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FORUM

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The material in FORUM is for informational purposes only and is not intended to render legal services or advice.

IRS Rules That Retirement Community Entrance Fees Are Not Replacement Proceeds

By: Erin R. Bosley, Esq.

On February 8, 2011, the IRS ruled that Mission Ridge, a continuing care retirement community (CCRC) in Montana, had done nothing impermissible under the Internal Revenue Code (IRC) by retaining and investing its residents' entrance fees. The ruling came as a result of a more than three year audit of Mission Ridge, the purpose of which was to determine whether collecting entrance fees from residents and retaining those funds for investment purposes violated the IRC provisions related to replacement proceeds of tax-exempt bonds.

Background on Mission Ridge

In connection with the issuance of tax-exempt bonds, Mission Ridge granted the bank trustee a first priority security interest in Mission Ridge's revenues, including its entrance fees. This security interest was recorded, giving the trustee the ability to take possession of the entrance fees to perfect its security interest. Until the time of possession, Mission Ridge had unrestricted use of the entrance fees and used the fees to cover operating deficits, the replacement of its facilities, and other capital needs.

Applicable Law

Under the IRC, gross income for federal income tax purposes does not include interest on any state or local bond, except for "arbitrage bonds." Arbitrage bonds are tax-exempt bonds where any portion of the bond proceeds are reasonably expected at the time of issuance to be used to replace funds (i.e., "replacement proceeds") which were used to acquire higher yielding investments. "Higher yielding investments" are any investment property which produces a yield over the term of the issue which is materially higher than the yield on the issue.

Bond proceeds are considered to be replacement proceeds if the amounts have a sufficiently direct nexus to the issue or to the governmental purpose of the issue to conclude that the amounts would have been used for that government purpose if the proceeds of the issue were not used or to be used for that governmental purpose. Governmental purposes include the expected use of amounts for the payment of debt service on a particular date. Replacement proceeds include pledged funds, which is any amount that is directly or indirectly pledged to pay principal or interest of the tax-exempt bonds. A

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pledge does not need to be in a particular form but must provide reasonable assurance that the collateral will be available if needed to pay debt service, even if the issuer encounters financial difficulties.

Internal Revenue Service's Analysis

Mission Ridge pledged its entrance fees as security for its tax-exempt bonds, but the pledge did not provide reasonable assurance that the entrance fees will be available to pay debt service on such bonds if Mission Ridge were to encounter financial difficulties. Rather, Mission Ridge commingled all of its revenues and was not limited in its ability to spend these monies. Further, at the end of the year, Mission Ridge's investment balance was approximately one-half of its collected entrance fee revenues. In its ruling, the IRS concluded that Mission Ridge would only have transferred cash from its investments to its checking account to the extent necessary to cover its immediately anticipated operating expenses. Thus, Mission Ridge spent a substantial portion of its entrance fees after the bonds were issued and expects to continue spending its cash as necessary on future expenditures without interference by the trustee, its creditors, or the residents. Therefore, absent action to take possession by the trustee, the monies could and would be dissipated to cover operating shortfalls and to finance other items prior to any payment to the bondholders.

Because the bondholders have no reasonable assurance that the entrance fees will be available to pay debt service on Mission Ridge's bonds, the IRS ultimately concluded that the entrance fees were not replacement proceeds and thus, Mission Ridge's bonds were not arbitrage bonds.

Lessons to Take from Mission Ridge Case

In structuring future financial transactions, CCRCs should consider the following:

- Entrance fee revenue and any other revenue from operations should be commingled and payables should be paid from the commingled account.
- Liquidity covenants should be measured no more often than semi-annually to avoid having its cash be deemed by the IRS to be always available to creditors.
- No loan covenant should require that a specific amount of cash be held in a separate reserve account.
- Investment accounts should not be pledged as security for a debt instrument or otherwise held as collateral accounts.

If you have any questions regarding the IRS ruling or its application to your CCRC, please contact Kimber L. Latsha.

Preventable Serious Adverse Events

By: Erin R. Bosley, Esq. and Tanya Daniels Harris, Esq.

On October 16, 2010, the Department of Public Welfare (DPW) published a Notice in the Pennsylvania Bulletin regarding a proposed bulletin to identify preventable serious adverse events (PSAE) for nursing facilities enrolled in the Medical Assistance (MA) Program and to notify nursing facilities of their obligation not to knowingly seek payment from the MA Program for PSAEs or for services to correct and/or treat PSAEs ("PSAE services").

A PSAE is "[a]n event that occurs in a health care facility that is within the…provider's control to avoid, but that occurs because of an error or other system failure and results in a patient's death, loss of body part, disfigurement, disability or loss of bodily function lasting more than seven days or still present at the time of discharge…." An event will qualify as a PSAE if it: (1) was preventable, (2) was serious, (3) was within the control of the nursing facility, and (4) occurred as a result of an error or other system failure within the nursing facility.

