24th Annual Health Sciences Tax Conference

ACO governance models and tax impacts on funds flow

December 10, 2014
ACO governance models and tax impacts on funds flow

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## Agenda

- **Evolution of accountable care organizations (ACOs)**
- **Performance overview of ACOs**
- **Governance models described with flow of funds and tax impact**
- **Case study: Austin Regional Clinic**
- **Key lessons**
ACO structure has been determined with core elements of ACO participants identified.

Provider network:
- Practice transformation is ongoing for new providers but has been completed on all of the initial provider partners.
- Add new providers to the network.

Technology:
- Implementation of HIE/care coordination platform system and connections between EMR systems is complete.
- Technology teams maintain systems and connection while connecting new members.

ACO strategy and governance driving effective outcomes as evidenced by:
- Increased market share
- Achievement of cost and quality goals
- Increased size and scope of provider participants
- Attracting new payers to contract with ACO

Management services organization (MSO)/ACO have established a clear road map of timelines and deliverables for various work streams.

Providers are informed of the fundamental goals of an ACO and how they will benefit from teaming.

Practice transformation begins on a limited number of providers; process is refined as needed.

Technology teams maintain systems and connection while connecting new members.

Determine the need for a health information exchange (HIE)/care coordination platform and determine a solution for disparate electronic medical records (EMR) systems among providers.
Accountable care organization evolution
Strategic transformation road map
*From fee for service to performance-based payments*

**Care coordination**
- Significantly decreased cost of care and increased patient satisfaction
- Care coordination process fully integrated with all provider entities within the ACO
- Basic care team in place with at least some resources for each of the care coordination work efforts engaging patients on a small scale
- Basic care program design and general analysis of population has begun

**Analytics**
- Data reports are being produced and provided to management on a regular basis
- Data is effectively used by the ACO/MSO to identify performance opportunities

**Payer contracts**
- Determine base contracts to build ACO (Medicare, Medicaid)
- Basic strategy for analytic acquisition, analysis and integration has been developed
- Expansion of contract base with payers and providers
- Effective integration of data
- Contracts with payers include specialists and primary care physicians (PCPs)
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## Performance overview of ACOs in 2014

<table>
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<tr>
<th>ACO type</th>
<th>Total number of ACOS reviewed</th>
<th>Savings</th>
<th>Losses</th>
<th>Qualitative score</th>
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<tr>
<td>Pioneer</td>
<td>23</td>
<td>Model savings: $96 million&lt;br&gt;Shared savings payments: $68 million</td>
<td>Three ACOS generated losses; three elected to defer reconciliation after year three</td>
<td>Increased by 19%</td>
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<td>Medicare Shared Savings Program (MSSP)</td>
<td>220</td>
<td>53 MSSP ACOs: $300 million&lt;br&gt;Another 52 MSSP ACOs reduced costs</td>
<td>One ACO in Track 2 overspent by $10 million and owed shared losses of $4 million</td>
<td>Improvement on 30 out of 33 measures</td>
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Source: CMS Fact sheets: Medicare ACOs continue to succeed in improving care, lowering cost growth.

### Additional insights

- ACOs in the Pioneer ACO Model and Medicare Shared Savings Program (Shared Savings Program) generated over $372 million in total program savings for Medicare ACOs. ACOs qualified for shared savings payments of $445 million.
- Key factors driving failure of ACOs: lack of physician buy-in, lack of shared goals and aligned incentives.
- Key factors driving success of ACOs: timely payback of shared savings, standardization of processes and transparency in operations, strong physician engagement, and shared values and goals.
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Governance models in discussion

- Not-for-profit, tax-exempt corporation model
- For-profit corporation model
- Limited liability company (LLC) model
Not-for-profit, tax-exempt ACO model

A not-for-profit (NFP) hospital provides working capital and reserves for the ACO initiative. Hospital and physician groups contract with an MSO for services at fair market value (FMV).

† Hospital must be not-for-profit for tax-exempt status of ACO.

- Under Section 501(c) (3) of the Internal Revenue Code (the IRC), the ACO can retain its tax-exempt status if it is organized and operated exclusively for charitable, scientific or educational purposes, and the net earnings do not benefit any shareholder or individual.
- Revenues are earned from care management fees, quality performance fees and gain share revenues.
- Costs include dedicated staff, care management fees to physicians and distribution of gain share.
- Typical distribution of gain share: 30%-35% to hospitals and 65%-70% to physicians in the MSSP model. The payments to hospital physicians are paid to the hospital. Payments to physician groups are made directly.
For-profit (FP) corporation model

A NFP/FP hospital provides substantial working capital for ACOs. Hospital and physician groups contract with an MSO for services at FMV and have equal common stock ownership.

- Net income of ACO is subject to taxes.
- Revenues earned from care management fees, quality performance fees and gain share revenues. Costs include dedicated staff, care management fees to physicians and distribution of gain share.
- Typical distribution of gain share: 30%-35% to hospitals, 65%-70% to physicians in the MSSP model and 0%-5% to shareholders and stakeholders. The payments to hospital physicians are paid to the hospital. Payments to physician groups are made directly.
- Annual membership dues from hospital and physician groups may flow through as taxable income.
- Management fees paid to MSO at FMV. For example, MSO costs, plus a fixed percentage or a percentage from the ACO’s operating income, will be treated as taxable income to the MSO.
A *NFP/FP* hospital provides substantial working capital for ACOs. *Allocations of profits, losses and distribution of savings are made in conformity with membership percentage interest.*

- The LLC ACO’s tax status is dependent on the activities of its partners.
- Revenues earned from care management fees, quality performance fees and gain share revenues.
- Costs include dedicated staff, care management fees to physicians and distribution of gain share.
- Typical distribution of gain share: 30%-35% to hospitals, 65%-70% to physicians in the MSSP model and 0%-5% to shareholders and stakeholders. The payments to hospital physicians are paid to the hospital. Payments to physician groups are made directly.
- Annual membership dues from hospital and physician groups may flow through as taxable income.
Other income tax considerations

► Timing differences
  ► IRC Section 461(h) – “all-events test”
    ► A taxpayer, whether using the cash or accrual method of accounting, may not deduct expenses until the year in which: all events have occurred that establish the fact of the liability, the amount of such liability can be determined with reasonable accuracy and economic performance has occurred with respect to the liability.
  ► IRC Section 404 and Treas. Reg. Section 1.404(b)-1T
    ► An accrual-basis taxpayer may not generally deduct accrued expenses payable to an independent contractor unless the compensation is paid within 2.5 months of the taxpayer’s year-end in which the services were performed.
  ► Cash-basis provider
    ► IRC Section 267 – related-party transactions
► Net operating loss (NOL) utilization and alternative minimum tax
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Key lessons

► The structure of the governance model dictates the tax status of the ACO entity.
► An exempt organization participating in an ACO sponsored by a commercial payer should not be an issue, as it furthers the cause of charitable promotion of health.
► Annual dues may not be taxable in a NFP, taxable ACO. However, annual dues may be considered as part of gross income in a FP, taxable ACO.
► In the case of an MSSP, the Internal Revenue Service (IRS) recognizes that certain non-MSSP activities may be related to charitable purposes and hence, they should not generate unrelated business taxable income (UBTI). Dividends and interests from ACO will be excluded from UBTI.
Questions?
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