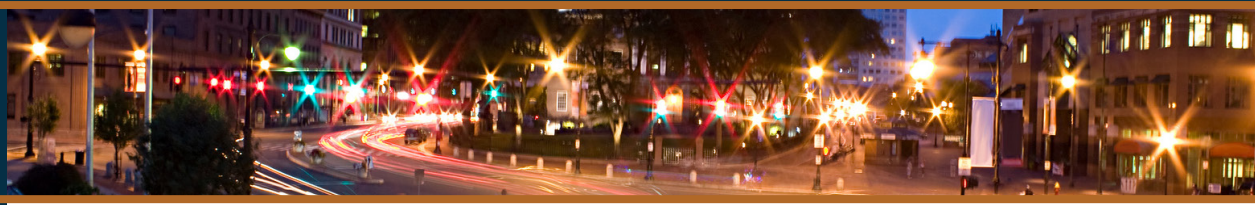
January 31, 2017



Authors:

Joan W. Feldman
(860) 251-5104
jfeldman@goodwin.com

Vincenzo Carannante
(860) 251-5096
vcarannante@goodwin.com

Bruce A. Chudwick
(860) 251-5114
bchudwick@goodwin.com

Robert L. Day III
(860) 251-5602
rday@goodwin.com

IRS Issues Clarification for Tax-Exempt Management Contracts – Impact on Healthcare Providers

In IRS Revenue Procedure 2017-13 (Rev. Proc. 2017-13), the IRS clarifies safe harbor conditions under which a management contract will not result in private business use of a property financed by tax-exempt bonds.

By way of background, the Internal Revenue Code allows tax-exempt bonds (i.e. interest on the bond is not taxable) to be issued by or on behalf of a nonprofit (i.e. Section 501(c)(3)) entity, provided certain conditions are satisfied. One such condition is that the bonds not be "private activity bonds," or support a "private business use" generally meaning that if a bond benefits a private business, as defined by statute and regulations, the interest on the bond is not tax-exempt. This ruling will have significance to many healthcare providers with physician contracts.

Last year, in Rev. Proc. 2016-44, in an effort to clarify provisions in (old) Rev. Proc. 97-13, the IRS provided more flexible safe harbor conditions under which a management contract would not result in private business use. The former provisions in Rev. Proc. 97-13 which limited the length of contracts between an issuer and private individuals were replaced. Under Rev. Proc. 2016-44, the term of the contract had to be no longer than 30 years or 80% of the weighted average of the reasonably expected economic life of the property financed with the tax-exempt bonds. However, there were questions raised that Rev. Proc. 2017-13 has attempted to address.

In particular, Rev. Proc. 2017-13 clarifies one provision of Rev. Proc. 2016-44 related to how physician groups set rates under management or service contracts with healthcare organizations. Rev. Proc. 2016-44 provided that, as one condition of meeting the safe harbor for avoiding private business use, a healthcare organization must exercise a significant degree of control over the property managed or used by the private business entity (e.g., demonstrating that the healthcare organization either approves such rates or requires that the rates charged are reasonable and customary as determined by an independent third party). Subsequent to the Rev. Roc. 2016-44, many questions arose about the requirement to approve the rates in various circumstances in which it may not be feasible to approve each specific rate charged, such as for a physician's professional services at a hospital. Rev. Proc. 2017-13 now clarifies that a healthcare organization may satisfy the approval of rates requirement by approving a reasonable general description of the method used to set the

rates or by requiring that the physicians charge rates that are reasonable and customary as specifically determined by, or negotiated with, an independent third party. Rev. Proc. 2017-13 also supplements prior guidance by clarifying (i) that payments to service providers cannot be based on profits or losses of the facility, and (ii) that deferred compensation payments cannot be made more than five years from when the compensation was earned.

Rev. Proc. 2017-13 applies to management or service contracts entered into on or after January 17, 2017, but can be applied to any such contract entered into before that date. This is a changing area of law that is heavily dependent on specific facts, as such, Rev. Proc. 2017-13, and related guidance, should be considered by healthcare organizations and physician groups as they enter into or renew their management and service contracts.

Questions?

If you have questions about this alert, please contact: Joan Feldman at (860) 251-5104 or jfeldman@goodwin.com; Vincenzo Carannante at (860) 251-5096 or vcarannante@goodwin.com; Bruce Chudwick at (860) 251-5114 or bchudwick@goodwin.com; or Robert Day at (860) 251-5602 or rday@goodwin.com.

These materials have been prepared by Shipman & Goodwin LLP for informational purposes only. They are not intended as advertising and should not be considered legal advice. This information is not intended to create, and receipt of it does not create, a lawyer-client relationship. Viewers should not act upon this information without seeking professional counsel. © 2017 Shipman & Goodwin LLP. One Constitution Plaza, Hartford, CT 06103.

289 Greenwich Avenue
Greenwich, CT 06830-6595
203-869-5600

One Constitution Plaza
Hartford, CT 06103-1919
860-251-5000

265 Church Street - Suite 1207
New Haven, CT 06510-7013
203-836-2801

400 Park Avenue - Fifth Floor
New York, NY 10022-4406
212-376-3010

300 Atlantic Street
Stamford, CT 06901-3522
203-324-8100

1875 K St., NW - Suite 600
Washington, DC 20006-1251
202-469-7750

www.shipmangoodwin.com