Part III. Administrative, Procedural, and Miscellaneous

Notice Regarding Participation in the MSSP through an ACO

Notice 2011–20

The Internal Revenue Service (IRS) is considering the application of the provisions of the Internal Revenue Code (Code) governing tax-exempt organizations to hospitals or other health care organizations that are recognized as organizations described in § 501(c)(3) of the Code (referred to herein as "tax-exempt organizations") participating in the Medicare Shared Savings Program (MSSP) described in § 3022 of the Patient Protection and Affordable Care Act, Pub. L. 111–148, 124 Stat. 119 (Affordable Care Act), enacted March 23, 2010. Accordingly, the IRS is soliciting comments as to whether existing guidance relating to the Code provisions governing tax-exempt organizations is sufficient for those tax-exempt organizations planning to participate in the MSSP through an "accountable care organization" (ACO) and, if not, what additional guidance is needed. The IRS is also soliciting comments concerning whether guidance is needed regarding the tax implications for tax-exempt organizations participating in activities unrelated to the MSSP, including shared savings arrangements with commercial health insurance payers, through ACOs.

BACKGROUND ON ACOS AND THE MSSP

Section 3022 of the Affordable Care Act amends Title XVIII of the Social Security Act (SSA) (42 U.S.C. 1395 *et seq.*) by adding a new § 1899, which directs the Secretary of the Department of Health and Human Services (HHS) to establish a Medicare shared savings program that promotes accountability for care of Medicare beneficiaries, improves the coordination of Medicare fee-for-service items and services, and encourages investment in infrastructure and redesigned care processes for high quality and efficient service delivery. Under § 1899(b)(1) of the SSA, groups of health care service providers and suppliers that have established a mechanism for shared governance and that meet criteria specified by HHS are eligible to participate as ACOs under the program.

Section 1899(b)(1) of the SSA provides examples of groups of service providers and suppliers that may form an ACO, including (i) physicians and other health care practitioners (ACO professionals) in a group practice, (ii) a network of individual practices, (iii) a partnership or joint venture arrangement between hospitals and ACO professionals, and (iv) a hospital employing ACO professionals. ACOs eligible to participate in the MSSP will manage and coordinate care for their assigned Medicare fee-for-service beneficiaries. Health care service providers and suppliers participating in an ACO will continue to receive Medicare fee-for-service payments in the same manner as such payments would otherwise be made. In addition, an ACO that meets quality performance standards established by HHS and demonstrates that it has achieved savings against an appropriate benchmark of expected average *per capita* Medicare fee-for-service expenditures will be eligible to receive payments for Medicare shared savings (MSSP payments) under § 1899(d)(2) of the SSA. Section 1899(i) of the SSA also authorizes the use of other payment models that the HHS Secretary determines will improve the quality and efficiency of items and services for Medicare.

Section 1899(b)(2) of the SSA establishes the following requirements for an ACO to participate in the program:

1. The ACO shall be willing to become accountable for the quality, cost, and overall care of the Medicare fee-for-service beneficiaries assigned to it.
2. The ACO shall enter into an agreement with the HHS Secretary to participate in the program for not less than a 3-year period (the MSSP agreement period).
3. The ACO shall have a formal legal structure that would allow the organization to receive and distribute payments for shared savings under § 1899(d)(2) to participating providers of services and suppliers.
4. The ACO shall include primary care ACO professionals that are sufficient for the number of Medicare fee-for-service beneficiaries assigned to the ACO under § 1899(c). At a minimum, the ACO shall have at least 5,000 such beneficiaries assigned to it under § 1899(c) in order to be eligible to participate in the MSSP.
5. The ACO shall provide the HHS Secretary with such information regarding ACO professionals participating in the ACO as the Secretary determines necessary to support the assignment of Medicare fee-for-service beneficiaries to an ACO, the implementation of quality and the other reporting requirements under § 1899(b)(3), and the determination of payments for shared savings under § 1899(d)(2).
6. The ACO shall have in place a leadership and management structure that includes clinical and administrative systems.
7. The ACO shall define processes to promote evidence-based medicine and patient engagement, report on quality and cost measures, and coordinate care, such as through the use of telehealth, remote patient monitoring, and other such enabling technologies.
8. The ACO shall demonstrate to the HHS Secretary that it meets patient-centeredness criteria specified by the Secretary, such as the use of patient and caregiver assessments or the use of individualized care plans.

