

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

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subject: Whether the amount of income a taxpayer will receive pursuant to the Medicare Shared Savings Program regulations is fixed and can be determined with reasonable accuracy.

This Chief Counsel Advice responds to your request for assistance dated July 21, 2014. This advice may not be used or cited as precedent.

LEGEND

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ISSUE

Whether the amount of income the Taxpayer will receive from Medicare pursuant to the Medicare Shared Savings Program regulations is fixed prior to the year of notification of shared savings.

CONCLUSION

Due to programmatic factors, the amount of income that the Taxpayer will receive from Medicare pursuant to the Medicare Shared Savings Program regulations is not fixed at the end of the taxable year in which patient services are provided. These factors are resolved and the amount of income is fixed and determinable with reasonable accuracy when the taxpayer is notified of shared savings, which is approximately seven to ten months after the close of the taxable year in which patient services are provided.

FACTS

1. Taxpayer

Taxpayer is in the F business, operating primarily in Business.

During tax years Year 3 and Year 4, Taxpayer started ! B to operate as Accountable Care Organizations (**ACOs**) under the Affordable Care Act (**ACA**) through its C indirect holding company, A. A is a disregarded entity for federal tax purposes and is included on Taxpayer's consolidated federal income tax return.

An ACO, is an organization of health care providers that agrees to be accountable for the quality, cost, and overall care of Medicare beneficiaries who are enrolled in the

traditional fee-for-service program who are assigned to it. *See generally*, Notice 2011-20, 2011-16 I.R.B. 652 (addressing the participation of tax-exempt organizations in ACOs).

Taxpayer established # types of ACOs: B ACOs and a C ACO. For the B ACOs, there are usually # B in each B: A and an D that has more than + Medicare patients. Taxpayer established = ACOs with a collective & beneficiaries assigned that have an R, start date, an additional % ACOs with a collective ^ beneficiaries assigned that have a S, start date, and an additional \$ ACOs with a collective @ beneficiaries that have a T, start date. For the C corporate ACO, Taxpayer, through A, established a corporate ACO, E.

2. Accountable Care Organizations & Medicare Shared Savings Program

Taxpayer, through A and its various ACOs, is participating in the Medicare Shared Savings Program (Shared Savings Program) described in § 3022 of the Patient Protection and Affordable Care Act, Pub. L. 111-148, 124 Stat. 119 (**ACA**), enacted on March 23, 2010.

Section 3022 of the ACA amends Title XVIII of the Social Security Act (**SSA**) (42 U.S.C.1395 et seq.) by adding new § 1899, which directs the Secretary of the Department of Health and Human Services (**HHS**) to establish the Shared Savings Program to promote accountability for care of Medicare beneficiaries, improve the coordination of Medicare fee-for-service (**FFS**) items and services, and encourage 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 the Secretary are eligible to participate as ACOs under the program.

The Shared Savings Program is a voluntary program in which ACOs accept responsibility for the overall quality, cost and care of a defined group of FFS beneficiaries for at least a three year agreement period. Under the program, ACOs are accountable for a minimum of 5,000 FFS beneficiaries. The ACO must define processes to promote evidence-based medicine and patient engagement, monitor and evaluate quality and cost measures, meet patient-centeredness criteria and coordinate care across the care continuum. Medicare service providers and suppliers participating in an ACO will continue to receive FFS payments in the same manner as such payments would otherwise be made; however, an ACO that meets quality performance standards established by the Secretary and demonstrates that it has generated savings against an appropriate benchmark of expected average per capita FFS expenditures will be eligible to share in savings earned, if the generated savings meet or exceed the minimum savings threshold under § 1899(d)(2) of the SSA. Quality reporting occurs after the performance year, as described later. 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 of Medicare.

Section 1899(d)(1)(B)(ii) of the SSA requires the Secretary to establish and update the “benchmark for each agreement period for each ACO using the most recent available 3 years of per-beneficiary expenditures for parts A and B services for Medicare fee-for-service beneficiaries assigned to the ACO.” This section also requires the benchmark to “be adjusted for beneficiary characteristics and such other factors as the Secretary determines appropriate and updated by the projected absolute amount of growth in national per capita expenditures for Parts A and B services under the original Medicare fee-for-service service program, as estimated by the Secretary.” A new benchmark is to be established consistent with these requirements at the beginning of each new agreement period.

