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Memorandum

Date: December 22, 2017

To: Healthcare Clients

From: Holland & Knight

Re: Tax Reform Changes to Healthcare

Following a final vote in the U.S. House of Representatives on Wednesday morning, Dec. 20, 2017, Congress sent the *Tax Cuts and Jobs Act* (H.R. 1) to President Donald Trump's desk. In addition to extensive revisions to the tax code, the bill includes major provisions that will affect the healthcare industry. Below is an outline of some of these provisions.

Reduction of the Individual Mandate Penalty: Most notably, effective Jan. 1, 2019, the bill eliminates the tax penalty under the Affordable Care Act (ACA) for individuals who do not obtain qualifying healthcare insurance. The Congressional Budget Office has estimated that repeal of the individual mandate will result in about 4 million fewer individuals having health coverage in 2019, rising to 13 million by 2027. Additionally, exchange premiums would rise by approximately 10 percent, due largely to a less healthy risk pool. It is worth noting that the bill language amends the individual penalty to set the amount at "0". In theory, a future Congress could reinstate a penalty amount by changing that number.

Pay-as-You-Go Act Ramifications: Because the tax bill adds to the deficit, it triggers requirements of the 2010 "pay as you go" (PAYGO) law that requires offsetting mandatory cuts (sequesters) to non-exempt entitlement programs. This includes an estimated annual cut of $25 billion to Medicare, $900 million to the Prevention and Public Health Fund, and $715 million to the Federal Hospital Insurance Trust Fund. Medicaid is exempt. On Dec. 21, Congress passed a short-term funding deal, which also averted the PAYGO cuts.

Medical Expense Tax Deduction: Current tax law allows filers who itemize deductions to deduct medical expenses that exceed 10 percent of income. The bill retains this itemized deduction and temporarily lowers it to 7.5 percent of adjusted gross income (AGI) for 2017 and 2018. The threshold returns to its current 10 percent in 2019 and thereafter. Notably, nearly three-quarters of tax filers using this deduction are age 50 or older and live with a chronic condition or illness according to the American Association of Retired Persons (AARP).

Executive Compensation Excise Tax: The bill **i**mposes a 21 percent excise tax on executive compensation of more than $1 million and "excess parachute payment" for any of the five highest-compensated employees of certain tax-exempt organizations, including nonprofit health systems. For purposes of determining a covered employee, remuneration paid to a licensed medical professional that is directly related to the performance of medical services by such professional is not taken into account.

Orphan Drug Research Credit: Currently, companies can claim a 50 percent tax credit for qualified clinical testing expenses incurred in testing certain drugs for rare diseases or conditions for disease populations with fewer than 200,000 individuals nationally, generally referred to as "orphan drugs." The tax bill reduces the credit rate to 25 percent of qualified clinical testing expenses effective in 2018.

Excise Tax Based on Net Investment Income of Private Colleges and Some Academic Medical Centers: Effective 2018, the bill imposes an excise tax of 1.4 percent on net investment income from endowments of private colleges and educational institutions with at least 500 students and non-exempt use assets with a value at the close of the preceding year of at least $500,000 per full-time student. This would affect some academic medical centers.

Employer Credit for Paid Family and Medical Leave: The law creates a new section in the tax code, Employer Credit for Paid Family and Medical Leave, that allows eligible employers to claim a credit equal to 12.5 percent of the amount of wages paid to qualifying employees during any period in which such employees are on family and medical leave (FMLA) if the rate of payment under the program is 50 percent of the wages normally paid to an employee. The credit is increased by 0.25 percentage points (but not above 25 percent) for each percentage point by which the rate of payment exceeds 50 percent.

Tax on Foreign Income U.S. Companies Generate from Intellectual Property: The bill will implement a 12.5 percent tax on income that U.S. companies generate from intellectual property, regardless of whether that property is housed in the United States or in another country. This tax is aimed at drugmakers that register their patents abroad in order to avoid paying U.S. taxes.

Private Activity Bonds: The bill maintains the individual tax exemption for interest earned on private activity bonds that are issued by or on behalf of local/state government to finance certain non-governmental projects. Repeal of the exemption would have raised borrowing costs for projects involving not-for-profit organizations, including investments in new construction, renovations and new technologies.

Advanced Refunding Bonds: The bill, effective in 2018, eliminates the use of advanced refunding bonds, which currently allow governments to refinance debt at a time of their choosing to take advantage of lower market interest rates. These bonds can also reduce costs for hospital borrowing.

Fringe Benefit Deductions and Exclusions: The bill makes some changes to which fringe benefits can be deducted as a business expense. The bill amends Section 274 of the Tax Code to provide that deductions are not allowed for "(1) an activity generally considered to be entertainment, amusement or recreation, (2) membership dues with respect to any club organized for business, pleasure, recreation or other social purposes, or (3) a facility or portion thereof used in connection with any of the above items."

Tax Treatment of Reduced Tuition for Graduate Students and Reductions Provided by Educational Institutions to Their Employees: Under current law, the value of tuition reductions provided to graduate students who teach or conduct research are not considered to be income. Medical schools and academic health centers pushed for preserving this approach, which makes graduate medical study more affordable. Changes proposed by the House were not included in the final bill. Similarly, the bill does not change the non-taxable status of tuition reductions provided by educational institutions to their employees and employee family members.

Unrelated Business Income Tax (UBIT): The bill would prohibit combining various activities subject to UBIT for tax purposes, so organizations can no longer offset gains from one line of business with losses from another line of business. Each business activity would be taxed separately. The provision is effective for taxable years beginning after Dec. 31, 2017, although a special transition rule permits operating losses arising in a taxable year beginning before Jan. 1, 2018, to be carried forward.