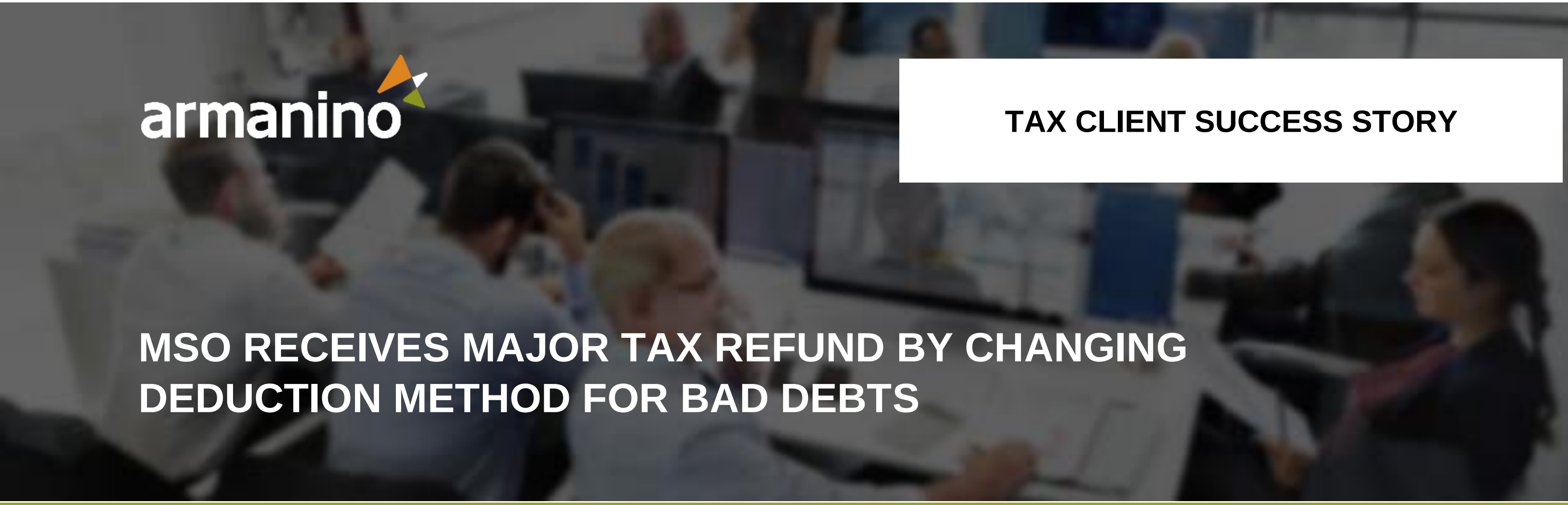

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TAX CLIENT SUCCESS STORY

MSO RECEIVES MAJOR TAX REFUND BY CHANGING DEDUCTION METHOD FOR BAD DEBTS

Challenge

The manner of writing off debt from self-pay patients was inefficient.

Solution

Change to the nonaccrual experience deduction method.

Result

Tax savings of $1.4 million in a year where cash reserves were especially vital.

A management service organization (MSO) with multi-state emergency care operations through friendly physician affiliates specializes in providing management and administrative support to these affiliates. These functions include management of accounts receivable, billings and collections.

As patients arrive at the company's emergency sites, the service providers immediately begin treatment without knowing the patient's ability to pay. Ultimately, any payments due from patients who are uninsured, owe amounts higher than their insurance coverage, are receiving uncovered services, etc., are classified as self-pay. Historically, the collection of accounts receivable from self-pay patients is extremely poor.

TAX IMPLICATIONS

The company's self-pay patient accounts clearly represent bona fide debts as described in IRC section 166 and are of a debtor-creditor nature. As a result, these self-pay accounts meet section 166's bad debt criteria and can be deducted when proven to be uncollectible.

As debts from self-pay accounts became wholly or partially worthless during the tax year, the MSO used the specific charge-off method to capture these deductions. This method requires that specific self-pay accounts are written off with the billing companies by year-end. Due to the substantial volume of patients comprising the self-pay accounts receivable balance, both the company and its third-party billing service providers struggled to write off all its bad debt from these accounts by the year-end deadline. The administrative burden of writing off all self-pay accounts was enormous and the risk of failing to do so could be disastrous. Deductions could be disallowed, and tax, interest and penalties could be assessed upon inquiry from taxing authorities.

ARMANINO'S SOLUTION

After accumulating several years of historical data, Armanino tax experts determined that since the MSO didn't charge interest or penalties on the unpaid amounts from its self-pay patients it qualified for a more advantageous deduction method reserved for organizations in the healthcare sector — the nonaccrual experience method. This method allowed the company to review and write off its self-pay bad debts from the previous five consecutive tax years.

We recommended that the company change its method of deducting self-pay bad debts to the nonaccrual experience method due to the administrative difficulty of writing off these debts by the billing companies in time for year-end.
As a result, a method based on historical collection will prove more supportable.

Additionally, this method will run parallel with the business as the tax deduction will be in proportion to the historical uncollectible self-pay accounts receivable.

THE RESULT

As a result of the method change, the MSO generated a net operating loss during a year in which the tax rate was 21%. But because of the method change and guidelines in the CARES Act, the company could carry back the loss to a year in which the tax rate was 35% — resulting in tax savings of $1.4 million. Also, the company claimed significant refunds at a time where cash reserves were strained and especially vital to the health of the business.

OUR EXPERT

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