Section 1899(d)(2) of the SSA provides that, if the ACO meets the quality performance standards established by the Secretary, “a percent (as determined appropriate by the Secretary) of the difference between such estimated average per capita Medicare expenditures in a year, adjusted for beneficiary characteristics, under the ACO and such benchmark for the ACO may be paid to the ACO as shared savings and the remainder of such difference shall be retained by the program under this title.” This percentage is referred to as the “**savings rate**.” This section also requires the Secretary to establish limits on the total amount of shared savings that may be paid to an ACO. This limit is referred to as the “**sharing cap**.”

Thus, to implement the provisions of section 1899(d) of the SSA for determining and appropriately sharing savings, the Secretary must make a number of determinations about the specific design of the shared savings methodology described by the statute. The Secretary promulgated regulations, after notice and comment, to implement these determinations.

3. The Shared Savings Program Regulations

On November 2, 2011, the regulations concerning the Shared Savings Program were finalized at 42 C.F.R. § 425, effective January 3, 2012, in order to implement the provisions set forth in section 3022 of the ACA¹. The regulations set forth the rules and regulations necessary for Centers for Medicare and Medicaid Services (CMS) to establish the Shared Savings Program and provide the calculation for the earned shared savings payments. In the regulations, the Secretary addressed the following programmatic factors for ACOs.

First, the Secretary must establish an expenditure benchmark, which involves determining: (1) the patient population for whom the benchmark is calculated; (2) appropriate adjustments for beneficiary characteristics such as demographic factors and/or health status that should be taken into account in the benchmark; (3) whether any other adjustments to the three-year benchmark are warranted so as to provide a level playing field for all participants; and (4) appropriate methods for trending the three-year benchmark forward to the start of the agreement period

¹ These rules were updated June 9, 2015, and modified Track 2 MSR/MLR, added a new Track 3, and modified the way the benchmark is reset at the beginning of a second or subsequent agreement period if the ACO chooses to renew. The basic benchmarking methodology remains the same.

and for subsequently updating the benchmark for each performance year during the term of the agreement with the ACO.

Second, the Secretary must compare the benchmark to the assigned beneficiary per capita Medicare expenditures in each performance year during the term of the agreement in order to determine the amount of any savings.

Third, the Secretary must establish the appropriate minimum savings rate (**MSR**), as required by the statute to account for normal variation in expenditures based upon the number of FFS beneficiaries assigned to an ACO; then, the Secretary must determine

the appropriate sharing rate for ACOs that have generated savings against the benchmark and meet or exceed the MSR. While the ACOs can generate savings, they can only realize them if they meet the quality performance standard.

Finally, the Secretary must determine the required sharing cap on the total amount of shared savings that may be paid to an ACO.

The programmatic factors adopted in the regulations and impacting the status of a taxpayer's right to a shared savings payment and the determination of the amount of the payment, if any, on December 31 of the performance year are as follows:

1. Timing of data used for retroactive reconciliation impacts knowledge of the final sharing rate and performance payment.
 - a. The beneficiaries used to determine an ACO's performance are a subset of those FFS beneficiaries seen by ACO practitioners and are assigned retroactively, after a three month claims run-out for the performance year.² In the June 9, 2015 rule, Track 3 was implemented with "prospective" assignment. There is minor reconciliation at the end of the year of the prospective list (e.g., removing beneficiaries that are not FFS beneficiaries anymore.)
 - b. The MSR in Track 1 is dependent on the number of assigned beneficiaries and knowable only after the final number of assigned beneficiaries is determined. ACOs must meet or exceed the MSR in order to be eligible to share in savings generated. * In the June 9, 2015 rule, the MSR was not modified for Track 1. For Track 2, the MSR/MLR was modified. The ACOs in Tracks 2 and 3 have a menu of symmetrical choices.
 - c. The CMS Office of the Actuary provides data (e.g., the statutory update amount to the benchmark) approximately six months after the performance year has ended.
 - d. The beneficiary per capita costs for the performance year are determined retrospectively, after a three month claims run-out.

2. ACOs are not closed systems.

² The 2012 regulations provided for two Tracks of ACO's. Track 1, the shared savings track, and Track 2 a shared savings and loss track. CMS published a proposed rule on December 8, 2014, for the Medicare Shared Savings Program. This rule was finalized June 9, 2015.

- a. Because FFS beneficiaries are likely to receive care outside the care rendered to them by ACO practitioners, the ACO may not have knowledge of all FFS claims billed for their assigned beneficiaries. While CMS shares a great deal of claims data with the ACO throughout the course of the year, including claims from providers unaffiliated with the ACO so that the ACO can get a more complete picture of the beneficiary's care throughout the course of the year, claims are not necessarily complete by December 31. There is a claims run out to make them complete and CMS is required to withhold certain claims, plus the availability of the claims is dependent on when the providers submit them.
3. Quality performance impacts the final savings rate.
 - a. CMS derives a sample of beneficiaries on which the ACO must report quality. The ACO receives this sample after the performance year ends. The ACO's quality report is submitted in February or March. They cannot qualify for savings, even if generated, unless they meet the quality standard. CMS assesses that after the reporting is over.
 - b. In performance years 2 and 3, the sharing rate depends on the ACO's performance on certain measures. CMS determines the final sharing rate based on quality performance approximately six months after the performance year has ended.