Section 1899(b)(3) of the SSA requires the HHS Secretary to establish quality performance standards to assess the quality of care furnished by ACOs and requires ACOs to report data, in a form and manner specified by the HHS Secretary, on measures the Secretary determines necessary to evaluate the quality of care furnished by the ACO. Section 1899(d)(3) of the SSA requires the HHS Secretary to monitor ACOs for avoidance of at-risk patients. If the HHS Secretary determines that an ACO has taken steps to avoid at-risk patients to reduce the likelihood of increasing costs to the ACO, the Secretary may impose appropriate sanctions, including termination from the MSSP.

On March 31, 2011, the Centers for Medicare & Medicaid Services (CMS), the agency within HHS that administers

the Medicare program, released a Notice of Proposed Rulemaking (NPRM) addressing § 1899 of the SSA and soliciting comments. The NPRM contains specific, proposed eligibility criteria (including patient and program safeguards) that entities would have to meet to qualify as ACOs under the MSSP, and describes proposed quality measures, reporting requirements, and monitoring by CMS. Consistent with the eligibility requirements under §1899(b), the NPRM proposes requiring an ACO to be an organization that is recognized under applicable State law and that has a governing body with adequate authority to execute the statutory functions of an ACO. The NPRM also proposes requiring an ACO's governing body to include ACO participants (or their designated representatives) and to include Medicare patients who are served by the ACO and do not have a financial connection to the ACO.

In the NPRM, CMS proposes to require potential ACOs seeking to participate in the MSSP to submit written applications to CMS and to describe in their applications how they plan to use and distribute any MSSP payments, and how that plan would contribute to achieving the specific goals of the MSSP and the general aims of better care for individuals, better health for populations, and lower growth in expenditures. The NPRM proposes that CMS would evaluate the ACO's proposal in determining its eligibility to participate in the program.

The NPRM further proposes that CMS will monitor and assess the performance of ACOs and their participants by making site visits, analyzing beneficiary and provider complaints, conducting audits, and analyzing specific financial and quality measurement data reported by the ACO, as well as aggregated annual and quarterly reports. CMS will use these methods to monitor such matters as the ACOs' avoidance of at-risk beneficiaries and its compliance with quality performance standards and eligibility requirements.

In addition, the NPRM proposes to require participating ACOs to comply with public reporting and transparency requirements. For example, each participating ACO would be required to publicly report information about its participating providers of services and suppliers, leadership, quality performance, and shared savings, including MSSP payments (if any) received by the ACO and the total proportion of shared savings distributed among ACO participants and the total proportion used to support quality performance and program goals.

Finally, consistent with the language in § 1899(i) of the SSA that authorizes the use of alternative payment models, the NPRM proposes a "two-sided model," under which participating ACOs would not only be eligible to share in cost savings at higher rates but would also have to repay losses resulting from spending that exceeds a benchmark of expected average *per capita* Medicare fee-for-service expenditures (MSSP losses). ACOs will be able to elect to participate in the two-sided model during the first two years of their initial MSSP agreement period, with all ACOs operating under the two-sided model by the third year of their initial MSSP agreement period, and during any subsequent MSSP agreement period.

LAW

Exemption under § 501(c)(3) of the Code

Section 501(c)(3) of the Code provides, in part, for the exemption from federal income tax of corporations organized and operated exclusively for charitable, scientific, or educational purposes, provided no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Treas. Reg. § 1.501(c)(3)–1(c)(1) states that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in § 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Treas. Reg. § 1.501(c)(3)–1(c)(2) states that an organization is not operated exclusively for charitable purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. Courts have interpreted the term "net earnings" as referring to an "advantage, profit, fruit, privilege, gain [or] interest" derived from the organization. *Harding Hospital v. United States*, 505 F.2d 1068, 1072 (6th Cir. 1964); *Retired Teachers Legal Defense Fund v. Commissioner*, 78 T.C. 280, 286 (1982).

