

Hospital Loses its Section 501(c)(3) Status Due to Noncompliance with Section 501(r)

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By: [R. Todd Greenwalt](#) and [Brian P. Teaff](#)

The IRS recently issued a [Private Letter Ruling](#) (the “PLR”) revoking a hospital organization’s section 501(c)(3) status for failing to comply with the section 501(r) requirements.¹ In what may be a sign of things to come, the PLR serves as a reminder of the importance of complying with section 501(r) in order to escape an audit unscathed and, in light of the IRS’s pre-audit techniques discussed in the PLR, highlights the emphasis that should be placed on maintaining an easy-to-navigate, compliant website to decrease the likelihood of an audit occurring in the first place.

Facts of the PLR

The Hospital was a “dual status” hospital that was exempt from federal income tax by virtue of being both a governmental hospital and a section 501(c)(3) organization (i.e., the Hospital, which was jointly created by a city and a county, had previously submitted a Form 1023 to the IRS applying for section 501(c)(3) status). According to the PLR, the IRS selected the Hospital for examination in light of possible deficiencies relating to section 501(r) compliance. Because the Hospital was a governmental entity that was exempt from filing Forms 990 (and particularly Schedule H thereto), the IRS sought information regarding the Hospital’s section 501(r) compliance from other sources, including the Hospital’s website.

Upon review of the Hospital’s website, the IRS could find no evidence of compliance with section 501(r). Specifically, the IRS could not locate the Hospital’s (i) Community Health Needs Assessment (“CHNA”) or a link or instructions identifying where the CHNA is located, (ii) its implementation strategy addressing the CHNA; (iii) Financial Assistance Policy (“FAP”); (iv) Emergency Medical Care Policy; or (v) Billing and Collection Procedures.

In light of the perceived noncompliance, the IRS sent an initial contact letter to the Hospital, along with several Information Document Requests. After initially failing to respond, the Hospital eventually contacted the IRS and stated that the CHNA had been prepared, but not posted to the Hospital’s website, and that an implementation strategy had not been completed. In addition, the Hospital stated that it was unaware that dual status hospitals are required to comply with the provisions of section 501(r).

The Hospital’s board of directors met to discuss the audit and determined that there was no tangible benefit for its continued status as a section 501(c)(3) organization because the reasons that a governmental hospital might elect dual status were not applicable. Accordingly, the Hospital informed the IRS that it wished to terminate its section 501(c)(3) status and requested

advice on the proper method for doing so in order to avoid financial penalties, if at all possible.

General Overview of Section 501(r) and the Final Regulations

Section 501(r), enacted in 2010 as part of the Affordable Care Act, imposes certain requirements on hospital organizations that are (or seek to be) exempt from federal income tax under section 501(c)(3). In general, section 501(r) requires a hospital organization to (i) conduct a CHNA at least once every three years and adopt an implementation strategy (updated annually) to address community health needs identified in the CHNA, (ii) establish a written FAP and a written policy governing emergency medical care, (iii) in the case of emergency medical care and other medically necessary care, refrain from charging persons eligible for financial assistance more than amounts generally billed to insured patients, and (iv) make reasonable efforts to determine whether patients are eligible for financial assistance before engaging in extraordinary collection efforts.

After issuing two sets of proposed regulations in 2012 and 2013, the IRS and the Department of the Treasury released final regulations (the “Final Regulations”), effective for tax years beginning after December 29, 2015, that set forth guidance regarding section 501(r) and the consequences for failing to meet any of its requirements.

A hospital organization that fails to comply with section 501(r) and the specific requirements set forth in the Final Regulations for each hospital facility that it operates can suffer extreme consequences, including the imposition of an excise tax and even loss of tax-exempt status in cases of willful or egregious non-compliance.

Takeaways from the PLR

Because the Final Regulations have now been in effect for multiple tax years, it is quite possible that we will see an uptick in IRS audits to determine compliance with section 501(r) and the Final Regulations. As the PLR reminds us, this includes not only section 501(c)(3) organizations that are required to file Forms 990, but also dual status hospitals that are exempt from the Form 990 filing requirement. Although the Hospital in the PLR saw no reason to continue its section 501(c)(3) status, that will not be the case for every dual status hospital. Accordingly, all section 501(c)(3) hospital organizations should ensure compliance with section 501(r) and, if noncompliance exists, take corrective actions.

In addition, because several provisions of the Final Regulations require items to be made widely available to the public, including by posting on a website, it is imperative that hospital organizations and their information technology personnel understand the importance that the website plays in ensuring section 501(r) compliance. As the PLR indicates, the IRS will review a hospital organization’s website not only during an audit, but also potentially before an audit is commenced to determine whether there is any noncompliance to address. Thus, hospital organizations will be well-served if their websites are easy to navigate and the information and policies required by section 501(r) and the Final Regulations are readily identifiable. In other words, the best audit for a hospital isn’t the one that is successfully closed – it’s the one that’s never opened in the first place.

Closing Remarks

[Bracewell LLP](#)’s **[Healthcare Practice Group](#)** is able to provide a variety of services related to section 501(r) compliance, including reviewing and drafting the required documents, policies, and content for webpages, as well as conducting educational sessions for hospital staff

regarding the Final Regulations. For more information, please contact [Todd Greenwalt](#),

¹ All references to “section” are to the applicable section of the Internal Revenue Code of 1986, as amended.