4. Taxpayer's Position

Taxpayer states that the actual amount of the Shared Savings Program payment is contingent upon factors that are not ultimately determinable until the end of the contract term.

Additionally, Taxpayer does not believe the information currently provided by CMS is sufficient and reliable for purposes of calculating Shared Savings Program payments. The reason for Taxpayer's uncertainty includes: The beneficiary population is subject to change; the final performance year benchmark for the ACOs is subject to change; the actual average per capita performance year Medicare expenditures for the beneficiary population for the ACOs is subject to change; the achievement of performance quality standards is unknown until after the tax year ends; the impact of the opt out beneficiaries on the calculation is unknown until after the tax year ends; the actual per capita expenditures for the beneficiary population related to claims for drug and alcohol is subject to change; and the information received from Medicare has contained errors and been unreliable.

Based on Taxpayer's understanding, the ACOs would not receive the final determination of savings or receive any payment until sometime in April of Year 1 for the savings generated in the first performance year, which includes the short period of time. In Year 3, the benchmarks were not yet set by Medicare for the ACO, so there was no way to determine if Taxpayer had generated any savings. Taxpayer recognized no income in Year 3. In Year 4, Medicare established benchmarks; however, as detailed above, based on the uncertainty of the amount, Taxpayer will not include any income from these operations in their financial statements for Year 4, nor

shared savings income on the B returns for Year 4. Taxpayer intends to report the MSSP payment on its Year 1 federal income tax return (the year of receipt of payment).

LAW AND ANALYSIS

Section 451 of the Internal Revenue Code provides the general rule that the amount of any gross income shall be included in gross income for the taxable year in which received by the taxpayer, unless such amount is to be properly accounted for in a different period. Accrual method taxpayers recognize income “when all the events have occurred that fix the right to receive the income and the amount of the income can be determined with reasonable accuracy.” Section 1.446-1(c)(ii) of the Treasury Regulations. Due to the programmatic factors set forth above, we do not believe that all events have occurred which fix the Taxpayer’s right to receive the income during the performance year. Further we do not believe the Taxpayer can determine the amount with reasonable accuracy at the end of the performance year due to the programmatic factors.

Legal analysis

1. Fixed right to receive the income

Ordinarily, a taxpayer’s right to income is fixed under the “all events test” when either the amount is unconditionally due or the taxpayer has performed. The general rule states that all the events that fix the right to receive income occur when (1) the required performance takes place, (2) payment is due, or (3) payment is received, whichever happens first. See *Schlude v. Commissioner*, 372 U.S. 128, 133, n.6 (1963); Rev. Rul. 84-31, 1984-1 C.B. 127. In order to be fixed, any material contingencies on the taxpayer’s eventual receipt of income must have been removed. *Standard Lumber Co. v. Commissioner*, 35 T.C. 192, 198 (1960), *acq. on this issue*, 1961-2 C.B. 5, *aff’d on another issue*, 299 F.2d 382 (9th Cir. 1962).

Health care service providers and suppliers participating in an ACO continue to receive FFS payments in the same manner as such payments would otherwise be made. Therefore, they will continue to be paid for their services in the same way they had always been. However, in order to be eligible to receive payments for Medicare share savings, the income at issue, an ACO must meet quality performance standards established by HHS/CMS and demonstrate that it has achieved savings against an appropriate benchmark of expected average per capita FFS expenditures.

Because of the first two programmatic factors, the Taxpayer cannot be assured at the end of its taxable year that it will have achieved the necessary savings to participate in the Shared Savings program. For instance, the beneficiaries used to determine an ACO’s performance are assigned retroactively, after a three month claims run-out. The MSR is dependent on the number of assigned beneficiaries and, during the tax years at issue, knowable only after the final number of assigned beneficiaries is determined.³ The benchmark of expected average per capita FSS expenditures is determined

³ This remains true for Track 1. This is not accurate for Track 2 and 3 after the June 9, 2015 rule.

approximately six months after the performance year ends. The beneficiary per capita costs for the performance year are determined retrospectively, after the three month claims run-out, and can include FFS claims billed by other practitioners if the FFS beneficiaries received care outside the care rendered to them by the ACO practitioners. At the conclusion of their tax year, the ACO practitioners may not have knowledge of all of the other FFS claims.