Treas. Reg. § 1.501(a)–1(c) defines "private shareholder or individual" as referring to persons having a personal and private interest in the activities of the organization. Such persons are commonly referred to as "insiders."

Treas. Reg. § 1.501(c)(3)–1(d)(1)(ii) states that an organization is not organized exclusively for any of the purposes specified in § 501(c)(3) unless it serves public, rather than private interests. Thus, an organization applying for tax exemption under § 501(c)(3) must establish that it is not organized or operated for the benefit of private interests.

Treas. Reg. § 1.501(c)(3)–1(d)(2) provides that the term "charitable" is used in § 501(c)(3) in its generally accepted legal sense and includes such purposes as relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; and lessening of the burdens of Government. A determination of whether an organization is lessening the burdens of government requires consideration of whether the organization's activities are ones that a government unit considers to be its burden, and whether such activities actually lessen that burden, based on all the facts and circumstances. *See* Rev. Rul. 85–1 (organization that assists a county's law enforcement agencies in policing illegal narcotics traffic lessens burdens of government); Rev. Rul. 85–2 (organization that provides legal counsel and training to volunteers who serve as guardians *ad litum* in a juvenile court dependency program lessens the burdens of government).

Rev. Rul. 81–276, 1981–2 C.B. 128, describes a professional standards review organization established pursuant to a federal statute to review health care practitioners' and institutions' provision of health care services and items for which payment is made under Medicare and Medicaid, and determine whether the quality of services met professionally recognized standards of care. The IRS ruled that by taking on the government's burden of reviewing the quality of services provided under Medicare and Medicaid, the organization lessened the burdens of government within the meaning of Treas. Reg. § 1.501(c)(3)–1(d)(2). Any benefit

to members of the medical profession from such activities was incidental to the benefit the organization provided in lessening the burdens of government. Therefore, the organization qualified for exemption under § 501(c)(3) of the Code.

The "promotion of health has long been recognized as a charitable purpose." Rev. Rul. 98–15, 1998–1 C.B. 718; *see also* Rev. Rul. 69–545, 1969–2 C.B. 117 (noting that "[i]n the general law of charity, the promotion of health is considered to be a charitable purpose"). However, not every activity that promotes health supports tax exemption under § 501(c)(3). For example, selling prescription pharmaceuticals promotes health, but pharmacies cannot qualify for recognition of exemption under § 501(c)(3) on that basis alone. *Federation Pharmacy Services, Inc. v. Commissioner*, 72 T.C. 687 (1979), *aff'd*, 625 F.2d 804 (8th Cir. 1980); *see also IHC Health Plans Inc. v. Commissioner*, 325 F.3d 1188, 1197 (10th Cir. 2003) (noting that "engaging in an activity that promotes health, standing alone, offers an insufficient indicium of an organization's purpose," as "[n]umerous for-profit enterprises offer products or services that promote health"). Furthermore, "an institution for the promotion of health is not a charitable institution if it is privately owned and is run for the profit of the owners." Rev. Rul. 98–15.

In Rev. Rul. 98–15, the IRS recognized that the activities of a limited liability company (LLC) "treated as a partnership for federal income tax purposes are considered to be the activities of a nonprofit organization that is an owner of the LLC when evaluating whether the nonprofit organization is operated exclusively for exempt purposes within the meaning of § 501(c)(3)." *See also* Rev. Rul. 2004–51, 2004–1 C.B. 974 (noting that the activities of an LLC treated as a partnership for tax purposes are attributed to a university that owns 50 percent of the LLC for purposes of determining whether the university "operates exclusively for educational purposes and therefore continues to qualify for exemption under § 501(c)(3)").

