

THE
NATIONAL LAW REVIEW

IRS Denies Exempt Status for Non-MSSP Accountable Care Organizations

Thursday, July 14, 2016

In April, the **IRS** released a private letter ruling denying section 501(c)(3) status to an accountable care organization (“ACO”) that contracted with third-party payers outside of the **Medicare Shared Savings Program (“MSSP”)**. [I.R.S. Priv. Ltr. Rul. 2016-15-022 \(Jan. 15, 2016\)](#). The ACO was formed by a non-profit, tax-exempt health system to coordinate a clinically integrated network of health care providers, including physicians employed by the health care system and independent physicians.

ACOs have become common vehicles in health care since passage of the **Affordable Care Act (“ACA”)**. Although ACOs may take many forms, generally they are legal entities or arrangements among health care systems, doctors, and hospitals to create a contracting agency that can contract collectively with payors, including government programs. The ACO’s contracts with payors are designed to create shared financial incentives among doctors, hospitals, and other providers and make the providers accountable for the care they provide. Commonly, if providers in the ACO meet performance goals based on improving health outcomes and controlling cost, while meeting quality criteria, they can share in benefits realized.

The ACA did not create a separate tax-exempt provision for ACOs under section 501(c). Instead, the tax treatment of ACOs formed as legal entities is determined by the IRS under the general rules for section 501(c)(3) organizations and other health care organizations. Likewise, income generated by an ACO in which a tax-exempt organization is a participant may or may not be unrelated business taxable income, depending upon the application of the general rules.

In 2011, the IRS ruled in Notice 2011-20 that an ACO providing contracts and services to patients enrolled in MSSP *is* tax exempt, as long as it meets the MSSP eligibility requirements established by CMS. The IRS stated that, while the ACO does not necessarily promote health, an ACO contracting with MSSP can qualify as tax-exempt because, due to the nature of the MSSP, the ACO would lessen the burdens of government (another category for obtaining tax-exempt status). Notice 2011-20, 2011-16 I.R.B. 652 (April 18, 2011).

However, in the recent private letter ruling, the IRS determined that an ACO contracting with third-party payors did not qualify as tax-exempt because it did not operate for a charitable purpose (it neither promoted health nor lessened the burdens of government) and it provided an impermissible benefit to the health care providers participating in the ACO. Each one of these findings is summarized below:

Promotion of Health

The private letter ruling states flatly that the ACA’s statement of its Triple Aim goals (reducing costs, improving patient access to and quality of care, and improving population health) are not necessarily in furtherance of charitable purposes, including the promotion of health.

Instead, the IRS determined that the primary activities of the ACO (to contract with providers and then to negotiate shared services agreements with third-party providers) are not charitable based on references to prior rulings concerning HMOs.



Article By [Jason J. Kohout](#)
[C. Frederick Geilfuss II](#) [Foley & Lardner LLP](#)
[Health Care Law Today](#)

[Health Law & Managed Care](#)
[Tax](#)
[All Federal](#)

Lessening the Burdens of Government

The ruling denied tax-exempt status on the grounds that the ACO was not “lessening the burdens of government.” To qualify as tax-exempt that is lessening the burdens of the government, there must be an objective manifestation that the government considers the activities to be its burden, typically by statute, management by government officials, or government funding.

The ruling allowed that although the ACA’s language contained an overall statement regarding the creation of ACOs to promote quality improvements and cost savings in health care, the ACA did not contain specific government manifestation that non-MSSP related ACO activities were the government’s burden. Simply furthering the ACA’s overall Triple Aim goals was insufficient.

Charitable Purposes and Private Benefit

In the private letter ruling, the IRS ruled that the ACO provides an impermissible private benefit to the private-party providers who had entered into participation agreements with the ACO. Section 501(c)(3) organizations may not provide private parties more than an incidental or insubstantial benefit in comparison to the community benefit. Even if the organization had met the tests for charitable purpose, this finding would bar the ACO from attaining tax-exempt status.

The IRS ruled that the ACO’s negotiations with the third-party providers were beneficial to the independent physicians and other private-party health care provider participants in the ACO. The ruling concluded that the benefits to the providers were substantial as compared to the community benefit of the ACO’s activities.

Conclusion

Failure to obtain tax-exempt status or a requirement to treat the income as unrelated (and subject to tax) could create a barrier for ACOs, entities which proponents (including government officials) believe could be the future of health care delivery and payment systems.

Although technically this ruling only reflects the IRS determination as to the case at hand and is not dispositive authority for other parties, it currently is the only IRS authority of any kind on the subject. The ruling also raises a number of unanswered questions. Among the questions are whether a section 501(c)(3) organization that conducts similar activities as the ACO in the ruling, such as contracting for an alternative payment arrangement that involves independent providers, could be subject to unrelated business income tax. Another question is whether a hospital that invests or contributes to the infrastructure of an ACO that both participates in the MSSP and also does commercial contracting on behalf of some independent providers risks running afoul of the private inurement prohibition.

Alysha L. Bohanon is co-author of this article.

© 2019 Foley & Lardner LLP

Source URL: <https://www.natlawreview.com/article/irs-denies-exempt-status-non-mssp-accountable-care-organizations>