Examples of potential PSAE events include: using a medical device other than as intended; resident elopement; medication errors; an event related to a fall (e.g., fractures/dislocations) while being cared for in a nursing facility; and physical abuse.

If an event meets the PSAE criteria, then the facility cannot submit a claim for the event or any PSAE services. If the nursing facility has inadvertently submitted a claim and/or has received payment from the MA Program or an MA recipient for a PSAE or PSAE services, the facility must refund the payment within 30 days of discovering the event or

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receiving payment, whichever is later. Alternatively, DPW may identify potential PSAEs or PSAE services and seek recovery of the MA payments. DPW will send written notice of its determination and indicate whether DPW will recover or adjust MA payments. A facility may appeal the determination to the Bureau of Hearings and Appeals. The proposed bulletin also describes the MA Program's payment policies relating to PSAEs, which are largely controlled by the affected resident's pre- and post-PSAE CMI scores.

On June 1, 2011, the Centers for Medicare and Medicaid Services (CMS) issued a final rule that prohibits states from making payments to providers under the Medicaid program for preventable conditions. The final rule becomes effective July 1, 2011, but states have until July 1, 2012 to comply with the regulatory provision. While DPW has yet to issue a final bulletin regarding PSAEs, the final rule appears to allow some flexibility in expanding the list of preventable conditions for which payment will be denied.

According to CMS's final rule, no reduction in payment for a preventable condition will be imposed on a provider when a "provider-preventable condition" for a particular patient existed prior to the initiation of treatment by the provider for that patient. Reductions in provider payment may be limited to the extent that the provider-preventable conditions would otherwise result in an increase in payment, and the state can reasonably isolate the portion of the payment directly related to treatment for the provider-preventable conditions.

If you would like to discuss the PSAE bulletin and/or the final rule issued by CMS, and its application to your organization, please contact David C. Marshall, or Tanya Daniels Harris.

ADA Amendments Act: New Regulations

By: Angela L. Thomas, Esq. and Daniel R. Jameson, Esq.

The Equal Employment Opportunity Commission (EEOC) released new regulations pertaining to the ADA Amendments Act of 2008 (ADAAA). The new regulations provide nine rules of construction to guide the analysis of what constitutes a disability. For example, the EEOC indicates that the focus should place less emphasis on the definition of disability and more on whether employers are meeting their obligations to refrain from discrimination and to provide reasonable accommodations.

While the new regulations affirm that "disability" remains an individualized determination, they also provide examples of impairments that should "easily be concluded to be disabilities," such as deafness, blindness, intellectual disabilities, autism, partially or completely missing limbs, mobility problems requiring use of a wheelchair, cancer, diabetes, HIV, multiple sclerosis, muscular dystrophy, cerebral palsy, epilepsy and serious mental disorders.

Further, the new regulations provide guidance in determining if an individual is substantially limited in a major life activity. According to the EEOC, this is not meant to be a demanding standard and should not require extensive analysis. Employers may compare the individual to other people in the general population with regard to the following: the condition and manner in which they perform the activity; the length of time it takes to perform the activity; the difficulty and effort required to perform the activity; any pain experienced when performing the activity; and any adverse affects or mitigating measures, such as side effects of medication.

Finally, the new regulations clarify that it is now easier for a person to support a "regarded as" disability claim. An employer "regards" an individual as having a disability if it takes an action prohibited by the ADA, such as termination, based on an individual's impairment or on an impairment the employer believes the individual has, unless the impairment is both transitory (lasting or expected to last for six months or less) and minor. An employer may challenge a claim under the "regarded as" prong by showing that the impairment in question, whether actual or perceived, is both transitory and minor.

Employers need to understand the requirements being imposed by these final ADAAA regulations. If you have any questions on the ADA Amendments Act, the new regulations, or any other employment law matter, please contact Angela L. Thomas, Glenn R. Davis or Daniel R. Jameson.

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Speaking Engagements

Event	Topic		Speaker(s)
July 21, 2011 PHCA Webinar	Provider Preventable Conditions/PSAEs	Speaker:	Kimber L. Latsha, Esq.
August 12, 2011 PAFIHRA	Legal Update	Speaker:	Angela L. Thomas, Esq.
September 25-27, 2011 16th Annual Values & Leadership Conference	State School Ethics Act	Speaker:	Kevin M. McKenna, Esq.
October 6, 2011 PHCA/CALM	Labor and Employment Law Legal Update	Speakers:	Glenn R. Davis, Esq. Angela L. Thomas, Esq
October 16-19, 2011 LeadingAge Annual Conference	HCACs/PPCs	Speaker:	Kimber L. Latsha, Esq.
October 18, 2011 LeadingAge Annual Conference	Electronics in the Workplace: Issues to Consider	Speakers:	Glenn R. Davis, Esq. Angela L. Thomas, Esq.
November 8-12, 2011 Education Law Association Annual Conference	Charter School Panel Special Education Panel	Speakers:	Kevin M. McKenna, Esq. Nicole D. Snyder, Esq.