Tax on Unrelated Business Income

Section 511(a) of the Code, in part, provides for the imposition of tax on the unrelated business taxable income (as defined in § 512) of organizations described in § 501(c)(3).

Section 512(a)(1) of the Code defines "unrelated business taxable income" as the gross income derived by any organization from any unrelated trade or business (as defined in § 513) regularly carried on by it less the deductions allowed, both computed with the modifications provided in § 512(b).

Section 512(c) of the Code provides that, if a trade or business regularly carried on by a partnership of which an organization is a member is an unrelated trade or business with respect to the organization, in computing its unrelated business taxable income, the organization shall, subject to the exceptions, additions, and limitations contained in § 512(b), include its share (whether or not distributed) of the gross income of the partnership from the unrelated trade or business and its share of the partnership deductions directly connected with the gross income.

Section 513(a) of the Code defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the exercise or performance by the organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under § 501.

Treas. Reg. § 1.513–1(d)(2) provides that a trade or business is "related" to an organization's exempt purposes only if the conduct of the business activities has a causal relationship to the achievement of exempt purposes (other than through the production of income). A trade or business is "substantially related" for purposes of § 513, only if the causal relationship is a substantial one. Thus, to be substantially related, the activity "must contribute importantly to the accomplishment of [exempt] purposes." Treas. Reg. § 1.513–1(d)(2).

Rev. Rul. 2004–51 describes a § 501(c)(3) university that, together with a video technology company, formed an LLC with the sole purpose of offering teacher training seminars at off-campus locations using interactive video technology. The university and the company each held a 50 percent ownership interest in the LLC, which was proportionate to the value of their respective capital contributions to the LLC. In addition, the governing documents of the LLC provided that (1) all returns of capital, allocations and distributions were to be made in proportion to the members' respective ownership interests; (2) the LLC would be managed by a governing board comprised of three directors chosen by the university and three directors chosen by the company; (3) the university had the exclusive right to approve the curriculum, training materials, and instructors, and to determine the standards for successful completion of the seminars; and (4) the terms of all contracts and transactions entered into by the LLC with the university and the company and any other parties had to be at arm's length and all contract and transaction prices had to be at fair market value. The IRS noted that because the LLC was treated as a partnership for federal tax purposes, its activities were attributed to the university for purposes of determining whether the university was engaged in an unrelated trade or business. Under these facts and circumstances, the IRS ruled that the university's activities conducted through the LLC constituted a trade or business that was substantially related to the exercise and performance of the university's exempt purposes.

DISCUSSION

Participation in the MSSP Through ACOs by Tax-Exempt Organizations

The IRS anticipates that tax-exempt organizations typically will be participating in the MSSP through an ACO along with private parties, including some that might be considered insiders with respect to the tax-exempt organization. The IRS further anticipates that a tax-exempt organization's participation may take a variety of forms, including membership in a nonprofit membership corporation, ownership of shares in a corporation, ownership of a partnership interest in a partnership (or a membership interest in an LLC), and contractual arrangements with the ACO and/or its other participants.

To avoid adverse tax consequences, the tax-exempt organization must ensure that its participation in the MSSP through an ACO is structured so as not to result in its net earnings inuring to the benefit of

its insiders or in its being operated for the benefit of private parties participating in the ACO. The IRS must determine whether prohibited inurement or impermissible private benefit has occurred on a case-by-case basis, based on all the facts and circumstances. Because of CMS regulation and oversight of the MSSP, as a general matter, the IRS expects that it will not consider a tax-exempt organization's participation in the MSSP through an ACO to result in inurement or impermissible private benefit to the private party ACO participants where:

- The terms of the tax-exempt organization'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.
- CMS has accepted the ACO into, and has not terminated the ACO from, the MSSP.
- The tax-exempt organization's share of economic benefits derived from the ACO (including its share of MSSP 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 its 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 MSSP 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.

