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Healthcare Industry and Tax Reform

Federally Mandated Cuts to Medicare, Tax-Exempt Municipal Bond Financing, Individual Mandate, UBIT and More

WEDNESDAY, MARCH 21, 2018

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Peter Domas, Of Counsel, **Dickinson Wright**, Troy, Mich.

Nicole M. Elliott, Partner, **Holland & Knight**, Washington, D.C.

Travis F. Jackson, Partner, **King & Spalding**, Los Angeles

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Health Care Industry and Tax Reform

March 21, 2018

Presenters

Nicole M. Elliott
Partner, Holland and Knight LLP
nicole.elliott@hklaw.com
202.469.5144

Travis Jackson
King & Spalding LLP
tjackson@kslaw.com
213.443.4374

Peter Domas
Dickinson Wright
PDomas@dickinsonwright.com
248.433.7595

Agenda

I. Tax Reform Overview
   A. Process
   B. Highlight of Individual Provisions
   C. Highlight of Business Provisions

II. Unique issues for healthcare
   A. PAYGO
   B. Individual - Standard Deduction and Individual Mandate
   C. Executive Compensation
   D. UBIT
   E. Advance Refunding

III. What's Next?
   A. Implementation
   B. Omnibus
   C. Miscellaneous

IV. Questions and Answers

Tax Cuts and Jobs Act – Overview

- First comprehensive tax reform legislation in more than 30 years
- Fulfills a campaign promise by President Trump and incorporates Republican Congressional tax plans that have been formulated over several years
- Passed by a vote of 227-203 in the House and 51-48 in the Senate
- Most provisions became effective January 1, 2018 (or taxable years beginning after December 31, 2017)
- Some provisions are retroactive and many are temporary

Tax Cuts and Jobs Act – Process

- **Reconciliation rules**
  - Allows the Senate to pass legislation with only 51 votes
  - Complicated process restricts subject matter, spending

11.16.17	12.02.17	12.15.17	12.19.17	12.20.17	12.22.17
House passes Tax Cut & Jobs Act	*Senate passes Tax Cut & Jobs Act*	*Conference Committee releases report*	*House and then Senate pass tax reform bills*	*House repasses the Senate bill*	*President Trump signs the tax reform act*

- **What's in a name?**
  - "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018."

Senate parliamentarian ruled the name "Tax Cut & Jobs Act" out of order.

Highlight – Individual Provisions

- Tax Rates (Seven brackets; rates changed – top rate now 37%)
- Standard Deduction (Doubled)
- Personal Exemptions (Eliminated)
- Alternative Minimum Tax (Modified)
- Miscellaneous Itemized Deductions 2% Floor (Eliminated)
- “Pease” limitation (Eliminated)
- Mortgage Interest Deduction (Limited)
- State and Local Deduction (Limited)
- Charitable Contributions (Modified)
- Personal Casualty Losses Deduction (Eliminated in many cases)
- Limitation on Wagering Loss Deduction (Modified)
- Medical Expense Deduction (Modified)
- Alimony Payment Deduction (Eliminated)
- Moving Expense Deduction (Eliminated in most cases)
- Child Tax Credit (Expanded)
- Education Savings Rules – 529 Plans (Expanded)
- Discharge of Student Loan Forgiveness (Modified)
- Contributions to ABLE Accounts (Modified)
- Employee Achievement Awards (Modified)
- Moving Expense Reimbursement (Eliminated in most cases)
- Individual Mandate (Eliminated)

Highlight – Business Provisions

- Corporate Tax Rate (Reduced)
- Corporate Alternative Minimum Tax (Eliminated)
- Pass Through Income Deduction
- Expensing Rules (Modified)
- Net Operating Loss Deduction (Modified)
- Cash Method of Accounting (Expanded)
- Interest Deduction (Limited)
- Like-Kind Exchanges (Limited)
- Business Entertainment Expense Deduction (Eliminated)
- Business Meal Deduction (Modified)
- Partnership Technical Terminations (Modified)
- Research Amortization (Modified)
- Orphan Drug Credit (Reduced)
- Rehabilitation Credit (Modified)
- Family or Medical Leave Credit (Modified)
- Net Operating Loss Deduction (Modified)
- Compensation Deduction (Limited)
- Repatriation of Deferred Foreign Profits
- Territorial Foreign Income Tax System

Highlight – Business Provisions
Corporate Tax Rate

- The corporate tax rate reduced to 21 percent for tax years beginning after December 31, 2017
  - The change affects for-profit health care providers as well as tax-exempt organizations who generate unrelated business income
  - For-profit healthcare providers will likely benefit from this change as they have few international operations and significant capital expenditures
  - Lowering the corporate tax rate could negatively affect the market for tax-exempt financings

