OBER | KALER
Attorneys at Law

April 6, 2011

Ober|Kaler ACO Update

Alan J. Arville | ajarville@ober.com

This is part of Ober|Kaler's comprehensive overview of federal agencies' implementation of the Accountable Care Act's ACO and Shared Savings Program provisions: CMS Proposed ACO Implementing Regulations; Antitrust; Fraud and Abuse; Privacy; Tax-Exempt Organizations.

Shared Savings among ACO Participants Protected Under IRS Guidance

Recently issued regulations and other notices for comments have given health care providers guidance on how to organize and operate accountable care organizations (ACOs) in order to be eligible to receive payments under Medicare's Shared Savings Program. The Affordable Care Act (ACA), signed into law in March 2010, included incentives for the creation of ACOs. Congress established the ACO Shared Savings Program in the ACA to promote accountability of providers to patient populations and to coordinate services under Medicare as well as to encourage providers to make investments in infrastructure and to design care processes for high-quality, efficient service delivery. Almost a year later on March 31, 2011, several federal agencies (CMS, OIG, DOJ, FTC and IRS) jointly announced the release of proposed rule making and guidance regarding the ACO program. The proposed rule and related guidance is expected to remove the existing legal impediments in the

areas of fraud and abuse, antitrust, tax and privacy to allow for the development of ACOs, and provide guidance on such issues as eligibility to participate, governance, legal structure, quality and privacy.

The IRS issued Notice 2011-20 concerning the application of Internal Revenue Code (IRC) provisions concerning private inurement and unrelated business income to the shared savings received by tax-exempt hospitals and other tax-exempt health care organizations participating in the Shared Savings Program. The IRS notice also solicits comments as to whether existing IRS guidance governing tax-exempt organizations is sufficient for those tax-exempt organizations planning to participate in the Shared Savings Program and, if not, what additional guidance is needed.

Although the guidance provided in the IRS notice appears preliminary in nature, nonprofit hospitals will take comfort that the IRS is employing a similar and familiar analysis to ACO participation as that applied to existing joint ventures between tax-exempt organizations and private parties. The IRS recognizes, however, that ACO participation creates a variety of novel and fact-specific issues, and that new guidance (and potentially new IRS regulations) specific to the activities of tax-exempt organizations through ACOs (and particularly non-Shared Savings Program activities) may need to be developed.

Private Inurement and Private Benefit

The IRS anticipates that tax-exempt organizations, such as hospitals, will participate in ACOs alongside private parties. The IRS stresses that the tax-exempt organization must ensure that its participation in the Shared Savings Program through an ACO does not result in its net earnings inuring to the benefit of insiders or its being operated for the benefit of private parties participating in the ACO, such as for-profit physician groups. The IRS suggests that it will not consider a tax-exempt organization's participation in the Shared Saving Program through an ACO to result in such "inurement" or "impermissible private benefit" to the private party ACO participants when the following criteria are met:

- The terms of the tax-exempt organization's participation in the Shared Savings Program through the ACO (including its share of shared savings payments or losses and expenses) are evidenced in advance in a written agreement negotiated at arm's length.
- CMS has accepted the ACO into the Shared Savings Program and the ACO is not terminated from the Shared Savings Program.
- The tax-exempt organization's share of economic benefits derived from the ACO (including its share of shared savings payments) is proportional to the benefits or contributions the tax-exempt organization provides to the ACO. If the tax-exempt organization receives an ownership interest in the ACO, the ownership interest received is proportional and equal in value to the tax-exempt organization's capital

contributions to the ACO and all ACO returns of capital, allocations and distributions are made in proportion to ownership interests.

- The tax-exempt organization's share of the ACO's losses (including its share of Shared Savings Program losses) does not exceed the share of ACO economic benefits to which the tax-exempt organization is entitled.
- All contracts and transactions entered into by the tax-exempt organization 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.

Unrelated Business Income Tax

The IRS notice discusses whether the Shared Savings Program payments received by a tax-exempt organization will be subject to unrelated business tax (UBIT) under section 511(a) of the IRC. The IRS expects that such payments usually will not be subject to UBIT, since they typically will be derived from activities that are substantially related to the exercise of the tax-exempt organization's charitable purposes. Under the Shared Savings Program, the IRS could consider a tax-exempt organization's charitable purpose to be the lessening of the government's burden associated with providing Medicare benefits by promoting quality improvements and cost savings.

Activities Unrelated to the Shared Savings Program

The IRS recognizes that ACOs will conduct activities unrelated to the Shared Savings Program. Some activities such as negotiating contracts with private health insurers on behalf of unrelated parties are unlikely to lessen the burden of the government, while other activities such as participating in shared savings arrangements with Medicaid could be seen as lessening the burden of the federal government. The IRS stops short, however, of addressing under what circumstances a tax-exempt organization's participation in activates unrelated to the Shared Savings Program would be inconsistent with the organization's tax-exempt status or not result in UBIT. Instead, the IRS requests comments for developing guidance, criteria and safeguards to make such a determination.

This publication contains only a general overview of the matters discussed herein and should not be construed as providing legal advice.