HALL RENDER
KILLIAN HEATH & LYMAN

HEALTH LAW NEWS

DECEMBER 28, 2017

TAX REFORM ACT WILL PRESENT CHALLENGES AND OPPORTUNITIES FOR HOSPITALS AND OTHER TAX-EXEMPT HEALTH CARE ORGANIZATIONS

The new Tax Reform Act (the "Act") contains numerous changes to the Internal Revenue Code that will affect tax-exempt hospitals and other health care organizations. Leaders of these organizations should begin 2018 by giving careful attention to the new restrictions and planning opportunities to avoid adverse consequences later.

REPEAL OF INDIVIDUAL MANDATE

Beginning in January 2019, the Act effectively repeals the so-called individual mandate that was originally enacted under the Affordable Care Act by reducing the applicable penalty tax to $0. Without the individual mandate, it is estimated that fewer people will obtain health insurance. For hospitals, fewer insured patients will likely mean increased bad debt as well as a greater reliance by patients on hospitals' financial assistance policies.

NEW EXCISE TAX ON EXECUTIVE COMPENSATION

The Act imposes a new excise tax on tax-exempt organizations with highly compensated executive employees. More specifically, this tax applies to any "covered employee," which means someone who is one of the organization's five highest compensated employees or has been a covered employee in any year beginning with 2017. The tax applies generally to wages exceeding $1 million and to any "excess parachute payment," as calculated pursuant to this new provision. The tax does not apply to payments to physicians for medical services, so the concern for hospitals and health care organizations will be executive compensation. Since this new provision is not a prohibition, tax-exempt organizations will face a significant planning issue in evaluating whether to modify compensation packages or incur the tax.

IMPACT OF TAX REFORM ON TAX-EXEMPT FINANCING FOR HOSPITALS

The Act did NOT repeal tax-exempt financing for private activity bonds, including 501(c)(3) bonds. The tax reform bill does prohibit new advance refunding bonds, but current refundings will still be available. However, the lowering of top corporate and individual income tax rates will likely affect the market for tax-exempt bonds. The spread in interest rates between tax-exempt and taxable financing is expected to narrow, and tax-exempt bank placements may become less common. For large issues from highly rated credits, taxable financings may be competitive with tax-exempt debt. To the extent the decrease in taxable rates leads to more health care activity taking place through taxable organizations, additional private business use of bond-financed facilities may arise.

UBIT - ACTIVITY SILOS AND NOLS

The Act modifies the unrelated business income tax ("UBIT") to require tax-exempt organizations to compute their tax liability separately for each trade or business activity (i.e., activity silos). This will prevent organizations from using net operating losses from one business activity to offset income from another. Meanwhile, the Act made several changes to the rules regarding net operating loss ("NOL") deductions. Changes include limiting NOLs to 80 percent of the taxpayer's taxable income, eliminating the ability for most taxpayers to carryback NOLs to prior years and extending the ability to carryforward NOLs to future years until the NOL is exhausted (pre-Act law limited carryforwards to 20 years). On a positive note, income from each separate activity will be subject to the newly lowered corporate tax rate. Overall, tax-exempt organizations with unrelated business activities, as well as existing or anticipated NOLs, will want to evaluate whether an alternative structure, such as a for-profit subsidiary, would be beneficial in order to better manage NOLs in relation to unrelated business activities.

JEOPARDY TO CHARITABLE CONTRIBUTIONS

The Act retained the charitable contribution deduction – and in fact increased the percentage of an individual's income that he or she may contribute to a charity in a tax year. Unfortunately for hospital foundations and tax-exempt organizations that rely upon donations for their financial survival, however, the law reduces the overall tax incentives for charitable giving. A primary issue is the doubling of the standard deduction, which will lead to fewer taxpayers itemizing their deductions and deriving a tax benefit for their gifts to charity. The reduced corporate tax rate and more limited estate tax amplify concerns about the amount of charitable giving. Estimates of the cumulative effect of these provisions vary, but charities certainly will want to enter into 2018 with a strong strategy for communicating the non-tax benefits for donors.

THIS IS AN ADVERTISEMENT
© 2002-2024. Hall, Render, Killian, Heath & Lyman, P.C. All Rights Reserved.

EMPLOYEE BENEFITS

With respect to employee benefit-related provisions, the Act is more noteworthy for what it does not include rather than what it includes. For example, previously contemplated changes were not included for rules regarding nonqualified deferred compensation, dependent care expense reimbursement, adoption assistance, unrelated business taxable income for governmental plans, hardship distributions and the minimum age for in-service distributions. Nonetheless, the Act does include several notable changes, including elimination of the opportunity to recharacterize non-Roth IRA assets to Roth IRA assets, repeal of the tax exclusion for employer-provided qualified moving expense reimbursements (until 2026), except for military, the addition of a tax credit for employers who provide paid FMLA in excess of 50 percent of an employee's normal wages (2018 and 2019 only) and changes to the inflation adjustment provisions in many areas of the Internal Revenue Code so that the Chained Consumer Price Index for All Urban Consumers is utilized (resulting in smaller inflation adjustments in future years).

CERTAIN EXPENSES SUBJECT TO UBIT

The Act makes several changes that will effectively cause certain employee fringe benefit expenses to be characterized as unrelated business taxable income, which will create an additional tax burden for most tax-exempt organizations. Such benefits include qualified transportation fringe benefits, certain parking benefits and on-premises athletic facilities.

PRACTICAL TAKEAWAY

Hospital leadership will need to move quickly to understand the new tax landscape. In the coming weeks, Hall Render attorneys will provide additional guidance concerning these high-impact areas, as well as other facets of the Act. Hall Render attorneys also will be holding a free webinar on January 10 to share their experience and knowledge regarding the implications of the new tax bill for health care organizations. Click here for more information and to register.

If you have questions or would like additional information about this topic, please contact:

- Jeff Carmichael at (317) 977-1293 or jcarmichael@hallrender.com;
- Calvin Chambers at (317) 977-1459 or cchambers@hallrender.com;
- Bill Roberts at (502) 568-9364 or ebplans@hallrender.com; or
- Your regular Hall Render attorney.

THIS IS AN ADVERTISEMENT
© 2002-2024. Hall, Render, Killian, Heath & Lyman, P.C. All Rights Reserved.