

Regional Health Information Organizations May Now Qualify for Tax-Exempt Status

By Monica Langfeldt
Healthcare and Tax Attorney
Miller Nash, LLP



The tax related developments for Regional Health Information Organizations ("RHIOs") and their attempts to qualify as tax-exempt entities have taken many twists and turns.

Before the American Recovery and Reinvestment Act of 2009 ("ARRA") was enacted, the IRS spent four years contemplating how to deal with applications for tax-exempt status by RHIOs. The purpose of this article is to inform you of the important aspects of the tax rules as applied to RHIOs.

On April 27, 2004, with increas-

ing healthcare costs and looming Medicare bankruptcy, President George W. Bush issued an executive order for the development and nationwide implementation of an interoperable health information technology infrastructure to improve the quality and efficiency of healthcare with the goal that most Americans will have an electronic health record by 2014.¹

The first such application from a RHIO was filed in 2005. October 2006 brought an exemption under the federal Stark law and established an Anti-kickback Safe Harbor. The IRS came out with a directive in May 2007 as well as related "Frequently Asked Questions," but these dealt only with hospitals entering into health IT subsidy agreements with their medical staff physicians for providing health IT items and services at a discount.² They did not deal with the creation of stand-alone RHIOs and their potential qualification as tax-exempt entities.

In February 2009, ARRA was enacted; less than a month later, the IRS began granting exempt status to RHIOs. As of last month, 33 RHIOs had qualified for tax-exempt status.

Why did it take the IRS so long

to approve the applications? And what language did ARRA contain that suddenly allowed the IRS to overcome four years of doubt in less than a month? In order to understand what happened, it is important to examine some of the basis for healthcare-related tax exemption, which include: promotion of health, lessening the burdens of government, and scientific research, or a combination of all the above. Although the IRS received the first application for exemption in 2005, followed by several more in 2006, it did not act on them until ARRA was enacted. Initially, all applications for RHIO exemptions were transferred from the IRS Cincinnati Office to IRS National Office in DC for processing ~ a typical move if the IRS does not know how to respond under current law or if policy issues are raised. Initially, the IRS focused on private benefit issues, as well as the types of information being shared and whether users would be charged to access the information. The unresolved issues focused on whether the funding, technology infrastructure, and support services needed for a RHIO would be an activity which would support stand alone or integral-part tax-exempt status for a new entity under

IRC § 501(c)(3), or if the activity was conducted by an existing tax-exempt entity, would the activities give rise to unrelated business income. The private inurement and private benefit issues also remain.

Although the issues still exist, ARRA finally provided the IRS with a solid basis for granting tax-exempt status. According to the conference report accompanying ARRA, "As a result of the incentives and appropriations for health information technology provided in this bill, it is expected that nonprofit organizations may be formed to facilitate the electronic use and exchange of health-related information consistent with standards adopted by the Department of Health and Human Services (HHS), and that such organizations may seek exemption from income tax as organizations described in IRC § 501(c)(3). Consequently, if

a nonprofit organization otherwise organized and operated exclusively for exempt purposes described in IRC § 501(c)(3) engages in activities to facilitate the electronic use or exchange of health-related information to advance the purposes of the bill, consistent with the standards adopted by HHS, such activities will be considered activities that substantially further an exempt purpose under IRC § 501(c)(3), specifically the purpose of lessening the burdens of government. Private benefit attributable to cost savings realized from the conduct of such activities will be viewed as incidental to the accomplishment of the nonprofit organization's exempt purpose."

The conference report goes a long way to pave the way for RHIOs' tax-exempt status. But a RHIO planning to apply for such status would do well to state as many

charitable reasons for the exemption as possible and not rely solely on "lessening the burdens of government." The reasons should include promotion of health, integral-party theory, scientific research, and education. And the RHIO should fully explain how and why the private benefit will not exceed incidental and that the private benefit is a logical by-product of a charitable purpose.

Monica Langfeldt is a healthcare and tax attorney and partner at Miller Nash LLP, a multi-specialty law firm with offices in Seattle and Vancouver Washington and Portland and Central Oregon. Ms. Langfeldt can be reached at monica.langfeldt@millernash.com.

¹ Exec. Order No. 13,335, 3 C.F.R. § 160 (2004-2005), reprinted in 42 U.S.C. § #300u (2009).

² www.irs.gov.

THE ATTORNEYS IN THE MILLER NASH HEALTHCARE PRACTICE GROUP



Robert Walerius

bob.walerius@millernash.com



Dana Kenny

dana.kenny@millernash.com



Monica Langfeldt

monica.langfeldt@millernash.com



Leslie Meserole

leslie.meserole@millernash.com



Greg Montgomery

greg.montgomery@millernash.com



Casey Moriarty

casey.moriarty@millernash.com



Robert Zech

bob.zech@millernash.com

Assisting
healthcare
organizations
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MILLER NASH
ATTORNEYS AT LAW

206.622.8484

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