Highlight – Business Provisions
Business Interest Deduction

- The tax reform act caps the deduction for business interest at 30 percent of adjusted taxable income
  - Under prior law, a taxpayer could deduct business interest in the tax year in which the interest is paid or accrued
  - Taxpayers with gross revenue of less than $25 million are exempt from the cap
  - This change may negatively affect highly leveraged for-profit healthcare providers
  - The tax reform act further limits the business interest deduction starting in 2022

Highlights – Business Provisions
Pass- Through

- The tax reform act did not lower the tax rate for pass-through entities, like LLCs or partnerships, but it creates a deduction of up to 20 percent of taxable income
- This change may be of little value to physicians and other service professionals
- Taxpayers who receive pass-through income from providing services (like health, law, consulting, etc.) are not eligible for the deduction unless they have taxable income not exceeding $157,500 ($315,000 in the case of a joint return) and phased out up to $207,500 ($415, 000 joint return)
- This change, however, may be valuable for health care providers with an interest in certain real property partnerships

Highlights – Business Provisions
Net Operating Loss

- The tax reform act limits the use of net operating losses to offset – or erase – taxable income
  - Prevents using net operating losses from erasing taxable income by allowing them to offset up to 80% of taxable income
  - Allows net operating losses to be carried forward indefinitely
  - Applies to NOLs arising in tax years beginning after December 31, 2017
- IRS has increasingly focused on how tax-exempt organizations calculate and utilize net operating losses to reduce unrelated business income tax
  - College and university project resulted in NOL disallowances in excess of $150 million

Highlights – Business Provisions
Entertainment Expenses

- No deduction for entertainment, amusement, or recreation, and membership dues.
- Generally retains deduction for food and beverage expenses (subject to 50% limitation).

Highlights – Business Provisions
Government Investigation Expenses

- Deduction denied for amounts paid in relation to a violation of a law or investigation into the potential violation of a law if a government (or similar entity) is the complainant or investigator.

- Companies and individuals in FCA settlement talks must negotiate the inclusion of language expressly defining what portion of the settlement is restitution or a qualified compliant expense to be able to deduct the amount from their taxes.

- Government is now required to file information with the IRS that identified what portion of a settlement is restitution.

Highlights – Business Provisions
"Bad Boy" Settlements

- Deductions disallowed for any settlement, payout, or attorney fees related to sexual harassment or sexual abuse if payments are subject to a nondisclosure agreement.

Unique Issues for Healthcare

PAYGO Ramifications

- Tax Cuts and Jobs Act Cost $1.5 trillion
- Initial concern that under PAYGO, the Tax Cuts and Jobs Act would trigger cuts
- Estimated at $25 billion to Medicare in 2018
- Certain federal programs such as Social Security and Medicaid are exempt
- Fortunate waiver of PAYGO included in temporary spending bill in December

Individual – Standard Deduction

- The tax reform act nearly doubled the standard deduction beginning in 2018.

Filing Status	Standard Deduction
Single	$12,000
Married Filing Jointly & Surviving Spouse	$24,000
Married Filing Separately	$12,000
Head of Household	$18,000

- Many charitable hospitals and other tax-exempt organizations fear increasing the standard deduction will result in fewer charitable donations.

Individual Mandate

- First effective in 2014.
- In 2015, 6.7 tax returns reported some penalty, $3.1 B total, average $462
- Individuals have to have MEC, an exception, or penalty
- Under Tax Cuts and Jobs Act, penalty was zeroed out in 2019
- In 2018, yearly penalty is greater of: 2.5% of applicable income, OR $695
- Impacts of zeroing out penalty
  - Saves $338 billion over 10 years
  - Increases the number of uninsured individuals to 13 million by 2027
  - Increases average premiums by 10% over the next 10 years
  - Shifts costs to hospitals, states and insurers

  - Litigation from 20 states / State actions to pass Individual Mandate

Executive Compensation

- The tax reform act imposes a 21 percent excise tax on compensation paid by the organization and related organizations in excess of $1M to the organization's five highest paid employees
  - The tax would be based on the cash and non-cash benefits the employee receives (except for payments to a tax-qualified retirement plan or that would be excludable from gross income)
  - Does not apply to compensation paid in exchange for professional medical services
  - Once an employee qualifies as a covered person, the tax continues to apply
  - Applies to parachute payments
  - Effective for tax years beginning after December 31, 2017
- These reforms creates governance and operational questions for charitable hospitals
  - Increases the cost of executives
  - Appropriate use of charitable funds
  - Allocation of compensation

UBIT Provisions

- Unrelated business income is income from a trade or business, regularly carried on, that is not substantially related to the charitable, educational, or other purpose that is the basis of the organization's exemption
  - Unrelated business income taxed at corporate rates
  - Organizations with $1,000 or more in gross income from unrelated business must file Form 990-T
  - Form 990-T must be publicly available
- UBIT provisions designed to promote fairness between tax-exempt and for-profit organizations
- IRS has long expressed concern that many tax-exempt organizations generate unrelated business income, but pay no tax

