

# Insights

## Current IRS Audit Activity and Compliance Overview of IRC §501(r) Requirements for Indiana Licensed Hospitals

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### Current IRS Audit Activity

In March 2024, in response to renewed calls from Congress for more robust oversight of tax-exempt hospitals, the Internal Revenue Service ("IRS") Tax-Exempt and Government Entities (TE/GE) Division announced a new compliance strategy on its Compliance Program and Priorities webpage.<sup>1</sup> The agency stated: "We will verify whether tax-exempt hospitals are complying with their statutory obligations under Internal Revenue Code ("IRC" or the "Code") §501(c)(3), including the community benefit standard, and §501(r). The treatment stream for this strategy is examinations."

Following the release of this compliance focus, TE/GE examination agents initiated a broad wave of hospital audits, described as "widespread and wide-ranging" in both scope and geography. By late 2024, reports confirmed that 35 hospital organizations were under active IRS examination for §501(r) compliance, with more expected. These developments reflect a clear message from the IRS: tax-exempt hospitals must demonstrate measurable compliance with both the statutory community benefit standard and the detailed operational rules of §501(r), or face significant consequences.

### Background: The ACA and Introduction of §501(r)

The Patient Protection and Affordable Care Act<sup>2</sup> ("ACA"), enacted March 23, 2010, represented the most comprehensive health care reform legislation enacted in the United States since the creation of Medicare and Medicaid in 1965. Among its wide-ranging provisions designed to expand access to health coverage and improve the delivery of care, the ACA also introduced new accountability measures for tax-exempt hospitals. Congress sought to ensure that hospitals receiving federal tax exemption provided meaningful benefits to the communities they serve. To that end, the ACA added §501(r) to the Code, establishing specific operational requirements that hospital organizations must meet in order to maintain their status as §501(c)(3) entities.

### Summary of Key §501(r) Requirements

The requirements under §501(r) are designed to ensure that charitable hospitals provide meaningful financial assistance, fair billing practices, and community accountability as a condition of maintaining tax-exempt status. The §501(r) requirements apply to an organization that operates a facility required by a state to be licensed, registered, or similarly recognized as a hospital.<sup>3</sup> On its website, the IRS acknowledges that different states have different ways of classifying hospitals. For example, some states may require nursing homes, rehab facilities, and psychiatric hospitals to obtain hospital licenses, while others may provide alternative registration procedures (e.g. allowing them to register as health facilities or clinics). Similarly, the IRS acknowledges that some states offer only one type of hospital license, while other states provide different types of hospital licenses to correspond with different categories of hospitals (e.g. acute care hospital licenses, psychiatric hospital licenses, rural hospital licenses, etc.).<sup>4</sup> In other words, the Code clearly requires the IRS to respect the categories that states create for hospitals and other types of health facilities, even if the categories differ from state to state. However, if a state requires a facility to be licensed as a hospital (of any type), §501 (r) will apply. The core obligations fall into four categories:

### **1. Financial Assistance Policy (FAP)**

Each hospital must have a written Financial Assistance Policy that is widely publicized in the community it serves. The policy must clearly explain: (i) who is eligible for assistance, (ii) how amounts charged are calculated, and (iii) the application process. In addition, hospitals must adopt a policy that restricts extraordinary collection actions—such as lawsuits or reporting to credit agencies—unless the hospital has made reasonable efforts to determine a patient's eligibility for financial assistance.

### **2. Emergency Medical Care Policy**

Hospitals must maintain a written emergency care policy ensuring that emergency services are provided without discrimination and without regard to a patient's financial assistance status.

### **3. Limitations on Charges**

Hospitals may not charge patients eligible for financial assistance more than the "amounts generally billed" (AGB) to insured patients for emergency or medically necessary care. This provision is designed to align charges for uninsured, FAP-eligible patients with rates paid by insurers.

### **4. Community Health Needs Assessment (CHNA)**

At least once every three years, hospitals must conduct a Community Health Needs Assessment and an implementation strategy to address the identified needs must be adopted by an authorized governing body of the hospital facility.<sup>5</sup> Failure to meet these requirements subjects the hospital to a \$50,000 excise tax per facility, per year. In certain cases, affiliated hospitals may conduct a joint CHNA if permitted under IRS guidance.

## **Consequences of Failing to Comply with Section 501(r)**

Failure to comply with §501(r) can result in revocation of a hospital *organization's* §501(c)(3) status,<sup>6</sup> or, in the alternative, treatment of the noncompliant hospital *facility* as taxable.<sup>7</sup> In addition, each facility that fails to meet the CHNA and implementation strategy requirements is subject to a \$50,000 excise tax.<sup>8</sup>

The IRS has shown its willingness to enforce these provisions. In August 2017 TE/GE published the first revocation of hospital tax-exempt status under §501(r).<sup>9</sup> The revocation was based on multiple failures, including: (i) failure to conduct a CHNA, (ii) failure to adopt an implementation strategy, and (iii) failure to make the CHNA report widely available to the public. The IRS determined that the failures were willful and that the hospital's §501(c)(3) status should therefore be revoked.

### **Key Takeaways for Indiana Hospitals**

The IRS is actively enforcing §501(r), particularly CHNA and FAP requirements. The rules apply to each hospital facility operated by a §501(c)(3) hospital organization that is required to be licensed as a hospital under Indiana law. In order to ensure compliance and readiness for an IRS examination, Indiana licensed hospitals should review policies, board minutes, and Schedule H reporting for accuracy and consistency and consult legal counsel with questions regarding applicability and compliance with the rules.

If you have any questions regarding this alert, please contact Kendall A. Schnurpel.

[1] Tax-Exempt & Government Entities: Compliance program and priorities | Internal Revenue Service.

[2] *Patient Protection and Affordable Care Act*, Pub. L. No. 111-148, 124 Stat. 119 (2010).

[3] See IRC § 501(r)(2)(A). Note: §501(r)(2)(A) also provides that the requirements apply to any other organization that the Secretary determines has the provision of hospital care as its principal function or purpose constituting the basis for its exemption under §501(c)(3), (without regard to §501(r)). However, to date, the Secretary has not identified any additional categories of organizations (other than hospital facilities and organizations operating them) that provide hospital care as their principal function.

[4] <https://www.irs.gov/charities-non-profits/hospital-definition-under-irc-sections-509a1-and-170b1a-iii-versus-irc-section-501r>

[5] Treas. Reg. § 1.501(r)-3(a)(2).

[6] IRC §§ 501(r)(1)-(2); Treas. Reg. § 1.501(r)-2(a)(1).

[7] Treas. Reg. § 1.501(r)-2(c)(1).

[8] IRC § 4959(a).

[9] See PLR 201731014. Note: the revocation letter is cited according to IRS convention although this was the result of an examination, not a private letter ruling request.

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