

HAWKINS ADVISORY

PROVISIONS OF THE AFFORDABLE CARE ACT AND THE AMPLIFICATION OF SAFE HARBOR MANAGEMENT CONTRACT GUIDELINES

Introduction

On October 24, 2014, the Internal Revenue Service (“IRS”) issued Notice 2014-67 (the “Notice”), in an effort to provide interim guidance to governmental and 501(c)(3) hospitals and health care organizations participating in the Medicare Shared Savings Program (“MSSP”) described in §§ 3022 and 10307 of the Patient Protection and Affordable Care Act, Pub. L. 111-148, 124 Stat. 119 (“Affordable Care Act”), enacted March 23, 2010. Participation in the MSSP through an “accountable care organization” (“ACO”) will not result in a private business use of a facility financed with the proceeds of a tax-exempt bond issue if the guidance provided in the Notice is followed. The question of whether such participation will result in an unrelated trade or business activity in respect of the rules governing 501(c)(3) organizations is addressed in Notice 2011-16, dated April 18, 2011. The provisions of Notice 2011-16 are reflected in the interim guidance provided by the IRS in the Notice.

The Notice also addresses certain provisions of Rev. Proc. 97-13, 1997-1 C.B. 632, as amended by Rev. Proc. 2001-39, 2001-2 C.B. 38 (“Rev. Proc. 97-13”), describing management contracts with private service providers that will not result in private business use.

Interim Guidance Regarding ACOs and Private Business Use

Participation by state or local governmental units or 501(c)(3) organizations in the MSSP through ACOs, in itself, will not result in private business use of the tax-exempt bond financed facility if all of the following conditions are met:

- The terms of the qualified user’s participation in the MSSP through the ACO (including its share of MSSP payments or losses and expenses) are set forth in advance in a written agreement negotiated at arm’s length.
- The Center for Medicare & Medicaid Services has accepted the ACO into, and has not terminated the ACO from, the MSSP.
- The qualified user’s share of economic benefits derived from the ACO (including its share of MSSP payments) is proportional to the benefits or contributions that the qualified user provides to the ACO. If the qualified user receives an ownership interest in the ACO, the ownership interest received is proportional and equal in value to its capital contributions to the ACO, and all ACO returns of

capital, allocations, and distributions are made in proportion to the ownership interests.

- The qualified user’s share of the ACO’s losses (including its share of MSSP losses) does not exceed the share of ACO economic benefits to which the qualified user is entitled.
- All contracts and transactions entered into by the qualified user with the ACO and the ACO’s participants, and by the ACO with the ACO’s participants and any other parties, are at fair market value.
- The qualified user does not contribute or otherwise transfer the property financed with tax-exempt bonds to the ACO unless the ACO is an entity that is a governmental person, or in the case of qualified 501(c)(3) bonds, either a governmental person or a 501(c)(3) organization.

Provisions Amplifying Rev. Proc. 97-13

The Notice acknowledges that quality performance standards and Medicare fee-for-service expenditures relevant to participation in the MSSP will be reflected in contractual agreements entered into between state and local governmental units or 501(c)(3) organizations.

The Notice generally amplifies the permissible productivity rewards and types of arrangements currently described in Rev. Proc. 97-13 that will not result in private business use, provided all other requirements of section 5 of Rev. Proc. 97-13 are met.

The Notice relaxes certain provisions of Rev. Proc. 97-13 relating to 5-year contracts by allowing such contracts to meet the safe harbor guidelines set forth therein if all of the compensation for services is based on a stated amount; a periodic fixed fee; a capitation fee; a per-unit fee; or a combination thereof. The compensation for services also may include a percentage of gross revenues, adjusted gross revenues, or expenses of the facility (but not both revenues and expenses). The term of the contract, including all renewal options, may not exceed five years. Such contract need not be terminable by the qualified user prior to the end of the term. For purposes of this section, a tiered productivity reward, as described below, will be treated as a stated amount or a periodic fixed fee, as appropriate.

The Notice provides that a tiered productivity reward for services in any annual period during the term of the contract

generally will not cause the compensation to be based on a share of net profits of the financed facility if:

- The eligibility for the productivity award is based on the quality of the services provided under the management contract (for example, the achievement of MSSP quality performance standards or meeting data reporting requirements), rather than increases in revenues or decreases in expenses of the facility; and
- The amount of the productivity award is a stated dollar amount, a periodic fixed fee, or a tiered system of stated dollar amounts or periodic fixed fees based solely on the level of performance achieved with respect to the applicable measure.

Applicability Provisions

The guidance of the Notice regarding the safe harbors against the creation of private business use as a consequence of entering into ACOs applies to governmental and 501(c)(3) bonds sold on or after January 22, 2015. The foregoing notwithstanding, these safe harbors may be applied to such bonds sold before January 22, 2015.

The guidance of the Notice amplifying Rev. Proc. 97-13 apply to contracts entered into, materially modified, or extended (other than pursuant to a renewal option) on or after January 22, 2015. These provisions also may be applied to contracts entered into before January 22, 2015.

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