UBIT Provisions – Cont'd

- The tax reform act requires charitable hospitals and other tax-exempt organizations to calculate UBIT separately for each activity
  - Gains from one activity could not be offset with losses from another
  - Applies to tax years beginning after December 31, 2017
- IRS has expressed concern about tax-exempt organizations utilizing large losses from activities with no profit motive to reduce or eliminate tax
- The tax reform act treats tax-exempt organizations differently than for-profit taxpayers
  - Creates opportunities for restructuring

UBIT Provisions – Cont'd

- The tax reform act treats the value of providing employees with certain identified fringe benefits as unrelated business income
  - Transportation
  - On-premises gyms and other athletic facilities
  - Parking facilities
- This change was proposed by the House as a means to harmonize changes in the deductibility of fringe benefits for for-profit employers
- Applies to amounts paid/incurred after December 31, 2017
- IRS will need to issue guidance on a number of points, such as whether UBTI is increased by employee salary reductions made through a 125 cafeteria plan and whether organizations may "gross up" compensation to avoid UBTI

Advance Refunding of Exempt Bonds

- The tax reform act eliminates all “advance refundings” of exempt bonds issued after December 31, 2017
  - Charitable hospitals and other tax-exempt organizations may no longer refinance bonds on a tax-exempt basis beyond 90 days of the call date
  - Analysts estimate that advance refunding bonds accounted for 18.8 percent of issuances in 2017 and 30 percent in 2016
  - Synthetic financing structures may emerge to preserve some of the benefits of advance refunding bonds
  - AICPA has called on the IRS to issue transition rules

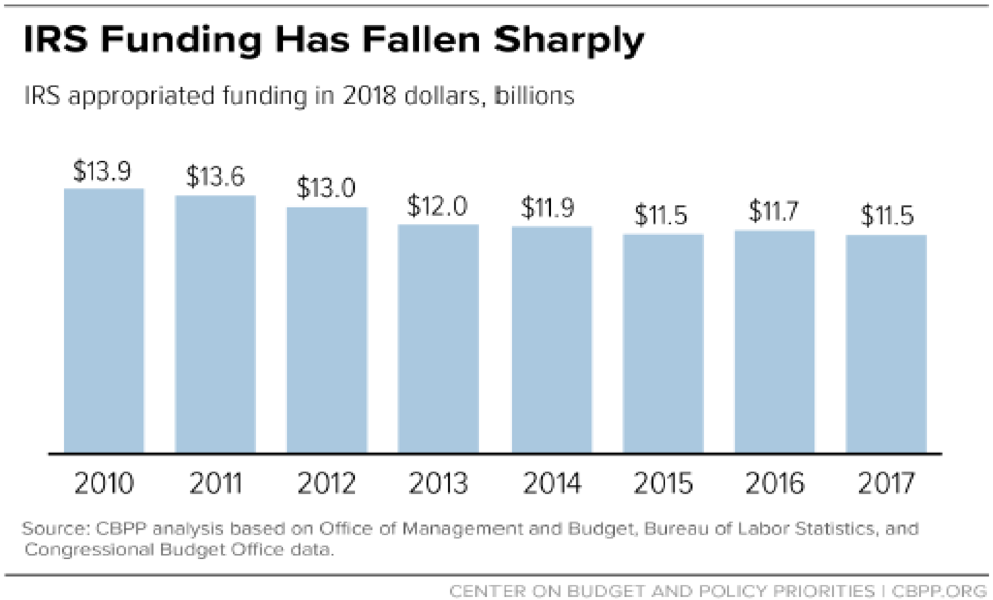
Endowment Excise Tax

- The tax reform act creates a new 1.4% tax on net investment income earned by certain college and university endowments
  - Applies to private colleges that have more than 500 students, at least 50 percent of their students located in the United States, and have assets of at least $500,000 per full time student
- May affect AMC funding provided pursuant to academic support agreements
- Applies to tax years beginning after December 31, 2017
- Slippery slope?

What’s Next?

Tax Cuts and Jobs Act – Implementation

- Guidance, Guidance, Guidance!
- Changes to Forms and Instructions
- Changes to Computer Systems
- Dedicated IRS Team, but severely underfunded
- Sensitivity to Regulatory Burden / Turn over



OTHER

» January Spending Bill

- Delayed Cadillac Tax Until 2022
- Medical Device Tax, Two Year Suspension until 2020
- HIT Tax (Section 9010), One Year Suspension

(2016 on / 2017 off / 2018 on / 2019 off)

» Omnibus Bills

- OUT OF MONEY MARCH 23rd
- Letter from Grassley / Hatch

Questions and Answers?

Nicole M. Elliott
Partner, Holland and Knight LLP
nicole.elliott@hklaw.com
202.469.5144

Travis Jackson
King & Spalding LLP
tjackson@kslaw.com
213.443.4374

Peter Domas
Dickinson Wright
PDomas@dickinsonwright.com
248.433.7595