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IRS Releases Private Business Use Guidelines for ACO Participants

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On Friday, October 24, 2014, the Internal Revenue Service (IRS) released Notice 2014-67, providing guidance regarding the circumstances under which participation by a hospital in an Accountable Care Organization (ACO) will not give rise to private business use of the participating hospital's bond-financed assets. The ACO guidance includes updates to Rev. Proc. 97-13, which sets forth safe harbor provisions under which certain management contracts and other similar arrangements will not give rise to private business use. While the guidance is focused primarily on ACO's, the modifications to Rev. Proc. 97-13, including the addition of a new safe harbor, are applicable more broadly.

Notice 2014-67 addresses private business use in connection with (i) a governmental or tax-exempt hospital's participation in an ACO and (ii) contracts between a participating governmental or tax-exempt hospital and the ACO or other ACO participants.

With respect to a hospital's participation in an ACO, Notice 2014-67 largely follows the guidance set forth in Notice 2011-20, which establishes the rules pursuant to which a tax-exempt hospital's participation in an ACO will not adversely affect its continued tax-exempt status. Thus, private business use will not generally result solely by reason of a governmental or tax-exempt hospital's participation in an ACO if (i) the terms of the participation are set forth in writing; (ii) the ACO is a participant in the Medicare Shared Savings Program; (iii) the hospital's share of benefits from the ACO is proportional to the hospital's contributions to the ACO; (iv) the hospital's share of ACO losses does not exceed its share of ACO benefits; (v) all ACO-related contracts entered into by the hospital are at fair market value; and (vi) the hospital does not contribute or otherwise transfer bond-financed property to the ACO.

With respect to ACO-related contracts, Notice 2014-67 indicates that the provisions of Rev. Proc. 97-13 are generally applicable and provides several modifications to Rev. Proc. 97-13 designed to accommodate the typical ACO financial structure. Thus, the definition of a productivity award is modified to include awards based on quality factors. In addition, a new safe harbor is added for certain five-year contracts. Interestingly, this safe harbor permits a wide variety of compensation methodologies and does not require the contract to be cancelable before its term expires.

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