

Healthcare Law Alert – IRS Expands Rev. Proc. 97-13 with New Safe Harbors for Management Contracts

The IRS issued Notice 2014-67 dated November 10, 2014, adding a new 5-year safe harbor to Revenue Procedure 97-13 (Rev. Proc. 97-13), which gives tax-exempt entities, including health care providers, significantly more flexibility when entering into management and service contracts.

As background, Rev. Proc. 97-13 provides criteria for whether a management or service contract gives rise to private business use for purposes of the tax-exempt bond rules, and also sets forth several safe harbors. The safe harbors contained in Rev. Proc. 97-13 are challenging to providers, and negotiating a compliant agreement can be time consuming and costly. Each of the safe harbors under Rev. Proc. 97-13 provides different term limits depending upon how the payment is structured.

The new Rev. Proc. 97-13 safe harbor allows for contracts of up to 5 years, with no need for the agreement to be terminable prior to the end of the 5-year period. Compensation may be based on “a stated amount; periodic fixed fee; a capitation fee; a per-unit fee; or a combination of the preceding. The compensation for services also may include a percentage of gross revenues, adjusted gross revenues or expenses of the facility.” It cannot, however, be based on net revenues – which is consistent with Rev Proc. 97-13.

The Notice also provides for the inclusion of quality-based incentive payments, either as a stated dollar amount or a tiered system of stated dollar amounts, based on the level of performance achieved. The incentive payments must be based on the quality of the services provided and not on any increases in revenues or decreases in expenses of the facility. For purposes of the new safe harbor, a tiered productivity award will be treated as a stated amount or a periodic fixed fee, as appropriate (i.e., such payments will not cause an agreement to fall outside the safe harbors).

The changes to Rev. Proc. 97-13 are effective for contracts entered into or amended on or after January 22, 2015, but may be applied to contracts entered into before such date.

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