(c)(3).

The ACO considered in the ruling was formed by a nonprofit tax-exempt health care system (the “System”) in order to promote clinical care integration, coordination, and accountability among physicians practicing throughout the System’s affiliated facilities. All of the ACO’s time and resources were dedicated to three goals promoted by the Patient Protection and Affordable Care Act (the “PPACA”): (1) reducing the cost of health care for individuals; (2) improving patient access to, and the quality of, healthcare; and (3) improving population health and patient experience. In furtherance of these goals, the ACO formed an integrated network of health care providers who met certain eligibility criteria. The network participants included: (i) physicians employed by the System and its facilities; (ii) physicians from independent practice groups that were members of the medical staff at System affiliated facilities; and (iii) physicians practicing at non-System affiliated hospitals and in other healthcare systems. According to the ruling, approximately one-half of the participating physicians were members of independent practice groups or otherwise unaffiliated with the System. Pursuant to the terms of the physician network participation agreements, the ACO collected, analyzed and warehoused data and also served as the representative for all participating providers, including independent and non-System affiliated physicians, in negotiating and executing agreements with third-party payers. The ACO did not participate in the MSSP.

The IRS determined that the ACO was not operated “exclusively” for section 501(c)(3) purposes. In reaching this conclusion, the IRS rejected the argument that the ACO qualified as a section 501(c)(3) organization because it lessened the burdens of government, finding instead that negotiating with third-party payers outside of the MSSP was not a governmental burden. The IRS also found that the ACO was not engaged primarily in assisting the Medicare or Medicaid population and, therefore, could not qualify as a section 501(c)(3) organization formed to relieve the poor and distressed. The IRS acknowledged that the promotion of health has been recognized as a charitable activity and that the goals identified by the PPACA generally promote health. However, the IRS found that the ACO’s

negotiation of third-party payer agreements on behalf of independent and non-System affiliated physicians was not a charitable activity (notwithstanding that the activity was aimed at achieving savings in health care delivery costs). The IRS further determined that the non-charitable activity comprised a substantial part of the ACO's activities and conferred an impermissible private benefit to the unaffiliated physicians. Because the private benefit was substantial compared to the benefit to the community as a whole, the IRS found that the ACO did not qualify for exemption under section 501(c)(3).

Moreover, because the ACO's activities were not exclusively for the benefit of the System, the IRS found that the ACO, even if it had qualified for exemption under section 501(c)(3), would not qualify as a supporting organization and would be considered a private foundation.

### Implications of the Ruling

The ruling does not change the IRS's position, announced in Notice 2011-20<sup>2</sup> and IRS Fact Sheet 2011-11,<sup>3</sup> that an ACO engaged exclusively in MSSP activities can qualify for section 501(c)(3) status, provided the other organizational and operational requirements of section 501(c)(3) are satisfied. The ruling, however, does clarify that the IRS will not grant section 501(c)(3) status to an ACO engaged primarily in non-MSSP activities on behalf of health care providers that are non-section 501(c)(3) organizations. What is unclear is whether an ACO engaged in both MSSP and non-MSSP activities could qualify for tax-exempt status and, if so, to what extent could the ACO perform non-MSSP activities on behalf of non-section 501(c)(3) organizations or physicians employed by such organizations.

Accordingly, the ruling raises concerns about the tax-exempt status of any nonprofit ACO (or tax-exempt organization participating in an ACO) that engages in non-MSSP activities. These organizations should consider the ruling in the context of Notice 2011-20 and IRS Fact Sheet 2011-11 to determine whether their activities could jeopardize their tax exemption or result in liability for unrelated business taxable income.

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1 I.R.S. Priv. Ltr. Ruling 201615022 (Jan. 15, 2016). A private letter ruling is a binding authority only for the taxpayer for whom it is issued.

2 Notice 2011-20, 2011-16 I.R.B. 652 (March 31, 2011).

3 See <https://www.irs.gov/pub/irs-news/fs-2011-11.pdf>.