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Healthcare Reform's Tax Provisions Strain IRS Resources

The Patient Protection and Affordable Care Act (ACA) contains several new tax provisions to be incorporated into the Internal Revenue Code (IRC) that take effect over the next several years. Implementing the tax provisions included in the ACA represent one of the Internal Revenue Service's (IRS) top priorities in 2011.[1] Among the numerous provisions, Section 501 (r), which applies to hospitals currently described in Section 501 (c)(3) of the IRC as exempt from federal income taxation, establishes requirements that certain hospital organizations must fulfill to maintain their tax exemption. The IRS has indicated that implementing certain requirements imposed by 501(r) and revising the essential forms, schedules, and instructions, e.g. Core Form 990 and Schedule H, will likely constitute its largest undertaking of the year.[2] Some IRS officials question whether the continued management of current projects, combined with new tasks mandated by the ACA related to implementation of the reform's tax provisions, may potentially impose a significant burden on the IRS's resources and strain its ability to offer productive guidance.[3] Further, attorneys have expressed concern about charitable hospitals' ability to comply with the new 501 (r) requirements, arguably the most substantial new changes applicable to these hospitals, without significant guidance from the IRS.[4]

To ease the transition for charitable hospitals and other tax-exempt healthcare organizations, the IRS has created a specific unit devoted to implementing ACA provisions and, among other responsibilities, to publishing guidelines for the reform's new 501(r) requirements. The IRS guidelines will likely advise nonprofit hospitals regarding issues related to accountable care organization formation, e.g. excessive private inurement, improper use of charitable assets, and gainsharing. [5] The new 501(r) provisions also require charitable hospitals to implement community health needs assessment (CHNA) and financial assistant policies to maintain their tax-exempt status.[6] Accordingly, in addition to publishing guidelines, implementing these provisions will necessitate the IRS's review of all tax-exempt hospitals' community benefits activities to ensure compliance.[7] For more information on the effect of healthcare reform on hospitals see, *Health Capital Topics Vol. 4 Issue 1: Healthcare Reforms: Impact on Hospitals.*

Additional large-scale projects reflecting the health reform goals have also started to utilize IRS resources. In 2009, in response to pressures from Congress to collect unpaid taxes and to identify questionable executive compensation arrangements, the IRS announced that beginning February 2010 it would audit the payroll tax practices, fringe benefits, and executive compensation of 6,000 companies for three years as part of the National Research Program.[8] The National Research Program estimated that the IRS may have to complete 1,500 randomly selected employment tax audits (500 a year, for three years) on tax-exempt organizations. This represents nearly one-third of the approximate 1,500 to 2,000 audits the program generally completes in a year.[9] In addition, these audits have already encumbered 200-300 agents, who underwent further training to perform the line-by-line reviews of employer's tax returns.[10]

Audits, rulings, and implementation of new reform provisions may potentially stall as the IRS's responsibilities expand, leaving less time for the agency to assist tax-exempt hospitals through this transitional period.[11] As part of their battle to repeal healthcare reform, Republicans have cautioned that expanding IRS power would require at least 16,000 new employees and could cost upwards of $1 billion for salaries alone, when considering the average annual salary for an IRS tax specialist ($65,696).[12] The IRS media office has countered that the healthcare reform legislation does not specify the number of new agents needed, but the office failed to make any of its own workforce requirement estimates.[13] In a likely response to challenges to its resource capacity, on March 7, 2011 the IRS announced an extension of the 2010 tax filing season for certain hospital organizations affected by the new reform requirements. The extension gives tax-exempt hospital organizations an automatic three month delay to file their Form 990 and Schedule H either electronically or in paper format on July 1, 2011 or later. The extension only applies to tax-exempt hospital organizations and expires at the end of the 2010 filing season.[14]

Despite the time and cost restraints hindering the IRS's ability to assist charitable hospitals in navigating the new provisions imposed by the reform, Congress has specified that tax-exempt organizations must comply with 501(r) tax requirements by the first tax year following March 23, 2010 (March 23, 2012 for CHNA

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requirements), even if the IRS has not yet issued definitive regulations and guidance. As of yet, no guidelines have been published, although the first comment period ended July 22, 2010.[15]

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3 "Health Care Initiatives Likely to Consume Resources of IRS Exempt Organizations Unit" By Diane Freda and Peyton M. Sturges, BNA's Health Law Reporter, Vol. 20, No. 137, January 27, 2011.

4 "Health Care Initiatives Likely to Consume Resources of IRS Exempt Organizations Unit" By Diane Freda and Peyton M. Sturges, BNA's Health Law Reporter, Vol. 20, No. 137, January 27, 2011.

5 "Health Care Initiatives Likely to Consume Resources of IRS Exempt Organizations Unit" By Diane Freda and Peyton M. Sturges, BNA's Health Law Reporter, Vol. 20, No. 137, January 27, 2011.

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12 "Obamacare to Cost $1 Billion in Salaries for New IRS Agents" Charles Boustany U.S. Congress, The Ellis County Press, November 23, 2010, http://www.charlesboustany.com/index.php/news_detail/obamacare_to_cost_1_billion_in_salaries_for_new_irs_agents/ (Accessed 1/31/11)

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14 "Part IV. Items of General Interest: Delayed Filing Season for Certain Tax-Exempt Hospitals" Internal Revenue Service, Internal Revenue Bulletin, No. 2011-10, March 7, 2011, Accessed at http://www.irs.gov/pub/irs-irbs/irb11-10.pdf (Accessed 3/11/2011).

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