24th Annual Health Sciences Tax Conference

Tax-exempt bonds update: wrestling with regulations and reporting

December 10, 2014
Disclaimer

► EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young LLP is a client-serving member firm of Ernst & Young Global Limited operating in the U.S.

► This presentation is © 2014 Ernst & Young LLP. All rights reserved. No part of this document may be reproduced, transmitted or otherwise distributed in any form or by any means, electronic or mechanical, including by photocopying, facsimile transmission, recording, rekeying, or using any information storage and retrieval system, without written permission from Ernst & Young LLP. Any reproduction, transmission or distribution of this form or any of the material herein is prohibited and is in violation of U.S. and international law. Ernst & Young LLP expressly disclaims any liability in connection with use of this presentation or its contents by any third party.

► Views expressed in this presentation are those of the speakers and do not necessarily represent the views of Ernst & Young LLP.

► This presentation is provided solely for the purpose of enhancing knowledge on tax matters. It does not provide tax advice to any taxpayer because it does not take into account any specific taxpayer’s facts and circumstances.

► These slides are for educational purposes only and are not intended, and should not be relied upon, as accounting advice.
Presenters

► Ken Garner
Ernst & Young LLP
Ft. Worth, TX
kenneth.garner@ey.com
+1 817 348 6073

► Kendall Schnurpel
Ernst & Young LLP
New York, NY
kendall.schnurpel@ey.com
+1 212 773 6583
Agenda

► Update to Schedule K
► Management contract and Revenue Procedure 97-13 review
► Accountable care organizations (ACOs) and clinical integration companies (CIC) overview
► Internal Revenue Service (IRS) update
Update to Schedule K
2013 Form 990 Schedule K changes

- Adds title of Form 8038-T to Line 1, Part IV
- $5 million threshold on definition of pooled financing
- Additions to instructions for Part III, Lines 7, 8a, 8b and 8c
  - Private security or payment test
  - Sale or disposition of property
  - Remedial action

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>7</td>
<td>Does the bond issue meet the private security or payment test?</td>
</tr>
<tr>
<td>8a</td>
<td>Has there been a sale or disposition of any of the bond-financed property to a nongovernmental person other than a 501(c)(3) organization since the bonds were issued?</td>
</tr>
<tr>
<td>b</td>
<td>If “Yes” to line 8a, enter the percentage of bond-financed property sold or disposed of</td>
</tr>
<tr>
<td>c</td>
<td>If “Yes” to line 8a, was any remedial action taken pursuant to Regulations sections 1.141-12 and 1.145-2?</td>
</tr>
</tbody>
</table>
2014 Form 990 Schedule K changes

► No changes to the Form
► Date changes in instruction examples
► Part III Instructions revised to permit omission (from Part III) of any qualified private activity bond that is not a qualified 501(c)(3) bond
Management contract and Revenue Procedure 97-13 review
Management contracts and 97-13 safe harbors

► Revenue Procedure 97-13 often applied as absolute requirement for unqualified bond counsel opinion
► Requirements for safe-harbor treatment:
  ► Reasonable compensation
  ► Not based on net profits
► Not considered net profits:
  ► Gross revenues or expenses (but not both)
  ► Per-Unit Fee
  ► Productivity award of stated dollar amount based on increases in gross revenues or reductions in total expenses (but not both) in any annual period
Management contracts and Rev. Proc. 97-13

Contract must fall within one of the following categories:

- 95% Per. Fixed Fee
- 80% Per. Fixed Fee
- 50% Per. Fixed Fee
- 100% Capitation Fee
- 100% Per-Unit Fee
- 100% Percentage of fees charged
- 15 years
- 10 years
- 5 years (terminable at 3 years)
- 5 years (terminable at 3 years)
- 3 years (terminable at 2 years)
- 2 years (terminable at 1 year)
ACO and CIC overview
Existing safe harbors don’t work in new world of health care

- Market, economic and regulatory forces
- Affordable Care Act (ACA)
- Cost reduction and quality improvements
- Innovative hospital-physician arrangements encouraged
- Contractual arrangements under which cost savings are shared with physicians and other service providers
Medicare Shared Savings Program (MSSP) and ACOs

► The ACA established the MSSP.
► Program promotes accountability for care, improves coordination of services, and encourages investment in infrastructure and redesigned care processes.
► Providers and suppliers must meet criteria of Centers for Medicare & Medicaid Services (CMS).
► Quality performance standards and savings against benchmarks lead to shared-savings payment from CMS (or shared loss).
► ACO is structured as a legal entity and may include both taxable and tax-exempt participants.
Notice 2011-20: ACO participation and tax-exempt status

- Provides that CMS’ regulation and oversight of the MSSP results in no private inurement or impermissible private benefit to participants if certain factors are present.
- Absent inurement or impermissible benefit, MSSP payments received are not considered unrelated.
- Open question: ACO participation a management contract?
- Concerns about sharing of savings and risk of loss?
- Rev. Proc. 97-13 permits very limited types of compensation.
Requests for updated safe harbors and additional guidance

- The National Association of Bond Lawyers (NABL), the American Bar Association (ABA) and the American Hospital Association (AHA) launched coordinated requests for updating Rev. Proc. 97-13 and additional guidance in 2012:
  - Participation in ACO under MSSP
  - Bundled payments
  - ACO-like CICs
  - Affordability or quality incentives
  - Restrictions on term limits
Notice 2014-67
Notice 2014-67 topics

► Released October 24, 2014
► Interim guidance for determining private business use from participation in the MSSP through an ACO
► “Amplifies” Revenue Procedure 97-13 regarding certain management contracts
► Solicits public comments on the Notice and on further guidance needed to facilitate participation in the MSSP
► Applicable January 22, 2015, but may be applied before that date
Private business use and ACOs

► Guidance limited to participation in the MSSP ACOs
► Participation in the MSSP through an ACO in itself will not result in private business use if:
  ► Terms of participation in MSSP through ACO are set forth in advance in writing negotiated at arm’s length
  ► CMS has accepted the ACO into, and has not terminated the ACO from, the MSSP
  ► User’s share of economic benefits from the ACO is proportional to benefits or contributions the user provides to the ACO (any ownership interests proportional to capital contributions)
  ► User’s share of losses proportional to share of benefits
  ► All contracts between user, ACO and ACO participants at fair market value
  ► User doesn’t transfer financed property to ACO unless exempt
Amplification of “productivity rewards” in management contracts

Rev. Proc. 97-13 permitted “productivity rewards”
► Award is a stated dollar amount
► Based on increases or decreases in gross revenues
  Or
► Reductions in total expenses (but not both)

Notice adds certain “quality-based awards”
► Award is a stated dollar amount, a periodic fixed fee or a tiered system
► Based solely on the level of performance achieved and not increase in revenues or decrease in expenses of the facility
Productivity and quality awards amplification

- Five-year safe harbor for “productivity/quality-based” incentive contracts
- No early termination clause needed
IRS update

- Changes in leadership structure and resources
- Audit activity
- Position on written procedures
- Proposed allocation and accounting regulations
Questions?
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

Ernst & Young LLP is a client-serving member firm of Ernst & Young Global Limited operating in the US.

© 2014 Ernst & Young LLP.
All Rights Reserved.

1410-1327060