An additional issue raised by the participation of tax exempt organizations in ACOs is whether the share of the MSSP payments received by a tax-exempt organization will be subject to unrelated business income tax (UBIT) under § 511. Whether the MSSP payments will be subject to UBIT depends on whether the activities generating the MSSP payments are substantially related to the exercise or performance of the tax-exempt organization's charitable purposes constituting the basis for its exemption under § 501.

The IRS expects that, absent inurement or impermissible private benefit, any MSSP payments received by a tax-exempt organization from an ACO would derive from activities that are substantially related to the performance of the charitable purpose of lessening the burdens of government within the meaning of Treas. Reg. § 1.501(c)(3)–1(d)(2), as long as the ACO meets all of the eligibility requirements established by CMS for participation in the MSSP. *See, e.g.*, Rev. Rul. 81–276 (recognizing that the federal government considers the provision of Medicare to be its burden). Congress established the MSSP to be conducted through ACOs in order to promote quality improvements and cost savings, thereby lessening the government's burden associated with providing Medicare benefits.

The IRS is soliciting comments regarding what additional guidance, if any, is needed to facilitate participation by tax-exempt organizations in the MSSP through ACOs. If additional guidance is needed, the IRS is soliciting comments regarding what criteria or requirements should be analyzed in determining whether participation by a tax-exempt organization in the MSSP through an ACO is consistent with tax-exempt status under § 501(c)(3) and whether the tax-exempt organization is receiving unrelated business income.

ACO's Conduct of Activities Unrelated to the MSSP

The IRS understands that some tax-exempt organizations might participate in ACOs conducting activities unrelated to the MSSP, including entering into and operating under shared savings arrangements with other types of health insurance payers (non-MSSP activities). The IRS anticipates that, in contrast to activities conducted as part of the MSSP, many non-MSSP activities conducted by or through an ACO are unlikely to lessen the burdens of government within the meaning of Treas. Reg. § 1.501(c)(3)–1(d)(2). For example, negotiating with private health insurers on behalf of unrelated parties generally is not a charitable activity, regardless of whether the agreement negotiated involves a program aimed at achieving cost savings in health care delivery. However, the IRS recognizes that certain non-MSSP activities may further or be substantially related to an exempt purpose. For example, the NPRM released by CMS anticipates that ACOs may also participate in shared savings arrangements with Medicaid, which may further the charitable purpose of relieving the poor and distressed or the underprivileged. *See* Treas. Reg. § 1.501(c)(3)–1(d)(2). This notice does not address whether and under what circumstances a tax-exempt organization's participation in non-MSSP activities through an ACO will be consistent with an organization's tax-exemption under § 501(c)(3) or not result in UBIT. However, the IRS requests comments regarding what guidance, if any, is necessary or appropriate regarding a tax-exempt organization's participation in non-MSSP activities through an ACO.

Specifically, the IRS requests comments regarding how a tax-exempt organization's participation in particular non-MSSP activities through an ACO further or are substantially related to an exempt purpose. Comments should describe the activities a tax-exempt organization might expect to participate in through an ACO and address under what rationale participation in such non-MSSP activities might further exempt purposes and also what criteria, requirements, and safeguards would ensure the furtherance of these exempt purposes. In particular, comments should address how a participating tax-exempt organization will ensure that non-MSSP activities further exempt purposes in the absence of safeguards similar to those present in the MSSP, such as (1) any regulatory requirements imposing quality performance and other standards on the non-MSSP activities and (2) any oversight and monitoring of the non-MSSP activities by a government agency such as CMS.

Comments should also take into account two principles under existing law. First, although the promotion of health has been recognized as a charitable purpose, not every activity that promotes health supports tax exemption under § 501(c)(3). *See IHC Health Plans*, 325 F.3d at 1197;

Fed'n Pharmacy Serv., 72 T.C. at 691–92; Rev. Rul. 98–15. Second, if a tax-exempt organization is a partner (or member, in the case of an LLC) of an ACO treated as a partnership for federal tax purposes, the ACO's activities will be attributed to the tax-exempt organization for purposes of determining both whether the organization operates exclusively for exempt purposes and whether it is engaged in an unrelated trade or business. *See, e.g.*, Rev. Rul. 2004–51; Rev. Rul. 98–15.