Because of the above programmatic factors, at the close of its taxable year, the Taxpayer is unable to determine if it will have achieved the necessary savings to participate in the Shared Savings Program. The amount is not fixed as it is not unconditionally due.

2. Amount can be determined with reasonable accuracy

The second requirement for accrual under the all events test is that the amount of income be determinable with reasonable accuracy. It is not necessary that the exact amount be known, income is accruable if a reasonable basis for calculation exists.

George K. Herman Chevrolet, Inc. v. Commissioner, 39 T.C. 846, 850 (1963) (“while the word ‘accuracy’ means exactness or precision, when used with ‘reasonable’ it implies something less than an exact or completely accurate amount”) Adjustments are made in the year of actual receipt. Section 1.451-1(b).

The determination of whether amounts are accruable under the all events test is made on the basis of information available to the taxpayer at the end of the year. This is a factual determination. See *Crescent Wharf & Warehouse Co. v. Commissioner*, 518 F.2d 772, 775 (9th Cir. 1975). If there is agreement on the general basis under which the amount due is to be calculated, accrual is generally required. The following are some cases where it was determined that income had to be accrued. *Continental Tie & Lumber Co. v. United States*, 286 U.S. 290 (1932) [railroad had to accrue income in 1920 when a Congressional act gave railroads in its situation the right to compensation based on a formula comparing its results from operations during the period concerned with its results from operations during a base period]; *Food Machine & Chemical Corporation v. United States*, 286 F.2d 177 (Ct. Cl. 1960) (tentative agreement on formula to calculate compensation due for cancellation of contract); *Cappel House Furnishing Co. v. United States*, 244 F.2d 525 (6th Cir. 1957) (amount of insurance award for lost business based largely on past experience was reasonably determinable); *Marquardt Corporation v. Commissioner*, 39 T.C. 443, 457-58 (1962) (amounts due under contracts providing for negotiation as to reasonable compensation and complete adjustment of payment after audit of all amounts due were reasonably ascertainable).

However, where there is a dispute over the method of calculation, or if there is no objective standard to be used in making the calculation, the amount is not ascertainable with reasonable accuracy. See *Globe Corporation v. Commissioner*, 20 T.C. 299, 304 (1953), *acq.*, 1953-2 C.B. 4 (where contracts called for later fixing of a “fair and equitable amount,” the amount was too uncertain to accrue because there was no formula, method or particular data which both could accept as the basis of the final

agreement); *Blake v. Commissioner*, 615 F.2d 731 (6th Cir. 1980) (no accrual on patent infringement claim when special master had not determined a reasonable royalty rate).

If the facts from which a calculation can be made are established as of the end of the tax year, the amount is accruable even though the calculation may not be made until afterwards. Rev. Rul. 81-176, 1981-2 C.B. 112, demonstrates this principle in a case involving Medicaid payments. In Rev. Rul. 81-176, the taxpayer ran a nursing home and was entitled to Medicaid payments. The taxpayer was entitled to compensation equal to the “reasonable costs” incurred by the taxpayer in rendering nursing home care plus a ten percent return on equity capital as a profit factor. The taxpayer billed the government monthly on the basis of a tentative rate based upon the projected “reasonable cost” of providing patient care during the year. After the close of the year, the taxpayer submitted cost reports to the government. Any refund owed the government needed to be submitted with the cost report. Any amount due to the taxpayer was made upon settlement of a desk audit performed by the health department. The Service ruled that the amounts eventually claimed on the cost sheets should be reflected in the taxpayer’s income for the year because all the facts necessary for the computation were fixed as of the close of the tax year.

In the instant case, the facts from which a calculation could be made were not knowable at the end of the tax year. At the end of the tax year, the Taxpayer did not know the beneficiaries used to determine its performance as those beneficiaries were not assigned until after a three month claims run-out after the close of the performance year. The MSR is dependent on the number of assigned beneficiaries and knowable only after the final number of assigned beneficiaries is determined. The performance benchmark is determined approximately six months after the performance year ends. The beneficiary per capita costs are determined after the three month claims run-out. The Taxpayer is given the sample of beneficiaries for whom it must report quality performance on certain measures after the close of the performance year and this quality performance impacts the final savings rate.

Thus, at the close of its taxable year, the amount of income, if any, the Taxpayer will receive from the Shared Savings Program is not fixed. Further, the amount cannot be determined with reasonable certainty.

Please call (202) 317-7011 if you have any further questions.

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