REQUEST FOR PUBLIC COMMENT

Public comments should be submitted in writing on or before May 31, 2011. Comments should be sent to the following address:

Internal Revenue Service
SE:T:EO:RA:G (Notice 2011–20)
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Comments may be hand delivered to:

SE:T:EO:RA:G (Notice 2011–20)
Courier's Desk
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Comments may also be sent electronically to *notice.comments@irscounsel.treas.gov*. Please include "Notice 2011–20" in the subject line.

All comments will be available for public inspection.

DRAFTING INFORMATION

The principal author of this notice is Mackenzie McNaughton of Exempt Organizations, Tax Exempt and Government Entities Division. For further information regarding this notice, contact Mackenzie McNaughton at (202) 283–9484 (not a toll-free call).

Interim Guidance on Informational Reporting to Employees of the Cost of Their Group Health Insurance Coverage

Notice 2011–28

I. PURPOSE

This notice provides interim guidance on informational reporting to employees of the cost of their employer-sponsored group health plan coverage. This informational reporting is required under § 6051(a)(14) of the Code, enacted as part of the Affordable Care Act to provide useful and comparable consumer information to employees on the cost of their health care coverage. As more fully described below —

- This reporting to employees is for their information only, to inform them of the cost of their health care coverage, and does not cause excludable employer-provided health care coverage to become taxable. Nothing in § 6051(a)(14), this notice, or the additional guidance that is contemplated under § 6051(a)(14), causes or will cause otherwise excludable employer-provided health care coverage to become taxable.

- This notice provides interim guidance that generally applies beginning with 2012 Forms W–2 (that is, the forms required for the calendar year 2012 that employers generally are required to furnish to employees in January 2013 and then file with the Social Security Administration (SSA)). Employers are not required to report the cost of health coverage on any forms required to be furnished to employees prior to January 2013. See Notice 2010–69. However, any employers that choose to report earlier (on the 2011 Forms W–2 generally furnished to employees in January 2012) may look to this notice for guidance regarding that voluntary earlier reporting.

- This notice also provides additional transition relief for certain employers and with respect to certain types of employer-sponsored coverage. This transition relief will continue at least through the 2012 Forms W–2 which are required to be furnished to employees in January 2013. In other words, those employers to which the additional transition relief applies (which includes smaller employers that are required to file fewer than 250 2011 Forms W–2) will not be required to report the cost of health care coverage on any forms required to be furnished to employees prior to January 2014. This transition relief will continue until the issuance of further guidance.

- Comments are invited on this interim guidance.

Section 6051(a)(14) was added to the Code by § 9002 of the Patient Protection and Affordable Care Act of 2010 (the Affordable Care Act), Public Law 111–148, enacted March 23, 2010, and provides that the reporting be made on Form W–2, *Wage and Tax Statement.* Notice 2010–69, 2010–44 I.R.B. 567, provides that this reporting will not be mandatory for 2011 Forms W–2 (that is, the forms required for the calendar year 2011 that employers are generally required to give employees in January 2012 and then file with the Social Security Administration).

As explained above, this notice provides interim guidance that generally is applicable beginning with 2012 Forms W–2. In addition, employers may rely on the guidance provided in this notice if they voluntarily choose to report the cost of coverage on 2011 Forms W–2, even though this reporting is not required for 2011. This interim guidance is applicable until further guidance is issued. To the extent that future guidance applies the reporting requirement to additional employers or categories of employers or additional types of coverage that guidance will apply prospectively only and will not apply to any calendar year beginning within six months of the date the guidance is issued. Also as explained above, this notice provides transition relief for certain employers and with respect to certain types of employer-sponsored coverage. See section IV of this notice. This transition relief will be extended at least through the 2012 Forms W–2 and the availability of this transition relief through the 2012 Forms W–2 will not be affected by the issuance of any further guidance. Thus,